Ontario

Annual Report

OEFC

ONTARIO ELECTRICITY FINANCIAL CORPORATION

2012

Mandate

Ontario Electricity Financial Corporation (OEFC or the Corporation) is one of five entities established by the *Electricity Act, 1998* (the Act) as part of the restructuring of the former Ontario Hydro.

Under the Act, the former Ontario Hydro was restructured into Ontario Power Generation Inc. (OPG), Hydro One Inc. (Hydro One), the Independent Electricity System Operator (IESO), the Electrical Safety Authority (ESA) and OEFC.

In accordance with the Act, 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 contracts with non-utility generators (NUGs) ;
- receiving all payments and administering other assets, liabilities, rights and obligations of the Corporation that were not transferred to another of the former Ontario Hydro successor corporations and disposing of any of these items as it deems appropriate or as directed by the Minister of Finance;
- providing financial assistance to the successor corporations of Ontario Hydro;
- entering into financial and other agreements relating to the supply of electricity in Ontario; and
- performing any additional objects specified by the Lieutenant Governor in Council.

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 (the Province) responsible for provincial borrowing and debt management.

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Statement from the Chair and Chief Executive Officer

We are pleased to present OEFC's 2012 Annual Report, which describes the Corporation's operational highlights and financial results for the year ended March 31, 2012.

Revenue exceeded expense by $1.1 billion in 2011–12, reducing the Corporation's unfunded liability from $13.4 billion to $12.3 billion as at March 31, 2012.

The unfunded liability has declined for eight consecutive years. It is $7.1 billion less than the initial unfunded liability on April 1, 1999, when the former Ontario Hydro was restructured. Total debt and liabilities are $28.9 billion, down from the $38.1 billion inherited by the Corporation from the restructuring.

Over the past year, the OFA completed OEFC's long-term public borrowing requirement of $0.2 billion, primarily to refinance maturing debt.

Cost savings of $5.9 million were achieved through the management of the power purchase with NUGs.

Looking ahead to 2012–13, the 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.

Steve Orsini
Chair

Gadi Mayman
Vice-Chair and Chief Executive Officer

Management's Discussion and Analysis

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Management's Discussion and Analysis

2011–12 HIGHLIGHTS:

- Eighth consecutive annual decline in OEFC's unfunded liability
- Completed long-term public borrowing requirement of $0.2 billion
- Achieved cost-savings of $5.9 million by managing power purchase agreements

Financial Results

Revenue and Expense

Total revenue for 2011–12 was $4.3 billion, a decrease of $159 million from 2010–11. Revenue included $952 million from the Debt Retirement Charge (DRC); $1,372 million in power supply contract recoveries; $742 million in interest income from the Province, OPG and the IESO; and $367 million in payments-in-lieu (PIL) of taxes.

Total expense was $3.1 billion, an increase of $76 million from 2010–11. Expense included interest payments on short- and long-term debt of $1,592 million, and power supply contract costs of $1,375 million.

Overall, revenue exceeded expense by $1.1 billion. In 2010–11, revenue exceeded expense by $1.4 billion.

Borrowing Program

In 2011–12, the OFA completed the Corporation's long-term public borrowing requirement of $0.2 billion, most of which was for long-term debt maturities.

Long-term public borrowing was completed in the Canadian dollar market.

Debt and Liabilities

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

A portion of the $38.1 billion was supported by the value of the assets of Ontario Hydro successor companies, leaving $20.9 billion of stranded debt not supported by those assets. The initial unfunded liability of $19.4 billion was the stranded debt adjusted for $1.5 billion of additional assets.

As at March 31, 2012, total debt and liabilities were $28.9 billion, with total debt of $26.9 billion. These figures compare to total debt and liabilities of $29.3 billion, with total debt of $27.1 billion, as at March 31, 2011.

The unfunded liability was $12.3 billion as at March 31, 2012, a decrease of $1.1 billion from March 31, 2011. This is the eighth consecutive annual decline in the unfunded liability, $7.1 billion below the $19.4 billion level as at April 1, 1999.

