Chapter 2: Nova Scotia's Financial Condition

Why we did this audit:

- To provide independent information on the Province's financial health through reporting on certain financial indicators
- To inform users of government's financial statements on matters of possible interest

Overall comments:

- 2015-16 deficit of $11 million lowest since 2010-11
- Five-year trends show long-term debt and net debt have increased
- Nova Scotians can find useful information in Volume I of the Public Accounts

What we found:

- Health and education expenses are half of the Province's spending and have increased 20% since 2012
- For each Nova Scotian at March 31, 2016:
  - $14,307 in long term debt
  - $15,971 in net debt
- In 2016, government spent per person:
  - $791 in interest costs
  - $4,755 at Department of Health and Wellness
- Government collected $5,773 per person in various tax revenues
- Provisions in the Finance Act of Nova Scotia mean that departments never overspend original approved budgets
- The Departments of Internal Services and Transportation and Infrastructure Renewal requested an extra $49 million over the original budget
- Government does not explain in the Public Accounts the reasons for additional funds
- Net debt and revenue have increased 13% since 2012
- Revenue from federal government has been constant over the past five years

2 Nova Scotia's Financial Condition

Background

2.1 One piece of information available in assessing the financial condition of the Province is its consolidated financial statements. The consolidated financial statements provide a snapshot of the Province's financial position at its fiscal year end (March 31) and the results of its operations, and changes in both cash flow and net debt for the preceding fiscal year. However, the consolidated financial statements are only one aspect of the Province's health and how well it is performing in relation to its economic and fiscal environment.

2.2 There are numerous indicators that can be used to assess a government's financial condition. The indicators we have included in this chapter are among those recommended for reporting by the Public Sector Accounting Board's Statement of Recommended Practice 4: Indicators of Financial Condition. The statement is not required as part of generally accepted accounting principles for the public sector, nor is there a requirement for government to implement its recommendations. The indicators reported in this chapter are meant to provide additional information on the Province's financial condition, but are not intended as commentary on the financial impact of government policies.

2.3 The Statement of Recommended Practice recommends that, at a minimum, indicators related to sustainability, flexibility and vulnerability are considered. We have included these types of indicators, along with other information we feel is useful in demonstrating the Province's financial condition. Definitions of sustainability, flexibility and vulnerability follow, as well as the selection of indicators related to each element.

Chapter Objective

2.4 The objective of this chapter is to provide independent information on the Province of Nova Scotia's financial health through reporting on certain indicators of financial condition; as well as to inform users of government's financial statements on matters of possible interest.

Overall government performance

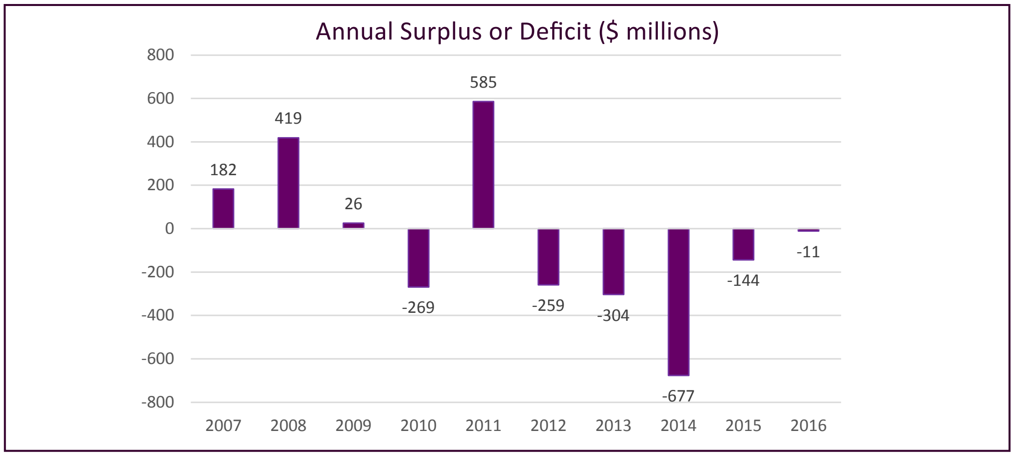
2.5 The following table provides an overview of the Province's financial performance for the year ended March 31, 2016. Further information on several financial indicators is found in the Financial Statement Discussion and Analysis section of the 2016 Public Accounts Volume 1. As can be seen in the following table, the overall financial condition of the Province of Nova Scotia is in a favorable position over the past year. However, the five-year trend continues to show deficits, as well as increasing net long-term debt and net debt.

