OEFC

ONTARIO ELECTRICITY FINANCIAL CORPORATION

Annual Report 2007

Ontario

Ontario Electricity Financial Corporation

Mandate

The Ontario Electricity Financial Corporation (OEFC or the Corporation) is one of five corporations established by the *Electricity Act, 1998*. Under the *Electricity 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.

Under the act, the OEFC has the following mandate:

- managing its debt, financial risks and liabilities, including the debt of the former Ontario Hydro
- managing the former Ontario Hydro's non-utility generator (NUG) contracts in the current market environment
- receiving all payments and administering other assets, liabilities, rights and obligations of the Corporation that were not transferred to another of the 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
- performing any additional objects specified by the Lieutenant Governor in Council.

The OEFC retains the services of the Ontario Financing Authority (OFA) and the Ministry of Revenue 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 2007 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, 2007.

Revenue exceeded expense by $894 million in 2006–07, compared to $1.1 billion in the previous year. The unfunded liability declined from $19.3 billion to $18.3 billion as at March 31, 2007 because of the 2006–07 results and a one-time elimination of a working capital adjustment payable to Ontario Power Generation in the amount of $110 million.

The unfunded liability has declined for three consecutive years. It is $1.1 billion less than the initial unfunded liability on April 1, 1999 when the former Ontario Hydro was restructured. Total debt and liabilities stand at $31.6 billion, down from $33.0 billion as at March 31, 2006, and down from the $38.1 billion inherited by the Corporation from the restructuring of Ontario Hydro in 1999.

Over the past year, the Ontario Financing Authority completed the Corporation's long-term public borrowing requirements of $2.8 billion, primarily to refinance maturing debt. Fixed rate bonds were issued to meet the Corporation's obligation to discharge its remaining commitment to the nuclear funding liability by the end of the fiscal year.

Cost savings of $0.9 million were achieved through the management of contracts with non-utility generators in 2006–07.

Looking ahead to 2007–08, the Ontario Electricity Financial Corporation will continue to manage its debt and liabilities in a cost-effective manner and support the implementation of the government's electricity policies and initiatives.

Colin Andersen
Chair

Gadi Mayman
Chief Executive Officer and Vice-Chair

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Management's Discussion and Analysis

2006–07 HIGHLIGHTS:

- Third consecutive annual decline in the unfunded liability
- Fulfilled commitment to eliminate the OEFC's $2.4 billion nuclear funding obligation
- Completed long-term public borrowing requirement of $2.8 billion
- Achieved cost-savings of $0.9 million through the management of non-utility generator contracts.

Financial Results

Revenue and Expense

Total revenue for 2006–07 was $3.8 billion, a decrease of $133 million from 2005–06. Revenue included $991 million from the debt retirement charge; $863 million in power sales; $757 million in payments-in-lieu (PiLs) of taxes; and $725 million in interest income from the Province, Ontario Power Generation and the Independent Electricity System Operator.

Total expense was $2.9 billion, an increase of $43 million from 2005–06. Expense included interest payments on short- and long-term debt of $1.8 billion and power purchases of $863 million under the power purchase agreements with non-utility generators.

Overall, revenue exceeded expense by $894 million, compared to the previous year, when revenue exceeded expense by $1.1 billion. The decline in 2006–07 was mainly due to lower payments-in-lieu of taxes, caused by a fall in Ontario Power Generation's operating results, partially as a result of lower electricity prices and consumer demand than in 2005–06.

Borrowing Program

In 2006–07, the OFA completed the Corporation's long-term public borrowing requirements of $2.8 billion, most of which was for long-term debt maturities. Borrowing requirements declined from the $3.5 billion estimated at the time of the 2006 Ontario Budget due to deferred call options of $387 million and a reduction in Ontario Power Generation's planned financing requirements of over $300 million.

Long-term public borrowing was completed primarily in the Canadian domestic market. Bonds (equivalent to $310 million Canadian) were also issued in Australian dollars and South African rand.

Borrowing program performance is measured by the difference between the "all-in" or total cost of the actual borrowing program and the total cost of a hypothetical domestic borrowing program of the same term and size, and implemented evenly over the fiscal year (known as the "even-pace benchmark"). As at March 31, 2007, the borrowing program's cost was $12 million lower than the even-pace benchmark, on a present-value basis.