Debt Repayment Plan

OEFC services and retires the debt and other liabilities of the former Ontario Hydro from the following revenue and cash flow sources in the electricity sector:

- Outstanding notes receivable from the Province, OPG and IESO
- PIL of corporate income, capital and property taxes and Gross Revenue Charges made by OPG, Hydro One and municipal electric utilities
- DRC 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 subsidiaries

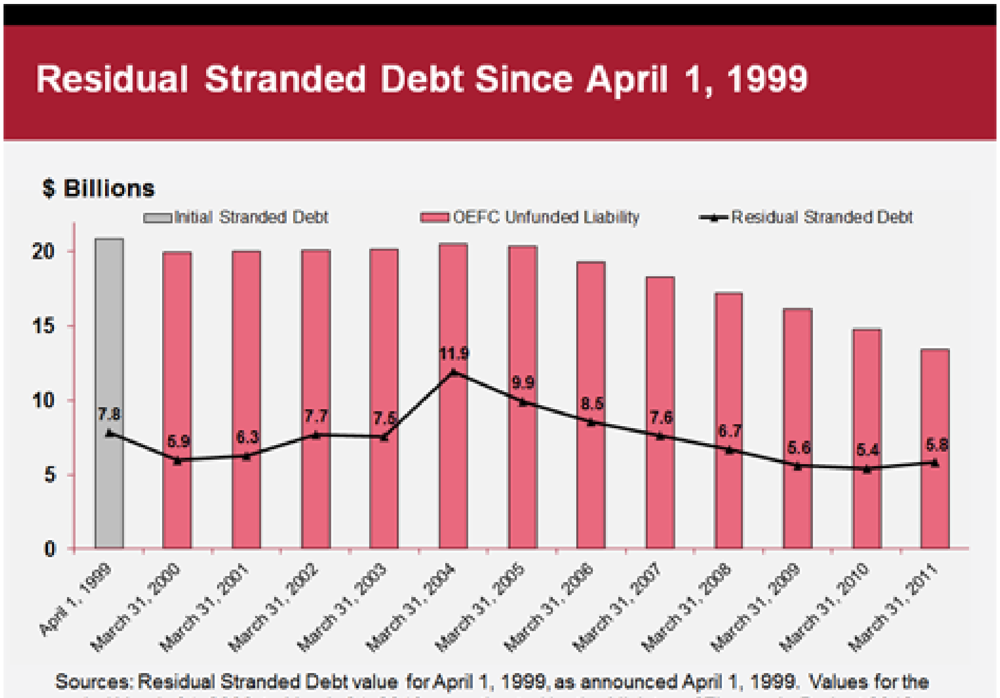
The Debt Retirement Charge and Retirement of Residual Stranded Debt

The *Electricity Act, 1998*, provides for the DRC to be paid by consumers until the residual stranded debt is retired.

On May 15, 2012, the government filed regulation 89/12 under the *Electricity Act, 1998*, with an accompanying news release, to provide transparency and meet reporting requirements on the outstanding amount of residual stranded debt.

In accordance with Ontario regulation 89/12, the Minister of Finance determined the residual stranded debt to be $5.8 billion as at March 31, 2011. This is a decrease of about $6.1 billion from an estimated peak of residual stranded debt of $11.9 billion as at March 31, 2004, based on estimates of residual stranded debt for prior years provided by the Ministry of Finance. Under the regulation, the Minister of Finance is to provide a determination of residual stranded debt as of the March 31 end of each fiscal year, following the submission to the Minister of Finance of OEFC's Annual Report.

Retirement of residual stranded debt is projected to occur when the stranded debt is fully offset by the present value of projected future PIL of taxes, Gross Revenue Charge (GRC) and electricity sector dedicated income to be paid to OEFC.



Sources: Residual Stranded Debt value for April 1, 1999, as announced April 1, 1999. Values for the period March 31, 2000, to March 31, 2010, as estimated by the Ministry of Finance in Budget 2012, and for March 31, 2011, as determined by the Minister of Finance in accordance with a regulation made under the Electricity Act, 1998.
Unfunded Liability amounts are from OEFC Annual Reports from 1999-00 to 2011.

Risk Management

OEFC's risk management policies and procedures are designed to manage risk exposures associated with the Corporation's debt, derivatives and related capital market transactions.

Foreign exchange and net interest rate resetting exposures remained within policy limits in 2011–12.

- Foreign exchange exposure remained at 0.0 per cent of outstanding debt as at March 31, 2012. The foreign exchange exposure limit for OEFC is 5 per cent.
- Net interest rate resetting exposure was 13.2 per cent of outstanding debt as at March 31, 2012, within the limit of 35 per cent.

Other Responsibilities

Management of Power Supply Contracts

Efficiencies were achieved in managing the existing power purchase agreements with the NUGs in 2011–12. Purchase costs dropped by $5.9 million, compared to a $3.0 million drop in 2010–11, through curtailments and other transactions that shift the time of electricity generation under the contracts.