Indicator	1-year Trend	5-year Trend
Sustainability		
Annual Surplus or Deficit	Deficit decreasing	Lowest deficit since 2011
Net Long-term Debt	Stable	Increasing
Net Debt	Stable	Increasing
Net Debt as a Percentage of Provincial GDP	Slight decrease	Increasing
Flexibility		
Interest on Long-term Debt	Decreasing	Fluctuating but back to stable
Vulnerability		
Federal Government Transfers as a Percentage of Total Revenues	Decreasing	Stable

Sustainability

2.6 Sustainability measures the ability of a government to maintain its existing programs and services, including maintaining its financial obligations to creditors, without having to introduce revenue and expenditure adjustments, such as increased debt or tax rates. Sustainability indicators provide insight into how a government balances its commitments and debts. In the following paragraphs, we discuss the indicators we have selected to assess sustainability.

2.7 *Annual surplus or deficit* – Annual surplus or deficit indicates the extent to which revenues are more or less than expenses during the year. A deficit occurs when expenses exceed revenues. Government reported a deficit of $11 million in 2016. It has reported deficits in each of the past five years and the deficit this year is the lowest it has been since 2011.

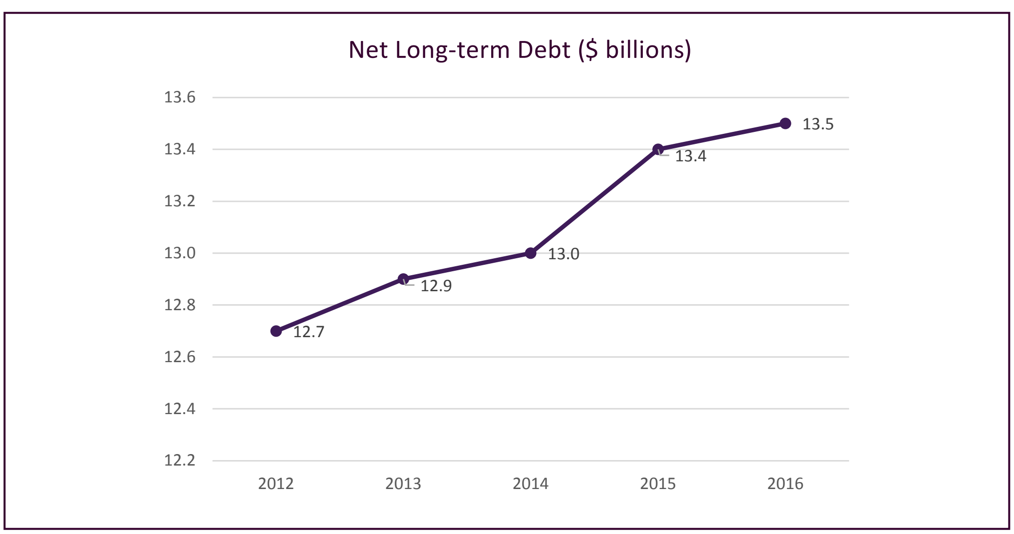


Information found in published Public Accounts

2.8 The annual deficit decreased because tax revenue grew at a greater rate than overall expenses. Government discusses changes in revenues and expenses in detail in Volume 1 of the Public Accounts.

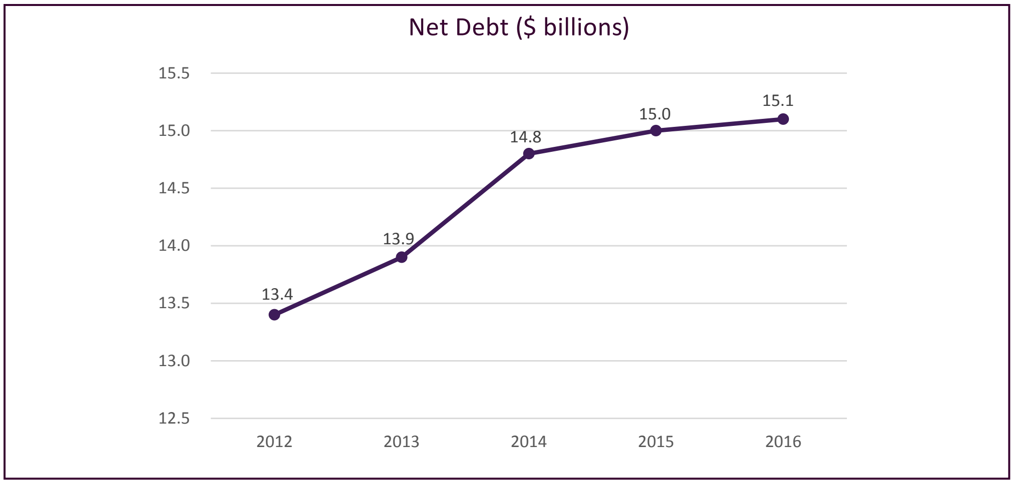
2.9 *Net long-term debt* – Unmatured debt is the total debt the Province owes to outsiders and consists primarily of debentures and long-term loans. Net long-term debt is government's unmatured debt less the amount that is set aside to fully fund specific debt when it becomes due. For the past couple of years, net unmatured debt has been approximately $13 billion. Schedule 4 of the 2016 Public Accounts Volume 1 contains more details on unmatured debt.

