OEFC

ONTARIO ELECTRICITY FINANCIAL CORPORATION

2005 Annual Report

Ontario

Mandate and Governing Legislation

The Ontario Electricity Financial Corporation (OEFC) is one of five corporations established by the *Electricity Act, 1998*. Under the Act, the former Ontario Hydro was restructured into Ontario Power Generation Inc. (OPG), Hydro One Inc. (Hydro One), the Independent Electricity System Operator (IESO), the Electrical Safety Authority (ESA) and the OEFC.

The OEFC's objects as set out in the Act are as follows:

- Managing its debt and derivatives portfolios, financial risks and other liabilities, including the debt of the former Ontario Hydro;
- Managing the administration of the existing power purchase agreements with non-utility generators in the new market environment;
- Receiving all payments and administering other assets, liabilities, rights and obligations of the Corporation that have not been transferred to another of the Ontario Hydro successor corporations and disposing of any of these items as it deems appropriate or as directed by the Minister of Finance;
- Providing financial assistance to the successor corporations of Ontario Hydro, including OPG and Hydro One; and
- Performing any additional objects as specified by the Lieutenant Governor in Council.

The OEFC retains the services of the Ontario Financing Authority (OFA) and the Ministry of Finance to carry out its daily operations on a cost-recovery basis. The OFA is the agency of the Province of Ontario responsible for provincial borrowing and debt management.

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Message from the Chair and Vice-Chair

We are pleased to present the 2005 Annual Report of the Ontario Electricity Financial Corporation. The report describes the Corporation's operational highlights and financial results for the year ended March 31, 2005.

During the year, the *Electricity Restructuring Act, 2004* was passed by the Ontario legislature. The Act provides the legislative framework for the government's new structure for the electricity sector, of which key sections have an impact on the OEFC. The main impact on the OEFC's 2004–05 results is that since January 1, 2005, it began receiving actual contract prices from electricity consumers for power sold under existing power purchase agreements (PPAs) with the non-utility generators (NUGs) and will no longer incur losses on these contracts. The Ministry of Finance estimates that the bulk of the liability will be eliminated over 12 years as existing electricity contracts expire.

For the year ended March 31, 2005, the OEFC recorded an excess of revenue over expense of $187 million, compared to the prior year's deficiency of revenue over expense of $367 million. As a result, the unfunded liability declined to $20.4 billion from the $20.6 billion as at March 31, 2004. The OEFC's total debt and liabilities now stand at $34.2 billion, down from $34.3 billion as at March 31, 2004.

Over the year, the Ontario Financing Authority (OFA) completed the OEFC's long-term public borrowing requirements of $3.7 billion, primarily to refinance maturing debt. The OFA also maintained the OEFC's foreign exchange exposure and floating interest rate exposures within the OEFC's policy limits.

The OEFC was able to achieve savings and efficiencies in managing the PPAs with the NUGs in 2004–05. The OEFC saved $1.4 million through the implementation of transactions to reduce overall costs of the PPAs and reduced annual costs by transferring the NUG contract administration to the OFA, effective January 1, 2005.

Looking ahead to 2005–06, the OEFC will continue to deliver cost-effective borrowing and debt management and will support the implementation of the government's electricity policy decisions.

Colin Andersen
Chair

Gadi Mayman
Chief Executive Officer and Vice-Chair (interim)

Management's Discussion and Analysis

Electricity Sector Restructuring

Overview

2004–05 was a significant year for Ontario's electricity sector. The government introduced a series of reforms to the existing pricing structure to better reflect the true cost of electricity.

On December 9, 2004, the *Electricity Restructuring Act, 2004* received Royal Assent. The Act reorganizes Ontario's electricity system to more effectively address the critical need for new supply, promote conservation and increase price stability for consumers across Ontario. Key elements of the Act include:

- Setting a new pricing structure reflecting the combination of a fully regulated and competitive electricity generation sector;
- Creating the Ontario Power Authority (OPA) to ensure an adequate, long-term supply of electricity;
- Creating the Conservation Bureau, led by the Province's first Chief Energy Conservation Officer;
- Setting targets for conservation, renewable energy, and the overall mix of supply sources in the electricity sector;
- Redefining the role for the Independent Electricity Market Operator, including its responsibility for operating the wholesale market and ensuring the reliability of the power system, and renaming it the Independent Electricity System Operator (IESO).

Electricity Pricing

On April 1, 2004, the government introduced an interim electricity pricing structure to replace the 4.3 cents per kilowatt hour (kWh) price freeze. Under the interim pricing structure, residential, low-volume and other designated consumers paid 4.7 cents/kWh for the first 750 kWh consumed per month and 5.5 cents/kWh for consumption above that level.

The interim structure remained in place until the Regulated Price Plan (RPP), established by the Ontario Energy Board (OEB), took effect on April 1, 2005. The RPP provides more stable prices to low-volume and designated consumers, with periodic adjustments to ensure consumers pay an average price that reflects the blended price of electricity over time. Beginning April 1, 2005, the price of electricity for RPP consumers became 5.0 cents/kWh for the first 750 kWh used each month, and 5.8 cents/kWh for electricity used per month over this amount. Starting November 1, 2005, that price threshold — the amount of electricity that is charged at the lower price — will change twice a year for residential consumers. The price threshold will be 1,000 kWh per month during a winter season (November 1st to April 30th) and 600 kWh during a summer season (May 1st to October 31st). For non-residential consumers that are eligible for the new price plan, the price threshold will remain at 750 kWh per month for the entire year.

In accordance with the *Electricity Restructuring Act, 2004* different electricity generators receive prices set through a variety of mechanisms. Effective April 1, 2005, the price of electricity generated by OPG's nuclear and baseload hydroelectric generation assets is set at regulated prices. Effective January 1, 2005, the OEFC is paid contract prices for power sold under existing PPAs with NUGs. A competitive market sets the price received by other generating stations, including OPG's non-regulated plants. Consumers pay bills that reflect a blend of all these prices.

Under this structure, OPG's regulated prices will be adjusted periodically by the OEB. Until the OEB assumes this responsibility, the initial regulated prices paid to OPG are set by government regulation. The government announced on February 23, 2005, that the price for electricity generated by OPG's regulated assets would be set at an average price of 4.5 cents/kWh. The new prices took effect on April 1, 2005.

The government also set a new revenue limit of 4.7 cents/kWh on 85 percent of the output from OPG's unregulated assets, excluding the Lennox generating station and volumes covered by existing forward contracts as at January 1, 2005. The revenue limit will act as a transitional measure from April 1, 2005 to April 30, 2006, and replaces the Market Power Mitigation Agreement (MPMA) implemented by the previous government.

Implications of Electricity Sector Reforms for the OEFC

Electricity Consumer Price Protection Fund (ECPPF)

The interim pricing structure introduced on April 1, 2004, effectively eliminated the net cost of the ECPPF to the OEFC. The ECPPF was established in December 2002 to support the fixed price of electricity for low-volume and designated consumers, and ceased operations on March 31, 2005.