Debt and Liabilities

The Corporation inherited about $38.1 billion in total debt and other liabilities from the former Ontario Hydro when the electricity sector was restructured on April 1, 1999. This amount included $30.5 billion in total debt.

As at March 31, 2007, total debt and liabilities declined to $31.6 billion, with total debt at $27.9 billion. These figures compare to total debt and liabilities of $33.0 billion, with total debt of $28.0 billion, as at March 31, 2006.

Stranded Debt

Stranded debt is the amount of debt and other liabilities of the Corporation that cannot be financially supported by commercial companies in the current electricity market.

As part of the restructuring on April 1, 1999, the Corporation received $17.2 billion in notes owing from the Province, Ontario Power Generation, Hydro One and the Independent Electricity System Operator. This resulted in about $20.9 billion of stranded debt, the difference between the $38.1 billion in total debt and liabilities and the value of the notes owed to the Corporation. The Corporation's initial unfunded liability of $19.4 billion was the stranded debt adjusted for $1.5 billion of additional assets.

As at March 31, 2007, the unfunded liability was $18.3 billion, a decrease of $0.9 billion from March 31, 2006. This is the third consecutive annual decline in the unfunded liability, $1.1 billion below the $19.4 billion level as at April 1, 1999.

Residual Stranded Debt

As at April 1, 1999, the present value of payments-in-lieu of taxes and electricity sector dedicated income was estimated at $13.1 billion. Subtracting the $13.1 billion from stranded debt of $20.9 billion resulted in a difference of $7.8 billion, known as residual stranded debt.

The *Electricity Act 1998* provided for the debt retirement charge, paid by consumers to the Corporation until the residual stranded debt is retired. The debt repayment plan supports estimates that residual stranded debt will likely be retired between 2012 and 2020.

Debt Repayment Plan

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

- Outstanding notes receivable from the Province, OPG and IESO
- Payments-in-lieu of corporate income, capital and property taxes, made by OPG, Hydro One and municipal electric utilities
- Debt retirement charge paid by electricity consumers
- Electricity sector dedicated income — the Province's combined cumulative net income from OPG and Hydro One in excess of the Province's interest cost of its investment in these electricity subsidiaries.

Risk Management

Risk management policies and procedures are in place to manage the market, credit and operational risk exposures associated with the Corporation's debt, derivatives and related capital markets transactions.

Foreign exchange and net interest rate resetting exposures remained within policy limits in 2006–07.

- Net interest rate resetting exposure was 14.4 per cent of outstanding debt as at March 31, 2007, within the limit of 35 per cent.
- Foreign exchange exposure was zero per cent of outstanding debt as at March 31, 2007. The foreign exchange exposure limit for the OEFC is five per cent.

In 2006–07, the OEFC Board of Directors accepted a recommendation by Management that the Corporation's market risk policy be consistent with that of the Ontario Financing Authority. The result was an increase in the interest rate exposure limit, which became 35 per cent of total debt. Previously, there was a 20 per cent limit on floating rate exposure. A detailed description of policies can be found in the Risk Management Policies and Procedures section.

Other Responsibilities

Management of Power Purchase Agreements

During 2006–07, the Corporation continued negotiating revisions to non-utility generator contracts so their terms are consistent with the hybrid electricity market. The hybrid market was created by the *Electricity Restructuring Act, 2004*, which combined regulated, contract and competitive market pricing.

Efficiencies were achieved in managing the existing power purchase agreements with the non-utility generators in 2006–07. Generator costs dropped by $0.9 million through auxiliary services revenue, incremental power agreements and other transactions that increase or shift the time of electricity generation under the contracts.

Previously, the Corporation purchased power from the non-utility generators under contract terms and sold the power at market prices lower than cost. However, as at January 1, 2005, the Corporation began to receive actual contract prices for power from ratepayers, eliminating losses on power purchase contracts. At that time, the Ministry of Finance estimated that most of the liability, valued at $3.0 billion at year-end, would be eliminated over 12 years as existing contracts expire.