Previously, the Corporation purchased power from the NUGs under contractual 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 most of the liability would be eliminated over 12 years as existing contracts expire. The liability for power purchase agreements was valued at $1.2 billion as at March 31, 2012, compared to $1.5 billion as at March 31, 2011.

OEFC continued to monitor and implement a contingency support agreement between OEFC and OPG to provide for the continued reliability and availability of the Lambton and Nanticoke coal-fired stations. Any OEFC net costs under this agreement are to be recovered from electricity consumers. The contingency support agreement was effective as of January 1, 2009, when OPG implemented a strategy to reduce greenhouse gas emissions from its coal-fired stations, as directed by the Province.

Supporting New Electricity Supply Projects

Beginning in 2005, the Corporation began to provide financing on commercial terms to OPG for new electricity supply projects.

For instance, OEFC is providing financing under a loan agreement with OPG for the Niagara Tunnel Project, which will increase electricity generated by the Sir Adam Beck hydro complex in Niagara Falls. OEFC has also agreed to provide financing to OPG for a portion of its investment in the Lower Mattagami project, which will increase the generating capacity of four hydroelectric units in northern Ontario.

These projects, and completed OPG supply projects financed by OEFC for the Portlands Energy Centre and Lac Seul, help Ontario build a clean, modern and reliable electricity system, which is consistent with the government's Long-Term Energy Plan and its direction to the Ontario Power Authority (OPA) to replace coal-fired generation and to continue to expand Ontario's capacity from clean, renewable energy sources.

2012–13 Outlook

The OEFC will focus on the following:

Managing debt and other liabilities cost-effectively

The OFA will continue to manage OEFC's debt and other liabilities in a cost-effective manner. In addition, the OFA will complete OEFC's forecasted 2012–13 long-term public borrowing requirement of $2.1 billion, mostly to refinance debt maturities.

Managing financial risk within approved policy limits

The debt portfolio will be managed within exposure limits approved by OEFC's Board of Directors (the Board) for 2012–13.

Administering NUG and Lambton and Nanticoke contracts

The Corporation will continue to minimize costs to ratepayers through effective administration of the NUG contracts, and continue to monitor the Lambton and Nanticoke contingent support agreement.

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 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 will monitor and analyze their impact on the Corporation.

Financial Statements

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- Statement of Revenue, Expense and Unfunded Liability
- Statement of Cash Flow
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Responsibility for Financial Reporting

The accompanying financial statements of OEFC have been prepared in accordance with Canadian public sector accounting standards and are management's responsibility. 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 21, 2012.

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.

The Board is responsible for ensuring management fulfills its responsibilities for financial reporting and internal controls. The Audit Committee assists the Board in carrying out these responsibilities. The Audit Committee periodically meets with management, the internal auditors and the external auditors to deal with issues raised by them, and to review the financial statements before recommending Board approval.

The financial statements have been audited by the Auditor General of Ontario (the Auditor). The Auditor's responsibility is to express an opinion on whether OEFC's financial statements fairly present OEFC's financial position in accordance with Canadian public sector accounting standards. 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
Vice-Chair and Chief Executive Officer

Auditor's Report

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

Independent Auditor's Report

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

I have audited the accompanying financial statements of the Ontario Electricity Financial Corporation, which comprises the statement of financial position as at March 31, 2012, and the statements of revenue, expense and unfunded liability and cash flow for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian public sector accounting standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Ontario Electricity Financial Corporation as at March 31, 2012 and the results of its operations, and its cash flow for the year then ended in accordance with Canadian public sector accounting standards.

Toronto, Canada
June 21, 2012

Jim McCarter, FCA
Auditor General
Licensed Public Accountant

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Ontario Electricity Financial Corporation

Statement of Financial Position

As at March 31, 2012 ($ millions)

	2012	2011
ASSETS		
Current Assets		
Cash and cash equivalents (Note 4)	$ 118	$ 1
Accounts receivable	366	460
Interest receivable	29	26
Current portion of notes receivable (Note 6)	235	188
	748	675
Payments-in-lieu of tax receivable (Note 10)	227	142
Due from Province of Ontario (Note 5)	2,750	2,255
Notes and loans receivable (Note 6)	12,882	12,743
Deferred debt costs	—	35
	$ 16,607	$ 15,850
LIABILITIES		
Current Liabilities		
Accounts payable	$ 295	$ 215
Interest payable	474	430
Short-term debt (Note 7)	1,181	1,174
Current portion of long-term debt (Note 7)	1,683	547
	3,633	2,366
Long-term debt (Note 7)	24,056	25,413
Power purchase contracts (Note 9)	1,202	1,519
Deferred debt costs	37	—
	28,928	29,298
Contingencies and guarantees (Note 11)		
UNFUNDED LIABILITY (Notes 1, 3, 10)	(12,321)	(13,448)
	$ 16,607	$ 15,850

