

**NEWFOUNDLAND AND LABRADOR
GOVERNMENT SINKING FUND**

**Annual Report
For the Period
April 1, 2017 to March 31, 2018**

NEWFOUNDLAND AND LABRADOR
GOVERNMENT SINKING FUND

PENSIONS AND DEBT MANAGEMENT DIVISION
DEPARTMENT OF FINANCE
CONFEDERATION BUILDING
P.O. BOX 8700
ST. JOHN'S, NL A1B 4J6

Honourable Tom Osborne
Minister of Finance
Government of Newfoundland and Labrador
Confederation Building
St. John's, NL
A1B 4J6

Dear Minister Osborne:

As the Chair of the Board of Trustees responsible for the Newfoundland and Labrador Government Sinking Fund (NLGSF), I am pleased to submit the 2017-18 Annual Report. The Board is a category 3 government entity, and in accordance with the **Transparency and Accountability Act** is required to prepare an annual activity report to present information on its activities of the preceding year. As such, the Board of Trustees is accountable for the preparation of this report and for the results reported therein.

The mandate of the Board of Trustees for the NLGSF is to administer the sinking funds established by the Government of Newfoundland and Labrador for the repayment of the Provincial Government's debenture debt. During the 2017-18 fiscal year, the NLGSF earned a net income of approximately \$54.2 million, which included a foreign exchange loss of \$5.4 million resulting from a decrease in the value of the U.S. dollar. This represents a 3.81 per cent return on the Sinking Fund Equity.

Sincerely,



Denise Hanrahan, CPA, MBA, ICD.D
Chairperson

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1.0 OVERVIEW

The Newfoundland and Labrador Government Sinking Fund (NLGSF) was created pursuant to the **Financial Administration Act** to consolidate sinking funds established for the repayment of the Provincial Government's debenture debt. The Provincial Government has established sinking funds for most of its long-term debenture issues and the annual contributions to these sinking funds are invested by the Board of Trustees, who are appointed by the Lieutenant Governor in Council to manage and control the day-to-day operation of the sinking funds. As of March 31, 2018, the Board of Trustees consisted of the incumbents in four senior public service positions within the Department of Finance:

Denise Hanrahan	Deputy Minister
Ann Marie Miller	Comptroller General
Michelle Jewer	Assistant Deputy Minister Financial Planning and Benefits Administration
Janice Butt	Director, Pensions and Debt Management

The NLSGF operates with a March 31 fiscal year end and the results of its activities are fully consolidated in the Provincial Government's annual financial statements.

1.1 Mandate

The mandate of the Board of Trustees is to manage and control the operational activities of the NLGSF and the sinking funds of certain crown corporations where the Provincial Government has guaranteed the related debt (i.e. Newfoundland and Labrador Municipal Financing Corporation and the Eastern Regional Integrated Health Authority). These activities include setting investment policy, investment of funds and the monitoring of such. These funds are invested in accordance with the **Financial Administration Act**, primarily in bonds, debentures or other securities issued or guaranteed by the Government of Canada, Provincial Governments within Canada or a chartered bank. The goal is to earn the maximum return from investment of the portfolio while ensuring security of the funds.

1.2 Sources of Funding

For debenture issues, which have sinking fund requirements, the Provincial Government makes the required sinking fund contributions to the operating bank account managed by the Board of Trustees. In 2017-18, these sinking fund payments amounted to \$43,884,500. Typically, sinking fund contributions are invested and the interest earnings, less an amount to cover administrative costs, are re-invested. However, there was no investment activity during fiscal year 2017-18.

The Newfoundland and Labrador Government Sinking Fund's day-to-day activities are managed by employees of the Department of Finance and the Sinking Fund is invoiced quarterly by the Provincial Government for reimbursement of these expenses on a cost-recovery basis.