Under the *Electricity Restructuring Act, 2004* and related regulations, the OEFC's role in financing the cost of electricity payable by low-volume and designated consumers ended in 2005. Beginning on January 1, 2005, the Ontario Power Authority (OPA) assumed responsibility for financing the pricing plan for low-volume and designated consumers. On April 1, 2005, the OEFC's responsibility to finance the cost of certain IESO charges also ended.

As at March 31, 2005, the ECPPF had a surplus of $704 million for the period of April 1, 2004 to March 31, 2005. In accordance with regulation, the OEFC used $176 million of the surplus to offset payments required to be made for the first quarter of 2005 by the OPA. The remaining surplus of $528 million is reflected as a liability on the balance sheet and will be returned to consumers.

Power Purchase Agreements

Since January 1, 2005, the OEFC has received actual contract prices from electricity consumers for power sold under legacy Ontario Hydro power purchase agreements (PPAs) with the non-utility generators (NUGs), and its related administrative costs, and is no longer incurring losses on these contracts, effectively eliminating this liability. The government determined that the most cautious and prudent accounting treatment is to eliminate the liability over time. The Ministry of Finance estimates that the bulk of the liability will be eliminated over 12 years as existing electricity contracts expire.

As the legal continuation of Ontario Hydro, the OEFC is counterparty to 84 remaining long-term PPAs with NUGs that the former Ontario Hydro entered into in the late 1980s and early 1990s. Details of the PPA liability are set out in Note 9 to the Financial Statements.

Electricity Sector Financial Performance

Under price regulation, OPG's regulated nuclear and baseload hydroelectric plants will receive prices that will allow OPG to recover approved costs, assuming OPG meets projected production levels. The average price of 4.5 cents/kWh for output of OPG's regulated assets under the initial price regulation, effective April 1, 2005, is based on estimated operating and capital costs, including an average five percent return on equity, if OPG operates within approved cost levels and meets projected production levels.

Also, on April 1, 2005, a transitional revenue limit of 4.7 cents/kWh for the period to April 30, 2006 was placed on most output from OPG's unregulated assets. This new pricing for OPG's output replaced the MPMA that was in place since the electricity market opened to competition on May 1, 2002. Since its inception, the MPMA has cost OPG almost $4.0 billion in total and affected the company's overall financial performance.

OPG's financial performance affects the OEFC through payments-in-lieu of taxes from OPG and Electricity Sector Dedicated Income.

New Electricity Generation

During 2004–05, the OEFC assisted the Ministry of Energy in the development and issuance of two Requests for Proposals (RFPs) for the delivery of 300 megawatts (MW) of new renewable energy supply and 2,500 MW of new clean energy supply and demand-side projects. Subsequently the OEFC entered into contracts for 395 MW under the RFP for new renewable energy supply. Under the contracts, the OEFC has the unilateral right to assign the contracts and it is anticipated that the contracts will be assigned to the OPA. Responsibility for these contracts was not yet transferred as at March 31, 2005. The cost of power purchased under these contracts (and the revenues from the resale of this power to the market) will be recorded as the power is generated and resold under the contracts. It is anticipated that future RFPs, as well as contracts under the RFP for 2,500 MW of new clean energy supply and demand-side projects, will be entered into by the OPA directly.

In March 2005, the Ontario Government, through the OEFC, submitted a joint proposal with Hydro-Québec and SNC-Lavalin to support the development of major hydroelectric generation facilities on the Lower Churchill River in Labrador. The proposed project would yield 2,824 MW of clean, affordable and sustainable electricity. The Ontario Government would contribute approximately a third of the project's cost and accordingly would be allocated a third of the power produced, 945 MW, which is enough to power 550,000 homes.

Financial Results

For the year ended March 31, 2005, revenues totalled $3,125 million, while expenses totalled $2,938 million, resulting in an excess of revenue over expense of $187 million, compared to the prior year's deficiency of revenue over expense of $367 million.

The improvement in 2004–05 financial results is primarily attributable to the elimination of the net cost of the ECPPF to the OEFC ($253 million in 2003–04), the elimination of expenditures for temporary generation ($70 million in 2003–04) and the full recovery of contract prices for PPAs starting January 1, 2005. Including the amortization of the liability for power purchase contracts, the net revenue to the OEFC on power operations was $6 million in 2004–05, up from a net cost of $183 million in 2003–04.

Revenues

The OEFC's total revenues for 2004–05 were $3,125 million, an increase of $103 million from 2003–04. Revenues included $997 million from the Debt Retirement Charge, $741 million in interest income from the Province, OPG and the IESO, $610 million in power sales under the PPAs and $511 million in payments-in-lieu of tax.

Expenses

The OEFC's total expenses for 2004–05 were $2,938 million, a decrease of $451 million from 2003–04. Expenses included interest payments on short- and long-term debt of $1,785 million, power purchases of $840 million and interest on the nuclear funding liability of $93 million.

Borrowing Program

In 2004–05, the OFA completed the OEFC's long-term public borrowing requirements of $3,741 million. This amount includes the refinancing of $3,498 million of long-term debt maturities. The 2004–05 borrowing requirements declined from $4,203 million estimated at the time of the 2004 Ontario Budget, largely due to lower debt maturities attributable to bonds with embedded options that were not exercised resulting in the extension of maturities into future years. As part of prudent forecasting, it was assumed that this debt would mature in 2004–05.

Long-term public borrowing was completed primarily in the Canadian domestic market. The Province also was successful in issuing four Euro Medium Term Notes, for a Canadian dollar equivalent of $837 million, and one U.S. dollar Global bond Issue, for a Canadian dollar equivalent $620 million.

The performance of the borrowing program is measured through the difference between the "all-in" cost of the actual borrowing program against the all-in costs of hypothetical domestic borrowing of the same term and size implemented evenly over the fiscal year ("even-pace benchmark"). During 2004–05, the cost of the borrowing program was $26.2 million lower than the even-pace benchmark, on a present value basis.

Debt and Liabilities

The OEFC assumed approximately $38.1 billion in total debt and other liabilities from the former Ontario Hydro upon the restructuring of Ontario's electricity sector on April 1, 1999. Included in this amount was total debt of $30.5 billion. As at March 31, 2005, the OEFC's total debt and liabilities have declined to $34.2 billion, of which total debt outstanding was $27.7 billion.

As part of the restructuring, the OEFC received a total of $17.2 billion in notes owing from the Province, OPG, Hydro One and the IESO. Deducted from the total debt and other liabilities, the difference of approximately $20.9 billion represented "stranded debt," which is defined under the *Electricity Act, 1998* as the amount of debt and other liabilities of the OEFC that cannot reasonably be serviced and retired by commercial companies in a competitive electricity market.

The OEFC's unfunded liability represents the stranded debt adjusted for $1.5 billion of additional assets transferred to the OEFC. The unfunded liability is the net deficiency of the OEFC's assets over its liabilities. Initially, on April 1, 1999, unfunded liability was $19.4 billion. As at March 31, 2005, the OEFC's unfunded liability was $20.4 billion, a decrease of $0.2 billion from March 31, 2004.