2.10 We have commented in prior years that the increasing trend in net long-term debt is a significant indicator of fiscal sustainability because the costs of servicing this debt takes priority over program expenses and reduces the ability of government to expand services or reduce taxes. The chart below shows an increase in net long-term debt of about $1 billion since 2012 and an average increase of 1.6% per year over the past five years.



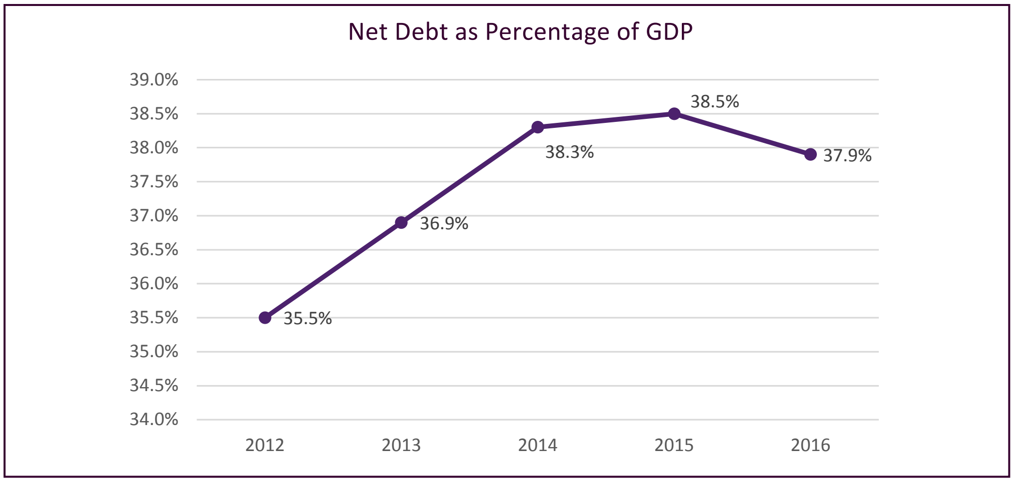
2.11 *Net debt* – Net debt is used to define the difference between financial assets and liabilities and informs the reader as to whether or not there are enough assets to discharge the liabilities for future generations. In other words, it is the amount of future revenue that is needed to pay for past transactions. Government talks about net debt further in the Financial Statement Discussion and Analysis of Volume 1 of the Public Accounts.

2.12 Over the past couple of years, the Province's net debt has been slowly rising, resulting in an increase of 13% from 5 years ago.



2.13 *Gross domestic product* – Gross domestic product (GDP) is one of the primary indicators used to measure a province's or country's economy. GDP can be measured by either summing the value of the income generated in an economy (income approach) or by the total dollar value of all goods and services purchased by households and government (expenditure measure). For the purposes of the public accounts, Government uses the expenditure measure.