Nuclear Funding Liability Management

The Corporation assumed a liability of $2.4 billion for the unfunded nuclear decommissioning and nuclear waste management liabilities of the former Ontario Hydro prior to April 1, 1999. The Ontario Nuclear Funds Agreement (ONFA) between the Province, Ontario Power Generation and certain OPG subsidiaries confirms the Corporation's obligation to pay an amount into the Decommissioning Segregated Fund to discharge the nuclear funding liability. The Corporation provided a commitment-in-lieu equal to the outstanding amount of the liability with interest of 3.25 per cent plus Ontario Consumer Price Index (CPI). The Board of Directors approved the funding of this liability over four years.

The remaining amount of the commitment-in-lieu ($768 million as at April 1, 2006) was paid in full by the end of the fiscal year. The obligation was met with the proceeds of fixed rate bonds issued as cost-effective borrowing opportunities arose in the capital markets.

Supporting New Electricity Supply Projects
Between 2005 and 2007, the Corporation provided financing on commercial terms to Ontario Power Generation to develop new electricity supply projects:

- Development of a loan agreement of up to $1.0 billion for the Niagara Tunnel project, which will increase electricity generated by the Sir Adam Beck hydro complex in Niagara Falls
- Long-term loan agreements of amounts up to $400 million for the Portlands Energy Centre in Toronto and up to $50 million for the Lac Seul hydroelectric project in Northwestern Ontario.

These projects will help Ontario meet its electricity supply needs and are part of the Ontario Power Authority's supply projections, as outlined in its discussion papers on the Integrated Power System Plan. This plan responds to the government's Supply Mix Directives and is expected to be submitted to the Ontario Energy Board in 2007.

2007–08 Outlook

The Ontario Electricity Financial Corporation will focus on the following:

Managing debt and other liabilities cost-effectively
The Ontario Financing Authority will continue to manage the Corporation's debt and liabilities in a cost-effective manner and within exposure limits approved by the Board of Directors. In addition, the OFA will complete the Corporation's 2007–08 long-term public borrowing requirements of $1.9 billion, nearly all of which is to refinance debt maturities.

Managing financial risk within approved policy limits
The debt portfolio will be managed within exposure limits throughout 2007–08.

Administering non-utility generator contracts in the new electricity market environment
The Corporation will continue to minimize costs to ratepayers through effective administration of the non-utility generator contracts.

Providing financial assistance as required to the Ontario Hydro successor corporations
The Corporation will facilitate the cash flow requirements of the Ontario Hydro successor corporations as directed or required.

Supporting the implementation of the government's electricity industry policies and analyzing and monitoring the impact on the Corporation
The Corporation will continue to support the government's electricity initiatives as requested and it will monitor and analyze their impact on the Corporation.

Financial Statements

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Responsibility for Financial Reporting

The accompanying financial statements of the Ontario Electricity Financial Corporation have been prepared in accordance with the recommendations of the Public Sector Accounting Board (PSAB) of 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 June 1, 2007.

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. The Ontario Internal Audit Division 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
Chief Executive Officer and Vice-Chair

Auditor's Report

Office of the Auditor General of Ontario
Bureau du vérificateur général de l'Ontario

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, 2007 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, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada
June 1, 2007, except as to Note 6
which is as of June 11, 2007

Jim McCarter, CA
Auditor General
Licensed Public Accountant

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Ontario Electricity Financial Corporation

Statement of Financial Position (as at March 31, 2007)
($ Millions)

	2007	2006
ASSETS		
Current Assets		
Cash and cash equivalents (Note 4)	$ 3	$ 49
Accounts receivable	328	287
Interest receivable	15	10
Current portion of notes receivable (Note 6)	400	700
	746	1,046
Payments-in-lieu of tax receivable (Note 11)	267	298
Due from Province of Ontario (Notes 5, 11)	418	351
Notes and loans receivable (Note 6)	11,660	11,734
Deferred debt costs	195	232
	$ 13,286	$ 13,661
LIABILITIES		
Current Liabilities		
Accounts payable	$ 150	$ 238
Interest payable	558	526
Short-term notes payable (Note 7)	1,583	1,479
Current portion of long-term debt (Note 7)	1,849	3,114
	4,140	5,357
Long-term debt (Note 7)	24,458	23,440
Power purchase contracts (Note 9)	2,977	3,389
Nuclear funding liability (Note 10)	—	768
	31,575	32,954
Contingencies and guarantees (Note 13)		
UNFUNDED LIABILITY (Notes 1, 3, 11)	$ (18,289)	$ (19,293)
	$ 13,286	$ 13,661

Approved on behalf of the Board of Directors:

Colin Andersen
Chair

Gadi Mayman
Chief Executive Officer and Vice-Chair

See accompanying Notes to Financial Statements.