Debt Repayment Plan

As the legal continuation of the former Ontario Hydro, the OEFC services and retires the debt and other liabilities through revenues and cash flows from the following sources within the electricity sector:

- Outstanding notes receivable from the Province, OPG and IESO;
- Payments-in-lieu (PILs) of corporate income, capital and property taxes, made by OPG, Hydro One and municipal electric utilities;
- Debt Retirement Charge paid by electricity consumers; and
- Electricity sector dedicated income: the Province’s combined net incomes from OPG and Hydro One in excess of the Province’s interest cost of its investment in these electricity subsidiaries.

The *Electricity Act, 1998* requires that payments-in-lieu of taxes must be paid by the successor entities and municipal electric utilities to the OEFC to service stranded debt. As at April 1, 1999, the present value of these dedicated revenues and Electricity Sector Dedicated Income was estimated at $13.1 billion, which, when subtracted from the $20.9 billion stranded debt, resulted in an estimated $7.8 billion of residual stranded debt. The Act also provides for a Debt Retirement Charge to be paid by consumers until the residual stranded debt is retired.

The long-term plan continues to support estimates that the OEFC’s obligations likely will be defeased in the years ranging from 2012 to 2020.

For more information on debt and other liabilities, see Notes 7 to 10 to the Financial Statements.

Risk Management

The OEFC has risk management policies and procedures in place to manage market, credit and operational risk exposures associated with its debt, derivatives and related capital markets transactions.

The OEFC’s foreign exchange and floating rate exposures remained within the OEFC’s policy limits in 2004-05.

- Floating interest rate exposure was 8.5 percent of total debt as at March 31, 2005, within the limit of 20 percent.
- Foreign exchange exposure was 0.1 percent of total debt as at March 31, 2005, down from 14.5 percent on April 1, 1999, and within the limit of five percent.

A description of the OEFC's risk management policies can be found in the section entitled Risk Management Policies and Procedures.

Other Responsibilities of the OEFC

Management of Power Purchase Agreements

During 2004–05, the OEFC negotiated revisions to four NUG contracts to facilitate their integration into the competitive electricity market and reduce above-market costs. This brings the total revised NUG contracts to 27 contracts. In addition, the OEFC achieved $1.4 million in cost savings through the implementation of contractual curtailments, auxiliary services revenue and incremental power transactions, whereby the OEFC allows the NUG to exceed its contracted production level in exchange for a share of the profit on that extra production.

Under the contract management agreement, the OEFC provided termination notice to the NUG contract manager to reduce costs and improve efficiencies in the NUG settlements section. The OEFC developed and implemented the necessary information systems to carry out the functions previously performed by an external contract manager.

Until December 31, 2004, the OEFC purchased power under the terms of the contracts with the NUGs and sold the power at market prices that were less than cost. The liability to the OEFC of the NUG contracts is valued at $3,785 million as at March 31, 2005. Details are set out in Note 9 to the Financial Statements.

Under the *Electricity Restructuring Act, 2004*, the OEFC began receiving actual contract prices for power from ratepayers effective January 1, 2005, and will no longer incur losses on these power purchase contracts.

Management of the Nuclear Funding Liability

The OEFC assumed a liability of $2,378 million representing unfunded nuclear decommissioning and nuclear waste management liabilities accumulated by the former Ontario Hydro prior to April 1, 1999. The Ontario Nuclear Funds Agreement (ONFA) between the Province, OPG and certain OPG subsidiaries confirms an obligation on the part of the OEFC to pay an amount into the Decommissioning Segregated Fund, thus discharging the nuclear funding liability. This liability is reported in the OEFC's financial statements as part of the liabilities of the former Ontario Hydro.

On July 24, 2003, the OEFC paid $1.2 billion and delivered a written commitment to pay (commitment-in-lieu) of approximately $1.9 billion to the segregated fund for nuclear decommissioning in respect of its ONFA obligation. The commitment-in-lieu carries an interest cost of 3.25 percent plus the change in the Ontario Consumer Price Index. The OEFC made an additional payment of $600 million on March 31, 2005, to bring the total funded to $1.8 billion, leaving a remaining commitment-in-lieu of $1.4 billion. The OEFC intends to fund the remaining commitment-in-lieu no later than the end of fiscal 2006–07.

2005–06 Outlook

The OEFC's activities in 2005–06 will focus on the following objectives:

Managing its debt and derivatives portfolios, financial risks and other liabilities, including the debt of the former Ontario Hydro.

The OFA will complete the OEFC's 2005–06 long-term public borrowing requirements of $2.5 billion in a sound and prudent manner and manage its debt portfolio within exposure policy limits reviewed and established by the Board of Directors. The OEFC will proceed with payments to discharge the commitment-in-lieu for nuclear liabilities associated with the financial restructuring of the former Ontario Hydro by making payments when cost-effective borrowing opportunities in the public capital markets arise.

Managing the administration of the existing non-utility generator contracts in the new market environment.

The OEFC will minimize costs to ratepayers by utilizing arrangements such as incremental power transactions. The OEFC will provide effective administration of the NUG contracts and also will continue to negotiate revisions to the remaining NUG contracts to ensure that these are consistent with the electricity sector as it develops.

Receiving all payments and administering other assets, liabilities, rights and obligations of the Corporation that have not been transferred to another of the Ontario Hydro successor corporations and disposing of any of these items as it deems appropriate or as directed by the Minister of Finance.

The OEFC will continue to validate and ensure the accuracy of claims from Local Distribution Companies and electricity retailers from the ECPPF for claims up to December 31, 2004, and transfer the ECPPF surplus to support the interim pricing plan for the OPA and pay out the remaining surplus to consumers.

Providing financial assistance to the successor corporations of Ontario Hydro.

Where required, the OEFC will facilitate the cashflow requirements of the successor corporations of Ontario Hydro.

Performing any additional objects as specified by the Lieutenant Governor in Council.

The OEFC will continue to support the implementation of the government's electricity policy decisions, such as providing interim funding to the Ontario Power Authority and participation in a joint proposal to the Government of Newfoundland and Labrador to develop hydroelectric generation facilities on the Lower Churchill River in Labrador.

Financial Statements

Responsibility for Financial Reporting

The accompanying financial statements of the Ontario Electricity Financial Corporation have been prepared in accordance with accounting principles recommended for governments by the Canadian Institute of Chartered Accountants 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 6, 2005.

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. Internal Audit Services of the Ministry of Finance 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 fulfills 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 and to review the financial statements before recommending approval by the Board of Directors.

The financial statements have been audited by the Auditor General of Ontario. The Auditor's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with accounting principles recommended for governments by the Canadian Institute of Chartered Accountants. The Auditor's Report, which appears on the following page, outlines the scope of the Auditor's examination and his opinion.

On behalf of Management:

Gadi Mayman

Gadi Mayman

Chief Executive Officer and Vice-Chair (interim)

Office of the Auditor General of Ontario

Bureau du vérificateur général de l'Ontario

AUDI ALTERAM PARTEM

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Auditor's Report

To the Ontario Electricity Financial Corporation
and to the Minister of Finance

I have audited the statement of financial position of the Ontario Electricity Financial Corporation as at March 31, 2005 and the statements of revenue, expense and unfunded liability and cash flow for the year then ended. These financial statements are the responsibility of the Corporation's management. 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 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 Corporation as at March 31, 2005 and the results of its operations and its cash flow for the year then ended, in accordance with the accounting principles recommended for governments by the Canadian Institute of Chartered Accountants.