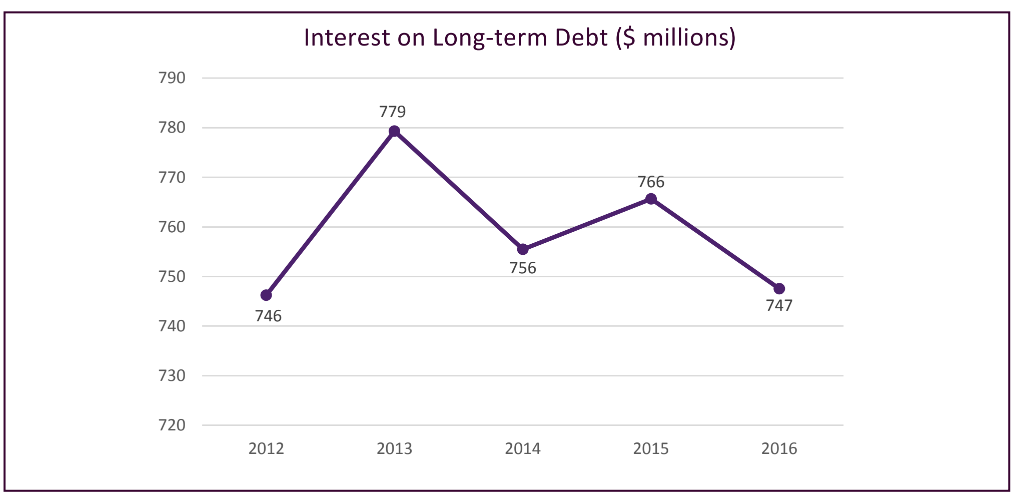
2.14 As shown below, we noted that the Province's net-debt-to-GDP ratio decreased this year indicating that broad economic activity in Nova Scotia is estimated to have increased at a rate faster than the increase in the Province's net debt.



Flexibility

2.15 Flexibility is the degree to which a government can change its debt burden or raise taxes within its economy to meet its existing financial obligations. Flexibility provides insights into how a government manages its finances. Increasing debt obligations and interest costs reduce a government's future flexibility and ability to respond to changing circumstances. The following indicator has been selected to assess flexibility.

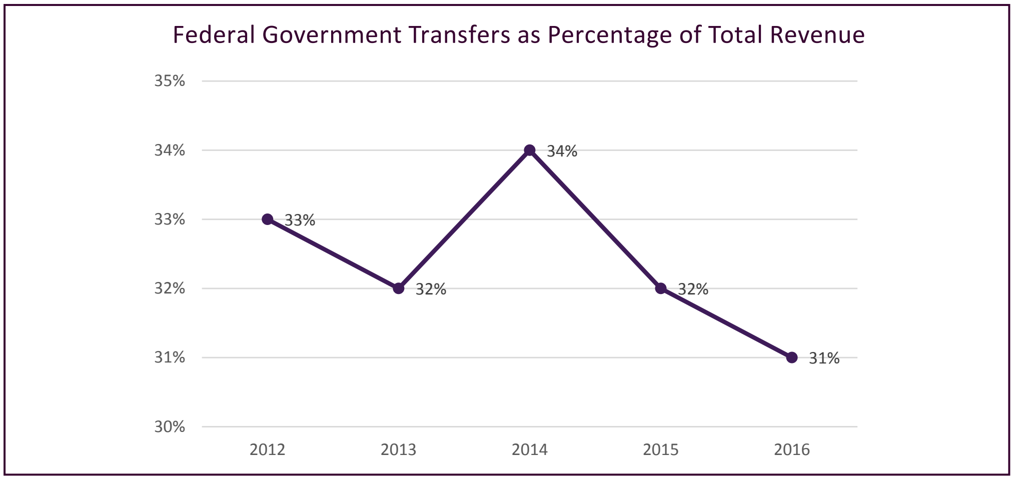
2.16 *Interest on long-term debt* – Interest on long-term debt is the cost associated with servicing past borrowing decisions. These costs represent a fixed cost once debt is issued. Failure to pay interest impacts the ability to raise future debt and would further increase costs of borrowing. Interest on long-term debt represents funds which cannot be used for general operations, such as providing programs and services to Nova Scotians. Interest on long-term debt was $747 million in the current year. This represents an increase of $1 million since 2012, reducing the amount that can be spent on providing programs and services to Nova Scotians.



Vulnerability

2.17 Vulnerability indicators measure the amount a government is dependent on sources of revenue outside its control and its exposure to risks which might affect government's ability to meet its commitments. The lower a government's own-source revenue is, means it would rely on the fiscal decisions of others.

2.18 As indicated below, Nova Scotia continues to rely on federal government equalization payments and other transfers.



2.19 Overall reliance on federal government funding has been decreasing, meaning the Government of Nova Scotia is finding other sources of revenue. In 2016, overall provincial sources of revenue increased.

What does all this mean for Nova Scotians?

2.20 As shown in the table below, Nova Scotia's population has been fairly stable over the past five years, increasing by .1% since 2012.