Ontario Electricity Financial Corporation

Statement of Revenue, Expense and Unfunded Liability
for the Year Ended March 31, 2007
($ Millions)

	2007	2006
REVENUE		
Debt retirement charge (Notes 1, 11)	$ 991	$ 1,021
Payments-in-lieu of tax (Notes 1, 11)	757	949
Interest	725	737
Power sales (Note 9)	863	785
Net reduction of power purchase contracts (Note 9)	412	396
Electricity sector dedicated income (Note 5)	67	—
Recovery of prior year expenditures - ECPPF (Note 12)	—	56
Other	6	10
Total Revenue	3,821	3,954
EXPENSE		
Interest - short-term debt	$ 88	$ 35
- long-term debt	1,720	1,767
Interest on nuclear funding liability (Note 10)	25	69
Amortization of deferred charges	59	60
Power purchases (Note 9)	863	809
Debt guarantee fee	140	138
Operating	32	6
Total Expense	2,927	2,884
Excess of revenue over expense	894	1,070
Unfunded Liability, beginning of year	19,293	20,363
Elimination of a working capital adjustment payable to OPG (Note 11)	110	—
Adjusted unfunded liability, beginning of year	19,183	20,363
Unfunded Liability, end of year	$ 18,289	$ 19,293

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation

Statement of Cash Flow
for the Year Ended March 31, 2007
($ Millions)

	2007	2006
CASH FLOWS USED IN OPERATING ACTIVITIES		
Excess of revenue over expense	$ 894	$ 1,070
Adjustments for:		
Net reduction of power purchase contracts (Note 9)	(412)	(396)
Amortization of deferred charges	59	60
Payments-in-lieu of tax receivable	31	(206)
Payment of ECPPF surplus to consumers	—	(505)
Other Items	(58)	105
Cash provided from operations	514	128
CASH FLOWS FROM FINANCING ACTIVITIES		
Long-term debt issues	$ 2,838	$ 1,701
Less long-term debt retired	3,114	1,556
Long-term debt issued (retired), net	(276)	145
Short-term debt issued, net	104	333
Payment towards nuclear funding liability (Note 10)	(768)	(640)
Notes receivable (advance) repayment	380	(55)
Cash required by financing activities	(560)	(217)
Increase (decrease) in cash and cash equivalents	(46)	(89)
Cash and cash equivalents, beginning of year	49	138
Cash and cash equivalents, end of year	$ 3	$ 49

Interest on debt paid during the year and included in excess of revenue over expense	$ 1,776	$ 1,812

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*, from dedicated electricity revenues in the form of payments-in-lieu of corporate income, capital and property taxes made by the successor entities and municipal electric utilities. OEFC also receives a Debt Retirement Charge (DRC) to be paid by electricity consumers at a rate of 0.7 cents/kWh for most Ontario consumers until the residual stranded debt is retired. The Ontario Financing Authority, the 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

Because 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 any 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, in accordance with the recommendations of the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants, 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. At that time, the Ministry of Finance estimated that the bulk of the liability would be eliminated over 12 years as existing electricity contracts expire.

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 cumulative 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. Under these arrangements, the Province can recoup all costs associated with its investments in electricity subsidiaries on a cumulative basis before any income can be recognized by OEFC. In the year ended March 31, 2007, OPG and Hydro One earned an aggregate amount of $914 million, $394 million in excess of the Province's annual financing cost of $520 million. OEFC has reflected $67 million as income for the year (March 2006 — Nil) as the accumulated shortfall of the Province at March 2006 amounted to $327 million.