1.3 Operational Information

The NLGSF earned a net income of approximately \$54.2 million during 2017-18, after a foreign exchange loss of \$5.4 million that resulted from a decrease in the value of the U.S. dollar. Any gains or losses resulting from foreign currency translations will not become realized until such time that the U.S. assets are converted to Canadian dollars. Special purpose financial statements for the year ending March 31, 2018, are included in this report.

The 2017-2020 Activity Plan as well as previous annual reports are available online at www.fin.gov.nl.ca.

2.0 REPORT ON PERFORMANCE

In accordance with the Board's mandate, the following objective was identified for the 2017-18 fiscal year, which focuses on the primary activities of establishing investment policy; and the investment and monitoring of funds.

Objective: By March 31, 2018, Board of Trustees will have continued with the prudent investment of the assets of the fund.

Indicators: The assets of the fund prudently invested in accordance with the **Financial Administration Act**, as evidenced by the completion of periodic reviews of reports to the Board.

Results: The Board completed a review of an annual report, which focused on the financial results of the fund. Normally the investing activity of the fund would also be highlighted to ensure that the assets were being prudently invested in accordance with the **Financial Administration Act** and with the Board's mandate. During fiscal year 2017-18, however, there was no investment activity completed because there was no change in the investment portfolio. Additionally it is noted that the US sinking fund earned a higher overnight interest rate as compared to the previous year's rate. During 2016-17, the US sinking fund earned the monthly average base interest rate, less 5 percent. During 2017-18, the fund earned the monthly average base interest rate, less 3.80 per cent.

The NLGSF will report on the same objective and performance indicators for the 2018-19 fiscal year.

3.0 OPPORTUNITIES AND CHALLENGES

The unpredictable nature of the investment market will continue to challenge the Board of Trustees to ensure that its investment strategy maximizes the rate of return earned on its investment portfolio, while at the same time protecting the security of the sinking funds. A slow global economic recovery with a low-interest-rate environment continues to restrict the earning potential of the investment portfolio.

4.0 FINANCIAL STATEMENTS – Please see attached.

**NEWFOUNDLAND AND LABRADOR
GOVERNMENT SINKING FUND**

FINANCIAL STATEMENTS

MARCH 31, 2018



**AUDITOR
GENERAL**
of Newfoundland and Labrador

INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of the
Newfoundland and Labrador Government Sinking Fund
St. John's, Newfoundland and Labrador

Report on the Financial Statements

I have audited the accompanying financial statements of the Newfoundland and Labrador Government Sinking Fund which comprise the balance sheet as at March 31, 2018, and the statements of statutory contributions, retained earnings, revenues and expenses, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting policies described in Note 1 to meet the information needs of the Newfoundland and Labrador Government Sinking Fund and the Government of Newfoundland and Labrador under Section 39 of the *Financial Administration Act* and under the various debentures which require the establishment of sinking funds, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the judgment of the auditor, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Independent Auditor's Report (cont.)

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Newfoundland and Labrador Government Sinking Fund as at March 31, 2018, and its financial performance and its cash flows for the year then ended in accordance with the accounting policies described in Note 1 to these financial statements.

Basis of Accounting and Restriction on Use

Without modifying my opinion, I draw attention to Note 1 of the financial statements which describes the basis of accounting. These financial statements are solely for the information of the Newfoundland and Labrador Government Sinking Fund and the Government of Newfoundland and Labrador to meet their information needs under Section 39 of the *Financial Administration Act* and under the various debentures which require the establishment of sinking funds. As a result, the financial statements may not be suitable for another purpose. My report is intended solely for the use of the Newfoundland and Labrador Sinking Fund and the Government of Newfoundland and Labrador and should not be used by anyone other than the specified users.



