| O | N | T | A | R | I | O | Financing Authority

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1999 Annual Report

Highlights in 1998-99

The Ontario Financing Authority fulfilled the Province's 1998-99 financing requirements, $12.6 billion, in a sound and cost-effective manner.

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Public debt interest costs were $142 million below the 1998-99 Budget plan, largely due to borrowing at lower-than-budgeted interest rates.

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The fourth annual Ontario Savings Bond campaign raised $2 billion, the biggest provincial savings bond campaign in Canadian history.

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The Ontario Financing Authority supported the successful restructuring of Ontario Hydro. Substantial advice was provided to the Province regarding the two new successor commercial corporations, Ontario Power Generation Inc. and Ontario Hydro Services Company, to finalize their debt and capital structures. Also, comprehensive support and advice were provided toward the establishment of Ontario Electricity Financial Corporation.

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The Ontario Financing Authority worked closely with representatives of the Ontario Ministry of Health and The Toronto Hospital to provide advice toward the Hospital's $281 million financing initiative. Ontario Financing Authority participation resulted in savings to the Hospital of more than $5 million.

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Statement from the Chair

Bryne Purchase

I am pleased to present the 1999 Annual Report of the Ontario Financing Authority. The report outlines the Ontario Financing Authority's objectives and responsibilities, reviews its accomplishments, operational highlights and financial results for the year April 1, 1998 to March 31, 1999 and outlines next year's priorities.

Ontario's Economy

Despite unsettled global economic and financial market conditions, the Ontario economy continued to grow in 1998. Real Gross Domestic Product (GDP) rose by an estimated 4.2 per cent, led by strong growth in consumer spending and export sales to the U.S. The direct effect of the Asian crisis on Ontario was minor as exports to Asia represented only 3 per cent of total exports and 1.3 per cent of GDP. Ontario's job market continued to improve in 1998 with the creation of 200,000 net new jobs. Consumer prices in Ontario increased by only 0.9 per cent in 1998.

The Ontario economy is well positioned to achieve sustained growth. Ontario's real GDP is expected to grow 3.7 per cent in 1999 and 2.8 per cent in 2000. Consumer price inflation in Ontario is expected to remain low over the next several years.

Ontario Government's Fiscal Plan

On the fiscal front, the Ontario Government exceeded its deficit target for the fourth consecutive year. In 1998-99, the interim deficit was $3.2 billion — $1.0 billion below the 1998 Budget forecast of $4.2 billion. In 1999-2000, the Province's deficit will be reduced to $2.1 billion. The Government is on track to balance its budget in 2000-01.

Ontario Financing Authority

The Ontario Financing Authority plays a central role in raising and managing funds on behalf of the Province, its Crown corporations and other public bodies. In 1998-99, the Ontario Financing Authority achieved lower-than-anticipated debt servicing costs for the Province due to Ontario's declining deficit, lower long-term interest rates and efficient financing operations. The fiscal 1998-99 year was the second consecutive year that financing requirements for maturing debt were greater than those for the deficit. As the deficit is being eliminated, the focus of the Province's financing operations are shifting more toward managing and refinancing maturing debt.

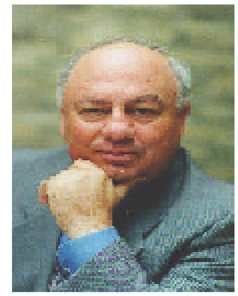
The Ontario Electricity Financial Corporation (OEFC) was established on April 1, 1999. The OEFC is responsible for servicing and retiring the former Ontario Hydro's provincially guaranteed debt and managing certain other legacy liabilities. Debt management, cash management, banking activities and accounting and reporting requirements are being provided by the Ontario Financing Authority. As with the management of the Province's debt, the Ontario Financing Authority's objective is to ensure that these services are provided in a sound and cost-effective manner.

Since becoming Chair, I have enjoyed working with Ontario Financing Authority Board members and staff. Led by Tony Salerno, I am confident that the Province is well served by the skills and professionalism of the Ontario Financing Authority team.

Bryne Purchase
Chair
Ontario Financing Authority

Statement from the CEO

For the Ontario Financing Authority, fiscal 1998-99 has been an active and challenging year on several fronts.



Tony Salerno

Despite increased volatility and uncertainty in global financial markets, the Ontario Financing Authority fulfilled its primary goal by raising $12.6 billion to fund the Province's deficit, maturities and other financial requirements. In 1998-99, actual Public Debt Interest expense was $142 million below the 1998 Budget forecast, largely reflecting lower-than-budgeted interest rates.

To enhance risk control practices, a substantial review was undertaken and all risk management and reporting policies were updated and consolidated into a comprehensive "Policy Framework for Risk Management." Also, significant resources were devoted to addressing Year 2000 readiness of the Ontario Financing Authority's business critical systems and to the development, implementation and testing of Year 2000 related contingency plans.

The Ontario Financing Authority team worked with other parts of the Ministry of Finance and other Ontario Government ministries, providing substantive advice and support for several financial projects, notably, the restructuring of Ontario Hydro and the Ontario electricity sector, the privatization sale of Highway 407 and the financing initiative with The Toronto Hospital.

At several opportunities, the Ontario Financing Authority increased awareness of prudent cash management practices across the Ontario Government and promoted new banking services to increase the efficiency and accuracy of revenue collection and funds disbursement.

The coming year promises to be as challenging and demanding. The Ontario Financing Authority will continue to provide the Province's financing requirements, banking services and cash management needs in a sound and cost-effective manner. In addition, a number of government initiatives and operational changes will take on added importance.

As of April 1, 1999, the Ontario Financing Authority is responsible for Ontario Electricity Financial Corporation's debt management, risk and cash management activities, and accounting and reporting requirements. The staff at the Ontario Financing Authority have been working diligently with representatives of the former Ontario Hydro and the resulting subsidiaries to ensure a smooth operational transition.

Building on the success of The Toronto Hospital financing initiative, the Ontario Financing Authority will review, in conjunction with other public sector entities, opportunities to pool or further facilitate various public sector financing opportunities, such as debt financing, investing and leasing.

Lastly, the Ontario Financing Authority will continue to work diligently to address the Year 2000 challenge. To further ensure Year 2000 readiness, additional testing of in-house technology will be completed by June 30, 1999. The OFA will continue to track the readiness of its fiscal agents, financial counterparties and external suppliers and conduct interface tests deemed necessary. Contingency plans will be completed by June 30, 1999.

Over the past year, in addition to providing cost-effective financing and debt management services, the Ontario Financing Authority has played an expanded role in providing advice on project financing, cash management and financial services. I have every confidence that the highly experienced and well-qualified staff at the Ontario Financing Authority will continue to provide the excellent service that Ontario taxpayers have come to expect.

Tony Salerno
Vice-Chair and Chief Executive Officer

Ontario Financing Authority

Responsibilities and Objectives

The Ontario Financing Authority (OFA) was established by the *Capital Investment Plan Act, 1993.* The OFA performs the following responsibilities for the Province of Ontario, its Crown corporations and other public bodies:

- **Executes Borrowing, Investment and Financial Risk Management Activities**
  The primary goal of the Ontario Financing Authority is to meet the Province's financial requirements in a sound and cost-effective manner.

- **Manages the Provincial Debt**
  The OFA manages the Province's debt and contributes to the government's overall deficit reduction efforts. The key principles guiding the management of the Provincial debt and associated risks are soundness, efficiency, a smooth debt maturity profile and safeguarding Ontario's credit rating.

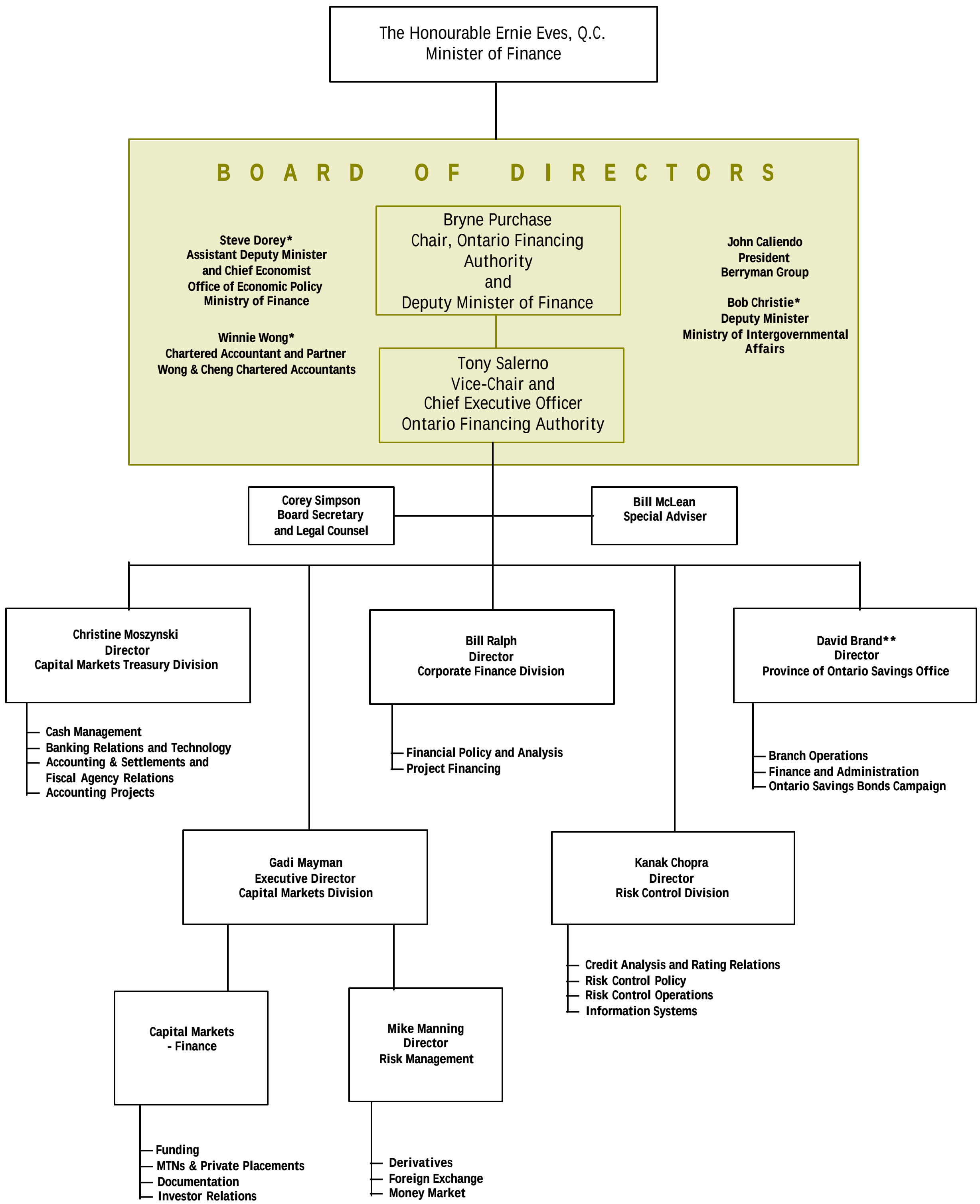
- **Advises on Financial Policies and Projects**
  The OFA provides financial policy advice to the Ontario Government on a wide range of corporate finance issues. These currently include electricity industry restructuring, privatization of public sector entities, sale of Government assets and alternative financing proposals.

