



MINISTRY OF FINANCE

**Public  
Accounts  
of  
ONTARIO**

**2007–2008**

FINANCIAL STATEMENTS OF  
CROWN CORPORATIONS,  
BOARDS AND COMMISSIONS

Volume **2b**



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BOARDS AND COMMISSIONS

Volume **2b**



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**RESPONSIBLE MINISTRY FOR GOVERNMENT BUSINESS ENTERPRISES,  
ORGANIZATIONS, TRUSTS & MISCELLANEOUS FINANCIAL STATEMENTS**

Ministry of Agriculture, Food and Rural Affairs  
    AgriCorp  
    Agricultural Research Institute of Ontario

Ministry of Attorney General  
    Legal Aid Ontario  
    The Public Guardian and Trustee for the Province of Ontario

Ministry of Culture  
    The Centennial Centre of Science and Technology  
    Ontario Trillium Foundation  
    Royal Ontario Museum

Ministry of Economic Development and Trade  
    Ontario Immigrant Investor Corporation

Ministry of Education  
    Education Quality and Accountability Office  
    Ontario Educational Communications Authority (TVO)

Ministry of Energy  
    Hydro One Inc.  
    Independent Electricity System Operator  
    Ontario Energy Board  
    Ontario Power Authority  
    Ontario Power Generation Inc.

Ministry of Environment  
    Ontario Clean Water Agency

Ministry of Finance  
    Deposit Insurance Corporation of Ontario  
    Losses deleted from the accounts  
    Motor Vehicle Accident Claims Fund  
    Ontario Electricity Financial Corporation  
    Ontario Financing Authority  
    Ontario Securities Commission  
    Pension Benefits Guarantee Fund  
    Provincial Judges Pension Fund  
    Revenue remissions

Ministry of Government Services  
    Ontario Pension Board  
    Ontario Racing Commission

Ministry of Health and Long-Term Care  
    Cancer Care Ontario  
    Local Health Integration Network – Central  
    Local Health Integration Network – Central East  
    Local Health Integration Network – Central West  
    Local Health Integration Network – Champlain  
    Local Health Integration Network – Erie St. Clair  
    Local Health Integration Network – Hamilton Niagara Haldimand Brant  
    Local Health Integration Network – Mississauga Halton  
    Local Health Integration Network – North East  
    Local Health Integration Network – North Simcoe Muskoka  
    Local Health Integration Network – North West  
    Local Health Integration Network – South East  
    Local Health Integration Network – South West  
    Local Health Integration Network – Toronto Central  
    Local Health Integration Network – Waterloo Wellington  
    Ornge  
    Smart Systems for Health Agency

**RESPONSIBLE MINISTRY FOR GOVERNMENT BUSINESS ENTERPRISES,  
ORGANIZATIONS, TRUSTS & MISCELLANEOUS FINANCIAL STATEMENTS**

Ministry of Labour  
    Workplace Safety and Insurance Board  
Ministry of Municipal Affairs and Housing  
    Ontario Mortgage and Housing Corporation  
Ministry of Natural Resources  
    Algonquin Forestry Authority  
Ministry of Northern Development and Mines  
    Northern Ontario Heritage Fund Corporation  
    Ontario Northland Transportation Commission  
Ministry of Public Infrastructure Renewal  
    Infrastructure Ontario  
    Liquor Control Board of Ontario  
    Ontario Lottery and Gaming Corporation  
    Ontario Realty Corporation  
    Toronto Waterfront Revitalization Corporation  
Ministry of Tourism  
    Metropolitan Toronto Convention Centre Corporation  
    Niagara Parks Commission  
    Ontario Place Corporation  
    Ontario Tourism Marketing Partnership Corporation  
Ministry of Transportation  
    Greater Toronto Transit Authority  
    Toronto Area Transit Operating Authority

## A GUIDE TO PUBLIC ACCOUNTS

### 1. SCOPE OF THE PUBLIC ACCOUNTS

The 2007-2008 Public Accounts of the Province of Ontario comprise the **Annual Report and Consolidated Financial Statements** and three volumes:

**Volume 1** contains the ministry statements for expenses, assets, revenue, detailed debt and other supplementary schedules. It provides a comparison of appropriations with actual spending.