Toronto, Ontario
May 6, 2005

J.R. McCarter, CA
Auditor General

Ontario Electricity Financial Corporation
Statement of Financial Position
as at March 31, 2005
($ Millions)

	2005	2004
ASSETS		
Current Assets		
Cash and cash equivalents (Note 4)	$ 138	$ 8
Accounts receivable	523	355
Interest receivable	10	12
Current portion of notes receivable (Note 6)	300	250
	971	625
Payments-in-lieu of tax receivable (Note 11)	92	248
Due from Province of Ontario (Notes 5, 11)	351	351
Notes and loans receivable (Note 6)	12,074	12,080
Deferred debt costs	360	451
	$ 13,848	$ 13,755
LIABILITIES		
Current Liabilities		
Accounts payable	$ 302	$ 250
Due to electricity consumers (Note 12)	528	-
Interest payable	536	563
Short-term notes payable (Note 7)	1,146	1,177
Current portion of long-term debt (Note 7)	1,556	3,945
	4,068	5,935
Long-term debt (Note 7)	24,948	22,433
Power purchase contracts (Note 9)	3,785	4,021
Nuclear funding liability (Note 10)	1,410	1,916
	34,211	34,305
Contingencies and guarantees (Note 14)		
UNFUNDED LIABILITY (Notes 1, 3, 11)	(20,363)	(20,550)
	$ 13,848	$ 13,755

Approved on behalf of the Board of Directors:

Colin Andersen
Chair

Gadi Mayman
Vice-Chair (interim)

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation

Statement of Revenue, Expense and Unfunded Liability
for the Year Ended March 31, 2005
($ Millions)

	2005	2004
REVENUE		
Debt retirement charge (Notes 1, 11)	$ 997	$ 1,000
Payments-in-lieu of tax (Notes 1, 11)	511	627
Interest	741	771
Power sales (Note 9)	610	510
Net reduction of power purchase contracts (Note 9)	236	104
Recovery of prior year expenditures - ECPPF (Note 12)	20	-
Other	10	10
Total Revenue	3,125	3,022
EXPENSE		
Interest - short-term debt	48	78
- long-term debt	1,737	1,812
Interest on nuclear funding liability (Note 10)	93	142
Amortization of deferred charges	69	91
Electricity Consumer Price Protection Fund (Note 12)	-	253
Power purchases (Note 9)	840	797
Temporary generation supply (Note 13)	-	70
Debt guarantee fee	138	134
Operating	13	12
Total Expense	2,938	3,389
Excess (deficiency) of revenue over expense	187	(367)
Unfunded Liability, beginning of year	20,550	20,183
Unfunded Liability, end of year	$ 20,363	$ 20,550

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation

Statement of Cash Flow
for the Year Ended March 31, 2005
($ Millions)

	2005	2004
CASH FLOWS USED IN OPERATING ACTIVITIES		
Excess (deficiency) of revenue over expense	$ 187	$ (367)
Adjustments for:		
Net reduction of power purchase contracts (Note 9)	(236)	(104)
Interest on nuclear funding liability (Note 10)	93	142
Amortization of deferred charges	69	91
Payments-in-lieu of tax receivable	156	(30)
Other items	198	(163)
Cash provided from (required by) operations	467	(431)
CASH FLOWS FROM FINANCING ACTIVITIES		
Long-term debt issues	3,741	5,490
Less long-term debt retired	3,498	2,279
Long-term debt issued (retired), net	243	3,211
Short-term debt issued (retired), net	(31)	(2,236)
Payment towards nuclear funding liability (Note 10)	(600)	(1,200)
Repayment of notes receivable	51	661
Cash provided from (required by) financing activities	(337)	436
Increase in cash and cash equivalents	130	5
Cash and cash equivalents, beginning of year	8	3
Cash and cash equivalents, end of year	$ 138	$ 8
Interest paid during the year and included in excess (deficiency) of revenue over expense	$ 1,812	$ 1,883

See accompanying notes to financial statements.

Notes to Financial Statements

1) Electricity Sector Reform

Effective April 1, 1999, pursuant to the *Electricity Act, 1998*, Ontario Hydro was continued as a corporation without share capital under the name Ontario Electricity Financial Corporation (OEFC). It is exempt from federal and provincial income taxes under paragraph 149(1)(d) of the *Income Tax Act* (Canada). OEFC is a Crown agency created to manage the debt and administer the assets, liabilities, rights and obligations of Ontario Hydro not transferred to other successor entities. These other successor entities include:

- Ontario Power Generation Inc. (OPG), an electricity generation company;
- Hydro One Inc. (Hydro One), a regulated electricity transmission and distribution business;
- Independent Electricity System Operator (IESO), the regulated centralized independent system coordinator responsible for directing system operations and operating the electricity market; and
- Electrical Safety Authority (ESA), which performs a regulatory function related to electrical inspections.

On April 1, 1999, the respective business units, including assets, liabilities, employees, rights and obligations of the former Ontario Hydro were transferred to OPG and Hydro One (and their subsidiaries) and the IESO for $8.5 billion, $8.6 billion and $78 million respectively in exchange for debt payable to OEFC. On the same day, the Province exchanged equity of $5,126 million and $3,759 million in OPG and Hydro One respectively for debt payable to OEFC.

OEFC debt, liabilities and associated financing costs will be repaid from interest on notes receivable from the Province and successor entities, and, as provided under the *Electricity Act, 1998* the dedicated electricity revenues in the form of payments-in-lieu (PILs) of corporate income, capital and property taxes made by the successor entities and municipal electric utilities. Residual debt is serviced through a Debt Retirement Charge (DRC) paid by electricity consumers at a rate of 0.7 cents/kWh for most Ontario consumers. The Ontario Financing Authority, an agency of the Province that is responsible for borrowing and investing monies for the Province and other public bodies, provides day-to-day management services to OEFC.

On December 9, 2004, the *Electricity Restructuring Act, 2004* was passed, resulting in a combination of a fully regulated and competitive electricity sector with different generators receiving prices set through a variety of mechanisms. Electricity generated from OPG's nuclear and baseload hydro generation assets receive regulated prices, and electricity from those generators with existing or new contracts receive prices as determined by their contracts. Consumers pay a blend of these costs including the pass-through of regulated prices for OPG-regulated plants, the full costs for existing and new contracts for generation and market prices for other generation facilities. The Act also created the Ontario Power Authority to ensure an adequate long-term supply of electricity.

2) Summary of Significant Accounting Policies

Basis of Accounting

As OEFC is a government organization, these financial statements are prepared in accordance with the recommendations of the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants.

