2006 Annual Report

OEFC

ONTARIO ELECTRICITY FINANCIAL CORPORATION

Ontario

Mandate and Governing Legislation

The Ontario Electricity Financial Corporation (OEFC) 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.

The OEFC's objects 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; and
- Performing any additional objects as specified by the Lieutenant Governor in Council, including providing financial assistance to the successor corporations of Ontario Hydro.

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 2006 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, 2006.

The OEFC recorded an excess of revenue over expense of $1,070 million in 2005-06, compared to the prior year's excess of revenue over expense of $187 million. As a result, the OEFC's unfunded liability declined to $19.3 billion from $20.4 billion as at March 31, 2005. This is the first time that the unfunded liability has declined below its initial level of $19.4 billion since the former Ontario Hydro was restructured on April 1, 1999. Total debt and liabilities now stand at $33.0 billion, down from $34.2 billion as at March 31, 2005.

Over the year, the Ontario Financing Authority completed the OEFC's long-term public borrowing requirements of $1.7 billion, primarily to refinance maturing debt. In addition, the OFA issued a Real Return Bond (RRB) on behalf of the OEFC, which enabled the Corporation to reduce its remaining commitment-in-lieu on the nuclear funding liability by $709 million. The RRB was issued at a lower interest rate than the commitment-in-lieu, with expected annual savings to the OEFC of $9 million going forward. As of March 31, 2006, the OEFC had funded $2.5 billion of its nuclear funding liability, and had a remaining commitment-in-lieu of $768 million.

The OEFC achieved efficiencies in managing the existing power purchase agreements (PPAs) with the non-utility generators (NUGs) in 2005–06. Cost savings of $1.1 million were gained through incremental power and various other arrangements under the NUG contracts.

Looking ahead to 2006–07, the OEFC will continue to manage its debt and liabilities in a cost-effective manner, and will support the implementation of the government's electricity policies and initiatives. In addition, the remaining commitment-in-lieu to the nuclear funding liability will be discharged by the end of the fiscal year.

Colin Andersen
Chair

Gadi Mayman
Chief Executive Officer and Vice-Chair

Management's Discussion and Analysis

Implications of Electricity Sector Reforms

The *Ontario Electricity Restructuring Act, 2004*, which came into effect January 1, 2005, is the legislative framework which reorganized Ontario's electricity system to address the critical need for new supply, promote conservation and increase price stability for consumers across Ontario. The *Ontario Electricity Restructuring Act* and related electricity reform measures impact the OEFC financially.

Electricity Pricing

A key impact of the reforms is that the OEFC is no longer responsible for financing the difference between the prices paid by residential and other low volume and designated consumers and prices paid to suppliers.

Effective April 1, 2005, a Regulated Price Plan (RPP), established by the Ontario Energy Board (OEB), provided more stable prices to residential, low-volume and designated consumers, with periodic adjustments to ensure consumers pay a price that reflects the blended price of electricity over time. The Ontario Power Authority became responsible for financing differences in the RPP prices and those paid to suppliers, with differences recovered from RPP customers in the prices set for the subsequent period.

Electricity prices are set through a variety of mechanisms. Effective April 1, 2005, the electricity generated by OPG's nuclear and baseload hydroelectric generation assets received regulated prices. Other generators receive contract prices, while other generating stations, including OPG's non price-regulated plants, receive prices set in the market. Consumers' bills reflect a blend of all prices.

Under this structure, OPG's regulated prices will be adjusted periodically by the OEB. Until the OEB assumes this responsibility, prices are set by government regulation. Effective April 1, 2005, the price for electricity generated by OPG's price-regulated nuclear and baseload hydroelectric plants was set at 4.95 cents/kilowatt hour (kWh) and 3.3 cents/kWh, respectively.

The government also set a transitional revenue limit of 4.7 cents/kWh on 85 per cent of the output from OPG's non price-regulated assets, excluding the Lennox generating station and volumes covered by existing forward contracts as at January 1, 2005. The transitional revenue limit was initially scheduled to be in place from April 1, 2005 to April 30, 2006.

On February 9, 2006, the government announced an initiative to improve price stability for consumers by extending and initially lowering the transitional revenue limit as follows:

- 4.6 cents/kWh from May 1, 2006 to April 30, 2007;
- 4.7 cents/kWh from May 1, 2007 to April 30, 2008; and
- 4.8 cents/kWh from May 1, 2008 to April 30, 2009.