**Volume 2** contains the financial statements of significant provincial corporations, boards and commissions that are part of the government's reporting entity and other miscellaneous financial statements.

**Volume 3** contains detailed schedules of payments made by ministries to vendors and transfer payment recipients.

### 2. A GUIDE TO VOLUME 2 OF THE PUBLIC ACCOUNTS

The financial statements of the selected crown corporations, boards and commissions are for fiscal periods ending within the Province's own fiscal period April 1, 2007 to March 31, 2008. They are presented in the same detail as the approved, audited financial statements and as nearly as possible in the same form. The statements have been presented in the order shown in the Table of Contents. In addition, a listing is provided which groups the crown corporations, boards and commissions by ministerial responsibility.





# **GOVERNMENT BUSINESS ENTERPRISES**



# Algonquin Forestry Authority

Year ended March 31, 2008

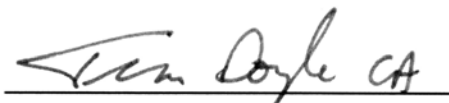
## Management's Responsibility for Financial Information

Management and the Board of Directors of the Algonquin Forestry Authority are responsible for the financial statements and all other information presented in this Annual Report. The financial statements have been prepared by management in accordance with generally accepted accounting principles and, where appropriate, include amounts based on Management's best estimates and judgements.


The Algonquin Forestry Authority is dedicated to the highest standards of integrity in its business. To safeguard the Authority's assets, the Authority has a sound and dynamic set of internal financial controls and procedures that balance benefits and costs. Management has developed and maintains financial and management controls, information systems and management practices to provide reasonable assurance of the reliability of financial information in accordance with the *Algonquin Forestry Authority Act*.

The Board of Directors ensures that Management fulfills its responsibilities for financial information and internal control. The Board of Directors meets regularly to oversee the financial activities of the Authority and at least annually to review the financial statements and the external auditors' report thereon, and recommends them to the Minister of Natural Resources for approval.

The financial statements have been examined by the Provincial Auditor. The Provincial Auditor's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles. The Auditor's Report outlines the scope of the Auditor's examination and opinion.



Tim Doyle C.A.  
Treasurer



Carl Corbett R.P.F.  
General Manager



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

### Auditor's Report

To the Members,  
Algonquin Forestry Authority,  
and to the Minister of Natural Resources

I have audited the statement of financial position of the Algonquin Forestry Authority as at March 31, 2008 and the statements of operations, changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Authority'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 Authority as at March 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Ontario  
May 22, 2008

Gary R. Peall, CA.  
Deputy Auditor General

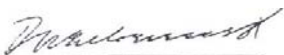
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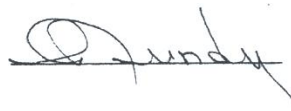
**Algonquin Forestry Authority**  
**Statement of Financial Position**  
 March 31

	2008	2007
<b>Assets</b>		
Current		
Cash and cash equivalents	\$ 2,590,676	\$ 2,430,182
Temporary investments	2,860,365	2,711,684
Receivables	5,405,821	5,102,847
Inventory	163,651	314,283
Prepays	<u>4,632</u>	<u>18,780</u>
	11,025,145	11,577,776
Capital assets (Note 6)	<u>479,654</u>	<u>559,233</u>
	<u><u>\$ 11,504,799</u></u>	<u><u>\$ 11,137,009</u></u>
<b>Liabilities</b>		
Current		
Payables and accruals	\$ 2,306,844	\$ 1,548,090
Contractors' performance holdbacks	103,915	115,783
Due to Consolidated Revenue Fund	<u>364,686</u>	<u>338,715</u>
	2,775,445	2,002,588
Deferred Contributions (Note 7)	99,499	57,375
Obligation for employee future benefits (Note 8)	<u>471,348</u>	<u>434,590</u>
	<u>570,847</u>	<u>491,965</u>
<b>Net assets</b>		
Invested in capital assets	479,654	559,233
Restricted - Forest Renewal Fund (Note 5)	2,630,704	2,861,166
Unrestricted - General Fund	<u>5,048,149</u>	<u>5,222,057</u>
	8,158,507	8,642,456
	<u><u>\$ 11,504,799</u></u>	<u><u>\$ 11,137,009</u></u>

On behalf of the Board



Director



Director

See accompanying notes to the financial statements.