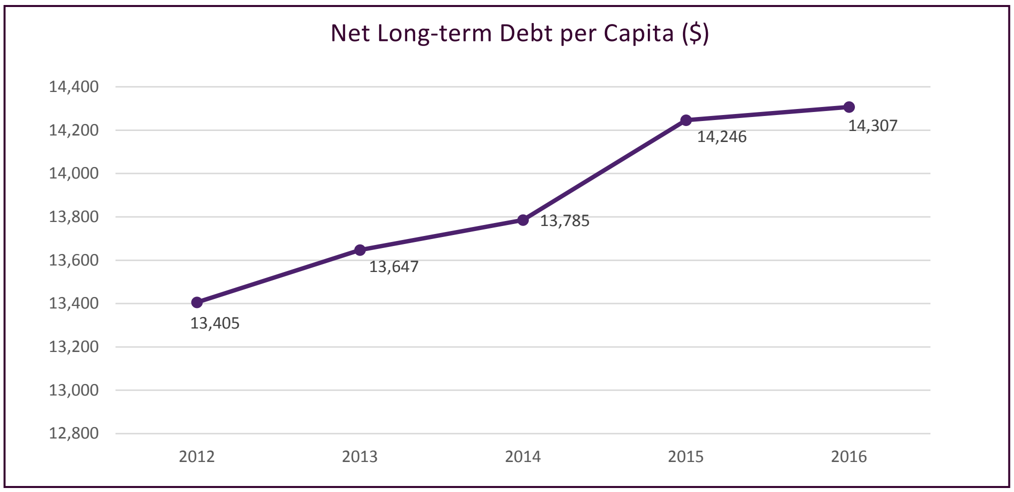
Population of Nova Scotia				
2012	**2013**	**2014**	**2015**	**2016**
944,800	943,000	942,400	943,000	945,300

Based on forecasted population figure

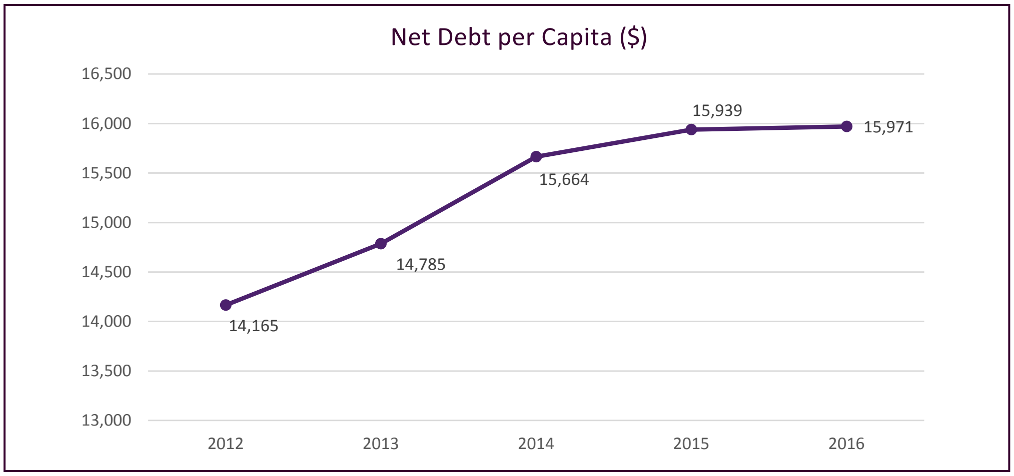
2.21 The following table provides an overview of the Province's financial performance as it relates to the number of Nova Scotians for the year ended March 31, 2016. Further information on several financial indicators per capita is found in the Financial Statement Discussion and Analysis section of the 2016 Public Accounts Volume I. As can be seen in the following table, the overall financial condition of the Province is in a favorable position over the past year. However, the five-year trend continues to show deficits, as well as increasing net long-term debt and net debt per capita.

Indicator	1-year Trend	5-year Trend
Sustainability		
Net Long-term Debt per Capita	Stable	Increasing
Net Debt per Capita	Stable	Increasing
Trends in Major Expense Categories per Capita such as Healthcare; Education and Community Services	Healthcare – Increasing Education – Stable Community Services – Stable	Healthcare – Increasing Education – Increasing Community Services – Stable
Tax Revenue per Capita	Increasing	Increasing
Flexibility		
Interest on Long-term Debt per Capita	Decreasing	Fluctuating but back to stable