- **Provides Financial and Cash Management Services**
  To reduce government-wide duplication and the overall cost of borrowing, the OFA is in the process of centralizing several financial activities. The resulting efficiencies should further ease cash balance requirements, allow liquid reserve levels to be lowered and lead to lower Public Debt Interest (PDI) charges.

- **Operates the Province of Ontario Savings Office**
  The Ontario Financing Authority operates the Province of Ontario Savings Office (POSO). Currently, POSO operates 23 branches and five agencies and has $2.5 billion in deposits.

The Ontario Financing Authority is committed to performing all of these activities to the highest professional standards.

ONTARIO FINANCING AUTHORITY



* **Members of the Audit Committee:** Through the Audit Committee, the OFA's Board of Directors ensures that OFA staff adheres to appropriate standards of internal control.

** David Brand departed the Ontario Financing Authority in April 1999.
Peter Roberts and Karen Deering have been appointed as Acting Directors.

As at March 31, 1999.

The Board of Directors

Appointed by the Lieutenant Governor in Council, the Board of Directors oversees the business of the Ontario Financing Authority. Specifically, it reviews and approves key policies related to capital market activities and it supervises the OFA's management of the Province's debt and investment portfolios. The Board receives regular reports on the Province's actual risk exposures and on policy compliance through the Director of Risk Control. The Board of Directors also reviews and approves the annual Corporate Plan.

In addition, the OFA Board approves the quarterly and annual financial statements of the Ontario Financing Authority and discusses the annual financial statements with its auditor - the Provincial Auditor. The Audit Committee supports the Board of Directors in these areas. The Audit Committee also recommends the annual internal audit plan and reviews the findings of the internal auditors regarding the adequacy of internal controls.

The Board of Directors meets at least quarterly. Currently, the Board of Directors is composed of the Deputy Minister of Finance, the Chief Executive Officer, two other senior members of the Ontario Civil Service and two members from the private sector. The directors' diverse backgrounds contribute to the effective supervision of the OFA.

Corporate Governance

Corporate governance at the Ontario Financing Authority involves the implementation and ongoing review of processes that permit the supervision and management of OFA's activities by senior officials, the Board of Directors and the Minister of Finance. Corporate governance also includes identifying those individuals and groups who are responsible for the OFA's activities and specifying their roles. Corporate governance processes and policies are reviewed by the Board of Directors annually.

The Ontario Financing Authority's accountability framework flows from its governing statute, the *Capital Investment Plan Act, 1993* and from a Memorandum of Understanding between the OFA and the Minister of Finance. Together, they provide that the Minister of Finance is accountable to Cabinet for the activities of the OFA. The Chief Executive Officer reports to the Board of Directors. In turn, the Board reports to the Minister of Finance.

The Minister of Finance reviews, approves and recommends to the Management Board of Cabinet the annual Corporate Plan, which contains long- and short-term objectives and reports on accomplishments for the preceding year.

The Chief Executive Officer (CEO) is responsible to the Board of Directors for day-to-day operations. The CEO also ensures that policies and procedures, including financial reporting, remain relevant and effective. Staff are accountable, through senior management, to the Chief Executive Officer.

Corporate Policies

The *Capital Investment Plan Act, 1993* sets out a broad framework for the Ontario Financing Authority's operations. This is supplemented by internal policies on risk management and financial reporting, which provide operational guidelines.

In carrying out its mandate, the Ontario Financing Authority faces financial risks that are inherent in managing financial assets and liabilities. Risk management policies ensure that the financial risks that the Province faces are identified, monitored, evaluated and managed. The OFA manages financial risk through a comprehensive framework of debt management infrastructure, policies and methods.

Overview and Structure

Board of Directors

- Reviews and approves key policies related to capital market activities.
- Supervises the management of the Province's debt and investment portfolio.

Audit Committee

- Oversees the financial reporting process on behalf of the Board of Directors.
- Reviews key debt management policies, internal audit reports and the financial statements.

Management Committees

Risk Management Committee

- Reviews daily market updates and outlook.
- Reviews current borrowing, investing and debt management positions and strategies.

Borrowing Strategy Committee

- Reviews economic conditions, fiscal plan and capital markets outlook.
- Reviews borrowing and debt management activities and management reports, cash flows and the public debt interest forecast.
- Reviews operational limits and procedures related to financial operations.
- Approves exceptions to approved risk management policies.
- Approves risk management policies for recommendation to the Board of Directors.

Risk Control Division

- Monitors and measures financial risks and performances associated with borrowing, debt management and investment of liquid reserves.
- Develops risk management policies and monitors compliance with Board-approved policies, limits and procedures.
- Assesses counterparty credit risk and manages rating agency relations.

Risk Management Policy Framework

The Ontario Financing Authority has a number of policies in place to minimize financial risk: market risk, credit risk, operational risk and the use of derivatives. These policies were developed after reviewing the Group of Thirty's best practices, the guidelines and directives of regulatory bodies, such as the Office of the Superintendent of Financial Institutions of Canada and consulting with Canadian bank representatives on their risk management practices. Key aspects of the policies are summarized below.

A. Market Risk

This policy provides a framework for borrowing and debt management activities and integrates several aspects dealing with the management of market risk.

- **Foreign Exchange Limit** - The Province's exposure in unhedged debt principal to foreign currency is limited to five per cent of outstanding debt. Foreign exchange exposures are limited to Group of Seven currencies and the Swiss franc or the equivalent currencies (i.e., Euro).

- **Floating Rate Limit** - The Province's net floating interest rate exposure is limited to 20 per cent of outstanding debt.

- **Public Debt Interest and Debt Management Loss Limits** - Actual Public Debt Interest (PDI) must not exceed budgeted annual PDI by more than three per cent as a result of adverse floating rate interest or foreign exchange movements (PDI loss limit). In addition, the CEO establishes a debt management trigger level to ensure that losses will not reach the PDI loss limit. The trigger level will be included in the annual borrowing and risk management plan.

- **Liquidity Risk** - Liquid reserves are maintained at levels sufficient to ensure that the Government can meet its short-term financial obligations. Syndicated lines of credit, Treasury Bill and U.S. Commercial Paper programs are also available to provide liquidity should the need arise.

- **Debt Maturity Profile** - When issuing new debt, the OFA will aim for a smooth debt maturity profile to diversify the interest rate risk of refinancing maturing and floating rate debt.

- **Risk Measurement** - The Province identifies and quantifies exposures to market risk in its annual borrowing and debt management plans to ensure that risk exposures and losses remain within the approved exposure and loss limits. Exposure to market, credit and liquidity risk is measured daily.

B. Credit Risk

Credit risk usually arises when the OFA borrows in foreign currencies and subsequently hedges the foreign exchange rate risk by converting the liability of an issue into Canadian dollars. The minimum credit rating of a counterparty for a new swap transaction is A- and the resulting exposure is capped at pre-set mark-to-market limits depending on the counterparty's credit rating.

Credit risk also arises in money market investments. These investments are restricted to instruments issued or guaranteed by the federal or provincial governments or by non-government counterparties with a credit rating of R-1 (Mid) or better. Investments in non-government paper are restricted to terms no greater than one year.

C. Operational Risk

The Ontario Financing Authority manages operational risk by following operating procedures that deal with model risk, legal issues, settlement issues and information systems risks.

- **Model Risk** - The OFA regularly reviews its pricing models for accuracy and compliance with industry standards. It also regularly reviews the valuation of financial instruments.

- **Legal Issues** - The OFA has established procedures and standards that ensure the documentation of debt issues, debt management and money market transactions meets industry standards and is enforceable.