**Algonquin Forestry Authority**  
**Statement of Operations**  
Year Ended March 31

	General Fund	Forest Renewal Fund	Total 2008	Total 2007
<b>Revenue</b>				
Product sales	\$ 20,036,363	\$ ---	\$ 20,036,363	\$ 24,026,657
Forest renewal activity	—	958,183	958,183	965,201
Standing timber sales	373,146	—	373,146	599,104
Other (Note 9)	<u>1,730,360</u>	<u>123,717</u>	<u>1,854,077</u>	<u>2,372,499</u>
	<u>22,139,869</u>	<u>1,081,900</u>	<u>23,221,769</u>	<u>27,963,461</u>
<b>Expenditure</b>				
Direct program costs	17,513,235	1,037,491	18,550,726	22,839,428
Crown timber stumpage charges	2,215,520	—	2,215,520	2,681,736
Public access road maintenance	257,876	—	257,876	242,625
Operations planning	161,834	—	161,834	205,184
Wood measurement	<u>63,245</u>	<u>—</u>	<u>63,245</u>	<u>76,355</u>
	<u>20,211,710</u>	<u>1,037,491</u>	<u>21,249,201</u>	<u>26,045,328</u>
<b>Operating Income</b>	<u>1,928,159</u>	<u>44,409</u>	<u>1,972,568</u>	<u>1,918,133</u>
<b>Administrative and other</b>				
Salaries and benefits	1,421,449	250,119	1,671,568	1,605,610
Amortization	203,694	48,246	251,940	364,121
Office supplies and expenses	99,566	233	99,799	95,923
Office rent	29,085	17,400	46,485	46,985
Director's allowances and expenses	42,874	—	42,874	42,081
Public relations	41,821	—	41,821	37,756
Consulting, legal and miscellaneous	25,082	493	25,575	3,825
Insurance	19,602	5,525	25,127	37,205
Staff travel and training	<u>15,629</u>	<u>1,101</u>	<u>16,730</u>	<u>25,567</u>
	<u>1,898,802</u>	<u>323,117</u>	<u>2,221,919</u>	<u>2,259,073</u>
<b>Income (loss) before assessment</b>	29,357	(278,708)	(249,351)	(340,940)
Penalties and interest on GST assessment (Note 12)	<u>234,598</u>		<u>234,598</u>	
<b>Net loss for the year</b>	<u>\$ (205,241)</u>	<u>\$ (278,708)</u>	<u>\$ (483,949)</u>	<u>\$ (340,940)</u>

See accompanying notes to the financial statements.

**Algonquin Forestry Authority**  
**Statement of Changes in Net Assets**  
Year Ended March 31

	<b>2008</b>			2007	
	Invested In Capital Assets	Restricted - Forest Renewal Fund	Unrestricted - General Fund	Total	Total
Balance, beginning of year	\$ 559,233	\$ 2,861,166	\$ 5,222,057	<b>\$ 8,642,456</b>	\$ 8,983,396
Net loss for the year	---	(278,708)	(205,241)	<b>(483,949)</b>	(340,940)
Amortization	(251,940)	48,246	203,694	---	---
Investment in capital assets	172,361	---	(172,361)	---	---
Balance, end of year	<u>\$ 479,654</u>	<u>\$ 2,630,704</u>	<u>\$ 5,048,149</u>	<u><b>\$ 8,158,507</b></u>	<u>\$ 8,642,456</u>