Measurement Uncertainty

Uncertainty in the determination of the amount at which an item is recognized in the financial statements is known as measurement uncertainty. Such uncertainty exists when it is reasonably possible that there could be a material variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used. Measurement uncertainty in these financial statements exists in the valuation of the power purchase contracts and the estimated defeasance date for OEFC's obligations. Estimates are based on the best information available at the time of preparation of the financial statements and will be updated annually to reflect new information as it becomes available.

Deferred Debt Costs

Deferred debt costs includes the unamortized amounts related to unrealized foreign exchange gains or losses resulting from the translation of long-term debt issued in foreign currencies and discounts, premiums or commissions arising from the issuance of debt or the acquisition of debt prior to maturity. These costs are amortized to operations over the life of the underlying debt.

Revenue Recognition

Revenues are recognized in the period in which they are earned.

Foreign Currency Translation

Debt is composed of short-, medium- and long-term bonds, notes and debentures. Debt denominated in foreign currencies that has been hedged is recorded at the Canadian dollar equivalent using the rates of exchange established by the terms of the hedge agreements. Other foreign currency debt, liabilities and assets are translated to Canadian dollars at period-end rates of exchange and any exchange gains or losses are deferred and amortized over the remaining term to maturity.

Power Purchase Contracts

The liability for power purchase contracts was originally calculated by discounting estimated losses over the life of the contracts. Under the *Electricity Restructuring Act, 2004*, OEFC began receiving actual contract prices for power from ratepayers, effective January 1, 2005, and will no longer incur losses on these power purchase contracts. The Ministry of Finance estimates that the bulk of the liability will be eliminated over 12 years as existing electricity contracts expire.

The cost of power under the new contracts for renewable energy supply announced in November 2004, and the revenues from the re-sale of this power to the market, will be recorded as the power is generated and re-sold under the contracts.

3) Going Concern

OEFC is dependent on the Province to borrow to finance maturing debt and to cover any cash shortfalls in the Corporation. It is also dependent on the government's long-term plan to defease the unfunded liability described in Note 11.

4) Cash and Cash Equivalents

Cash and cash equivalents includes cash on deposit and highly liquid investments with maturities of less than three months. They are recorded at cost, which approximates current market value.

5) Due from Province of Ontario

The Province has committed to dedicate the combined net income of OPG and Hydro One in excess of the Province's interest cost of its investment in its electricity subsidiaries to OEFC. For the year ended March 31, 2005, earnings in the subsidiaries did not exceed the Province's financing cost of its investment. Consequently, no dedicated income transfer has been reflected (March 2004 – Nil).

6) Notes and Loans Receivable

($ millions)

	Maturity date	Interest rate	Interest payable	March 31, 2005	March 31, 2004
Province of Ontario	2039 – 2041	5.85	Monthly	$ 8,885	$ 8,885
OPG	2006 – 2011	5.44 to 6.65	Semi-annually	3,295	3,200
IESO	2009	7.90	Semi-annually	78	78
				12,258	12,163
Less: Current portion of notes receivable				300	250
				11,958	11,913
Add: Loans receivable from non-utility generators (NUGs) (See Note 9)				116	167
				$ 12,074	**$ 12,080**

OEFC has agreed with OPG and the IESO not to sell notes owing from these successor entities without their prior approval.

In 2002, OEFC had agreed with OPG to defer principal repayments of $200 million originally due in March and September 2002 until December 2004. These maturities totalling $200 million have been further deferred until December 2006. In addition, OEFC had agreed with OPG to defer principal repayments totalling $500 million originally due in the period March 2003 to September 2004 to new maturity dates of March 2005 to September 2006.

In January 2005, OEFC agreed with OPG to further defer principal repayments of $200 million due in March 2005 to March 2010 and to defer principal repayments of $300 million due in September 2005 to September 2010. In addition, OPG issued an interest-bearing promissory note for $95 million maturing March 2010 in lieu of an interest payment due to OEFC in March 2005.

With respect to fiscal 2005–06, OEFC has agreed to accept an interest-bearing promissory note from OPG for $98 million maturing in 2010 in lieu of the scheduled interest payment due from OPG in September 2005. In addition, as outlined in an agreement between OPG and OEFC dated April 28, 2005, OEFC has agreed to provide up to $600 million to OPG to be advanced during the period ending March 31, 2006. On April 29, 2005, OEFC advanced $400 million to OPG under the agreement. This advance and any further advances under the agreement will be recorded in the accounts of OEFC as they occur.

Set out below is a summary by year of maturity of OPG's debt to OEFC:

($ millions)

Fiscal Year	Amount
2005-06	$ 300
2006-07	700
2007-08	400
2008-09	375
2009-10	707
2010-11	625
2011-12	188
Total	**$ 3,295**

7) Debt

Debt at March 31, 2005 is set out below by maturity and by currency of repayment, expressed in Canadian dollars.

($ millions) Currency	Canadian Dollar	U.S. Dollar	Other Foreign	2005 Total	2004 Total
Maturing in:					
1 year	2,211	491	—	2,702	5,122
2 years	2,285	829	—	3,114	1,556
3 years	528	1,385	—	1,913	2,813
4 years	3,496	388	—	3,884	1,581
5 years	1,629	—	140	1,769	3,483
1-5 years	10,149	3,093	140	13,382	14,555
6-10 years	5,548	1,615	307	7,470	5,708
11-15 years	484	—	—	484	648
16-20 years	3,273	—	—	3,273	3,678
21-25 years	2,191	—	—	2,191	2,116
26-50 years	850	—	—	850	850
Total	**$22,495**	**$4,708**	**$447**	**$27,650**	**$27,555**

The effective rate of interest on the debt portfolio was 6.52 percent (March 2004 - 6.54 percent) after considering the effect of derivative instruments used to manage interest rate risk. The longest term to maturity is to October 17, 2031. Total foreign currency denominated debt at March 31, 2005 was $5.2 billion (March 2004 - $4.5 billion), 100 percent of which (March 2004 – $4.5 billion or 100 percent) was fully hedged to Canadian funds. Bonds and notes payable are either held, or guaranteed as to principal and interest, by the Province as set out below:

	March 31, 2005			March 31, 2004		
($ millions)	Held by the Province	Guaranteed by the Province	**Total**	Held by the Province	Guaranteed by the Province	**Total**
Short-term debt	1,146	—	1,146	1,177	—	1,177
Current portion of long-term debt	1,056	500	1,556	3,697	248	3,945
Long-term debt	14,608	10,340	24,948	11,520	10,913	22,433
	$16,810	**$10,840**	**$27,650**	**$16,394**	**$11,161**	**$27,555**

Fair value of debt issued approximates amounts at which debt instruments could be exchanged in a current transaction between willing parties. In valuing OEFC's debt, fair value is estimated using discounted cash flows and other valuation techniques and is compared to public market quotations where available. These estimates are affected by the assumptions made concerning discount rates and the amount and timing of future cash flows.

The estimated fair value of OEFC debt at March 31, 2005 was $31.6 billion (March 2004 – $32.2 billion). This is higher than the book value of $27.7 billion (March 2004 – $27.6 billion) because current interest rates are generally lower than the interest rates at which the debt was issued and because of exchange rate movements. The fair value of debt does not reflect the effect of related derivative contracts.