JULIA MULLALEY, CPA, CA
Auditor General

September 12, 2018
St. John's, Newfoundland and Labrador

**NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
BALANCE SHEET**

As at March 31

2018

2017

(000's)

(000's)

ASSETS

Current

Cash	\$ 174,568	\$ 27,922
Term deposits and short-term investments	-	50,536
Interest and other receivables		
Province of Newfoundland and Labrador - guaranteed	11,581	11,780
Other	5,801	5,735
	191,950	95,973

Investments, at amortized cost (Schedule)

Cost	1,157,315	1,174,997
Accumulated amortization of discounts and premiums	71,247	63,796
	1,228,562	1,238,793
	\$ 1,420,512	\$ 1,334,766

LIABILITIES AND SINKING FUND EQUITY

Current

Accounts payable and accrued liabilities	\$ 10	\$ 11
Due to Province of Newfoundland and Labrador	5	9
	15	20

Sinking fund equity

Accumulated statutory contributions	768,398	731,844
Retained earnings	652,099	602,902
	1,420,497	1,334,746
	\$ 1,420,512	\$ 1,334,766

See accompanying notes

Signed on behalf of the Board:


Chairperson and Trustee


Trustee

**NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF STATUTORY CONTRIBUTIONS**

For the Year Ended March 31

	2018	2017
	(000's)	(000's)
Balance, beginning of year	\$ 731,844	\$ 682,266
Add: receipts for the year	43,885	44,087
Foreign currency translation adjustment (Note 2)	(7,331)	5,491
	768,398	731,844
Statutory contributions applicable to matured/redeemed debentures	-	-
Balance, end of year	\$ 768,398	\$ 731,844

See accompanying notes

**NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF RETAINED EARNINGS**

For the Year Ended March 31

2018

2017

(000's)

(000's)

Balance, beginning of year	\$ 602,902	\$ 537,147
Net income for the year	54,176	60,937
<u>Foreign currency translation adjustment (Note 2)</u>	<u>(4,979)</u>	<u>4,818</u>
	652,099	602,902
<u>Retained earnings applicable to matured/redeemed debentures</u>	<u>-</u>	<u>-</u>
Balance, end of year	\$ 652,099	\$ 602,902

See accompanying notes

**NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF REVENUES AND EXPENSES**

For the Year Ended March 31

	2018	2017
	(000's)	(000's)
REVENUES		
Interest income		
Debentures	\$ 52,899	\$ 52,199
Term deposits and short-term investments	32	2
Other	1,159	251
	54,090	52,452
Amortization of foreign currency translation (losses) gains (Note 2)	(5,400)	3,000
Amortization of discounts and premiums	5,754	5,760
	54,444	61,212
EXPENSES		
Salaries and benefits	147	147
General	121	128
	268	275
Net income	\$ 54,176	\$ 60,937

See accompanying notes

**NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF CASH FLOWS**

For the Year Ended March 31

	2018	2017
	(000's)	(000's)
Cash flows from operating activities		
Net income	\$ 54,176	\$ 60,937
Adjustment for non-cash items		
Amortization of discounts and premiums	(5,754)	(5,760)
Amortization of foreign currency translation losses (gains) (Note 2)	5,400	(3,000)
	53,822	52,177
Change in non-cash working capital	128	(1,333)
	53,950	50,844
Cash flows from financing activities		
Statutory contributions	43,885	44,087
Cash flows used in investing activities		
Purchase of investments	-	(74,840)
Proceeds from redemption and sale of investments	-	-
	-	(74,840)
Net increase in cash	97,835	20,091
Effect of foreign currency translation adjustment (Note 2)	(1,725)	1,388
Cash and cash equivalents, beginning of year	78,458	56,979
Cash and cash equivalents, end of year	\$ 174,568	\$ 78,458
Cash and cash equivalents include:		
Cash	\$ 174,568	\$ 27,922
Term deposits and short-term investments	-	50,536
	\$ 174,568	\$ 78,458