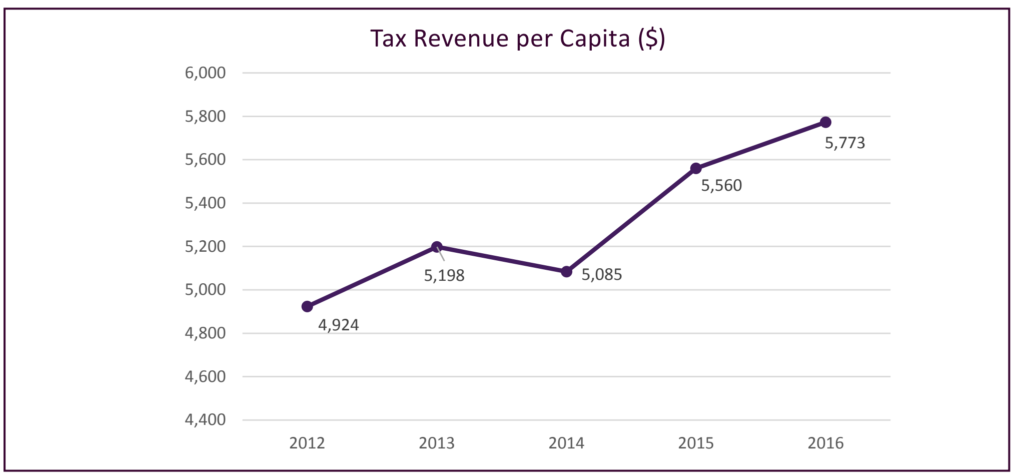
2.22 *Net long-term debt per capita* – Long-term debt has increased by 6.7% over the past five years and the Province now owes $14,307 per person in net long-term debt.



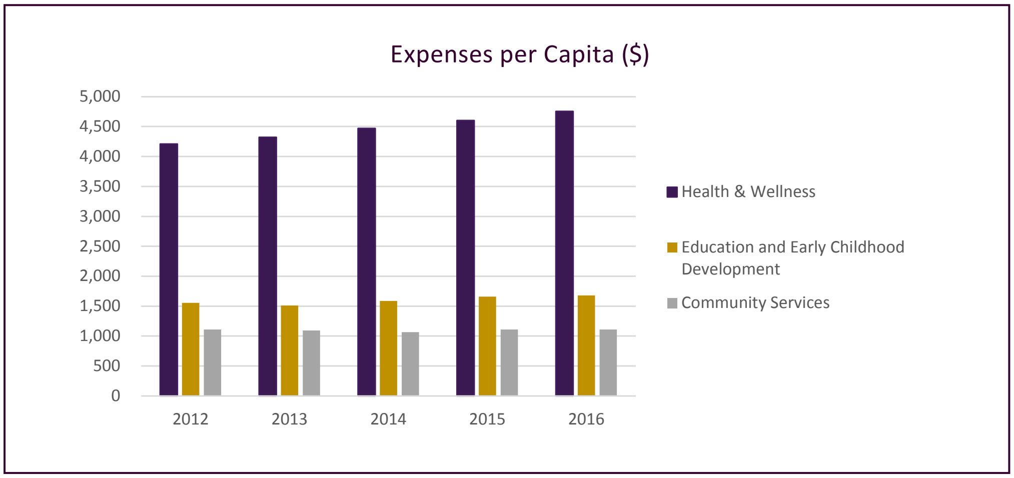
2.23 *Net debt per capita* – Net debt per capita shows the amount of net debt attributable to each person living in the province. The Government of Nova Scotia owes $15,971 for each Nova Scotian for past decisions that resulted in spending exceeding revenues. The Province's net debt has increased by 12.8% since 2012 but Nova Scotia's population remained relatively stable, resulting in an increasing net debt per person. In 2016, net debt per capita has started to stabilize.



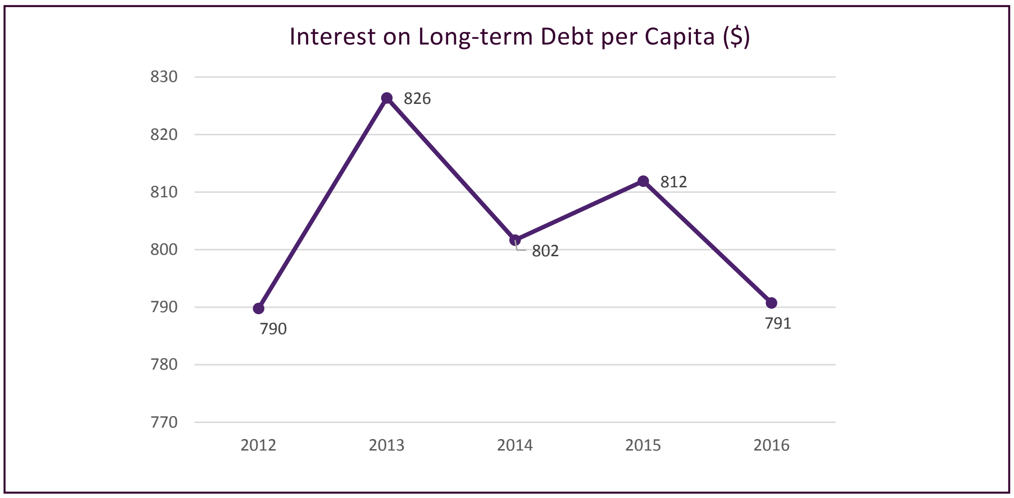
2.24 *Tax revenue per capita* – Tax revenue per capita is the average amount collected per Nova Scotian and includes personal and corporate income tax, harmonized sales tax and other taxes. The Province collected $5,773 for every Nova Scotian in the current year. This represents an increase of $850 per person or 17% since 2012.