*See accompanying notes to the financial statements.*



**Algonquin Forestry Authority**  
**Statement of Cash Flows**  
Year Ended March 31

	2008	2007
Cash and cash equivalents derived from (applied to)		
<b>Operating</b>		
Net loss for the year:		
General Fund	\$ (205,241)	\$ (56,769)
Forest Renewal Fund	(278,708)	(248,171)
Add (deduct): non-cash items		
Amortization	251,940	364,121
(Gain) loss on sale of capital assets	(21,454)	2,118
	(253,463)	25,299
Change in non-cash operating working capital	634,663	(893,084)
	<u>381,200</u>	<u>(867,785)</u>
<b>Financing</b>		
Obligation for employee future benefits	36,758	4,668
Deferred contributions	42,124	57,375
	<u>78,882</u>	<u>62,043</u>
<b>Investing</b>		
Acquisition of temporary investments	(148,681)	(79,750)
Acquisition of capital assets	(182,041)	(107,350)
Proceeds on sale of capital assets	31,134	11,070
	<u>(299,588)</u>	<u>(176,030)</u>
Increase (decrease) in cash and cash equivalents	160,494	(981,772)
Cash and cash equivalents, beginning of year	2,430,182	3,411,954
Cash and cash equivalents, end of year	<u>\$ 2,590,676</u>	<u>\$ 2,430,182</u>

*See accompanying notes to the financial statements.*

**Algonquin Forestry Authority**  
**Notes to the Financial Statements**  
March 31, 2008

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**1. Purpose of the organization**

The Authority is responsible for forest management in Algonquin Provincial Park. The Authority is a Crown Agency which was established by the Ontario government on January 4, 1975 under the Algonquin Forestry Authority Act, 1974. The Authority is exempt from income taxes under the Income Tax Act.

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**2. Significant accounting policies****Basis of accounting**

The Authority's financial statements are prepared in accordance with generally accepted accounting principles as prescribed by the Canadian Institute of Chartered Accountants.

**Fund accounting**

The General Fund accounts for the Authority's profit generating and administrative activities. The Forest Renewal Fund accounts for the forest management activities, including silvicultural work.

**Revenue recognition**

The Authority follows the deferral method of accounting for contributions. Restricted contributions are recognized as revenue in the year in which the related expenses are incurred.

Revenue from product and standing timber sales and forest renewal charges are recognized when the wood is delivered. Consulting and other income is recognized as revenue when earned.

**Inventories**

Inventories, which consist of harvested wood not yet delivered to customers, are valued on the first in, first out basis at the lower of cost or net realizable value.

**Capital assets**

Capital assets are recorded at cost. Amortization is provided on a straight-line basis, using rates of 10% per annum for furniture, fixtures, technical equipment, trailers and leasehold improvements, 20% per annum for data processing equipment and portable steel structures, and 25% per annum for automotive equipment. The cost of bridges and access roads is amortized over the estimated number of operating seasons for which the bridges and roads are to be used, with a maximum amortization period of 10 years. Forest renewal assets are amortized at the same rates as the assets mentioned above.

**Use of estimates**

In preparing the Authority's financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Algonquin Forestry Authority**  
**Notes to the Financial Statements**  
March 31, 2008

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## **2. Significant accounting policies (cont'd)**

### **Impairment of long-lived assets**

Long-lived assets are reviewed for impairment upon the occurrence of events or changes in circumstances indicating that the carrying value of the asset may not be recoverable, as measured by comparing their net book value to the estimated undiscounted future cash flows generated by their use. Impaired assets, if any, are recorded at fair value, determined principally using discounted future cash flows expected from their use and eventual disposition.

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## **3. Application of new accounting standards**

On April 1, 2007, the Authority retroactively adopted, without restatement of prior periods, the recommendations included in the CICA Handbook Section 3855 "Financial Instruments - Recognition and Measurement".

Section 3855 describes the standards for the recognition and measurement of financial assets, financial liabilities and non-financial derivatives. These standards prescribe when to recognize a financial instrument on the statement of financial position and at what amount. Depending on their classification, fair value or cost-based measures are used. These standards also prescribe the basis of presentation for gains and losses on financial instruments.