Approved on behalf of the Board:

Steve Orsini
Chair

Gadi Mayman
Vice-Chair and Chief Executive Officer

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation

Statement of Revenue, Expense and Unfunded Liability

For the year ended March 31, 2012 ($ millions)

	2012	2011
REVENUE		
Debt retirement charge (Notes 1, 10)	$ 952	$ 944
Payments-in-lieu of tax (Notes 1, 10)	367	321
Interest	742	742
Power supply contract recoveries (Note 9)	1,372	1,288
Net reduction of power purchase contracts (Note 9)	317	339
Electricity sector dedicated income (Notes 5, 10)	495	771
Other	9	8
Total Revenue	$ 4,254	$ 4,413
EXPENSE		
Interest - short-term debt	$ 13	$ 13
- long-term debt	1,579	1,581
Amortization of deferred charges	18	26
Power supply contract costs (Note 9)	1,375	1,288
Debt guarantee fee	136	137
Operating	6	6
Total Expense	3,127	3,051
Excess of revenue over expense	1,127	1,362
Unfunded liability, beginning of year	13,448	14,810
Unfunded Liability, end of year	$ 12,321	$ 13,448

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation

Statement of Cash Flow

For the year ended March 31, 2012 ($ millions)

	2012	2011
CASH FLOWS USED IN OPERATING ACTIVITIES		
Excess of revenue over expense	$ 1,127	$ 1,362
Adjustments for:		
Payments-in-lieu of tax (Notes 1, 10)	(85)	241
Net reduction of power purchase contracts (Note 9)	(317)	(339)
Electricity sector dedicated income (Notes 5, 10)	(495)	(771)
Amortization of deferred charges	18	26
Other Items	356	(129)
Cash provided from operations	$ 604	$ 390
CASH FLOWS FROM FINANCING ACTIVITIES		
Long-term debt issues	$ 236	$ 1,028
Less long-term debt retired	547	1,253
Long-term debt (retired), net	(311)	(225)
Short-term debt issued (retired), net	7	(27)
Notes receivable advance	(183)	(145)
Cash (required by) financing activities	(487)	(397)
Increase (decrease) in cash and cash equivalents	117	(7)
Cash and cash equivalents, beginning of year	1	8
Cash and cash equivalents, end of year	$ 118	$ 1
Interest on debt paid during the year and included in excess of revenue over expense	$ 1,548	$ 1,610

See accompanying notes to financial statements.

Notes to Financial Statements

1) Electricity Sector Reform

Effective April 1, 1999, pursuant to the *Electricity Act, 1998* (the Act), 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 whose objects include managing the former Ontario Hydro's non-utility generator (NUG) contracts; providing financial assistance to the successor corporations of Ontario Hydro; entering into financial and other agreements relating to the supply of electricity in Ontario; and managing the debt and administering the assets, liabilities, rights and obligations of Ontario Hydro not transferred to other successor entities.

These other successor entities include:

- Ontario Power Generation (OPG), an electricity generation company;
- Hydro One, a regulated electricity transmission and distribution company;
- 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 of Ontario (the Province) exchanged equity of $5.1 billion and $3.8 billion in OPG and Hydro One respectively for debt payable to OEFC.

The opening stranded debt of $20.9 billion at April 1, 1999 was composed of $38.1 billion in liabilities assumed from the former Ontario Hydro less the value of assets transferred to OEFC at April 1, 1999, including $17.2 billion in notes receivable. After receipt of $1.5 billion in loans receivable and other assets, the opening unfunded liability stood at $19.4 billion. As at April 1, 1999, the present value of future payments-in-lieu (PIL) 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 OEFC debt, liabilities and associated financing costs will be repaid from interest on notes receivable from the Province and successor entities, and from dedicated electricity revenues in the form of PIL of corporate income, capital and property taxes made under the Act by the successor entities and municipal electric utilities. OEFC also receives the Debt Retirement Charge (DRC) paid by electricity consumers at a rate of 0.7 cents/kWh until the residual stranded debt is retired. The Ontario Financing Authority (OFA), an agency of the Province 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, electricity from those generators with existing or new contracts receive prices as determined by their contracts, while other generation receives prices set in the electricity spot market. Consumers pay a blend of these costs including the pass-through of regulated prices for OPG's 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 (OPA) 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 Canadian public sector accounting standards.