6) Notes and Loans Receivable

($ millions)					
	Maturity date	**Interest rate**	**Interest payable**	**March 31, 2007**	**March 31, 2006**
Province of Ontario	2039-2041	5.85	Monthly	8,885	8,885
OPG	2007-2017	4.81 to 6.65	Semi-annually	3,015	3,395
IESO	2009	7.9	Semi-annually	78	78
				11,978	12,358
Less: Current portion of notes receivable				400	700
				11,578	11,658
Add: Loans receivable from non-utility generators (NUGs) (See Note 9)				82	76
				$ 11,660	**$ 11,734**

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

During fiscal 2006–07, OPG repaid $700 million in notes maturing in the year.

OEFC has agreed to provide OPG financing for new generation project development in the form of 10-year notes on commercial terms and conditions. These agreements provide for up to $1 billion in loans for the Niagara Tunnel project, up to $400 million for OPG's interest in the Portlands Energy Centre and up to $50 million for the Lac Seul project.

Under these agreements, OEFC advanced OPG $160 million in October 2006 and $50 million in January 2007 for the Niagara Tunnel project. Similarly, in December 2006, OEFC provided OPG with loans of $90 million for the Portlands Energy Centre and $20 million for the Lac Seul project.

On June 11, 2007, the Minister of Finance signed a directive committing OEFC to lend to OPG for general corporate requirements in a principal amount of up to $500 million during the period up to March 31, 2008 and to lend to OPG to finance existing maturities in a principal amount of up to $950 million during the period up to December 31, 2009. Maturities for these loans would be up to ten years.

Below is a summary by year of maturity of OPG's debt to OEFC:

($ millions) Fiscal Year	Amount
2007-08	$ 400
2008-09	375
2009-10	707
2010-11	625
2011-12	188
2012-13	400
2016-17	320
Total	**$3,015**

7) Debt

Debt at March 31, 2007, is set out below by maturity and by currency of repayment, expressed in Canadian dollars.

($ millions) Currency	Canadian Dollars	U.S. Dollars	Other Foreign	2007 Total	2006 Total
Maturing in:					
1 year	$2,111	$1,321	—	$3,432	$4,593
2 years	3,496	387	—	3,883	1,842
3 years	2,180	—	139	2,319	3,883
4 years	1,050	—	53	1,103	2,269
5 years	500	—	47	547	1,103
1-5 years	9,337	1,708	239	11,284	13,690
6-10 years	6,298	1,597	688	8,583	6,778
11-15 years	2,938	—	—	2,938	1,130
16-20 years	2,929	—	—	2,929	3,687
21-25 years	1,041	—	—	1,041	1,191
26-50 years	1,115	—	—	1,115	1,557
Total	**$23,658**	**$3,305**	**$927**	**$27,890**	**$28,033**

The effective rate of interest on the debt portfolio was 6.51per cent (March 2006 — 6.47 per cent) after considering the effect of derivative instruments used to manage interest rate risk. The longest term to maturity is to June 2, 2037. Total foreign currency denominated debt at March 31, 2007, was $4.2 billion (March 2006 — $4.8 billion), 100 per cent of which (March 2006 — $4.8 billion or 100 per cent) 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, 2007			March 31, 2006		
($ millions)	**Held by the Province**	**Guaranteed by the Province**	**Total**	**Held by the Province**	**Guaranteed by the Province**	**Total**
Short-term debt	$ 1,583	—	$ 1,583	$ 1,479	—	$ 1,479
Current portion of long-term debt	881	968	1,849	3,114	—	3,114
Long-term debt	15,147	9,311	24,458	13,146	10,294	23,440
Total	**$17,611**	**$10,279**	**$27,890**	**$17,739**	**$10,294**	**$28,033**

Fair value of debt issued approximates amounts at which debt instruments could be exchanged in a current transaction between willing parties. In valuing the 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, 2007, was $32.1 billion (March 2006 — $31.5 billion). This is higher than the book value of $27.9 billion (March 2006 — $28.0 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

The 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 with a value that is derived from underlying instruments. The 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 the OEFC agrees with another party to exchange cash flows based upon one or more notional amounts during a specified period. This allows the OEFC to offset its existing obligations and thereby effectively convert them into obligations with more desirable characteristics. Other derivative instruments used by the 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, the 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, net of foreign currency holding, to reach a maximum of 5 per cent of total debt. At March 31, 2007, the actual unhedged level was 0.0 per cent (March 2006 — 0.0 per cent) of total debt.