8) Risk Management and Derivative Financial Instruments

OEFC employs various risk management strategies and operates within strict risk exposure limits to ensure exposure to risk is managed in a prudent and cost-effective manner. A variety of strategies are used including the use of derivative financial instruments ("derivatives"). Derivatives are financial contracts, the value of which is derived from underlying instruments. OEFC uses derivatives for the purpose of hedging and to minimize interest costs. Hedges are created primarily through swaps, which are legal arrangements under which OEFC agrees with another party to exchange cash flows based upon one or more notional amounts during a specified period. This allows OEFC to offset its existing obligations and thereby effectively convert them into obligations with more desirable characteristics. Other derivative instruments used by OEFC include forward foreign exchange contracts, forward rate agreements, futures and options.

Foreign exchange or currency risk is the risk that foreign currency debt principal and interest payments and foreign currency transactions will vary in Canadian dollar terms due to fluctuations in foreign exchange rates. To manage currency risk, OEFC uses derivative contracts to convert foreign currency cash flows into Canadian dollar denominated cash flows. The current policy allows unhedged foreign currency debt principal and related hedge transactions in foreign currencies to reach a maximum of 5 percent of total debt. At March 31, 2005, the actual unhedged level was 0.1 percent (March 2004 – 0.1 percent) of total debt.

Floating rate risk is the exposure of OEFC to changes in short-term interest rates. OEFC reduces its exposure to rate changes by entering into derivative contracts that convert floating interest payments to fixed interest payments. The current policy allows unhedged floating rate debt, net of liquid reserves, to reach a maximum of 20 percent of total debt. At March 31, 2005, OEFC's floating rate debt as a percentage of total debt was 8.5 percent (March 2004 – 8.0 percent).

Liquidity risk is the risk that OEFC will not be able to meet its current short-term financial obligations. As explained in Note 3, OEFC is dependent on the Province to borrow and on-lend the funds required to refinance maturing debt and to cover any cash shortfalls in the Corporation.

The table below presents a maturity schedule of OEFC's derivatives, by type, outstanding at March 31, 2005, based on the notional amounts of the contracts. Notional amounts represent the volume of outstanding derivative contracts and are not indicative of credit risk, market risk or actual cash flows.

Derivative Portfolio Notional Value ($ millions)

As at March 31, 2005

Maturity in Fiscal Year	2006	2007	2008	2009	2010	6-10 Years	Over 10 Years	TOTAL 2005	TOTAL 2004
Cross-currency swaps	425	829	868	387	517	1,287	—	4,313	3,357
Interest rate swaps	1,429	2,282	1,200	988	1,241	3,138	1,404	11,682	8,348
Forward foreign exchange contracts	1,395	—	—	—	—	—	—	1,395	1,578
Other [1]	62	111	—	—	—	—	—	173	112
Total	**$ 3,311**	**3,222**	**2,068**	**1,375**	**1,758**	**4,425**	**1,404**	**$17,563**	**$13,395**

(1) Other includes options and futures.

The use of derivatives introduces credit risk, which is the risk of a counterparty defaulting on contractual derivative obligations in which OEFC has an unrealized gain. The table below presents the credit risk associated with the derivative financial instrument portfolio, measured through the replacement value of derivative contracts, at March 31, 2005.

Credit Risk Exposure ($ millions)	**March 31, 2005**	**March 31, 2004**
Gross credit risk exposure[1]	6,797	5,398
Less: Netting[2]	(7,177)	(5,787)
Net credit risk exposure[3]	$ (380)	$ (389)

Notes:

(1) Gross credit risk exposure includes credit exposure on swaps, options, futures, forward rate agreements and forward foreign exchange agreements.

(2) Contracts do not have coterminous settlement dates. However, master agreements provide for close-out netting.

(3) Total exposure to counterparties with positive exposure (meaning that counterparties owed OEFC) was $22 million (March 2004 — $130 million) and the total exposure to counterparties with negative exposure (meaning that OEFC owed the counterparties) was $402 million (March 2004 — $519 million) for a total net credit exposure of $(380) million (March 2004 — ($389) million).

The gross credit risk exposure represents the amount of loss that OEFC would incur if every counterparty to which OEFC had credit risk exposure were to default at the same time and the netting of individual counterparty credit risk exposure was not allowed. OEFC manages its credit risk exposure from derivatives by entering into contractual agreements (master agreements) that provide for termination netting and, if applicable, payment netting with virtually all of its counterparties. The net credit risk exposure includes the mitigating impact of these netting provisions.

OEFC manages its credit risk exposure by regularly monitoring compliance with credit limits and by dealing with counterparties with high credit quality. At March 31, 2005, OEFC's most significant concentration of credit risk was with one A+ rated counterparty, which represented more than 10 percent of the credit risk exposure. The net cost to OEFC, if it had to replace the swap contracts with this counterparty would be $20 million (2004 — $60 million).

9) Power Purchase Contracts

Power purchase contracts and related loan agreements were entered into by Ontario Hydro with non-utility generators (NUGs) located in Ontario. As the legal continuation of Ontario Hydro, OEFC is the counterparty to these contracts. The contracts, expiring on various dates to 2048, provided for the purchase of power at prices that were expected to be in excess of the market price. Accordingly, a NUG liability was recorded at $4,286 million on a discounted cash-flow (DCF) basis when Ontario Hydro was continued as OEFC on April 1, 1999. Prior to open access in May 2002, power purchased from NUGs was resold at cost to the revenue pool managed by OPG. After the market opened, OEFC sustained annual losses on power purchased from NUGs. The DCF model was updated as at March 31, 2003, which reduced the estimated liability by $422 million to $3,745 million. This revaluation change from 2002–03 is being amortized to operations over a 10-year period.

Under legislated reforms to the electricity market, OEFC began receiving actual contract prices for power from ratepayers, effective January 1, 2005, and will no longer incur losses on these power purchase contracts. The Ministry of Finance estimates that the bulk of the liability will be eliminated over 12 years as existing electricity contracts expire.

During the year, OEFC purchased power in the amount of $840 million (March 2004 — $797 million) and sold this power for $610 million (March 2004 — $510 million). Loans receivable from NUGs decreased during the year by $51 million to $116 million (March 2004 — $167 million), primarily due to principal repayments.

Statement of Liability for Power Purchase Contracts ($ millions)
As at March 31, 2005

	2005	2004
Liability, beginning of year	$ 3,683	$ 3,745
Interest charged during the year*	163	221
Deduct estimated in-year loss	(357)	(283)
Subtotal	3,489	3,683
Add: Unamortized Revaluation Changes		
Gross Revaluation	422	422
Accumulated Amortization	(126)	(84)
	296	338
	$ 3,785	**$ 4,021**

* Effective January 1, 2005, interest is no longer added to the liability.

During the year, the Ministry of Energy issued a Request for Proposals for the delivery of 300 MW of new renewable energy supply. OEFC entered into contracts for 395 MW under the RFP. Under the contracts, OEFC has the unilateral right to assign the contracts to the Ontario Power Authority (OPA). Responsibility for these contracts had not yet been transferred at March 31, 2005. The cost of power purchased under these contracts, and the revenues from the resale of this power to the market, will be recorded as the power is generated and resold under the contracts.