See accompanying notes

**NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
SCHEDULE OF INVESTMENTS**

As at March 31

2018

2017

	<u>Face Value or Par</u> (000's)	<u>Amortized Cost</u> (000's)	<u>Face Value or Par</u> (000's)	<u>Amortized Cost</u> (000's)
Canadian				
Province of Newfoundland and Labrador - guaranteed				
Province of Newfoundland and Labrador	\$ 171,074	\$ 194,907	\$ 171,074	\$ 196,774
Newfoundland and Labrador Hydro	30,248	33,584	30,248	33,884
Health Care Corporation (Eastern Health)	17,500	24,698	17,500	25,023
Coupons and residuals	259,464	169,987	259,464	162,214
	478,286	423,176	478,286	417,895
Other coupons and residuals	322,317	203,168	322,317	193,486
Other securities	91,017	103,092	91,017	103,818
	891,620	729,436	891,620	715,199
U.S.				
Province of Newfoundland and Labrador - guaranteed				
Other securities	185,773	195,579	191,608	205,052
Coupons	256,735	275,105	264,799	290,406
Residuals	27,683	24,664	28,553	24,393
	4,042	3,778	4,169	3,743
	474,233	499,126	489,129	523,594
Total investments	\$ 1,365,853	\$ 1,228,562	\$ 1,380,749	\$ 1,238,793

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
NOTES TO FINANCIAL STATEMENTS
March 31, 2018

Authority

The Province of Newfoundland and Labrador issues debentures, most of which have sinking fund requirements. For debentures which have sinking fund requirements, the Province makes the required sinking fund payments (statutory contributions) to the Board of Trustees of the Newfoundland and Labrador Government Sinking Fund. This is an unincorporated body formed under the *Financial Administration Act*. All members of the Board are full-time employees of the Province and are appointed by the Lieutenant-Governor in Council.

The Newfoundland and Labrador Sinking Fund is not subject to Provincial or Federal income taxes.

1. Basis of accounting

These special purpose financial statements have been prepared by the Newfoundland and Labrador Government Sinking Fund in accordance with the summary of significant accounting policies set out below to meet the information needs of the Newfoundland and Labrador Government Sinking Fund and the Government of Newfoundland and Labrador under Section 39 of the *Financial Administration Act* and under the various debentures which require the establishment of sinking funds.

Summary of significant accounting policies

These financial statements have been prepared on the accrual basis of accounting. Outlined below are the significant policies followed.

(a) Cash and cash equivalents

Cash and cash equivalents include balances with banks, and term deposits and short-term investments with original maturities of three months or less.

Term deposits and short-term investments are recorded at cost which approximates market value because of the short term nature of the securities.

(b) Investment transactions

- (i) Purchases: Investments are initially recorded at cost.
- (ii) Amortization: Discounts and premiums are amortized on a straight-line basis from the date of purchase until maturity.
- (iii) Sales: Sales of investments are at a negotiated selling price. Sales are recorded at the proceeds less the investment's average amortized cost, with any resulting gain or loss also recorded.
- (iv) Redemptions: On occasion, investments held in the Fund will be called for redemption by the issuer. In such instances, a gain is recorded equal to the redemption proceeds less the investment's average amortized cost.

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
NOTES TO FINANCIAL STATEMENTS
March 31, 2018

1. Basis of accounting (cont.)

Summary of significant accounting policies (cont.)

- (c) Maturity of a Province of Newfoundland and Labrador debenture issue for which a sinking fund has been provided:

(i) General

A sinking fund is created pursuant to the provisions of a debenture issue in order to provide funds to be used for redemption at debenture maturity. Statutory sinking fund contributions are invested in interest bearing securities and other investments. Both the contributions and the interest are used to pay debenture holders when debentures mature.

A record is maintained of statutory contributions received on account of each issue and of income allocated to each issue (retained earnings). The accumulated amount of an issue's statutory contributions and allocated income is called its Sinking Fund Value.

At the maturity of a debenture issue, accumulated statutory contributions are reduced by the total amount of statutory contributions received over the life of the debenture issue. Retained earnings are reduced by the excess of the Sinking Fund Value over statutory contributions received related to the debenture issue.

(ii) Cash flow

At maturity, cash is paid into a redemption bank account in an amount equal to the lesser of the total face value of the issue or the Sinking Fund Value of the issue, less the face value of the particular debenture issue being redeemed held in the Fund's investments. If the Sinking Fund Value of the issue is less than the total face value, the difference is paid into the redemption bank account by the Province.