The Authority has made the following classification for the purpose of measuring the value of the financial instruments:

- Cash and cash equivalents includes cash on hand, balances with banks and short term deposits with original maturities of three months or less. Cash and cash equivalents have been classified as "held for trading". They are initially measured at fair value and the gains and losses resulting from the revaluation at fair value at the end of each period are recognized in net income.
  - Temporary investments consist of short term treasury bills with original maturities of three months to one year and are recorded at the lower of cost or market. Temporary investments have been classified as "held to maturity". They are recorded at cost, which, upon their initial measurement, is equal to their fair value. Subsequent measurements are recorded at amortized cost which usually corresponds to the amount initially recorded plus accrued interest.
  - Receivables are classified as "loans and receivables". They are recorded at cost, which, upon their initial measurement, is equal to their fair value. Subsequent measurements of receivables are recorded at amortized cost which usually corresponds to the amount initially recorded less any allowance for doubtful accounts.
  - Payables and accruals, contractors' performance holdbacks, Due to Consolidated Revenue Fund, deferred contributions and obligations for future employee benefits are classified as "other financial liabilities". They are initially measured at fair value and the gains and losses resulting from their subsequent measurement at amortized cost, at the end of each period, are recognized in net income.
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**Algonquin Forestry Authority**  
**Notes to the Financial Statements**  
March 31, 2008

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#### **4. Future accounting pronouncements**

##### **Financial instruments disclosures and presentation**

Effective April 1, 2008, the Authority will be required to adopt CICA Handbook Section 3862 "Financial Instruments - Disclosures" and Section 3863 "Financial Instruments - Presentation" which will replace Section 3861 "Financial Instruments - Disclosure and Presentation". The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial Instruments and how these risks are managed. The presentation standard carries forward former presentation requirements unchanged. The Authority is currently assessing the impact these new standards will have on its financial statements.

##### **Inventories**

Effective April 1, 2008, the Authority will be required to adopt CICA Handbook Section 3031, "Inventories". This new standard replaces the existing Section 3030 of the same name and contains requirements on measurement and disclosure of inventories and revises and enhances the requirements for assigning costs to inventories. This new standard also allows for reversal of previous write-downs. The Authority has not yet determined the impact that the adoption of this change will have on the disclosure in its financial statements.

##### **General standards on financial statement presentation**

Effective April 1, 2008, the Authority will be required to adopt CICA Handbook Section 1400 "General Standards on Financial Statement Presentation". This new standard amends the previous standard to include requirements to assess and disclose an entity's ability to continue as a going concern. The Authority does not expect the adoption of this change to have an impact on its financial statements.

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#### **5. Forest Renewal Fund**

Effective April 1, 2002, the Authority renewed its 20-year agreement with the Ministry of Natural Resources, a related party, to perform forest management activities, including silvicultural work. Funding, on a cost recovery basis, for these activities is derived from stumpage charges levied under the Crown Forest Sustainability Act and grants from the Forestry Futures Fund.

The agreement also requires the Authority to maintain a minimum balance of \$1,500,000 in the Forest Renewal Fund.

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**Algonquin Forestry Authority**  
**Notes to the Financial Statements**  
March 31, 2008

## 6. Capital assets

	Cost	Accumulated Amortization	2008 Net Book Value	2007 Net Book Value
Bridges and access roads	\$ 5,346,799	\$ 5,149,007	\$ 197,792	\$ 313,421
Automotive equipment	299,433	169,348	130,085	149,504
Portable steel structures	338,908	259,864	79,044	40,095
Forest renewal assets	361,192	320,518	40,674	30,674
Data processing equipment	149,267	134,223	15,044	2,764
Furniture and fixtures	83,358	76,099	7,259	10,958
Technical equipment	182,531	177,950	4,581	5,608
Leasehold improvements	44,804	41,174	3,630	4,277
Trailers	13,690	12,145	1,545	1,932
	<u>\$ 6,819,982</u>	<u>\$ 6,340,328</u>	<u>\$ 479,654</u>	<u>\$ 559,233</u>

## 7. Deferred contributions

Deferred contributions represent unspent resources externally restricted for public access road maintenance received from the Ministry of Natural Resources in the current period and which relate to expenses of future periods. Changes in the deferred contributions balance are as follows:

	2008	2007
Beginning balance	\$ 57,375	\$ ---
Add: amount received in the year	300,000	300,000
Less: amount spent on road maintenance and related amortization costs in the year	<u>(257,876)</u>	<u>(242,625)</u>
Ending balance	<u>\$ 99,499</u>	<u>\$ 57,375</u>

## 8. Employee future benefits

The Authority provides pension benefits for all its full-time employees through participation in the Public Service Pension Fund (PSPF) established by the Province of Ontario, which is a multi-employer defined benefit plan providing pension benefits. This plan is accounted for as a defined contribution plan as there is insufficient information available to apply defined benefit plan accounting. The Authority's contributions related to the pension plan for the year were \$104,623 (2007 - \$100,008) and are included in salaries and benefits in the Statement of Operations.

The Authority also provides termination benefits to qualifying employees. All full-time employees qualify for a severance payment equal to one week of salary for each year of continuous service with the Authority, to a maximum of one half of the employee's annual salary. The total obligation for severance payments vested amounts to \$ 471,348 at year-end (2007 - \$434,590).

The cost of other non-pension post-retirement benefits is the responsibility of the Ontario Ministry of Government and Consumer Services, a related party, and accordingly is not accrued or included in the Statement of Operations.

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**Algonquin Forestry Authority**  
**Notes to the Financial Statements**  
March 31, 2008

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**9. Road maintenance funding**

Included in General Fund Other Revenue is revenue of \$ 1.22 million ( 2007 - \$1.73 million) received by the Authority pursuant to an agreement with the Ontario Ministry of Natural Resources. The purpose of the agreement is to provide the Authority with reimbursement of road construction and maintenance costs on eligible primary and secondary forest access roads where access to those roads is not limited to the forest industry. All of the Ministry funding ( 2007 - a portion) is passed on to the Authority's customers through a rebate allocated on the basis of sales volumes.

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**10. Remuneration of appointments**

Total remuneration of the Board members of the Authority was approximately \$ 13,821 during the fiscal year (2007 - \$13,024).

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**11. Financial Instruments**

Unless otherwise noted, it is management's opinion that the Authority is not exposed to significant interest, currency or credit risks arising from its financial instruments. The fair value of the Authority's financial instruments approximate their carrying values, unless otherwise noted.

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**12. Penalties and interest on GST assessment**

In 2007, the Authority was subject to a GST audit from Canada Revenue Agency (CRA). This audit covered the periods April 1, 2005 to December 31, 2006. The Authority was required to remit GST to CRA relating to stumpage fees which the Authority was able to recover from its customers. As a result of the assessment by CRA, the Authority also paid penalty and interest charges of \$234,598. In February 2008, the Authority submitted a Notice of Objection to the CRA which is still being reviewed by CRA. If the Authority is successful with its Notice of Objection, and if CRA reverses its penalty and interest charges, the charges recovered from CRA will be recorded as revenue when received and the GST will be credited to its customers when received.

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## HYDRO ONE INC. MANAGEMENT'S REPORT

The Consolidated Financial Statements, Management's Discussion and Analysis ("MD&A") and related financial information presented in this Annual Report have been prepared by the management of Hydro One Inc. ("Hydro One" or the "Company"). Management is responsible for the integrity, consistency and reliability of all such information presented. The Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in Canada and applicable securities legislation. The MD&A has been prepared in accordance with National Instrument 51-102, Part 5.

The preparation of the Consolidated Financial Statements and information in the MD&A involves the use of estimates and assumptions based on management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. Estimates and assumptions are based on historical experience, current conditions and various other assumptions believed to be reasonable in the circumstances, with critical analysis of the significant accounting policies followed by the Company as described in Note 2 to the Consolidated Financial Statements. The preparation of the Consolidated Financial Statements and the MD&A includes information regarding the estimated impact of future events and transactions. The MD&A also includes information regarding sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from the present assessment of this information because future events and circumstances may not occur as expected. The Consolidated Financial Statements and MD&A have been properly prepared within reasonable limits of materiality and in light of information up to February 13, 2008.