Interest rate resetting risk is the exposure of the OEFC to changes in 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 and fixed rate debt maturing within the next 12 months, net of liquid reserves, to reach a maximum of 35 per cent of total debt. At March 31, 2007, OEFC's interest rate resetting risk as a percentage of total debt was 14.4 per cent (March 2006 — 9.6 per cent).

Liquidity risk is the risk that the OEFC will not be able to meet its current short-term financial obligations. As explained in Note 3, the 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 the OEFC's derivatives, by type, outstanding at March 31, 2007, 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

As at March 31, 2007 ($ millions)

Maturity in Fiscal Year	2008	2009	2010	2011	2012	6-10 Years	Over 10 Years	Total	March 2006
Cross-currency swaps	$1,340	$ 387	$ 511	$104	$ 96	$2,303	—	$ 4,741	$ 4,208
Interest rate swaps	1,159	988	1,025	—	47	3,477	653	7,349	9,427
Forward foreign exchange contracts	473	—	—	—	—	—	—	473	1,218
Other [1]	—	—	—	—	—	—	—	—	111
Total	**$2,972**	**$1,375**	**$1,536**	**$104**	**$143**	**$5,780**	**$653**	**$12,563**	**$14,964**

(1) Other includes interest rate options.

The use of derivatives introduces credit risk, which is the risk of a counterparty defaulting on contractual derivative obligations in which the 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, as at March 31, 2007.

Credit Risk Exposure ($ millions)	**March 31, 2007**	**March 31, 2006**
Gross credit risk exposure[(1)]	$ 6,833	$ 6,254
Less: Netting[(2)]	(7,525)	(7,136)
Net credit risk exposure[(3)]	**$ (692)**	**$ (882)**

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 $2 million (March 2006 — $20 million) and the total exposure to counterparties with negative exposure (meaning that OEFC owed the counterparties) was $694 million (March 2006 — $902 million) for a total net credit exposure of $(692) million (March 2006 — ($882) million).

The gross credit risk exposure represents the amount of loss that the 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 were not allowed. The 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.

The OEFC manages its credit risk exposure by regularly monitoring compliance with credit limits and by dealing with counterparties with high credit quality. Exclusive of contracts with the Province, the OEFC's most significant concentration of credit risk as at March 31, 2007, was with one A+ rated counterparty which represented more than 10 per cent of the credit risk exposure. The net cost to the OEFC, if it had to replace the contracts with this counterparty, would be $2 million (March 2006 — $5 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, the 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 liability was recorded at $4,286 million on a discounted cash flow (DCF) basis when Ontario Hydro was continued as the OEFC on April 1, 1999. The DCF model was updated as of 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 revenue over a 10-year period.

Under legislated reforms to the electricity market, 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. At that time, the Ministry of Finance estimated that the bulk of the liability would be eliminated over 12 years as existing electricity contracts expire. As a result, the Corporation is amortizing the liability to revenue over that period.

During the year ended March 31, 2007, the OEFC purchased power from NUGs in the amount of $863 million (2006 — $809 million) and sold power to the IESO and municipal electric utilities in the amount of $863 million (2006 — $785 million).

Loans receivable from NUGs increased during the year by $6 million to $82 million (March 2006 — $76 million), primarily due to interest which has been added to the principal balance.

Statement of Liability for Power Purchase Contracts ($ millions)

As at March 31, 2007

	2007	2006
Liability, beginning of year	$3,389	$3,785
Amortization	412	396
Liability, end of year	**$2,977**	**$3,389**

10) Nuclear Funding Liability

The 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 nuclear waste management and station decommissioning costs for OPG's existing nuclear stations. Interest on the liability to the fund is accrued at a rate equal to the Ontario Consumer Price Index plus 3.25 per cent in accordance with the terms of ONFA which were finalized on July 24, 2003. OEFC is not involved in the management of these funds which are reflected on the balance sheet of OPG and jointly managed by OPG and the Province.

The Board of Directors of the OEFC approved the funding of the OEFC's nuclear liability to the Decommissioning Segregated Fund over a four-year period. The OEFC's contributions began in 2003 and the entire liability including interest has been discharged, with a final payment on March 30, 2007.