10) Nuclear Funding Liability

OEFC as the continued Ontario Hydro assumed a liability in the amount of $2,378 million representing nuclear waste management and asset removal liabilities that were incurred prior to April 1, 1999. In March 2002, the Province and OPG entered into the Ontario Nuclear Funds Agreement (ONFA) to establish, fund and manage segregated funds to ensure that sufficient funds are available to pay for costs of nuclear waste management and station decommissioning.

The Board of Directors of OEFC approved the funding of the Decommissioning Segregated Fund, established by OPG, over a four-year period, thus discharging the nuclear funding liability. OEFC contributed $1,200 million towards the fund liability on July 24, 2003, and $600 million on March 31, 2005.

Interest is accrued at a rate equal to the Ontario Consumer Price Index plus 3.25 percent in accordance with the terms of ONFA which were finalized on July 24, 2003. A commitment-in-lieu of $1,410 million as at March 31, 2005 (March 2004 — $1,916 million) has been provided to the Decommissioning Segregated Fund.

11) Unfunded Liability

The opening unfunded liability of $19.4 billion at April 1, 1999 was composed of $38.1 billion in liabilities assumed from old Ontario Hydro less the value of assets transferred to OEFC at April 1, 1999, including $17.2 billion in notes receivable and $1.5 billion in loans receivable and other assets. Pursuant to the *Electricity Act, 1998* and consistent with the principles of electricity restructuring, the government has a long-term plan in place to retire OEFC liabilities from within the electricity sector. The Plan includes cash flows from the following sources as at April 1, 1999:

Notes receivable from the Province of $8.9 billion, OPG of $3.4 billion, Hydro One of $4.8 billion and IESO for $0.1 billion for a total of $17.2 billion as a result of the transfer of assets to successor companies;

Payments-in-lieu of corporate income, capital and property taxes made by OPG, Hydro One and municipal electric utilities;

Debt Retirement Charge to be paid by ratepayers based on the consumption of electricity; and

Electricity Sector Dedicated Income — Consistent with the government's commitment to keep electricity income in the electricity sector, the combined net income of OPG and Hydro One in excess of the Province's interest cost of its investment in its electricity subsidiaries will be allocated to the retirement of OEFC's debt.

The long-term plan supports estimates that OEFC's obligations will likely be defeased in the years ranging from 2012 to 2020.

12) Electricity Consumer Price Protection Fund

On November 11, 2002, the Province announced a program designed to provide electricity to low volume and designated consumers at a fixed price of 4.3 cents/kWh until at least 2006, retroactive to May 1, 2002. Power generators continued to receive the free market price as set in the IESO electricity market. The program was supported and administered through the Electricity Consumer Price Protection Fund (ECPPF) managed by OEFC.

On December 18, 2003, the *Ontario Energy Board Amendment Act (Electricity Pricing), 2003* was passed into law to remove, effective April 1, 2004, the 4.3 cents/kWh price freeze in favour of a pricing structure that better reflects the true cost of electricity, including a strong incentive to conserve energy. Effective April 1, 2004, the 4.3 cents/kWh fixed price plan was ended and an interim pricing plan was introduced whereby the first 750 kWh consumed in any month is priced at 4.7 cents /kWh and consumption above that level is priced at 5.5 cents/kWh. These legislated pricing plans were supported by the ECPPF.

For the period April 1, 2004 to March 31, 2005, ECPPF reflected a surplus of $704 million (2004, net cost $253 million). Pursuant to the *Electricity Pricing Act, 2003* and regulations thereto, the responsibility for managing the ECPPF was transferred to a new agency, the Ontario Power Authority, effective January 1, 2005. Accordingly, $176 million of the fiscal 2005 surplus was transferred to the OPA representing the payments required to be made for the first quarter of 2005. The remaining surplus of $528 million is reflected as a liability on the balance sheet and will be returned to consumers.

In addition, OEFC recovered $20 million during the year related to Fund expenditures prior to April 1, 2004 as a result of OEFC's ongoing audit of claims from the Fund made by local distribution companies.

13) Temporary Generation Supply

In April of 2003, OEFC was directed to undertake a project to install 200 to 400 MW of temporary generation to provide support to Ontario's electricity reserves during the summer and fall of 2003.

OEFC arranged for the installation of 249 MW of gas-fired generation by the summer of 2003 at a cost of $70 million. Since all of the contracts expired on December 31, 2003, there is no current year expense for this item.

14) Contingencies and Guarantees

OEFC is involved in various legal actions arising out of the ordinary course and conduct of business, some of which relate to the former Ontario Hydro prior to the establishment of OEFC on April 1, 1999. Under the terms of the April 1, 1999 restructuring of Ontario Hydro, each successor entity (OPG, Hydro One, ESA and IESO, and their respective subsidiaries) is responsible for any liabilities relating to those operations of the former Ontario Hydro that were transferred to it. In the event any such liabilities remained with OEFC, the successor entity is also required to indemnify OEFC. With respect to legal actions relating to operations of Ontario Hydro that were retained by OEFC, the outcome and ultimate disposition of these legal actions is not determinable at this time. Accordingly, no provision for the above actions is reflected in the financial statements. Settlements of these contingencies, if any, will be reflected in the period in which settlement occurs.

Subject to a $10 million and $20 million deductible respectively, OEFC has agreed to indemnify Hydro One and OPG in respect of any adverse claim to title to any asset, right or thing transferred or intended to be transferred to the companies at April 1, 1999, and any failure of the transfer order to transfer such assets, rights or things and with respect to payment to or from or other dealing with any equity account of Ontario Hydro, including certain related litigation. The Province of Ontario has guaranteed any liability arising from these indemnifications.

OEFC is contingently liable under guarantees given to third parties that have provided long-term financing to certain independent power producers in connection with the power purchase agreements described in Note 9. These guarantees total approximately $91 million at March 31, 2005 (2004 — $102 million).

15) Related Party Transactions

In the normal course of operations, OEFC has transactions with the following related parties, all of which have been disclosed in the notes to the financial statements. Each of the following entities is included in the Province's financial statements:

a) Ontario Power Generation Inc.

b) Hydro One Inc.

c) Independent Electricity System Operator

d) Ontario Power Authority

e) Ontario Financing Authority

Corporate Governance

Corporate governance at the Ontario Electricity Financial Corporation involves processes that permit the effective supervision and management of the OEFC's activities by its senior management staff, its Board of Directors and the Minister of Finance. It includes identifying those individuals and groups who are responsible for the OEFC's activities and specifying their roles. The OEFC's governance framework is fully described in the OEFC's corporate governance policy which is reviewed annually by the Board of Directors.

The OEFC is the legal continuation of Ontario Hydro and an agent of the Crown. It is classified as an "Operational Enterprise" agency pursuant to Management Board of Cabinet's (MBC) Agency Establishment and Accountability Directive.