Net Debt Presentation

The statement of changes in net debt is not presented since this information is readily apparent.

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 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 payments-in-lieu of tax revenue and tax receivable. Estimates are based on the best information available at the time of preparation of the financial statements.

Deferred Debt Costs

Deferred Debt Costs include the unamortized amounts related to any foreign exchange gains or losses resulting from the translation of long-term debt issued in foreign currencies; discounts, premiums or commissions arising from the issuance of debt or the acquisition of debt prior to maturity; and fees and other costs relating to swaps and other debt related derivatives. 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 year-end rates of exchange and, in accordance with Canadian public sector accounting standards, 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 electricity consumers, effective January 1, 2005, and no longer incurs 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.

Future Change in Accounting Policies

Effective April 1, 2012, OEFC will be required to adopt new accounting standards issued by the Public Sector Accounting Board of the CICA. Changes due to the new standards, Section 2601, Foreign Currency Translation and Section 3450, Financial Instruments will be applied prospectively.

3) Going Concern

OEFC is dependent on the Province to borrow funds to finance maturing debt and to cover any cash shortfalls in the Corporation, and on OPG repaying its outstanding notes receivable. It is also dependent on the government's long-term plan to defease the unfunded liability described in Note 10.

4) Cash and Cash Equivalents

Cash and cash equivalents includes cash on deposit and highly liquid investments recorded at cost, which approximates current market value.

5) Due from the Province

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. For the year ended March 31, 2012, OPG and Hydro One earned an aggregate amount of $1,015 million (2011 – $ 1,291 million). After deducting the Province's $520 million interest cost of its investment in these subsidiaries, there remains an amount of electricity sector dedicated income of $495 million (2011 – $771 million).

6) Notes and Loans Receivable

($ millions)	Maturity Date	Interest Rate	Interest Payable	March 31, 2012	March 31, 2011
The Province	2039-2041	5.85	Monthly	$ 8,885	$ 8,885
OPG	2012-2042	3.24 to 6.63	Semi-annually	4,015	3,868
IESO	2013	Variable/2.25	Monthly/Semi-Annually	113	78
				13,013	12,831
Less: Current portion of notes receivable				235	188
				12,778	12,643
Add: Loans receivable from NUGs				104	100
				$ 12,882	**$ 12,743**

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

OEFC has agreed to provide OPG financing for new generation project development in the form of 10-year and 30-year notes on commercial terms and conditions. These agreements provide for up to $1.6 billion in loans for the Niagara tunnel project and up to $700 million in support of OPG's investment in the Lower Mattagami project. Under these agreements, $915 million has been advanced for the Niagara Tunnel project and there are no outstanding borrowings for the Lower Mattagami project.

OEFC agreed to provide to OPG a $375 million line of credit to finance existing maturities, expiring on December 31, 2011. Under this agreement, $300 million was advanced.

Subsequent to the year-end, OEFC agreed to provide to OPG a refinancing facility for up to $400 million to finance notes maturing with OEFC on April 30, 2012. Under this agreement, $200 million has been advanced.

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

Fiscal Year	Amount ($ millions)
2012-13	200
2014-15	300
2015-16	200
2016-17	320
2017-18	1,125
2018-19	260
2019-20	505
2020-21	420
2021-22	185
2040-41	150
2041-42	350
Total	**$4,015**

In May 2011, OEFC refinanced a loan to the IESO for $78.2 million for a term of 2 years.

In October 2011, OEFC increased its revolving credit facility to the IESO from $60 million to $110 million. The credit facility, expiring on May 1, 2013, bears interest at a floating rate equal to the Province's cost of borrowing for a 30 day term plus 25 basis points for advances up to $60 million and an additional 25 basis points for advances in excess of $60 million. The facility will be used for liquidity purposes and to temporarily fund corporate requirements. At March 31, 2012, IESO had drawn $35 million on the credit facility.

Loans receivable from NUGs increased during the year by $4 million to $104 million (2011 – $100 million), primarily due to interest, which has been added to the principal balance.

7) Debt

Debt at March 31, 2012, is set out below by maturity and by currency of repayment, expressed in Canadian dollars.