- **Settlement Issues** - The OFA has established internal control procedures to ensure that transactions are settled correctly in a timely manner and are recorded accurately.

- **Information Systems Risk** - The OFA has taken measures to protect the computer systems and offices of the OFA by supervising the computing environment, establishing back-up power sources, regular data back-ups, off-site storage, firewalls to protect against unauthorized intruders, and scanning for computer viruses. Security is reviewed periodically.

D. Use of Derivatives

Derivatives are used solely to advance the OFA's objective of providing the Province's financing and liquidity requirements in a sound and cost-effective manner. Derivatives are used to manage exposures arising from existing and planned debt and in a manner consistent with the borrowing and debt management plans. Risks that arise from the use of derivatives are identified, monitored, evaluated and managed prudently.

Financial Reporting

The Ontario Financing Authority's Board of Directors receives quarterly progress reports on borrowing and debt management plans and current risk exposures. Also, the CEO provides the Board of Directors with a monthly assessment of performance relative to the OFA's benchmarks governed by the Board. In addition to borrowing and debt management plans, the CEO provides the Board of Directors with progress reports on staffing, administrative and operational matters. The CEO also reports on the Authority's compliance with ministerial or government directives.

Legal counsel and the Director of Risk Control report on the OFA's compliance with applicable laws and policies. The Deputy Minister of Finance, on behalf of the Minister of Finance, receives weekly financial and financing program reports.

The adequacy and effectiveness of internal controls are examined independently by the Audit Services Branch of the Ministry of Finance. Internal Audit also verifies compliance with policies, procedures and operational limits. The results of these audits are reported to management and the Audit Committee of the Board of Directors.

The OFA prepares annual financial statements in accordance with Generally Accepted Accounting Principles (GAAP) for approval by the Audit Committee and the Board of Directors. The financial statements are reviewed by the Provincial Auditor who expresses an opinion on whether they are presented fairly and in accordance with GAAP. The Provincial Auditor's findings are reviewed by the Audit Committee and the Board of Directors. These audited financial statements are tabled in the Ontario Legislature as part of the Ontario Financing Authority's Annual Report.

The Ontario Financing Authority Team

The Ontario Financing Authority team encompasses a diverse group of professionals with expertise and background in a number of financial services and related fields. Without this professional support, the OFA would not achieve its mandate of providing sound and cost-effective financing, debt management and treasury services to the Province and ultimately to the taxpayers of Ontario. The OFA currently employs approximately 280 full-time equivalent staff in five divisions.

The financial services industry has been dramatically transformed over the past several years. International financial markets have become more integrated, innovative financial instruments have been created, the regulatory environment has continued to evolve and modern technologies have begun to provide new avenues of service delivery. To foster the innovation, creativity and dedication that is critical to thrive in this ever-changing environment, the OFA is committed to providing a learning environment for its staff.

The Ontario Financing Authority encourages career development, relationship building and leadership training. Staff development opportunities are provided through participation in seminars, courses, developmental assignments and professional programs. The OFA is committed to ensuring that its staff is equipped with the skills and resources necessary to meet the challenges and complexity of providing sound and cost-effective financing, debt management and treasury services. The Ontario Financing Authority team is dedicated to providing the excellent service that Ontario taxpayers have come to expect.

Management's Discussion and Analysis

This section of the Annual Report provides management's discussion and analysis of the performance and priorities of the Ontario Financing Authority. The analysis focuses on the OFA's assessment of the business environment, subsequent strategies and results in 1998-99 and objectives for 1999-2000.

Business Environment

- **Financial Markets in Review**

The year 1998-99 was marked by volatility and uncertainty in international financial markets. Some of the key factors contributing to market uncertainty included a severe recession in Southeast Asia; ineffective economic stimulus plans in Japan; Russian loan defaults; the collapse of a large hedge fund, Long-Term Capital Management; devaluations of the Russian ruble and Brazilian real; and falling commodity prices.

Crises and unprecedented volatility in many emerging markets posed dangers to the world's financial system and led the U.S. Federal Reserve to lower its short-term "Fed Funds" interest rate three times in the second half of 1998. The collapse of many commodity prices caused by falling worldwide demand helped keep inflation low in developed countries. Continued good inflation news, federal government budget surpluses and the emergence of a "flight to quality" or "safe haven" bid from investors re-evaluating their risk appetite, allowed U.S. and Canadian government bond yields to reach generational lows in October 1998. The yield on the 10-year U.S. Treasury note fell to 4.16 per cent and the yield on the Government of Canada 10-year bond reached a low of 4.67 per cent.

Despite benefitting somewhat from "safe haven" status, Canada was affected negatively by financial market volatility in 1998. Weak commodity prices put downward pressure on the Canadian dollar. Over the course of the year, the Canadian dollar fell from 70 cents US to 65 cents US, and traded as low as 63 cents US.

Also, Canadian government bonds did not benefit to the same extent from the "flight to quality" as their U.S. counterparts, and the yield on all terms of Canadian government debt rose back above U.S.

government bond yields for the first time in over a year. When the U.S. Federal Reserve eased interest rates in late 1998, the Bank of Canada began to follow suit and reversed all of its August 100 basis point increase in administered rates by March. Canadian interest rates remained above U.S. interest rates for the remainder of the 1998 calendar year with longer-term interest rates ending the 1998-99 fiscal year, once again, below their U.S. counterparts.

- **Year 2000 Preparedness**

The OFA devotes significant efforts to address Year 2000 (Y2K) readiness and plans to have its critical business systems Y2K ready by June 30, 1999. A task force has been established to provide leadership for coordinating the Y2K readiness, correspondence and communication activities within the OFA. The Chair of the Y2K task force, through the Director of Risk Control, reports to the CEO and to the OFA's Board of Directors. The task force assesses Y2K associated risks to determine the appropriate actions and guidelines needed to reduce these risks for the OFA. Preparation of business continuity plans is included in these activities.

The OFA's business critical computer systems used to manage the Province's financial requirements have always used four-digit codes in order to correctly calculate cash flows associated with debt maturities beyond 2000. Most of these systems have been developed in the past few years during which the OFA was aware of the Y2K issue and thus took steps to address it. Some modifications that were required because of outside interfaces, which were not Y2K ready, have been completed. The key business critical systems were tested in 1998 and were found to be Y2K ready. The business critical hardware and desktop software have been upgraded to be Y2K ready. In 1999, the OFA is focusing on additional testing and verification that all its systems are Y2K ready.

Within the Province of Ontario Savings Office (POSO), three systems have been identified as being business critical for its operations. Remedial Y2K modifications to its customer deposit accounts system, which were of a minor nature, have been completed and full end-to-end testing of this system is being undertaken by staff. The other two systems are both based on desktop PCs and their software and hardware are being upgraded and replaced, respectively. All three systems are targeted to be Y2K ready in the summer of 1999. Other equipment and services used by POSO are also being examined for Y2K readiness.

The OFA is examining Y2K readiness of its fiscal agents, counterparties and other entities with whom it has financial relationships or depends on for services. Also being monitored are suppliers of non-financial services such as landlords.

- **The Province's Borrowing Program for 1999-2000**

The Province's financing requirements for 1999-2000 will total $11.4 billion. This mainly consists of maturities of $8.1 billion and a deficit of $2.1 billion. Debt maturity refinancing forms a significant component of the Province's borrowing requirements in 1999-2000 and in the future as annual deficits fall to zero.

- **Management of Former Ontario Hydro Guaranteed Debt and Derivatives**

The Ontario Electricity Financial Corporation (OEFC) is responsible for servicing and retiring the former Ontario Hydro's provincially guaranteed debt and certain other legacy liabilities. The OFA will provide, on a cost recovery basis, the debt, risk and cash management, banking and accounting services to manage and retire the outstanding debt and derivative contracts of the former Ontario Hydro. Further details are provided in subsequent sections.

The Ontario Electricity Financial Corporation

The Ontario Electricity Financial Corporation (OEFC) is a Crown agent responsible for servicing and retiring the former Ontario Hydro's provincially guaranteed debt and certain other legacy liabilities. The OEFC is governed by a board of directors and chaired by the Deputy Minister of Finance. The CEO and Vice-Chair of the Ontario Financing Authority are the CEO and Vice-Chair of the OEFC.

The OEFC will provide the debt and risk management, banking and accounting services to manage and retire the outstanding debt and derivative contracts of the former Ontario Hydro. The OEFC will also administer the pension plan and pension assets of the former Ontario Hydro until the assets can be allocated among the pension plans of the successor companies. Day-to-day administration of the pension plan and pension assets will be conducted by OEFC's subsidiary, Ontario Electricity Pension Services Company.

The OEFC will rely on dedicated revenue streams to extinguish its obligations. The $30.5 billion of outstanding Ontario Hydro debt held by the OEFC will be serviced as follows:

- Debt from the successor companies: $8.2 billion.
- Debt from the Province under the debt-for-equity-swap: $8.9 billion.
- Payments-in-lieu of taxes from the successor companies and Municipal Electric Utilities.
- A Competition Transition Charge (CTC), if needed, to service residual stranded debt.

The OEFC will finance any cash flow timing differences between debt servicing payments and dedicated revenue receipts. Since the OEFC will not have its own credit rating, the Province of Ontario will borrow on its behalf. The OEFC will, in return, issue securities to the Province bearing like terms and conditions.