Accountability

The OEFC's accountability structure flows from its governing statute, the *Electricity Act, 1998*, and from a Memorandum of Understanding between the OEFC and the Minister of Finance, as well as from directives issued by MBC relating to crown agencies. Together, these provide that the Minister of Finance is accountable to Cabinet for the activities of the OEFC. In turn, the Chair of the OEFC Board of Directors is accountable to the Minister for OEFC's performance in fulfilling its mandate. The OEFC Board of Directors is appointed by the Lieutenant Governor in Council on the recommendation of the Minister of Finance and is accountable to the Minister, through the Chair, for supervising the management of the OEFC's business. The Chief Executive Officer (CEO) is accountable to the Chair of the OEFC Board for the day-to-day management of the OEFC's operations.

Roles and Responsibilities

The Minister maintains communications with the OEFC regarding government policies, expectations and new directions for the OEFC. The Minister is responsible for reviewing and approving the OEFC's annual business plan and for recommending the plan for approval to MBC every three years or as otherwise required by government directives.

The Chair, who is also the Deputy Minister of Finance, provides leadership and direction to the CEO and the Board and ensures the OEFC's compliance with government policies and directives. The CEO is responsible for the ongoing activities of the OEFC and ensures that policies and procedures, including financial reporting, remain relevant and effective.

The Board of Directors is comprised primarily of public servants, drawn from all relevant government areas, such as the Ministry of Finance, the Ontario Financing Authority and the Ministry of Energy. The Board meets at least quarterly and receives regular reports from the CEO and OFA staff concerning the operations of the OEFC and its compliance with applicable laws and policies. The Audit Committee of the OEFC Board approves an annual internal audit plan for the OEFC and liaises with the internal auditors (Audit Services Division of MBC) and the Auditor General regarding the OEFC's financial reporting and controls. It also reviews financial policies and the OEFC's financial statements to the Board. Standards of conduct for Board members are set out in a Board-approved Code of Conduct.

The OEFC does not have any employees, although some OFA staff members are designated as officers of OEFC for the purpose of executing agreements and other documents on its behalf. The OFA and staff in the Ministry of Finance Tax Revenue Division carry out the OEFC's day-to-day operations under the supervision of the CEO and the OEFC Board.

Board of Directors

Colin Andersen	Chair and Deputy Minister of Finance [Appointed from March 2004 to March 2007]
Gadi Mayman	Vice-Chair and Chief Executive Officer, (interim) [Appointed from August 2000 to June 2002 and from November 2003 to October 2005]
Brian FitzGerald	Fellow of the Canadian Institute of Actuaries [Appointed from April 1999 to June 2005]
James Gillis	Deputy Minister of Energy [Appointed from October 2004 to October 2007]
Tom Sweeting	Assistant Deputy Minister, Office of the Budget and Taxation, Ministry of Finance [Appointed from March 1999 to June 2008]
Bruce Macnaughton	Director, Pension and Income Security Policy Branch, Ministry of Finance [Appointed from March 1999 to June 2008]
Robert Siddall	Chair, OEFC Audit Committee; Provincial Controller, Ministry of Finance [Appointed from November 2002 to November 2005]
Karen Sadlier-Brown	Assistant Deputy Minister, Corporate and Electricity Finance Division, Ontario Financing Authority [Appointed from July 2003 to July 2006]

Risk Management Policies and Procedures

Overview

The OEFC risk management policies and procedures provide for the management of risk exposures created by capital market activities. Current policies and procedures address market, credit and operational risk exposure as they pertain to the OEFC's debt and derivatives portfolios and capital markets transactions.

These policies were developed following the guidelines and directives of regulatory bodies, such as the Office of the Superintendent of Financial Institutions of Canada, the Bank for International Settlements (BIS) and by consulting with Canadian bank representatives on their risk management practices.

The OEFC's Board and management committees establish and approve risk management policies and monitor the performance of the OFA's OEFC-related capital market activities.

Market Risk Policy

Market Risk is the risk of financial loss attributable to changes in interest rates, foreign exchange rates and market liquidity. This policy provides a framework for borrowing activities and integrates several aspects dealing with the management of market risk. The policy includes several limits:

- Foreign Exchange Limit — the OEFC's unhedged foreign currency exposure is limited to five percent of outstanding debt. Foreign exchange exposures are limited to Group of Seven currencies and the Swiss franc or the equivalent currencies (e.g., the Euro).
- Floating Rate Exposure Limit — the OEFC's floating rate exposure, net of liquid reserves, is limited to a maximum of 20 percent of outstanding debt.
- Debt Cost Loss Limit — The total amount of financial losses resulting from market risk and the default of counterparties shall not exceed a debt cost loss limit specified by the Board of Directors. In addition, the CEO establishes a trigger level to ensure that market and credit losses will not reach the debt cost loss limit. The trigger level is included in the Annual Financing, Debt and Electricity Management Plan.

The OEFC identifies and quantifies exposures to market risk in its Annual Financing, Debt and Electricity Management Plan 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.

When issuing new debt on behalf of the OEFC, the OFA will aim for a smooth debt maturity profile to diversify the interest rate risk for the refinancing of maturing and floating rate debt.

Credit Risk Policy

Credit risk is the risk that a counterparty defaults on its financially contracted obligations. Credit risk arises when the OFA undertakes financial and derivative transactions on behalf of the OEFC. The minimum credit rating of a new counter-party for swap transactions is AA- and R1-mid for money market investments. The resulting exposure to a financial counterparty is capped at mark-to-market limits depending on the counterparty's credit rating and capital base.

Policy on the Use of Derivatives

Derivatives are used to manage exposures arising from existing and planned debt issues in a sound and cost-effective manner consistent with the Annual Financing, Debt and Electricity Management Plan. Risks arising from the use of derivatives are identified, monitored, evaluated and managed prudently.

Policy on Risk Management Reporting

At its regular quarterly meetings, the OEFC Board of Directors is kept informed of OEFC's activities:

- The CEO of the OFA provides the OEFC Board of Directors with a progress report on the implementation of the Annual Financing, Debt and Electricity Management Plan, staffing and other administrative and operational matters. The CEO also reports on the OEFC's compliance with applicable government directives, and the OFA Legal Director reports on compliance with applicable laws; and
- The Director, OFA Risk Control Division, reports on program exposures and performance, as well as exceptions to policies.

In addition, OFA Management is kept informed of the OEFC's risk exposures and positions on a daily basis.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, systems or external events. Each division at the OFA manages operational risk through reviews and improvements of work processes, documented policies and procedures, data processing systems, contingency plans and staff training.

- The OFA maintains a Business Continuity Plan (which covers the OEFC's operations), which is regularly updated to facilitate the continuation of essential operational functions with a minimum of disruption in the event of an emergency.

Additional Sources of Information

Internet Links

Ontario Electricity Financial Corporation	www.oefc.on.ca
Ontario Financing Authority	www.ofina.on.ca
Ministry of Finance	www.fin.gov.on.ca
Ministry of Energy	www.energy.gov.on.ca
Ontario Power Generation Inc.	www.opg.com
Hydro One Inc.	www.hydroone.com
Independent Electricity System Operator	www.ieso.com
Ontario Electrical Safety Authority	www.esainspection.net

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