Power Purchase Agreements

- Effective January 1, 2005, the OEFC started to receive actual contract prices for power sold under legacy Ontario Hydro Power Purchase Agreements (PPAs) with the non-utility generators (NUGs), as well as related administrative costs, and is no longer incurring losses on these contracts, effectively eliminating this liability to the OEFC.
- The government determined that the most cautious and prudent accounting treatment is to eliminate the liability over time.
- The NUG contracts expire at various dates up to 2048. The Ministry of Finance estimates that the bulk of the liability would be eliminated over 12 years as existing electricity contracts expire.
- Total capacity of the NUGs portfolio is about 1,700 megawatts (MW), or about six per cent of Ontario's generating capacity.

Electricity Consumer Price Protection Fund (ECPPF)

Between April 1, 2004, and March 31, 2005, an interim pricing plan priced the first 750 kWh consumed in any month by low volume and designated consumers at 4.7 cents/kWh, with consumption above that level priced at 5.5 cents/kWh. For this period, the OEFC managed the difference between prices paid by these consumers and the prices paid to suppliers of the electricity through the ECPPF.

In November 2005, a final determination of the ECPPF surplus accumulated from low volume and designated consumers for the interim pricing plan period was determined to be about $505.4 million, which included $10.5 million as an allowance for interest. The OEFC transferred the surplus to the IESO for distribution to eligible low volume and designated consumers.

Electricity Sector Financial Performance

Under price regulation, OPG's regulated nuclear and baseload hydroelectric plants receive prices that allow OPG to recover approved costs, assuming OPG meets projected production levels. In addition, from April 1, 2005, to April 30, 2006, a revenue limit on most of the output from OPG's non price-regulated assets was established as a transitional measure to replace, along with the price regulation of OPG's nuclear and baseload hydroelectric generation, the Market Power Mitigation Agreement (MPMA). The MPMA was in place since the electricity market opened to competition on May 1, 2002. The MPMA rebate 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

In 2005–06, the government advanced projects and initiatives that would add about 11,000 MW of new supply as well as conservation and demand management measures over a five year period to meet the Province's electricity requirements. While a number of the new supply projects involved the OEFC, these are not expected to have a net financial impact on the Corporation as costs will be recovered from electricity consumers. The projects involving the OEFC include the following:

- Contracts for ten renewable energy projects totalling 395 MW. These contracts were transferred to the OPA, however, the OEFC provides administration services for two contracts on behalf of the OPA.
- Development of a loan agreement of up to $1.0 billion with OPG for the Niagara Tunnel project to increase the output of the Sir Adam Beck generating complex.

In March 2005, the OEFC submitted a joint proposal with Hydro-Québec and SNC-Lavalin to support Newfoundland and Labrador in developing major hydroelectric generation projects on the Lower Churchill River in Labrador. On May 8, 2006, the government of Newfoundland and Labrador announced that it will take the lead on the potential development of the Lower Churchill hydroelectric resource.

Financial Results

For the year ended March 31, 2006, revenues totalled $3,954 million, while expenses were $2,884 million, resulting in an excess of revenue over expense of $1,070 million, compared to the prior year's excess of revenue over expense of $187 million.

The improvement in 2005–06 financial results is primarily attributable to higher payments-in-lieu of taxes from OPG and Hydro One, a year of the full recovery of the cost of PPAs with NUGs, and the amortization of the NUG liability.

Revenues

Total revenues for 2005–06 were $3,954 million, an increase of $829 million from 2004–05. Revenues included $1,021 million from the Debt Retirement Charge, $737 million in interest income from the Province, OPG and the IESO, $785 million in power sales under the PPAs and $949 million in payments-in-lieu of tax.

Expenses

Total expenses for 2005–06 were $2,884 million, a decrease of $54 million from 2004–05. Expenses included interest payments on short- and long-term debt of $1,802 million, power purchases of $809 million and interest on the nuclear funding liability of $69 million.

Borrowing Program

In 2005–06, the OFA completed the OEFC's long-term public borrowing requirements of $1.7 billion. This amount includes the refinancing of $1.6 billion of long-term debt maturities. The 2005–06 borrowing requirements declined from $2,442 million estimated at the time of the 2005 Ontario Budget, due to a reduction in OPG financing requirements, an increase in planned short-term borrowing levels, a deferred call of $347 million in long-term debt maturities until 2006-07, and early repayment of a loan for the NUGs.