($ millions) Currency	Canadian Dollars	U.S. Dollars	Other Foreign	2012 Total	2011 Total
Maturing in:					
1 year	$ 1,981	$ 765	$ 118	$ 2,864	$ 1,721
2 years	3,514	1,032	370	4,916	2,660
3 years	2,133	553	—	2,686	3,904
4 years	1,950	—	83	2,033	2,686
5 years	2,493	—	487	2,980	2,033
1-5 years	12,071	2,350	1,058	15,479	13,004
6-10 years	5,451	73	339	5,863	6,983
11-15 years	2,967	—	—	2,967	3,687
16-20 years	1,041	—	—	1,041	1,191
21-25 years	788	—	—	788	850
26-50 years	782	—	—	782	1,419
Total	**$23,100**	**$2,423**	**$1,397**	**$26,920**	**$27,134**

The effective rate of interest on the debt portfolio was 5.86 per cent after considering the effect of derivative instruments used to manage interest rate risk (2011 – 5.87 per cent). The longest term to maturity is to June 2, 2041. Total foreign currency denominated debt at March 31, 2012 was $3.8 billion, 100 per cent of which was fully hedged to Canadian funds (2011 – $3.8 billion or 100 per cent). Bonds and notes payable are either held, or guaranteed as to principal and interest, by the Province as set out below:

Debt	March 31, 2012			March 31, 2011		
($ millions)	**Held by the Province**	**Guaranteed by the Province**	**Total**	**Held by the Province**	**Guaranteed by the Province**	**Total**
Short-term debt	$ 1,181	—	$ 1,181	$ 1,174	—	$ 1,174
Current portion of long-term debt	1,683	—	1,683	547	—	547
Long-term debt	16,122	$7,934	24,056	17,479	$7,934	25,413
Total	**$18,986**	**$7,934**	**$26,920**	**$19,200**	**$7,934**	**$27,134**

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

The estimated fair value of OEFC debt at March 31, 2012 was $32.2 billion (2011 – $31.2 billion). This is higher than the book value of $26.9 billion (2011 – $27.1 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 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, derivative contracts are used 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, 2012, the actual unhedged level was 0.0 per cent of total debt (2011 – 0.0 per cent).

Net interest rate resetting risk is the exposure to changes in interest rates. Exposure to rate changes is reduced 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, 2012, net interest rate resetting risk as a percentage of total debt was 13.2 per cent (2011 – 13.7 per cent).

Liquidity risk is the risk 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 funds to finance maturing debt and to cover any cash shortfalls in the Corporation, and on OPG repaying its outstanding notes receivable.

The table below presents a maturity schedule of OEFC's derivatives, by type, outstanding at March 31, 2012, 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, 2012 ($ millions)

Maturity in years Fiscal Year	2013	2014	2015	2016	2017	6-10 Years	Over 10 Years	Total	March 2011
Cross-currency swaps	$ 978	$ 1,786	$ 553	$ 83	$ 693	$ 529	—	$ 4,622	$ 4,868
Interest rate swaps	398	1,145	2,049	216	1,123	650	$ 653	6,594	5,871
Forward foreign exchange contracts	791	—	—	—	—	—	—	791	147
Total	**$ 2,167**	**$ 2,931**	**$ 2,962**	**$ 299**	**$ 1,816**	**$ 1,179**	**$ 653**	**$12,007**	**$10,886**

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, 2012.

Credit Risk Exposure ($ millions)	**March 31, 2012**	**March 31, 2011**
Gross credit risk exposure	$ 440	$ 472
Less: Netting	(440)	(472)
Net credit risk exposure	**$ 0**	**$ 0**

OEFC manages its credit risk exposure from derivatives by, among other ways, dealing only with high credit quality counterparties and regularly monitoring compliance to credit limits. In addition, OEFC enters into contractual agreements ("master agreements") that provide for termination netting and, if applicable, payment netting with most of its counterparties. Gross credit risk exposure represents the loss OEFC would incur if every counterparty to which OEFC had credit risk exposure were to default at the same time, and the contracted netting provisions were not exercised or could not be enforced. Net credit risk exposure is the loss including the mitigating impact of these netting provisions.

9) Power Supply Contracts

Power supply contracts include both power purchase contracts and power supply support agreements. Power purchase contracts and related loan agreements were entered into by the former Ontario Hydro with NUGs located in Ontario. As the legal continuation of the former Ontario Hydro, OEFC is the counterparty to these contracts. The contracts, expiring on various dates to 2048, provide for the purchase of power at prices in excess of future market price. Accordingly, a liability was recorded at $4,286 million on a discounted cash-flow (DCF) basis when the former Ontario Hydro was continued as OEFC on April 1, 1999.

Under legislated reforms to the electricity market, OEFC began receiving actual contract prices for power from ratepayers effective January 1, 2005, and no longer incurs losses on these contracts. At that time, the Ministry of Finance estimated the bulk of the liability to be eliminated over 12 years as existing electricity contracts expire. As a result, the Corporation is amortizing the liability to revenue over that period.