2.25 *Expenses per capita* – Expenses per capita measures the amount spent per person for each of the expense categories. For example, the Department of Health and Wellness spent $4,755 per person during the current year, which was an increase of $546 per person, or 13% since 2012.



2.26 *Interest on long-term debt* – Interest on long-term debt per capita represents interest government pays for every Nova Scotian each year on unmatured debt. In the current year, the Province paid $791 in interest costs on long-term debt for every Nova Scotian.



How is government doing?

2.27 Public sector entities are held to a higher standard of accountability than private organizations. They use funds raised from taxpayers to provide public services, and the public expects the use of those funds to be transparent.

2.28 An Appropriations Act of Nova Scotia is passed each year and lays out the charges and expenses of the public service for the fiscal year. An appropriation is the expenditures for government programs and services that are authorized to be paid out of the General Revenue Fund. The Finance Act of Nova Scotia states that an additional appropriation must be obtained when it is apparent that the initial appropriation approved is insufficient. In addition, a final appropriation can be obtained within 15 days after tabling the Public Accounts. In other words, departments will never overspend their approved budgets.

2.29 Throughout the year, Executive Council approved additional appropriations totaling $85 million. It also approved a final appropriation of $43 million within 15 days after Public Accounts had been tabled. This resulted in no department overspending its approved appropriations.

2.30 Overall, information on budgeting when compared to actual expenses can be useful in gaining an understanding and assessing the performance of a government in managing the economic resources of a province.

2.31 Public Sector Accounting Standards indicate that the statement of operations should present a comparison of the results for the accounting period with those originally planned. Planned results should be presented for the same scope of activities as that used for actual results.

2.32 In Volume 1 of the Public Accounts, Government includes an expense variance analysis for departments and the reasons why a department overspent the original appropriation. However, there is no information that details why a department asked for additional budget amounts.

2.33 We compared the original estimate for some departments to actual expenditures for 2015-16 and noted that some departments exceeded the original budget that had been approved by the Legislature. Departments requested additional funds in order to ensure that they did not exceed their spending authority. Listed below are the departments we bring to the reader's attention.

Actual Expenses Exceeded Original Budget (in 000's)			
Department	**Original Estimate**	**Actual 2015-16 Expenses**	**Actual Expenses Exceeded Original Budget**
Community Services	915,410	922,341	6,931
Internal Services	180,300	215,145	34,845
Transportation and Infrastructure Renewal	419,277	433,717	14,440

2.34 As indicated in the following table, the Department of Health and Wellness had an original approved budget (or appropriation) that was significantly greater than the amount actually needed. As well, Public Service and the account for restructuring costs requested appropriations that were not required. It is possible that these approved amounts could have been spent on other programs and services.

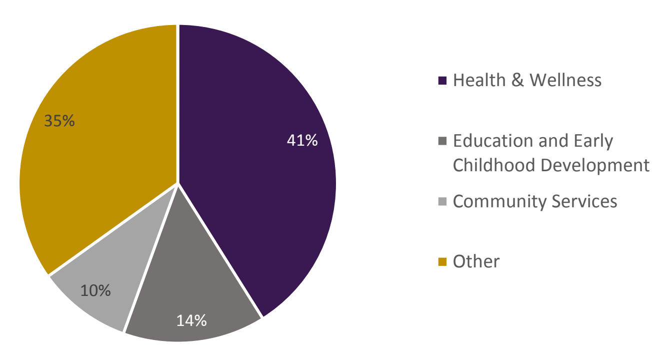
Departments Asked for More Budget Than Needed (in 000's)			
Department	Original Estimate	Actual 2015-16 Expenses	Actual Expenses Less Than Original Budget
Health and Wellness	4,137,741	4,106,403	31,338
Public Service	200,947	191,878	9,069
Restructuring Costs	175,853	98,639	77,214