- **Capital Financing for Broader Public Sector**

As part of the Ontario Government's initiative to restructure local government services, the OFA is reviewing the capital needs of the broader public sector. Funding for the capital needs will emanate from a number of sources including debt financing. One example is the $281 million financing for The Toronto Hospital in December 1998. The proceeds of this debt financing are being used to replace and renew existing outdated physical plant and equipment at the Hospital.

Other broader public sector institutions have been reviewing the applicability of The Toronto Hospital financing to their needs and it is expected that there will be requests to undertake similar cost-effective financings. The OFA is developing options for the Province to assist in responding to these requests.

- **Promoting Efficient Cash Management and Financial Services Activities**

As part of ongoing efforts to optimize the Government's cash flows, the OFA issued best practices guidelines to all Ontario ministries in July 1998. The OFA will work closely with the Management Board Secretariat and other Ontario ministries to incorporate these guidelines in their cash management operations.

The OFA also worked to promote new banking services to improve revenue collection and payment disbursement while reducing the Government's administrative costs. In 1999-2000, the OFA will promote efficient use of Internet-based, e-commerce services and electronic benefits cards.

Responsibilities

Execute borrowing program and risk management activities.

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Manage legal requirements and securities commission filings.

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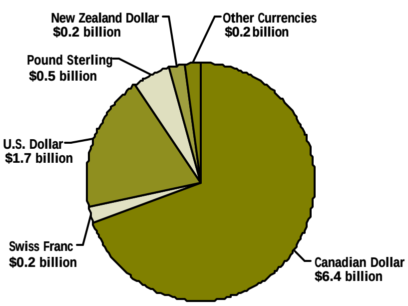
Manage relations with investors and the investment community.

1998-1999 Long-Term Borrowing



Total: $9.3 billion

Capital Markets Division

The Province's 1998-99 Financing Program

In 1998-99, funding requirements to finance the deficit, cash timing adjustments, borrowing on behalf of agencies and maturing debt totalled $12.6 billion. The OFA financed this amount with $9.3 billion in long-term borrowing, a $0.4 billion increase in short-term borrowing and $2.9 billion from a decrease in liquid reserves. Of the $9.3 billion in long-term borrowing, just over 69 per cent was borrowed in Canadian dollars, including sales of $2.0 billion from the fourth issue of Ontario Savings Bonds (OSB), several domestic benchmark issues, three Euro-Canadian dollar issues totalling $600 million, marking the first return to this market for the Province since 1993, and a number of structured institutional and retail transactions.

While the Canadian market was the main source of financing, the Province accessed foreign markets when cost-effective arbitrage opportunities were available. In September 1998, the Province issued a US$750 million global bond (C$1.1 billion), which was reopened in November 1998 for an additional US$250 million (C$0.4 billion). Also, C$1.1 billion was sourced from a number of foreign issues including Pounds sterling, Swiss franc, Japanese yen, Greek drachma, New Zealand dollar and €uro issues.

In December 1998, the Province began to borrow on behalf of Ontario Hydro for the remainder of that entity's calendar 1998 and first quarter of 1999 requirements. These requirements, essentially to refinance Ontario Hydro's maturing debt over this period, were approximately $1.5 billion.

Flexible, Cost-effective Borrowing

The OFA's flexible approach to borrowing allows it to take advantage of cost-effective financing opportunities. This is particularly important during periods of high market volatility.

- ***Diversified Financing Sources***
  While the Canadian market remained the primary source of financing for the Province's long-term borrowing, foreign markets were accessed when they provided lowercost financing opportunities. An active investor relations program, with the increased use of internet technology, has helped to expand the investor base for Ontario securities and greatly facilitated information dissemination to the financial community. In 1998-99, two new modules, the "Glossary of Terms" and "Year 2000" sections, were added. In addition, an e-mail alert service was created.

- ***Structured Institutional and Retail Transactions***

  The OFA developed several debt security products that reduce borrowing costs and meet investor requirements. In particular, the OFA issued a number of structured institutional and retail transactions aimed at fulfilling investor needs. In January 1999, for example, the OFA issued $89 million in seven-year monthly pay bonds to meet the demand of retail investors in Canada.

- ***Lower Commissions***

  Given that Ontario is, by a substantial margin, the largest issuer other than the Government of Canada in the domestic market, the OFA negotiated a volume discount in commissions. On the first $2 billion borrowed each fiscal year in the domestic market, the regular commission levels are set at 0.5% for five-year domestic issues, 0.6% for 10-year domestic issues and 0.7% on 30-year domestic issues; thereafter, commissions will be reduced by 0.1%, to 0.4%, 0.5% and 0.6%, respectively. For this fiscal year, this change has saved the Province $2.6 million.

The €uro

Under the Maastricht Treaty, Member States of the European Union are obligated to merge their currencies into a single currency called the €uro. Eleven member states (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal and Spain) participated in the initial merger. The €uro was substituted for the currency of each participating member state at various conversion rates on January 1, 1999. During a three-year transitional period, the €uro will be used as a means of payment but the banknotes and coins of former national currencies will continue to circulate.

For the Province, the €uro will not affect existing debt obligations as all affected issues were swapped into Canadian dollars. The Province has six debt issues totalling $4.1 billion denominated in the affected currencies. Of the $4.1 billion, two Deutschemark issues (totalling C$900 million) mature before the final redenomination date of January 1, 2002. The remaining four issues (totalling C$3.2 billion) will be re-denominated into the €uro by January 1, 2002. The swaps that the Province entered into to hedge these issues into Canadian dollar exposure will be redenominated at the same time, ensuring that the Province will continue to have no foreign exchange exposure on these issues.

Priorities in 1999-2000

The Province's borrowing requirements for 1999-2000 will total $11.4 billion mainly consisting of maturities of $8.1 billion and a deficit of $2.1 billion. Most borrowing will likely be done in the domestic market. The OFA intends to develop and implement a Canada Medium-Term Note program in 1999-2000 in order to streamline the issuance process. An additional source of domestic borrowing will be the Canada Pension Plan Investment Fund which is expected to have sufficient funds available to refinance nearly all of that entity's holdings of maturing provincial debt. Foreign markets will be accessed when cost-effective arbitrage is available.

A fifth issue of Ontario Savings Bonds (OSB) will be included in the 1999-2000 financing program. Staff and stakeholder consultations have led to a number of changes for the 1999 OSB campaign including improved informational materials sent to financial institutions, elimination of ineffective parts of the program such as payroll deduction and additional features to facilitate the sale and redemption of savings bonds.

The OFA will also borrow on behalf of the OEFC, as there will be cash flow timing mismatches between the required debt service payments and the revenues available to make such debt service payments. For fiscal year 1999-2000, the amount of borrowing to finance cash flow mismatches is estimated at $2.2 billion. The borrowing will be recouped when dedicated revenues exceed debt-servicing obligations.

The OFA will assume responsibility from the Ministry of Housing for the tendering process with respect to the Province's social housing-related mortgage-backed securities portfolio. This transfer of responsibility will streamline the tendering process and any cost savings will be flowed through to the municipalities that are responsible for servicing these obligations.

The OFA will develop options to expand the Province's investor base. The OFA keeps abreast of emerging developments in the Internet industry and plans to integrate these developments into the Province's traditional investor relations activities. Plans for a live Internet broadcast for future events are being explored, combining live audio, slideshow and a chat board. In addition, the Province's OSB campaign will be promoted using banner advertisements on various Web sites. The OSB purchase application form will be available on the OSB Web site.

Risk Control Division

1998 - 1999 Accomplishments

To ensure completeness of risk control practices, a substantive review was undertaken and all risk management policies were updated and consolidated. The result was the formulation of the "Policy Framework for Risk Management." This framework will ensure that the risks facing the OFA are measured accurately and consistently. The framework consists for four facets:

- ***Risk Management Reporting Policy***, to ensure that the Board of Directors is kept informed of OFA's operations, risk exposures and performance;

- ***Use of Derivatives and Other Financial Instruments***, to govern the use of derivative instruments;

- ***Market Risk Policy***, to address market risks associated with borrowing and debt management activities (this policy amalgamated former policies on maturities, loss limits and exposures); and

- ***Credit and Related Legal Policies***, to update the OFA's existing policies to reflect the potential merger of financial institutions and to cover non-rated entities.

Risk management reporting was enhanced with the development of new reports for the Board and the CEO. In addition, a review of all risk management reports was initiated to streamline reports targeted to different levels of management and staff. This work is being carried out in conjunction with the redesign of a system to value exposures and positions (Mark-to-Market system), enhancing the analytical capability of the OFA. It is expected to be completed in the early part of 1999-2000.

The monitoring of counterparties was expanded in view of the changing financial system and Y2K issues. Also, discussions were held with rating agencies to apprise them of developments regarding the restructuring of Ontario Hydro and the formation of the two new companies, which will receive their own ratings and borrow without the Provincial guarantee.

The division's objectives include minimizing susceptibility to human error through process automation, incorporating system checks and increasing reliance on direct data feeds. During 1998-99, an aggressive information technology (IT) development schedule was developed. Work on several Treasury Systems, the Integrated Treasury System (combining the Settlement and Trading Blotter), the Cash Management System and the Accounting and Financial Reporting System was initiated.

Responsibilities

Monitor and measure financial risks and performance associated with borrowing, debt management and investment of liquid reserves.

❖

Develop risk management policies and monitor compliance.

❖

Forecast and analyze Public Debt Interest for the Provincial budget and quarterly fiscal updates.

❖

Assess counterparty credit risk and manage rating agency relations.

❖

Provide systems development and information technology support.