11) Unfunded Liability

The opening Unfunded Liability has been reduced to reflect the elimination of a working capital adjustment payable to Ontario Power Generation that was originally recognized as an increase to opening Unfunded Liability in the amount of $110 million. Subsequently, it was determined that there was no obligation for this additional amount of working capital.

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 the 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 cumulative 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 the OEFC's debt.

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

12) Electricity Consumer Price Protection Fund

Beginning in December 2002, the Corporation managed the Electricity Consumer Price Protection Fund (the "Fund"), which supported the Province's policy to provide electricity to low volume and designated consumers at a fixed price initially and subsequently under a two-tiered pricing plan for the period from April 1, 2004 to March 31, 2005. Starting in January 2005, until the program was terminated as at March 31, 2005, this support function was transferred to the Ontario Power Authority. In fiscal 2005–06 and as a result of OEFC's on-going audit of claims from the fund made by local distribution companies, OEFC recovered $56 million in revenue relating to recoveries for wholesale market service charge variances attributable to non-low volume and designated consumers.

13) 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 deductible, the OEFC has agreed to indemnify Hydro One in respect of any adverse claim to title to any asset, right or thing transferred or intended to be transferred to the company 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. A similar indemnity provided to OPG was terminated as at May 31, 2006.

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 $69 million at March 31, 2007 (2006 — $80 million).

14) 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:

- Province of Ontario
- Ontario Power Generation Inc.
- Hydro One Inc.
- Independent Electricity System Operator
- Ontario Power Authority
- Ontario Financing Authority

15) Comparative Figures

Certain of the prior year's comparative figures have been reclassified to conform with the financial statement presentation adopted for March 2007.

Corporate Governance

Overview

Board of Directors

Risk Management Policies and Procedures

Corporate Governance

Overview

Corporate governance at the Ontario Electricity Financial Corporation involves processes that permit the effective supervision and management of activities by senior management, the Board of Directors, its Audit Committee and the Minister of Finance. It includes identifying individuals and groups responsible for the Corporation's activities and specifying their roles. The governance framework is based on Management Board of Cabinet's (MBC) Agency Establishment and Accountability Directive.

The Corporation is the legal continuation of the former Ontario Hydro. It is an agent of the Crown and is classified as an operational enterprise agency.

Accountability

The Corporation's accountability structure flows from its governing statute, the *Electricity Act, 1998*, and from a Memorandum of Understanding between the Corporation and the Minister of Finance. Accountability is also achieved from directives issued by MBC. Together, these provide that the Minister of Finance reports and responds to the Legislative Assembly and Cabinet regarding the OEFC. In turn, the Chair of the Board of Directors is accountable to the Minister for the Corporation's performance in meeting its mandate. The 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 Corporation's business. The Chief Executive Officer is accountable to the Board including its Chair for the day-to-day management of operations.

Roles and Responsibilities

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

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

The Board of Directors is comprised of public servants. The Board meets at least quarterly and receives regular reports from the CEO and OFA staff concerning the Corporation's operations and its compliance with applicable laws and policies. The Audit Committee of the Board approves an annual internal audit plan and liaises with the Corporation's internal auditors and the Auditor General of Ontario regarding financial reporting and controls. It also reviews financial policies and financial statements and recommends them to the Board. Standards of conduct for Board members are set out in a Board-approved Code of Conduct.

The Corporation does not have employees, although some Ontario Financing Authority employees are designated as officers for executing agreements and other documents on the Corporation's behalf. The OFA and the Tax Revenue Division of the Ministry of Revenue carry out the Corporation's day-to-day operations under the supervision of the CEO and the Board.

Financial Reporting

The OEFC prepares annual financial statements in accordance with accounting principles recommended for governments by the Canadian Institute of Chartered Accountants. They are reviewed and recommended by the Audit Committee and approved by the Board of Directors. Unaudited financial statements are prepared quarterly and presented to the Audit Committee and the Board. The annual financial statements are audited by the Auditor General who expresses an opinion on whether they present the financial results fairly and in accordance with Canadian generally accepted accounting principles. The 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 OEFC's Annual Report and are included as a schedule to the Public Accounts of the Province.

Internal Controls

Management is responsible for establishing and maintaining adequate internal controls to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements. These controls:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions
- provide reasonable assurance that transactions are executed in accordance with authorizations
- provide reasonable assurance regarding prevention or timely detection of unauthorized transactions that could have a material effect on the financial statements.