In meeting its responsibility for the reliability of financial information, management maintains and relies on a comprehensive system of internal control and internal audit. The system of internal control includes a written corporate conduct policy; implementation of a risk management framework; effective segregation of duties and delegation of authorities; and sound and conservative accounting policies that are regularly reviewed. This structure is designed to provide reasonable assurance that assets are safeguarded and that reliable information is available on a timely basis. In addition internal and disclosure controls have been documented, evaluated, tested and identified consistent with Multilateral Instrument 52-109 (Bill 198). An internal audit function independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to management and the Audit and Finance Committee of the Hydro One Board of Directors.

The Consolidated Financial Statements have been examined by Ernst & Young LLP, independent external auditors appointed by the Hydro One Board of Directors. The external auditors' responsibility is to express their opinion on whether the Consolidated Financial Statements are fairly presented in accordance with accounting principles generally accepted in Canada. The Auditors' Report, which appears on page 28, outlines the scope of their examination and their opinion.

The Hydro One Board of Directors, through its Audit and Finance Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Audit and Finance Committee of Hydro One met periodically with management, the internal auditors, and the external auditors to satisfy itself that each group had properly discharged its respective responsibility and to review the Consolidated Financial Statements before recommending approval by the Board of Directors. The external auditors had direct and full access to the Audit and Finance Committee, with and without the presence of management, to discuss their audit and their findings as to the integrity of the financial reporting and the effectiveness of the system of internal controls.

The Company's President and Chief Executive Officer, and Chief Financial Officer have certified Hydro One's annual Consolidated Financial Statements and annual MD&A filed under provincial securities legislation, related disclosure controls and procedures, and the design of related internal controls over financial reporting pursuant to Multilateral Instrument 52-109.

On behalf of Hydro One Inc.'s management:



Laura Formusa  
President and Chief Executive Officer



Beth Summers  
Chief Financial Officer



**HYDRO ONE INC.  
AUDITORS' REPORT**

To the Shareholder of Hydro One Inc.

We have audited the Consolidated Balance Sheets of Hydro One Inc. (the Company) as at December 31, 2007 and December 31, 2006, and the Consolidated Statements of Operations, Retained Earnings and Cash Flows of the Company for each of the years in the two-year period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we 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 our opinion, these Consolidated Financial Statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and December 31, 2006 and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2007 in accordance with Canadian generally accepted accounting principles.



Ernst & Young LLP  
Chartered Accountants  
Licensed Public Accountants  
Toronto, Canada

February 13, 2008

## HYDRO ONE INC. CONSOLIDATED STATEMENTS OF OPERATIONS

<i>Year ended December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
<b>Revenues</b>		
Transmission (Notes 7 and 13)	1,242	1,245
Distribution (Note 13)	3,382	3,273
Other	31	27
	<b>4,655</b>	<b>4,545</b>
<b>Costs</b>		
Purchased power (Note 13)	2,240	2,221
Operation, maintenance and administration (Note 13)	995	880
Depreciation and amortization (Note 3)	521	515
	<b>3,756</b>	<b>3,616</b>
<b>Income before financing charges and provision for payments in lieu of corporate income taxes</b>	<b>899</b>	<b>929</b>
Financing charges (Note 4)	295	295
<b>Income before provision for payments in lieu of corporate income taxes</b>	<b>604</b>	<b>634</b>
Provision for payments in lieu of corporate income taxes (Notes 5 and 13)	205	179
<b>Net income</b>	<b>399</b>	<b>455</b>
Other comprehensive income	3	-
<b>Comprehensive income</b>	<b>402</b>	<b>455</b>
<b>Basic and fully diluted earnings per common share (Canadian dollars) (Note 12)</b>	<b>3,809</b>	<b>4,366</b>

## CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

<i>Year ended December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
Retained earnings, January 1	1,184	1,079
Net income	399	455
Dividends (Note 12)	(325)	(350)
<b>Retained earnings, December 31</b>	<b>1,258</b>	<b>1,184</b>

See accompanying notes to Consolidated Financial Statements.