Managing Risk Prudently

In order to mitigate the financial risks inherent in having a large and diversified debt portfolio, it is important to maintain prudent risk management policies. The OFA uses financial options and swaps to manage the Province's exposure to fluctuations in interest rates and foreign currency exchange rates.

Risk exposures are monitored daily and audited annually. The cost-effectiveness of borrowing, debt management and investment activities is measured daily against pre-established benchmarks. In 1998-99, the OFA saved a total of $86 million on a present value basis versus the industry benchmarks.

As of March 31, 1999, the Province's total swap portfolio had a notional value of $84 billion. The volume of transaction during the course of 1998-99 totalled $33.9 billion in bonds, $7.6 billion in interest rate and currency swaps, $10.4 billion in forward rate and currency agreements, $0.5 billion in interest rate options and $1.8 billion in currency options.

Risk Management Policy	Actual Exposure
Foreign Exchange Risk	
Currency exposure on debt principal cannot exceed five per cent of total outstanding debt.	Net foreign exchange exposure was 1.1% of total outstanding debt as of March 31, 1999 and averaged 1.0% throughout the year.
Floating Rate Risk	
Floating rate debt (net of liquid reserves) cannot exceed 20 per cent of total debt.	The percentage of net floating rate exposure was 6.7% of total outstanding debt as of March 31, 1999. Throughout the year, exposure averaged 5.9%.
Liquidity Risk	
Liquidity risk is controlled through the management of liquid reserve levels, short-term borrowing programs and pre-arranged lines of credit.	Due to the Province's improved fiscal performance, the OFA reduced the average level of liquid reserves from $6.9 billion in 1996-97 to $4.0 billion in 1998-99. The Province's Treasury Bill and U.S. Commercial Paper programs have authorized limits of $6.0 billion and $2.5 billion, respectively. The OFA can also draw on the Province's US$1.25 billion line of credit.
Refinancing Risk	
Term selection is sensitive to the Province's maturity schedule.	During 1998-99, debt refinancing amounted to $6.4 billion. In 1999-2000, maturities are estimated at $8.1 billion.
Credit Risk	
Ontario only enters into new transactions with counterparties rated single "A" or higher.	At year end, 78% of the swaps outstanding were with financial institutions with a credit rating of "AA minus" or higher.

Priorities for 1999 - 2000

During 1999-2000, the focus of the division will be on enhancing analytical capabilities to implement quantitative measures of risk: Public Debt Interest at Risk (PaR), Value at Risk (VaR), and the trade-off between credit and market risks. These measures will be used to analyze borrowing and debt management plans as well as to enhance the monitoring, reporting and managing of market and credit risks faced by the Ontario Financing Authority.

Work is under way to ensure that appropriate investment, debt management and reporting policies are in place for OEFC-related transactions. Communications with credit rating agencies will continue to ensure that the Province's credit rating is based on current information and with accurate interpretation of the Province's finances.

The accuracy of the PDI forecast will be improved by enhancing the analysis of PDI variances, between the actuals and forecasts, as well as the forecast process itself. In addition, work will be carried out with the Capital Markets Division in developing PDI management strategies and hedging PDI risks.

Efforts to upgrade and standardize the risk measurement and reporting system based on best industry practices will continue. Model risks will be managed by testing and documenting all the OFA valuation and pricing models to ensure that they are up-to-date with respect to recent developments in the financial industry.

During 1999-2000, ongoing improvements will be made by the OFA to its IT systems to fulfill the core objective of providing cost-effective government financing and debt management services. In cooperation with the Capital Markets Division, specifications will be developed for the Risk Reporting System and Risk and Portfolio Analytics System. It is expected that a portion of these systems will be operational by year-end 1999-2000. Also, upgrades to the Cash Management, Integrated Treasury and Risk and Financial Reporting and Accounting Systems are expected to be completed before the end of fiscal year 1999-2000.

Responsibilities

Advise Ontario ministries on financial policy issues such as alternative financing, public-private partnerships and asset management.

❖

Advise on project and infrastructure financing approaches.

❖

Advise on the financial implications of potential privatizations.

❖

Develop financial options for Ontario agencies and Crown corporations.

Corporate Finance Division

1998 - 1999 Accomplishments

During 1998-99, significant contributions were made toward the successful restructuring of Ontario Hydro, including the preparation of the *Financial Update* paper, the subsequent presentation on the Preliminary Estimates of Asset Valuation and Stranded Debt and the release of final stranded debt numbers. Advice was provided during the incorporation of the two new commercial successor corporations, Ontario Power Generation Inc. and Ontario Hydro Services Company Inc., to finalize their debt and capital structures. In addition, substantial advice was provided toward the establishment of the Ontario Electricity Financial Corporation.

Working with the Office of Privatization, financial policy advice and analysis were provided with respect to the sale of Highway 407. The division also supported the Office of Privatization in its review of a number of other privatization candidates including the Metro Toronto Convention Centre, Province of Ontario Savings Office, a number of tree nurseries, the Ontario Clean Water Agency and ORTECH Corporation. Based on the Metro Toronto Convention Centre review, the Government decided to retain ownership of this facility while refinancing the outstanding debt currently owed to the Province. The division is currently working on this refinancing initiative with the completion of the transaction expected in early 1999-2000.

The Province provided direct loans to New Tecumseh for a water pipeline related to the expansion of the Honda car plant in Alliston and to the Ontario Northland Transportation Corporation's Agrium project. The OFA worked closely with the Ministry of Municipal Affairs and Housing to identify efficiencies in managing debt owed by the Ontario Housing Corporation to Canada Mortgage and Housing Corporation.

Electricity Sector Restructuring Update

In November 1997, the Ontario Government announced a proposal to restructure Ontario's electricity sector and to create a competitive market by 2000 for both wholesale and retail customers. The objectives include:

- Providing the lowest possible electricity costs while safeguarding a reliable, safe and environmentally sound electricity supply;
- Restoring the vitality and financial soundness of Ontario's electricity system; and
- Ensuring a level playing field for all participants through an independent regulator.

On April 1, 1999, under *The Energy Competition Act, 1998,* five corporations, together with their subsidiaries, were formed from the former Ontario Hydro:

- Ontario Hydro Services Company (OHSC)
- Ontario Power Generation Inc. (OPGI)
- Independent Electricity Market Operator (IMO)
- Electrical Safety Authority (ESA)
- Ontario Electricity Financial Corporation (OEFC)

Financial Structure of the Successor Corporations

On April 1, 1999, Ontario Hydro's assets were transferred by the Ontario Electricity Financial Corporation to OHSC, OPGI, IMO and the ESA.

- OHSC received the transmission, distribution and retail assets and issued $8.6 billion in debt.
- OPGI received the electricity generating assets and issued $8.5 billion in debt.
- The IMO, a non profit corporation responsible for ensuring the reliability and fairness of the electricity market, issued $70 million in debt to the OEFC in return for Ontario Hydro's central market operator assets.

In order for OHSC and OPGI to have capital structures competitive with those of other industry participants, the two companies entered into a debt-for-equity swap with the Province of Ontario:

- The Province assumed $8.9 billion of the debt issued by the two corporations to OEFC in exchange for $3.8 billion in equity ($3.4 billion common, $323 million cumulative preferred) from Ontario Hydro Services Company and $5.1 billion of common equity from Ontario Power Generation Inc.
- The debt-for-equity swap resulted in debt-to-equity ratios of 56/44 for OHSC and 40/60 for OPGI.

Financial restructuring will put the new companies on a sound financial footing with investment grade capital structures. The steps taken to date will allow Ontario Hydro's outstanding debt to be paid off efficiently and expeditiously, while protecting both Ontario taxpayers and electricity users.

Priorities for 1999 - 2000

The financial restructuring of Ontario Hydro will be completed, including the establishment and successful implementation of the OEFC. The Corporate Finance Division will also have an ongoing role in monitoring and providing advice to the Province as the shareholder of the new commercial successor corporations.

With respect to the sale of Highway 407, the division provided assistance in negotiating the terms and conditions of the sale. On April 13, 1999, the Honourable Rob Sampson, Minister Without Portfolio with Responsibility for Privatization, announced the sale of Highway 407 for $3.1 billion to a consortium of Grupo Ferrovial, SNC-Lavalin and Capital d'Amerique CDPQ.

The division will provide assistance to the Office of Privatization in its review of other potential privatization candidates.

Building on the success of The Toronto Hospital financing initiative, the division is reviewing possible cost saving opportunities that could be brought about through a pooled borrowing vehicle. Such a vehicle would be designed to reduce the financing and transaction costs of broader public sector institutions that borrow in the debt markets. The objective is to ensure that, as much as possible, public funds are going toward frontline services. Internal government pooling vehicles, such as a leasing pool, will also be explored to allow ministries to obtain competitive financing costs when they are leasing equipment.

Capital Markets Treasury Division

1998 - 1999 Accomplishments

The division implemented a number of initiatives to improve the timing of the Province's cash flows, to enhance financial services to client groups and to strengthen internal operations and controls.

- **Cash Management**
  A key initiative was the issuance of corporate guidelines outlining cash management best practices. The division also adopted a four-year cycle for reviewing each ministry's cash management practices. As part of this initiative, cash management practices of five ministries were evaluated in 1998-99, resulting in more stable cash flows throughout the fiscal year. Subsequently, the OFA has proposed that cash management practices be included as part of the government-wide audit program.

  In addition, the OFA initiated an improvement in the timing of gasoline tax remittances, resulting in annual savings of approximately $4 million.