In addition, effective January 1, 2009, OEFC entered into a support contract with OPG whereby OPG agreed to maintain the reliability and availability of Lambton and Nanticoke coal-fired stations following implementation of a greenhouse gas emissions-reduction strategy. Under the contract, OEFC agreed to ensure OPG would recover the actual costs of operating the stations after implementing this strategy. Any costs to OEFC under this agreement, which expires December 31, 2014, are fully recovered from ratepayers.

During the year ended March 31, 2012, OEFC's costs under power supply contracts totalled $1,375 million, including purchases of power from NUGs of $1,020 million (2011 – $1,021 million) and OPG support contract costs of $355 million (2011 – $267 million).

Statement of Liability for Power Purchase Contracts ($ millions)

As at March 31, 2012

	2012	**2011**
Liability, beginning of year	$ 1,519	$ 1,858
Amortization	(317)	(339)
Liability, end of year	**$ 1,202**	**$ 1,519**

10) Unfunded Liability

Pursuant to the Act and consistent with the principles of electricity restructuring, the government has a long-term plan to defease the unfunded liability from the electricity sector. The plan includes cash flows from the following sources:

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 at April 1, 1999 as a result of the transfer of assets to successor companies;

PIL of corporate income, capital and property taxes made by OPG, Hydro One and municipal electric utilities;

DRC 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 help retire OEFC's debt.

11) 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. For some of these claims, OPG or Hydro One is required to indemnify OEFC for any liability arising from the claim. For claims on which OEFC is provided no indemnification and where the outcome and ultimate disposition of these legal actions is not determinable at this time, the settlements, if any, will be reflected in the period in which settlement occurs.

Subject to a $10 million deductible, 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 has guaranteed any liability arising from these indemnifications. A similar indemnity provided to OPG was terminated as of 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 $20 million at March 31, 2012 (2011 – $28 million).

12) Related Party Transactions

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

a) Province of Ontario
b) Ontario Power Generation Inc.
c) Hydro One Inc.
d) Independent Electricity System Operator
e) Ontario Financing Authority

Corporate Governance

- Overview
- Board of Directors
- Risk Management Policies and Procedures

Corporate Governance

Overview

OEFC is an agent of the Crown and is classified by Management Board of Cabinet as an operational enterprise agency.

Corporate governance at OEFC involves processes that permit the effective supervision and management of activities by senior management, the Board, its Audit Committee and the Minister of Finance (the Minister). It includes identifying individuals and groups responsible for the Corporation's activities and specifying their roles.

Accountability and Responsibilities

The OEFC's accountability structure flows from its governing statute, the Act. The Minister is responsible for the administration of the Act in respect of OEFC. The Act together with directives issued by Management Board of Cabinet, or the Minister of Finance, form a framework under which OEFC is governed.

Each year, the Minister is required to submit the OEFC Annual Report to the Lieutenant Governor in Council and then table the Annual Report in the Legislature. In addition, the Minister reviews and approves OEFC's annual business plan. The Minister also maintains communications with OEFC through the Chair of the Board (the Chair) regarding government policies and expectations relevant to OEFC.

The Chair is accountable to the Minister for the performance of OEFC in fulfilling its mandate. The current Chair is also the Deputy Minister of Finance. The Chair is responsible for providing advice and information to the Minister with regard to the operation and affairs of OEFC. In addition, the Chair provides leadership and direction to the Board and the Chief Executive Officer (CEO) and ensures OEFC complies with applicable government policies and directives. As Deputy Minister of Finance, the Chair ensures organizational capacity in the Ministry to monitor OEFC, and that it manages its risks appropriately.

The Board is appointed by the Lieutenant Governor in Council and is accountable to the Minister, through the Chair. The OEFC Board performs a supervisory role. It oversees the management of OEFC and helps to ensure the OEFC's mandate, as determined by the Province, is implemented effectively. The current Board is largely comprised of public servants employed by the Crown. The Board meets at least quarterly and receives regular reports from the CEO and staff of the OFA concerning the operations of OEFC and its compliance with applicable laws and policies. Another function of the Board is the review of the Corporation's major risks and mitigation strategies. Standards of conduct for Board members are set out in a Board-approved Code of Conduct.

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 internal controls. It also reviews financial policies and financial statements and recommends them to the Board.

The CEO is appointed by the Lieutenant Governor in Council on the recommendation of the Minister. The CEO is accountable to the Board, including the Chair, for the day-to-day management of OEFC and for the performance of any other functions assigned by the Board. In addition, the CEO ensures OEFC's policies and procedures remain relevant and effective.