Long-term public borrowing was completed primarily in the Canadian domestic market. Two Euro Medium Term Notes were also issued, for a Canadian dollar equivalent of $171 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 2005–06, the cost of the borrowing program was $10 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, 2006, the OEFC's total debt and liabilities declined to $33.0 billion, of which total debt outstanding was $28.0 billion. This compares with total debt and liabilities of $34.2 billion, and total debt outstanding of $27.7 billion as at March 31, 2005.

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. As at March 31, 2006, the OEFC's unfunded liability was $19.3 billion, a decrease of $1.1 billion from March 31, 2005. This is the first time that the unfunded liability has declined below its initial level of $19.4 billion since the former Ontario Hydro was restructured on April 1, 1999.

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 *Electricity Act* also provides for a Debt Retirement Charge to be paid to the OEFC by consumers until the residual stranded debt is retired.

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

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 cumulative net incomes from OPG and Hydro One in excess of the Province's interest cost of its investment in these electricity subsidiaries.

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.

Foreign exchange and floating rate exposures remained within policy limits in 2005-06.

- Floating interest rate exposure was 9.6 per cent of total debt as at March 31, 2006, within the limit of 20 per cent.
- Foreign exchange exposure was 0 per cent of total debt as at March 31, 2006. The foreign exchange exposure limit for the OEFC is 5 per cent.

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 2005–06, the OEFC negotiated revisions to 14 NUG contracts to facilitate their integration into the competitive electricity market and reduce above-market costs, bringing the total revised contracts to 41 contracts.

The OEFC achieved efficiencies in managing the existing power purchase agreements (PPAs) with the non-utility generators (NUGs) in 2005–06. NUG costs were reduced by $1.1 million through auxiliary services revenue, incremental power transactions and other transactions which increase or shift the time of generation by a NUG under the contracts.

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 contracts is valued at $3,389 million as at March 31, 2006. The OEFC began receiving actual contract prices for power from ratepayers, effective January 1, 2005, and no longer incurs 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, 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 Decommissioning Segregated Fund in respect of its ONFA obligation. The commitment-in-lieu (CiL) carries an interest cost of 3.25 per cent plus the change in the Ontario Consumer Price Index (CPI). The OEFC made an additional payment of $600 million on March 31, 2005, bringing the funding to $1.8 billion, with a remaining CiL of $1.4 billion.

On September 28, 2005, a Real Return Bond was issued by the Province on behalf of the OEFC, with proceeds paid to the Decommissioning Fund. These replaced $709 million of the nuclear funding liability at a lower interest rate of two per cent plus Canada CPI, with expected annual savings to the OEFC of $9 million going forward. As of March 31, 2006, the OEFC had funded $2.5 billion and had a remaining CiL of $768 million. The OEFC intends to fund the remaining CiL no later than the end of fiscal 2006–07.

2006-07 Outlook

OEFC's activities in 2006-07 will focus on the following:

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

The OFA will continue to manage the debt and liabilities of the OEFC in a cost-effective manner, and within exposure policy limits reviewed and established by the Board of Directors. In addition, the OFA will complete the OEFC's 2006–07 long-term public borrowing requirements of $3.7 billion, of which $3.5 billion is for the refinancing of maturities, in a sound and prudent manner.

The OEFC also intends to discharge the remaining 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 continue to minimize costs to ratepayers, provide effective administration of the NUG contracts and continue to negotiate revisions to the remaining NUG contracts to ensure that these are consistent with the electricity sector as it develops.

Supporting government initiatives for the electricity sector.

On June 13, 2006, the Minister of Energy announced the Supply Mix Directives to the Ontario Power Authority and related initiatives. The OEFC will support, as required, the implementation of these and related government electricity policy initiatives.

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 26, 2006.