- **Banking Services**
  To improve revenue collection and payment disbursement, the division promoted the use of effective banking solutions to Ontario ministries. For example, the division encouraged Ontario ministries to use electronic payments in lieu of cheques to reduce processing costs and time.

  Staff worked with the Ministry of Finance to maximize its use of electronic payments under the new Child-Care Supplement Program. Also, a design change to Corporation and Employer Tax Remittance forms improved the accuracy of data for cashflow forecasting purposes and is expected to result in approximately $500,000 in savings annually.

  Through a reallocation of deposits among bank branches and a renegotiation of certain bank fees, bank deposit charges were reduced by $280,000 in 1998-99. The division also worked with the Ontario Public Guardian and Trustee and the Family Responsibility Office on its banking services tenders, resulting in a transfer of $800,000 to the Province. Collaboration with the Canadian Bankers Association has resulted in more efficient Ontario Savings Bond issuance and service to bondholders.

  In light of potential Y2K risks, the competitive tender for the Province's debit/credit card acceptance services contract has been deferred to fiscal year 1999-2000. A one-year extension of the Province's existing contract ensures that the debit/credit acceptance services will continue without disruption into 2000.

Responsibilities

Lead government-wide initiatives aimed at centralizing the Province's cash management and financial services activities.

❖

Make payments to debt, securities and derivatives transactions.

❖

Provide banking advice regarding Consolidated Revenue Fund revenues and disbursements.

❖

Manage banking and fiscal agency relations.

❖

Generate accounting, financial and management reporting.

❖

Advise on accounting issues and their implications.

- **Organizational Improvements**

  The Accounting and Settlements Section is critical to ensuring that payments are made on schedule and accounting records and reports are in compliance with industry's high standards. A reorganization of this section increased the separation of the settlements and payments function from the reporting and analysis function. This separation improved internal controls, while additional organizational changes and systems development have improved the flow and accuracy of information, resulting in new operational efficiencies.

Priorities in 1999 - 2000

The division will continue to promote cash management awareness and business-like practices throughout the Government of Ontario. Other cash management initiatives include the planning and implementation of the bank funding and cash flow projection activities for OEFC; implementation of a new computerized integrated cash flow projection system in conjunction with the IT section of Risk Control Division; and continuous improvements to cash flow forecasting for short- and longer-term needs.

In banking services, the division will continue to promote efficient use of banking technologies with particular emphasis on Internet-based e-commerce services and electronic benefits cards; prepare to re-tender the Province's debit and credit card acceptance services; advise the OEFC regarding its banking needs; and assist the Ministry of Education and Training in its efforts to establish a cost-effective, harmonized federal/provincial student loan program.

To improve revenue collection, the division, in partnership with the Ministry of Finance and Ontario Business Connects, will implement a third-party electronic tax filing service. This initiative will provide Ontario taxpayers an electronic method of paying taxes and transmitting related data to the Ministry of Finance.

Collaboration will continue with the Audit Services Branch of the Ministry of Finance and the Risk Control Division on the development and implementation of an integrated deal capture, settlement and accounting ledger systems.

Developments on accounting issues, in Canada and internationally, will be closely monitored to determine the impact on the Province's accounts and reporting requirements.

Province of Ontario Savings Office

The mandate of the Province of Ontario Savings Office (POSO) is to supply financing to the Province while providing financial services to the public. Currently, POSO provides deposit-taking services to the public through a network of 23 branches and five agencies. There is currently a total of $2.5 billion in deposits, ranging from demand deposits paying daily interest to five-year guaranteed investment certificates. Deposits made at POSO offer depositors the same security as a holder of the Province's bonds.

Also, the OSB campaign is conducted with assistance, planning and implementation from POSO staff. A total of $6.1 billion was raised in the first four campaigns. The 1998 Savings Bond campaign raised $2 billion and was the biggest provincial savings bond campaign in Canadian history. In June 1999, a fifth issue of Ontario Savings Bonds will be offered to residents of Ontario.

POSO has introduced new products in the last few years: a U.S. dollar account, automated bill payments on behalf of customers, a cashable guaranteed investment certificate and an improved method of quickly pricing high-value deposits. POSO has also tailored products to suit the needs of Ontario Crown corporations with temporary surplus funds and now holds $500 million in such deposits.

In 1999-2000, POSO plans to improve customer service by implementing the government-wide quality service standard for telephones, mail, walk-in service and customer feedback resolution.

In April 1997, the Government announced that POSO was a candidate for privatization. In December 1998, the federal government announced its position on bank mergers. With this decision, it is expected that the privatization review process for the Savings Office will commence again. If this process culminates in a decision to privatize, staff at POSO will assist in the implementation of that decision in a way designed to minimize the impact on customers.

Responsibilities

Offer chequing/savings accounts, short-term deposits and Guaranteed Investment Certificates to the public.

Plan and execute the Ontario Savings Bond Campaign.

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Summary of Financial Results

The Authority's main source of revenue continues to be derived from the operations of the Province of Ontario Savings Office (POSO), which accepts deposits from the general public. The Authority operates POSO as agent of the Minister of Finance and POSO deposits are direct liabilities of the Consolidated Revenue Fund.

Total funds on deposit with POSO as at March 31, 1999 were $2.5 billion, representing an increase of over $300 million from the $2.2 billion reported as at March 31, 1998. The increase was made up largely from higher demand and GIC deposits maturing within one year ($170 million), deposits by the Ontario Casino Corporation ($154 million) and the Ontario Clean Water Agency ($49 million). Long-term GIC deposits decreased by $75 million.

The average effective rate of interest paid on all POSO deposits increased to 4.15% in 1998-99 from 3.42% in 1997-98. The increase is a reflection of the general rise in short-term interest rates compared to last year.

The Authority's net income for the year ended March 31, 1999 was $8.6 million, an increase of $2.3 million over the $6.3 million reported for the same period last year. The increase is mainly due to higher levels of deposits and a decline in operating expenses.

Salaries, wages and benefits for the Authority declined by $600,000 mainly as a result of Management Board Secretariat's assuming responsibility for payment of the unfunded pension liability ($460,000). In addition, the cost of benefits dropped due to one-time union dues paid on behalf of certain POSO employees in 1997-98 ($200,000).

Administrative and general expenses for the Authority were held at the 1997-98 level due to cost control initiatives.

Net capital assets were virtually unchanged ($2.4 million at March 31, 1999; $2.3 million at March 31, 1998), with purchases of $1.1 million offset by amortization of $980,000. The purchases pertained mainly to computer workstation and technology infrastructure upgrades required for Y2K and the specialized financial applications in the areas of risk and cash management in the monitoring of global markets.

Retained earnings of $47.0 million (since inception) represent notional amounts. Annually, the Authority's financial results are consolidated on a line-by-line basis with those of the Province. This accounting treatment is in accordance with the Public Sector Accounting Board (PSAB) of the CICA, under which the Authority is considered a service organization.

As agent for the Province, the Authority made loans to public bodies, the repayment of which is to be funded through third-party revenues. These loans are reported in Note 5 to the financial statements and consist of loans made to the Ontario Transportation Capital Corporation (OTCC) for the building of Highway 407, the Metro Toronto Convention Centre for expansion of its facilities, the Corporation of the City of Windsor for the construction of the Windsor Justice Facility and the Ontario Northland Transportation Commission for acquisition of new lumber cars. The outstanding balance of these loans, including capitalized interest, as at March 31, 1999 was $1.71 billion, an increase of $130 million from the $1.58 billion reported a year ago, due mainly to advances to the OTCC.

Subsequent to March 31, 1999, the Ontario Financing Authority assigned and transferred all of its rights, title and interest in debt owed to it by the OTCC, to the Province. The Province agreed to accept such assignment as payment in full of its $1,524,642,000 indebtedness to facilitate the sale of the OTCC by the Province of Ontario.

The Authority continued to provide investment management services to the Northern Ontario Heritage Fund Corporation during 1998-99. As at March 31, 1999, the Authority managed investments of $199 million, on its behalf (March 31, 1998 - $186 million).

The Authority also administers the loans receivable and payable of the former Ontario Municipal Improvement Corporation (OMIC). OMIC assets of $80.2 million consist of debentures receivable from various municipalities and school boards. An equal amount of liabilities are payable to the Canada Pension Plan and the Province. During the 1998-99 year approximately $315,000 of loans receivable from municipalities matured, and a similar amount of related debt was repaid. The interest earned and paid annually on account of OMIC assets and liabilities amounts to $7.8 million and is expected to remain at this level until 2011, when CPP loans start maturing.

Responsibility for Financial Reporting

The accompanying financial statements of the Ontario Financing Authority have been prepared in accordance with accounting principles generally accepted in Canada and are the responsibility of management. The preparation of financial statements necessarily involves the use of estimates based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to May 21, 1999.

Management maintains a system of internal controls designed to provide reasonable assurance that the assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. An internal audit function independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to management and the Audit Committee of the Board of Directors.

The Board of Directors, through the Audit Committee, is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal controls. The Audit Committee meets periodically with management, the internal auditors and the external auditor to deal with issues raised by them to review the financial statements before recommending approval by the Board of Directors.

The financial statements have been audited by the Provincial Auditor. The Provincial Auditor's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles. The Auditor's Report, which appears on the following page, outlines the scope of the Auditor's examination and opinion.