In meeting its responsibility for the reliability and timeliness of financial information, the OEFC uses a comprehensive system of internal controls, including organizational and procedural controls. The system for internal controls includes:

- written communication of policies and procedures governing corporate conduct and risk management
- comprehensive business planning
- segregation of duties
- responsible delegation of authority and personal accountability
- careful selection and training of personnel
- regularly updated accounting policies.

As part of its annual business plan, the OEFC conducts a risk assessment of corporate-wide risks and develops appropriate mitigation strategies.

The Ontario Internal Audit Division of the Ministry of Finance develops an annual internal audit plan based on its risk assessment and input from the OEFC Audit Committee and OEFC management. The internal audit plan is presented for review and approval by the OEFC Audit Committee. Internal Audit reports to the OEFC Audit Committee on the results of their audit work in the OEFC.

Board of Directors

Colin Andersen	Chair and Deputy Minister of Finance [First appointed March 2004. Current term to February 2010.]
Gadi Mayman	Chief Executive Officer and Vice-Chair [First appointed August 2000. Current term to July 2008.]
Bruce L. Bennett*	Assistant Deputy Minister, Provincial Controller [First appointed August 2006. Current term to August 2009.]
Frank Denton**	Legal Director, Ministry of Economic Development & Trade [First appointed August 2006. Current term to August 2009.]
James R. Gillis	Deputy Minister of Energy [First appointed October 2004. Resigned from Ontario Public Service and Board, December, 2006.]
Bruce Macnaughton	Director, Pension and Income Security Policy Branch, Ministry of Finance [First appointed March 1999. Current term to June 2008.]
Mahmood Nanji	Assistant Deputy Minister, Ministry of Public Infrastructure Renewal [First appointed August 2006. Current term to August 2008.]
Nancy Naylor**	Assistant Deputy Minister, Elementary-Secondary Business and Finance Division, Ministry of Education [First appointed August 2006. Current term to August 2009.]
Bohodar Rubashewsky	Assistant Deputy Minister, Road User Safety Division, Ministry of Transportation [First appointed August 2006. Current term to August 2008.]
Karen Sadlier-Brown	Assistant Deputy Minister, Corporate and Electricity Finance Division, Ontario Financing Authority [First appointed July 2003. Current term to July 2009.]
Tom Sweeting	Assistant Deputy Minister, Office of the Budget and Taxation, Ministry of Finance [First appointed March 1999. Retired from the Ontario Public Service and Board, May 2006.]
Peter Wallace	Deputy Minister of Energy [First appointed February 2007. Current term to February 2010.]

* Chair, Audit Committee
** Member, Audit Committee

Risk Management Policies and Procedures

Overview

The Corporation's 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 exposures as they pertain to 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 and by consulting with Canadian bank representatives on their risk management practices.

The Board and management committees establish and approve risk management policies and monitor the performance of the Ontario Financing Authority's capital market activities related to the Corporation.

Market Risk Policy

Market risk is the risk of financial loss attributable to changes in interest rates and foreign exchange rates. 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 — unhedged foreign currency exposure is limited to five per cent of outstanding debt. Unhedged foreign exchange exposures are limited to Group of Seven currencies and the Swiss franc.
- Net Interest Rate Resetting Limit — the interest rate resetting exposure, net of liquid reserves, is limited to a maximum of 35 per cent of outstanding debt.
- Management Loss Trigger Level — to prevent a potentially large loss resulting from capital market transactions, the annual Financing, Debt and Electricity Management Plan establishes an aggregate management loss trigger level, covering both the Province and OEFC.

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 Corporation. The minimum credit rating of a new counterparty 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 the borrowing and debt management programs in a sound and efficient manner consistent with the Annual Financing, Debt and Electricity Management Plan. Risks arising from the use of derivatives are monitored and managed prudently.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or 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 Corporation'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.

Policy on Risk Management Reporting

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

- The CEO of the OFA provides the Corporation's Board 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 compliance with applicable government directives.
- 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 Corporation's risk exposures and positions on a daily basis.

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 Revenue	www.rev.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
Ontario Power Authority	www.powerauthority.on.ca

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