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
Chief Executive Officer and Vice-Chair

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, 2006 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, 2006 and the results of its operations and its cash flow for the year then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada
May 26, 2006

J.R. McCarter, CA
Auditor General

Box 105, 15th Floor
20 Dundas Street West
Toronto, Ontario
M5G 2C2
416-327-2381
fax 416-326-3812

B.P. 105, 15e étage
20, rue Dundas ouest
Toronto (Ontario)
M5G 2C2
416-327-2381
télécopieur 416-326-3812

www.auditor.on.ca

Ontario Electricity Financial Corporation

Statement of Financial Position
as at March 31, 2006
($ Millions)

	2006	2005
ASSETS		
Current Assets		
Cash and cash equivalents (Note 4)	$ 49	$ 138
Accounts receivable	287	523
Interest receivable	10	10
Current portion of notes receivable (Note 6)	700	300
	1,046	971
Payments-in-lieu of tax receivable (Note 11)	298	92
Due from Province of Ontario (Notes 5, 11)	351	351
Notes and loans receivable (Note 6)	11,734	12,074
Deferred debt costs	232	360
	$ 13,661	$ 13,848
LIABILITIES		
Current Liabilities		
Accounts payable	$ 238	$ 302
Due to electricity consumers (Note 12)	—	528
Interest payable	526	536
Short-term notes payable (Note 7)	1,479	1,146
Current portion of long-term debt (Note 7)	3,114	1,556
	5,357	4,068
Long-term debt (Note 7)	23,440	24,948
Power purchase contracts (Note 9)	3,389	3,785
Nuclear funding liability (Note 10)	768	1,410
	32,954	34,211
Contingencies and guarantees (Note 13)		
UNFUNDED LIABILITY (Notes 1, 3, 11)	(19,293)	(20,363)
	$ 13,661	$ 13,848

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, 2006
($ Millions)

	2006	2005
REVENUE		
Debt retirement charge (Notes 1, 11)	$ 1,021	$ 997
Payments-in-lieu of tax (Notes 1, 11)	949	511
Interest	737	741
Power sales (Note 9)	785	610
Net reduction of power purchase contracts (Note 9)	396	236
Recovery of prior year expenditures - ECPPF (Note 12)	56	20
Other	10	10
Total Revenue	3,954	3,125
EXPENSE		
Interest - short-term debt	35	48
- long-term debt	1,767	1,737
Interest on nuclear funding liability (Note 10)	69	93
Amortization of deferred charges	60	69
Power purchases (Note 9)	809	840
Debt guarantee fee	138	138
Operating	6	13
Total Expense	2,884	2,938
Excess of revenue over expense	1,070	187
Unfunded Liability, beginning of year	20,363	20,550
Unfunded Liability, end of year	$ 19,293	$ 20,363

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation
Statement of Cash Flow
for the Year Ended March 31, 2006
($ Millions)

	2006	2005
CASH FLOWS USED IN OPERATING ACTIVITIES		
Excess of revenue over expense	$ 1,070	$ 187
Adjustments for:		
Net reduction of power purchase contracts (Note 9)	(396)	(236)
Interest on nuclear funding liability (Note 10)	69	93
Amortization of deferred charges	60	69
Payments-in-lieu of tax receivable	(206)	156
Payment of ECPPF surplus to consumers	(505)	—
Other Items	105	198
Cash provided from operations	197	467
CASH FLOWS FROM FINANCING ACTIVITIES		
Long-term debt issues	1,701	3,741
Less long-term debt retired	1,556	3,498
Long-term debt issued, net	145	243
Short-term debt issued (retired), net	333	(31)
Payment towards nuclear funding liability (Note 10)	(709)	(600)
Notes receivable (advance) repayment	(55)	51
Cash required by financing activities	(286)	(337)
Increase (decrease) in cash and cash equivalents	(89)	130
Cash and cash equivalents, beginning of year	138	8
Cash and cash equivalents, end of year	$ 49	$ 138

Interest paid during the year and included in excess of revenue over expense	$ 1,812	$ 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 (PILs) 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, 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 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 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.

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. Consequently, no dedicated income transfer has been reflected in these financial statements (March 2005 - Nil). As at March 31, 2006, the Province's accumulated shortfall amounted to $327 million (2005 - $914 million).

6) Notes and Loans Receivable

($ millions)	Maturity date	Interest rate	Interest payable	March 31, 2006	March 31, 2005
Province of Ontario	2039-2041	5.85	Monthly	8,885	8,885
OPG	2006-2012	5.44 to 6.65	Semi-annually	3,395	3,295
IESO	2009	7.9	Semi-annually	78	78
				12,358	12,258
Less: Current portion of notes receivable				700	300
				11,658	11,958
Add: Loans receivable from non-utility generators (NUGs) (See Note 9)				76	116
				$ 11,734	**$ 12,074**

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 totaling $200 million have been further deferred until December 2006. In addition, OEFC had agreed with OPG to defer principal repayments totaling $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 $250 million due in March 2005 to March 2010, and to defer principal repayments of $250 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.