On behalf of Management:

Tony Salerno

Tony Salerno
Vice-Chair and
Chief Executive Officer

Office of the
Provincial Auditor
of Ontario

Bureau du
vérificateur provincial
de l'Ontario

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Auditor's Report

To the Ontario Financing Authority
and to the Minister of Finance

I have audited the balance sheet of the Ontario Financing Authority as at March 31, 1999 and the statements of net income and retained earnings and of cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Authority as at March 31, 1999 and the results of its operations and its cash flows for the year then ended, in accordance with generally accepted accounting principles.

Toronto, Ontario
June 11, 1999

Erik Peters

Erik Peters, FCA
Provincial Auditor

Balance Sheet

(in thousands of dollars)	Corporate	POSO	Total March 31, 1999	Total March 31, 1998
ASSETS				
Current assets				
Cash	$ 116	44,876	44,992	$ 23,618
Receivable from the Province of Ontario (note 2i)	314	1,890,430	1,890,744	1,709,618
Accounts receivable	2,160	38,569	40,729	32,789
Loans receivable (note 4)	316	—	316	316
Total current assets	$ 2,906	1,973,875	1,976,781	$ 1,766,341
Long-term assets				
Capital assets (note 3)	1,656	749	2,405	2,326
Receivable from the Province of Ontario (note 2ii)	—	624,602	624,602	546,267
Loans receivable (note 4)	79,832	—	79,832	80,147
Total assets	$ 84,394	2,599,226	2,683,620	$ 2,395,081
LIABILITIES AND RETAINED EARNINGS				
Current liabilities				
Accounts payable and accrued liabilities	$ 3,717	35,500	39,217	$ 31,380
Funds on deposit (note 2i)	—	1,892,681	1,892,681	1,698,592
Due to the Province of Ontario (note 4)	316	—	316	316
Total current liabilities	$ 4,033	1,928,181	1,932,214	1,730,288
Long-term debt				
Funds on deposit (note 2ii)	—	624,602	624,602	546,267
Due to CPP and the Province of Ontario (note 4)	79,841	—	79,841	80,157
Total liabilities	$ 83,874	2,552,783	2,636,657	$ 2,356,712
Retained earnings	520	46,443	46,963	38,369
Total liabilities and retained earnings	$ 84,394	2,599,226	2,683,620	$ 2,395,081

See accompanying notes to financial statements

Approved on behalf of the Board:

Bryne Purchase
Chair

Tony Salerno
Vice-Chair and Chief Executive Officer

Statement of Net Income and Retained Earnings

(in thousands of dollars)	Corporate	POSO	Total March 31, 1999	Total March 31, 1998
REVENUE				
Interest revenue	$ 7,867	119,073	126,940	$ 101,400
Cost recovery from the Province	10,202	—	10,202	10,199
Miscellaneous revenue	—	1,334	1,334	1,545
Total revenue	$ 18,069	120,407	138,476	$ 113,144
EXPENDITURES				
Interest on short-term debt	$ 16	68,988	69,004	$ 48,055
Interest on long-term debt	7,846	29,918	37,764	34,939
Salaries, wages and benefits	7,533	8,822	16,355	16,988
Administrative and general	1,951	3,827	5,778	5,802
Amortization	718	263	981	1,101
Total expenditures	$ 18,064	111,818	129,882	106,885
Net income for the period	$ 5	8,589	8,594	$ 6,259
Retained earnings, beginning of period	515	37,854	38,369	32,110
Retained earnings, end of period	$ 520	46,443	46,963	$ 38,369

See accompanying notes to financial statements

Cash Flow Statement

(in thousands of dollars)	Corporate	POSO	Total March 31, 1999	Total March 31, 1998
Cash flows from operating activities				
Net income for the year	$ 5	8,589	8,594	$ 6,259
Adjustments to reconcile net income to funds provided by operating activities:				
Amortization	718	263	981	1,101
Net change in accounts receivable, payable and accrued liabilities	(20)	(83)	(103)	659
Cash flows from operating activities	$ 703	8,769	9,472	$ 8,019
Cash flows from financing activities				
Increase in proceeds from depositors	$ —	272,424	272,424	$ 94,397
Repayments to the Province re: OMIC loans	(316)	—	(316)	(323)
Repayments from holders of OMIC loans	315	—	315	323
Cash flows from financing activities	$ (1)	272,424	272,423	$ 94,397
Cash flows from investing activities				
Increase in POSO funds loaned to the Province of Ontario	$ —	(259,461)	(259,461)	$ (99,635)
Purchase of capital assets	(697)	(363)	(1,060)	$ (927)
Cash flows used in investing activities	$ (697)	(259,824)	(260,521)	$ (100,562)
Net increase in cash	$ 5	21,369	21,374	$ 1,854
Cash at beginning of period	111	23,507	23,618	21,764
Cash at end of period	$ 116	44,876	44,992	$ 23,618

See accompanying notes to financial statements

Notes to Financial Statements
for the year ended March 31, 1999

(all tables are in thousands of dollars)

BACKGROUND

The Ontario Financing Authority (the "Authority") was established as an agency of the Crown, on November 15, 1993, by the *Capital Investment Plan Act, 1993* (the "Act"). In accordance with the Act, the Authority's objects are:

- to assist public bodies and the Province of Ontario to borrow and invest money;
- to develop and carry out financing programs, issue securities, manage cash, currency and other financial risks on behalf of the Province, or any public body;
- to provide such other financial services as are considered advantageous to the Province or any public body;
- to operate offices as provided under the Province of Ontario Savings Office Act, as agent for the Minister of Finance; and
- any additional objects as directed by the Lieutenant Governor in Council.

The Authority is a corporation established under the laws of Ontario. The Authority is exempt from federal and provincial income taxes under paragraph 149(1)(d) of the *Income Tax Act* of Canada.

1. SIGNIFICANT ACCOUNTING POLICIES

(i) General: The financial statements are prepared in accordance with generally accepted accounting principles prescribed by the Canadian Institute of Chartered Accountants.

(ii) Capital assets: Capital assets are stated at cost. Amortization is provided using the straight-line method over the estimated useful life of the asset as listed below. Amortization is not taken in the year of acquisition.

Furniture and equipment	5 years
Computer hardware	3 years
Leasehold improvements	remaining life of lease

2. PROVINCE OF ONTARIO SAVINGS OFFICE

The Authority operates the Province of Ontario Savings Office (POSO) as agent of the Minister of Finance. POSO accepts deposits from the general public, government and other public bodies that form part of the Consolidated Revenue Fund and are direct liabilities of the Province. Administration costs for the period ended March 31, 1999 of $933,800 (March 31, 1998 - $965,000) relating to POSO are provided by the Ministry of Finance and are not included in these financial statements. The average rate of interest paid to depositors and earned from the Province for the year ended March 31, 1999 was 4.15% and 4.99% respectively (March 31, 1998 - 3.42% and 4.24% respectively). These deposits are comprised as follows:

(i) Receivable from the Province of Ontario and short-term funds on deposit

	March 31, 1999	March 31, 1998
Short-term deposits	$ 190,223	$ 115,040
Demand deposits	1,124,201	1,151,414
GICs maturing within one year	578,257	432,138
Total short-term funds on deposit	**$ 1,892,681**	**$ 1,698,592**

Short-term funds on deposit include deposits made by the Ontario Clean Water Agency (OCWA), Ontario Realty Corporation (ORC) and other government agencies of about $117 million (March 31, 1998 - $93 million). Funds held on behalf of OCWA and ORC totalling $109 million earned a variable rate of interest of 4.50% to 5.50% at March 31, 1999, (March 31, 1998 - $85 million earning a variable rate of interest of 4.00% to 4.86%).

The total current "Receivable from the Province" of $1,890,744 (March 31, 1998 - $1,709,618) includes short-term funds on deposit plus working capital, mainly of POSO.

(ii) Receivable from the Province of Ontario and long-term funds on deposit

The long-term "Receivable from the Province" represents deposits with POSO that form part of the Consolidated Revenue Fund of the Province and for which POSO has issued long-term GICs. These deposits include $236 million (March 31, 1998 - $82 million) of deposits made by the Ontario Casino Corporation (OCC). The OCC funds are invested in two-year GICs, earning a variable rate of interest of 4.33% to 5.65% at March 31, 1999 (March 31, 1998 - 4.06% to 4.62%) and can be redeemed at the option of the holder on a quarterly basis.

These deposits mature as follows:

	As at March 31, 1999		As at March 31, 1998	
Year ended March 31	**Principal Maturing**	**Effective Average Interest Rate (%)**	**Principal Maturing**	**Effective Average Interest Rate (%)**
2000	$ —		$ 304,768	5.87
2001	384,899	5.02	82,754	6.16
2002	120,839	5.82	91,062	6.02
2003	75,510	5.37	67,683	5.63
2004	43,354	5.22	—	
Total	**$ 624,602**		**$ 546,267**	

3. CAPITAL ASSETS

The balance of capital assets, net of amortization, is as follows (amortization begins in the year following acquisition):

	Cost	Accumulated Amortization	Net March 31, 1999	Net March 31, 1998
Furniture and equipment	$ 1,112	$ (798)	$ 314	$ 496
Computer hardware	4,011	(2,165)	1,846	1,507
Leasehold improvement	1,180	(935)	245	323
	$ 6,303	**$ (3,898)**	**$ 2,405**	**$ 2,326**

4. ONTARIO MUNICIPAL IMPROVEMENT CORPORATION (OMIC)

In accordance with the *Capital Investment Plan Act, 1993*, the Ontario Municipal Improvement Corporation (OMIC) ceased to exist and its assets and liabilities were transferred to the Authority on November 15, 1993. OMIC received loans from the Canada Pension Plan (CPP) and the Province, which OMIC used to make loans to municipalities and school boards under similar terms as its debt.