The Corporation does not have employees, although some OFA employees are designated as officers for executing agreements and other documents on the Corporation's behalf. The OFA carries out the Corporation's day-to-day operations under the supervision of the CEO and the Board and pursuant to a Services Agreement between the OFA and OEFC. In addition, the Tax and Benefits Administration Program of the Ministry of Finance collects certain payments on behalf of OEFC.

Financial Reporting

OEFC prepares annual financial statements in accordance with the recommendations of the PSAB of the Canadian Institute of Chartered Accountants. The financial statements are reviewed and recommended by the Audit Committee and approved by 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 accounting principles recommended for governments by the Canadian Institute of Chartered Accountants. The findings are reviewed by the Audit Committee and the Board. These audited financial statements are tabled in the Ontario Legislature as part of the Annual Report and are included as a schedule to the Public Accounts of the Province.

Internal Controls

Management is responsible for establishing and maintaining internal controls to provide reasonable assurance regarding the reliability of financial reporting and to safeguard OEFC's assets and manage its liabilities.

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

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

As part of its annual business plan, 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. The Internal Audit Division reports to the OEFC Audit Committee on the results of their audit work in OEFC.

Board of Directors

Steve Orsini	Chair and Deputy Minister of Finance Date of Initial Appointment to OEFC Board of Directors: December 2011 Current term expires: December 2014
Gadi Mayman	Vice-Chair and Chief Executive Officer Date of initial appointment to OEFC Board of Directors: August, 2000 Current term expires: July 2014
Bruce L. Bennett	Chair, Audit Committee (Former Assistant Deputy Minister, Provincial Controller, Ministry of Finance) Date of initial appointment to OEFC Board of Directors: August 2006 Current term expires: July 2012
Serge Imbrogno	Deputy Minister of Energy Date of initial appointment to OEFC Board of Directors: April 2008 Current term expires: April 2014
John Lieou	Assistant Deputy Minister, Policy and Planning Division, Ministry of Transportation Date of initial appointment to OEFC Board of Directors: June 2010 Current term expires: June 2013
David Lindsay	Deputy Minister, Ministry of Energy Date of initial appointment to OEFC Board of Directors: July 2010 Current term expires: July 2013
Mahmood Nanji	Associate Deputy Minister, Tax and Benefits Administration, Ministry of Finance Date of initial appointment to OEFC Board of Directors: August 2006 Current term expires: August 2012
Nancy Naylor	Assistant Deputy Minister, Postsecondary Education Division, Ministry of Training, Colleges and Universities Audit Committee Member Date of initial appointment to OEFC Board of Directors: August 2006 Current term expires: July 2012
Bohodar Rubashewsky	Assistant Deputy Minister, Family Responsibility Office, Ministry of Community and Social Services Audit Committee Member Date of initial appointment to OEFC Board of Directors: August 2006 Current term expires: August 2014

Total Annual Remuneration paid to the Board of Directors for 2011-12: $1,000

Directors whose term ended during or after 2011–12

Peter Wallace, Chair, OEFC Board of Directors
Appointment expired: December 2011, upon ceasing to be the Deputy Minister of Finance

David Lindsay, OEFC Board of Directors
Appointment expired: April 2012, upon his retirement from the Ontario Public Service

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 and 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 OFA's capital market activities related to OEFC.

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 5 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 Trigger Level** — this is an aggregate loss trigger level covering both the Province and OEFC to prevent a potentially large loss resulting from capital market transactions.

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 OEFC. The minimum credit rating of a new counterparty for swap transactions is AA- and R1-mid, A-1 or P-1 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 and Financial Instruments

Use of derivatives and other financial instruments is restricted to those that the OFA can price and whose risk exposures can be measured by the OFA. Derivatives are used to manage exposures arising from the borrowing and debt management programs in a sound and efficient manner. 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. The OFA manages operational risk relating to OEFC 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 OEFC's operations), which is regularly updated to facilitate the continuation of essential operational functions with minimal disruption in the event of an emergency.

Policy on Risk Management Reporting

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

- The CEO of OEFC provides the Board with a progress report on its borrowing activities and other 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 informed of the Corporation's risk exposures and positions on a daily basis so it can direct appropriate actions on behalf of OEFC.

Additional Sources of Information

Internet

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.mei.gov.on.ca
Ontario Power Generation Inc.	www.opg.com
Hydro One Inc.	www.hydroone.com
Independent Electricity System Operator	www.ieso.com
Electrical Safety Authority	www.esasafe.com
Ontario Power Authority	www.powerauthority.on.ca

Inquiries

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