Under an agreement between OPG and OEFC dated April 28, 2005, OEFC agreed to provide up to $600 million in new loans to OPG to be advanced during the period ending March 31, 2006. As of March 31, 2006, OEFC had advanced $400 million to OPG in accordance with the agreement.

In addition, pursuant to agreements with OPG dated September and October 2005 respectively, OEFC agreed to provide loans up to $1 billion over five years in connection with the Niagara Tunnel project and $95 million as required in connection with the Thunder Bay project. As at March 31, 2006, no moneys had been advanced in connection with these two projects.

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

($ millions)

Fiscal Year	Amount
2006-07	700
2007-08	400
2008-09	375
2009-10	707
2010-11	625
2011-12	188
2012-13	400
Total	**$3,395**

7) Debt

Debt at March 31, 2006 is set out below by maturity and by currency of repayment, expressed in Canadian dollars.

($ millions) Currency	Canadian Dollar	U.S. Dollar	Other Foreign	2006 Total	2005 Total
Maturing in:					
1 year	3,706	887	—	4,593	2,702
2 years	528	1,314	—	1,842	3,114
3 years	3,496	387	—	3,883	1,913
4 years	2,130	—	139	2,269	3,884
5 years	1,050	—	53	1,103	1,769
1-5 years	10,910	2,588	192	13,690	13,382
6-10 years	4,748	1,605	425	6,778	7,470
11-15 years	1,130	—	—	1,130	484
16-20 years	3,687	—	—	3,687	3,273
21-25 years	1,191	—	—	1,191	2,191
26-50 years	1,557	—	—	1,557	850
Total	**$23,223**	**$4,193**	**$617**	**$28,033**	**$27,650**

The effective rate of interest on the debt portfolio was 6.47 per cent (March 2005 - 6.52 per cent) after considering the effect of derivative instruments used to manage interest rate risk. The longest term to maturity is to December 1, 2036. Total foreign currency denominated debt at March 31, 2006 was $4.8 billion (March 2005 - $5.2 billion), 100 per cent of which (March 2005 - $5.2 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, 2006			March 31, 2005		
($ millions)	Held by the Province	Guaranteed by the Province	Total	Held by the Province	Guaranteed by the Province	Total
Short term debt	1,479	—	1,479	1,146	—	1,146
Current portion of long term debt	3,114	—	3,114	1,056	500	1,556
Long term debt	13,146	10,294	23,440	14,608	10,340	24,948
Total	**$17,739**	**$10,294**	**$28,033**	**$16,810**	**$10,840**	**$27,650**

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, 2006 was $31.5 billion (March 2005 - $31.6 billion). This is higher than the book value of $28.0 billion (March 2005 - $27.7 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, net of foreign currency holding, to reach a maximum of 5 percent of total debt. At March 31, 2006, the actual unhedged level was 0.0 percent (March 2005 - 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, 2006, OEFC's floating rate debt as a percentage of total debt was 9.6 percent (March 2005 - 8.5 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, 2006 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, 2006 ($ millions)

Maturity in Fiscal Year	2007	2008	2009	2010	2011	6-10 Years	Over 10 Years	Total	March 2005
Cross-currency swaps	829	868	388	512	105	1,506	—	4,208	4,313
Interest rate swaps	2,282	1,169	988	1,110	—	3,225	653	9,427	11,682
Forward foreign exchange contracts	1,218	—	—	—	—	—	—	1,218	1,395
Other [1]	111	—	—	—	—	—	—	111	173
Total	**$4,440**	**$2,037**	**$1,376**	**$1,622**	**$105**	**$4,731**	**$653**	**$14,964**	**$17,563**

(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 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, 2006.