- (d) Province of Newfoundland and Labrador debentures held by the Sinking Fund are cancelled upon the related sinking fund becoming fully funded. This occurs when the value of a sinking fund for a debenture issue equates to the outstanding principal amount of that issue. The Sinking Fund will return to the Province, for cancellation, any debentures of that issue held by the Sinking Fund. The cancellation of sinking fund assets results in a corresponding reduction in sinking fund equity.

- (e) Interest income

Interest income is recorded on an accrual basis.

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
NOTES TO FINANCIAL STATEMENTS
March 31, 2018

1. Basis of accounting (cont.)

Summary of significant accounting policies (cont.)

(f) Foreign currency translation

Assets, liabilities, revenues and expenses denominated in U.S. currency are translated as follows:

- (i) assets and liabilities are translated at the rate of exchange in effect at the balance sheet date; and
- (ii) revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such.

Gains and losses resulting from foreign currency translation are amortized on a straight-line basis over the remaining life of each issue's sinking fund.

2. Effect of foreign currency translation

At March 31, 2018, the Fund held \$1,228,562,000 (2017 - \$1,238,793,000) in investments. These investments include \$499,126,000 denominated in U.S. currency (2017 - \$523,594,000).

The Fund assets, liabilities, statutory contributions and retained earnings denominated in U.S. currency are translated at the rate of exchange in effect at the balance sheet date. The Fund's revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such.

In 2018, the translation of assets denominated in U.S. currency at year end resulted in a net foreign exchange loss due to a decrease in the value of the U.S. dollar. In 2017, the translation of assets denominated in U.S. currency at year end resulted in a net foreign exchange gain due to an increase in the value of the U.S. dollar. Any gains or losses resulting from foreign currency translations will not become realized until such time the assets denominated in U.S. currency should ever actually be converted to Canadian dollars. It is not the intention of the Fund that its U.S. assets will be converted into Canadian dollars.

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
NOTES TO FINANCIAL STATEMENTS
March 31, 2018

2. Effect of foreign currency translation (cont.)

	<u>2018</u> (000's)	<u>2017</u> (000's)
The effect of the translation is as follows:		
Statutory contributions have (decreased) increased by	\$ (7,331)	\$ 5,491
Retained earnings have (decreased) increased by	(4,979)	4,818
<u>Net income (decreased) increased by</u>	<u>(5,400)</u>	<u>3,000</u>
<u>Total impact of foreign currency translation</u>	<u>\$ (17,710)</u>	<u>\$ 13,309</u>
The effect of this amount on the Fund assets is as follows:		
Investments have (decreased) increased by	\$ (15,985)	\$ 11,921
<u>Cash has (decreased) increased by</u>	<u>(1,725)</u>	<u>1,388</u>
	<u>\$ (17,710)</u>	<u>\$ 13,309</u>

The decrease of \$1,725,000 (2017 - increase of \$1,388,000) is reflected in the Statement of Cash Flows because of its impact on the Fund's cash flow position. However, the other transactions did not have an impact on the Fund's cash flow position and are, therefore, not reflected in the Statement of Cash Flows.

3. Financial instruments

The Newfoundland and Labrador Government Sinking Fund's short-term financial instruments recognized on the balance sheet consist of cash, term deposits and short-term investments, interest and other receivables, accounts payable and accrued liabilities, and due to Province of Newfoundland and Labrador. The carrying values of these instruments approximate current fair value due to their nature and the short-term maturity associated with them.

The Fund holds long-term investments which have an amortized cost of \$1,228,562,000 (2017 - \$1,238,793,000). The face value of these investments is \$1,365,853,000 (2017 - \$1,380,749,000). The policy and intention of the Board is to hold these long-term investments to maturity. Therefore, their reported value is current fair value to the Fund and there is no significant market risk associated with these investments.