As at March 31, 1999, the portion of long-term debt maturing in 1999-2000 is $316,000 (March 31, 1998 - $316,000 maturing in 1998-99) and is due to the Province. Long-term debt (maturing in the year ended March 31, 2001 and future) is comprised of debt due to the Province of $820,000 and to the Canada Pension Plan of $79 million (March 31, 1998 - $1.15 million, and $79 million respectively, maturing in year ended March 31, 2000 and future). The terms of the outstanding debt are as follows:

	As at March 31, 1999		As at March 31, 1998	
Year ended March 31	**Principal Maturing**	**Effective Average Interest Rate (%)**	**Principal Maturing**	**Effective Average Interest Rate (%)**
1999	$ —		$ 316	13.06
2000	316	13.39	316	13.39
2001	326	13.58	326	13.58
2002	354	13.59	354	13.59
2003	64	11.55	64	11.55
2004	54	11.55	—	
1-5 years	1,114		1,376	
6-20 years	79,043	9.61	79,097	9.61
Total	**$ 80,157**		**$ 80,473**	

5. TRANSACTIONS WITH THE PROVINCE AND OTHER PUBLIC BODIES

(i) Financing activities between the Province and other Public Bodies: Acting as a financial conduit for the Province, the Authority provides financing to various public bodies, the repayment of which is expected from third-party revenues. The funds for these loans are advanced to the Authority by the Province under a credit facility of $2.16 billion. Repayments received from public bodies by the Authority are forwarded to the Province. These transactions are not reflected in these financial statements.

In compliance with an Ontario Financing Authority Lending Policy adopted by its Board of Directors on December 17, 1997, each advance received by the Authority under the current facility bears interest at a rate that is equivalent to the rate of interest payable to the Authority on the corresponding loan to a public body(ies). As at March 31, 1999, $1.71 billion (March 31, 1998 - $1.58 billion), including accrued interest, was advanced by the Province to the Authority and must be repaid by the Authority on or before August 31, 2027.

Funds are generally advanced by the Authority to public bodies under interim financing arrangements, consisting of a number of promissory notes for terms not exceeding one year. Interest is payable on the principal plus any capitalized interest. As at March 31, 1999, these interest rates ranged from 4.75% to 5.65% (March 31, 1998 from 3.05% to 5.10%). It is the Authority's intention to replace these promissory notes with term debt, at which point repayment terms will be finalized.

As at March 31, 1999, the following have been converted into debentures: Ontario Transportation Capital Corporation - $500 million at 6.66% and $500 million at 8.25% maturing on August 28, 2013 and June 2, 2026 respectively; Ontario Northland Transportation Commission - $3.9 million at 5.64% maturing April 1, 2008.

The following represent amounts receivable by the Authority on behalf of the Province, including capitalized interest, net of financing costs. These are related party transactions, with the exception of those with the City of Windsor.

	March 31, 1999	March 31, 1998
Ontario Transportation Capital Corporation - Hwy 407	$ 1,524,642	$ 1,424,246
Metro Toronto Convention Centre	151,360	146,728
Corporation of the City of Windsor	19,923	11,577
Ontario Northland Transportation Commission	17,725	—
Centennial Centre of Science and Technology	600	1,629
	$ 1,714,250	**$ 1,584,180**

The Ontario Transportation Capital Corporation (OTCC) is a Crown agency of the Province established by the *Capital Investment Plan Act, 1993*. The Board of Directors is appointed by the Lieutenant Governor in Council. The OTCC was continued as a share capital corporation under the *Ontario Business Corporations Act*, wholly owned by the Province, and renamed "407 ETR Concession Company Limited."

To facilitate the sale on May 5, 1999 of the OTCC by the Province of Ontario, effective April 6, 1999 the Ontario Financing Authority assigned and transferred all of its rights, title and interest in debt owed to it by the OTCC, including long-term debt, promissory notes and accrued interest, to the Province. The Province agreed to accept such assignment as payment in full of the corresponding indebtedness of the OFA to the Province. The Province also confirmed that the indebtedness of the OFA to the Province of $1,524,642,000 and accrued interest was discharged.

The Metro Toronto Convention Centre Corporation (MTCC) is a Crown agency of the Province under the *Metropolitan Toronto Convention Centre Corporation Act*. The majority of directors on the MTCC board are appointed by the Lieutenant Governor in Council.

The Corporation of the City of Windsor is a municipality within the meaning of the *Municipal Act*. The financing provided is for the acquisition, design and construction of the Windsor Justice Facility, consisting of provincial division courthouse and city police headquarters.

The Ontario Northland Transportation Commission (ONTC) is a Crown agency of the Province under the *Ontario Northland Transportation Commission Act, 1990*. Members of the Commission are appointed by the Lieutenant Governor in Council.

The Centennial Centre of Science and Technology is a Crown agency of the Province under the *Centennial Centre of Science and Technology Act*. Its Board of Trustees is appointed by the Lieutenant Governor in Council.

(ii) **Investing for Related Parties**: In the normal course of operations, the Authority provides investment management services to other public bodies. Funds managed on behalf of other public bodies (which are not reflected in these financial statements) as at March 31, 1999, consist of $199 million held on behalf of the Northern Ontario Heritage Fund Corporation (March 31, 1998 - $186 million).

(iii) **Province of Ontario Savings Office:** Other related parties have deposited their funds as described in Note 2 (i) and 2 (ii). Total amounts deposited as at March 31, 1999 were $389 million. (March 31, 1998 - $175 million).

6. PENSION PLAN

The Authority provides pension benefits for its employees through participation in two pension plans of the Ontario Public Service established by the Province of Ontario: the Ontario Public Service Employees' Union Pension Plan and the Public Service Pension Plan. The Authority's pension contributions for the period ended March 31, 1999 were $817,000 with no cost for unfunded pension liability (March 31, 1998 - $1,312,000 including $460,000 for unfunded liability). Pursuant to a recent Management Board decision, starting in fiscal 1998-99, the cost of unfunded pension liability will not be recovered from Ministries and Agencies.

7. FINANCIAL INSTRUMENTS

The carrying amounts for cash, accounts receivable, receivable from the Province of Ontario, accounts payable and accrued liabilities and short-term funds on deposit approximate their fair values because of the short-term maturity of these instruments.

Given that the terms and amounts of the Authority's long-term receivables offset the Authority's long-term debt, providing fair values for these instruments would not add any more useful information to that which has already been presented in these financial statements.

8. SALARIES (absolute dollars)

Provincial Legislature requires disclosure of Ontario Public-sector employees paid an annual remuneration in excess of $100,000. The amounts paid in 1998 to individuals listed below, who are identified with an asterisk (*), include salary and performance-based pay.

Name	Position	Remuneration Paid	Taxable Benefits
Charles Allain	Manager - Risk Management	$ 131,808*	$ 324
David Brand	Director - Province of Ontario Savings Office	$ 103,361	$ 281
Morris Cheung	Project Manager - Capital Markets Program	$ 105,816*	$ 208
Kanak Chopra	Director - Risk Control	$ 147,786*	$ 370
James Devine	Manager - Fixed Income & Medium-Term Notes	$ 120,509*	$ 296
Andrew Hainsworth	Manager - Funding	$ 120,509*	$ 296
Douglas Harrington	Manager - Risk Control Operations	$ 106,423*	$ 280
Michael Manning	Director - Risk Management	$ 165,693*	$ 408
Gadi Mayman	Executive Director - Capital Markets	$ 173,209*	$ 425
Christine Moszynski	Director - Capital Markets Treasury	$ 101,962	$ 276
David Peters	Manager - Foreign Exchange	$ 120,455*	$ 296
William Ralph	Director - Corporate Finance	$ 103,861	$ 275
Tony Salerno	ADM - Office of Treasury/CEO - Vice Chair, OFA	$ 210,253*	$ 515
Corey Simpson	Legal Counsel	$ 115,601	$ 330

9. CONTINGENT LIABILITIES

The Province of Ontario Savings Office is involved in two legal actions, the outcome and ultimate disposition of which are not determinable at this time.

10. THE YEAR 2000 CHALLENGE

The Year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using a year 2000 date is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 issue affecting the Corporation including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

11. COMPARATIVE FIGURES

Certain of the 1997-98 comparative figures have been reclassified to conform with the financial statement presentation adopted in 1998-99.

Sources of Information

Internet: www.ofina.on.ca

Provides information on Ontario's debt, debt issues and retail products and contains major publications from the Ontario Financing Authority and Ontario Ministry of Finance.

Publications

Ontario Budget

- Paper D: Ontario's Financing Operations provides a discussion of the Province's borrowing and debt management activities for the fiscal year ended and reviews the outlook for the fiscal year ahead.

Ontario Economic Outlook and Fiscal Review (Fall Statement)

- The *Ontario Economic Outlook and Fiscal Review* provides a semi-annual update to the Province's economic outlook, fiscal and financing plan.

Ontario Financing Authority Bulletins

- *OFA Bulletins* provide quarterly updates of Ontario's Finances and Government initiatives of interest to the financial community.

Open Financial Disclosure Report

- The Province's annual report to the U.S. Securities and Exchange Commission.

Ontario Financing Authority Annual Report

- The Annual Report provides information on past achievements and current objectives of the Ontario Financing Authority.

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