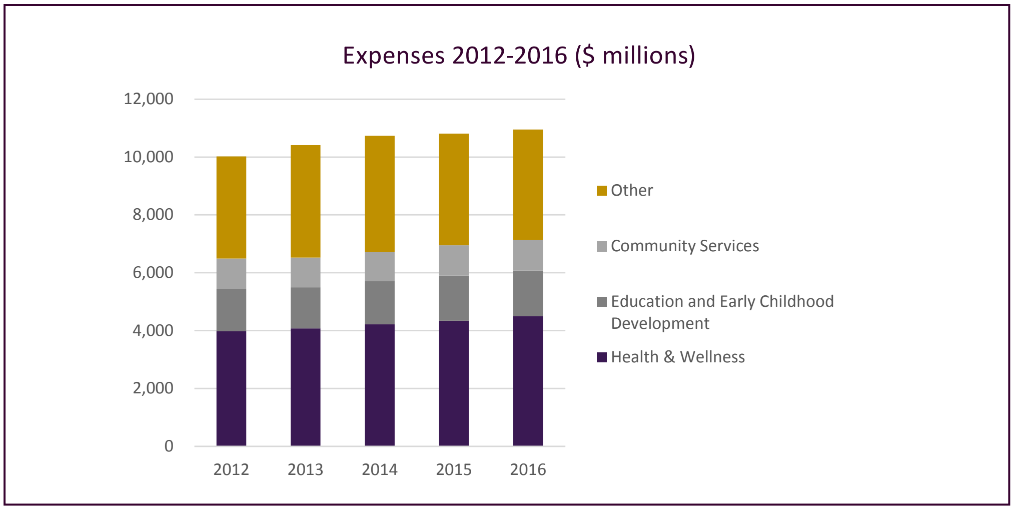
Where does the revenue come from and where does the government spend?

2.35 The majority of the Province's expenses fall into three major categories; revenue also falls in to three major categories. Government provides further analysis in Volume 1 of the Public Accounts.

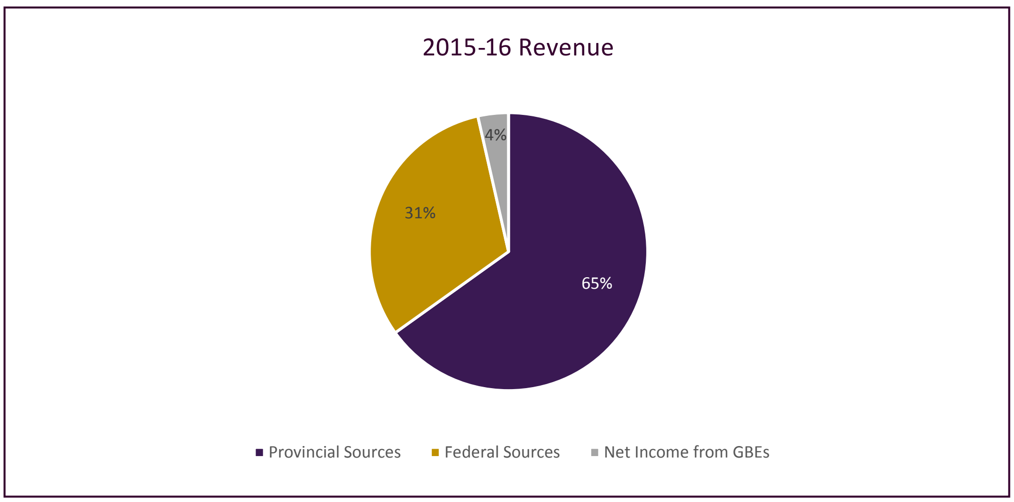
2.36 *Expenses* – Healthcare-related expenses have accounted for approximately 40% of government's total expenses in each of the past five years and have increased by 13% since 2012. Education-related expenses account for 15% of total expenses and have increased 8% since 2012. Community services-related expenses have remained relatively stable over the past five years and account for 10% of government's total expenses.

2015-16 Expenses by Function





2.37 *Revenue* – Provincial sources of revenue account for two-thirds of government's total revenue. The composition of total revenue has remained fairly stable over the past five years.



2.38 Total revenue has increased by 13% since 2012, with provincial-source revenue having grown more than the other revenue sources.