Credit Risk Exposure ($ millions)	March 31, 2006	March 31, 2005
Gross credit risk exposure[1]	$ 6,254	$ 6,797
Less: Netting[2]	(7,136)	(7,177)
Net credit risk exposure[3]	**$ (882)**	**$ (380)**

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 $20 million (March 2005 - $22 million) and the total exposure to counterparties with negative exposure (meaning that OEFC owed the counterparties) was $902 million (March 2005 - $402 million) for a total net credit exposure of $(882) million (March 2005 - ($380) 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. Exclusive of contracts with the Province, OEFC's most significant concentration of credit risk at March 31, 2006 was with one A+ rated counterparty which represented more than 10 per cent of the credit risk exposure. The net cost to OEFC, if it had to replace the contracts with this counterparty would be $5 million (March 2005 - $20 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. 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 operations over a ten-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 ended March 31, 2006, OEFC purchased power from NUGs in the amount of $809 million (2005 - $840 million) and sold power to the IESO and municipal electric utilities in the amount of $785 million (2005 - $610 million). The additional cost of $24 million this year was a result of the requirement to settle retroactive contract price increases which applied to the periods prior to OEFC beginning to fully recover the cost of power from consumers on January 1, 2005.

Loans receivable from NUGs decreased during the period by $40 million to $76 million (March 2005 - $116 million), primarily due to principal repayments.

Statement of Liability for Power Purchase Contracts ($ millions)		
As at March 31, 2006		
	2006	**2005**
Liability, beginning of period	$3,489	$3,683
Interest charged during the period*	—	163
Deduct estimated in-period loss	(354)	(357)
Sub-total	3,135	3,489
Add: Unamortized Revaluation Changes		
Gross Revaluation	422	422
Accumulated Amortization	(168)	(126)
	254	296
	$3,389	**$3,785**

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

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. Interest on the liability to the fund 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.

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, $600 million on March 31, 2005 and $709 million on October 4, 2005.

A commitment-in-lieu of $768 million as at March 31, 2006 (March 2005 - $1,410 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 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. A remaining estimated surplus of $528 million was reflected as a liability on the balance sheet as at March 31, 2005.

A final determination of the surplus for the interim pricing plan for the period April 1, 2004 to March 31, 2005, resulted in a payment of $505 million to the IESO on November 30, 2005 for distribution to eligible consumers. In addition, OEFC has recognized $56 million in revenue in 2005-06 relating to ECCPF recoveries for wholesale market service charge variances attributable to non-low volume and designated consumers and as a result of OEFC's on-going audit of claims from the Fund made by local distribution companies (March 2005 - $20 million).

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 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 $80 million at March 31, 2006 (2005 - $91 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:

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

Corporate Governance

Corporate governance at the OEFC 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 the Legislature for OEFC's fulfilment of its mandate. 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 OEFC Board including its Chair 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 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 OEFC's internal auditors 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 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 [Appointed from July 2005 to July 2008]
James R. Gillis	Deputy Minister of Energy [Appointed from October 2004 to October 2007]
Bruce Macnaughton	Director, Pension and Income Security Policy Branch, Ministry of Finance [Appointed from June 2005 to June 2008]
Robert Siddall	Chair, OEFC Audit Committee, Provincial Controller, Ministry of Finance [Appointed November 2002. Resigned from Ontario Public Service and OEFC Board, June, 2006]
Karen Sadlier-Brown	Assistant Deputy Minister, Corporate and Electricity Finance Division, Ontario Financing Authority [Appointed from July 2003 to July 2006]
Tom Sweeting	Assistant Deputy Minister, Office of the Budget and Taxation, Ministry of Finance [Appointed from April 2005 to May 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 capital market activities related to the OEFC.

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 - unhedged foreign currency exposure is limited to five per cent of outstanding debt. Foreign exchange exposures are limited to Group of Seven currencies and the Swiss franc or the equivalent currencies (e.g., the Euro).
- Floating Rate Exposure Limit - the floating rate exposure, net of liquid reserves, is limited to a maximum of 20 per cent of outstanding debt.
- Debt Cost Loss Limits - 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.

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 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 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.

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.

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
Ontario Power Authority	www.powerauthority.on.ca

Inquiries

For general information and additional copies of this annual report, please contact:

Investor Relations, Ontario Financing Authority

Telephone: (416) 325-8000

E-mail: investor@oefc.on.ca

Ontario Electricity Financial Corporation
1 Dundas Street West, Suite 1400
Toronto, Ontario
M7A 1Y7
Canada

Telephone: (416) 325-8000

investor@oefc.on.ca
www.oefc.on.ca

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