## HYDRO ONE INC. CONSOLIDATED BALANCE SHEETS

<i>December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
<b>Assets</b>		
Current assets:		
Accounts receivable (net of allowance for doubtful accounts - \$21 million; 2006 - \$19 million) ( <i>Note 13</i> )	759	777
Regulatory assets ( <i>Note 7</i> )	103	121
Materials and supplies	67	56
Other	17	13
	946	967
Fixed assets ( <i>Note 6</i> ):		
Fixed assets in service	16,812	16,238
Less: accumulated depreciation	6,220	6,180
	10,592	10,058
Construction in progress	622	468
	11,214	10,526
Other long-term assets:		
Deferred pension asset ( <i>Note 10</i> )	380	382
Regulatory assets ( <i>Note 7</i> )	110	190
Goodwill	133	133
Other assets	7	12
	630	717
<b>Total assets</b>	<b>12,790</b>	<b>12,210</b>

*See accompanying notes to Consolidated Financial Statements.*

**HYDRO ONE INC.**  
**CONSOLIDATED BALANCE SHEETS (continued)**

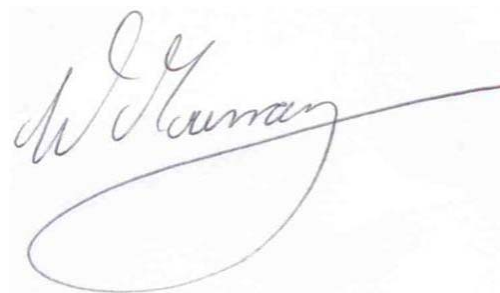
<i>December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
<b>Liabilities</b>		
Current liabilities:		
Bank indebtedness	12	29
Accounts payable and accrued charges ( <i>Notes 11 and 13</i> )	731	661
Regulatory liabilities ( <i>Note 7</i> )	114	-
Accrued interest	55	49
Short-term notes payable ( <i>Note 8</i> )	-	60
Long-term debt payable within one year ( <i>Note 8</i> )	540	395
	<u>1,452</u>	<u>1,194</u>
Long-term debt ( <i>Note 8</i> )	5,063	4,848
Other long-term liabilities:		
Employee future benefits other than pension ( <i>Note 10</i> )	855	803
Regulatory liabilities ( <i>Note 7</i> )	469	473
Environmental liabilities ( <i>Note 11</i> )	52	55
Long-term accounts payable and accrued charges	13	16
	<u>1,389</u>	<u>1,347</u>
<b>Total liabilities</b>	<u>7,904</u>	<u>7,389</u>
Contingencies and commitments ( <i>Notes 9, 15 and 16</i> )		
<b>Shareholder's equity (<i>Note 12</i>)</b>		
Preferred shares (authorized: unlimited; issued: 12,920,000)	323	323
Common shares (authorized: unlimited; issued: 100,000)	3,314	3,314
Retained earnings	1,258	1,184
Accumulated other comprehensive income	(9)	-
<b>Total shareholder's equity</b>	<u>4,886</u>	<u>4,821</u>
<b>Total liabilities and shareholder's equity</b>	<u>12,790</u>	<u>12,210</u>

See accompanying notes to Consolidated Financial Statements.

On behalf of the Board of Directors:



Rita Burak  
Chair



Walter Murray  
Chair, Audit and Finance Committee

**HYDRO ONE INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

<i>Year ended December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
<b>Operating activities</b>		
Net income	399	455
Adjustments for non-cash items:		
Depreciation and amortization (net of removal costs)	482	474
Revenue difference deferral account	73	-
Retail settlement variance accounts	46	7
Other regulatory asset and liability accounts	1	19
Transmission earnings sharing mechanism	-	33
Amortization of debt discount	5	27
	1,006	1,015
Changes in non-cash balances related to operations (Note 14)	135	(106)
<b>Net cash from operating activities</b>	<b>1,141</b>	<b>909</b>
<b>Financing activities</b>		
Long-term debt issued	700	775
Long-term debt retired	(355)	(589)
Short-term notes payable	(60)	60
Dividends paid	(325)	(350)
Other	(1)	(4)
<b>Net cash used in financing activities</b>	<b>(41)</b>	<b>(108)</b>
<b>Investing activities</b>		
Capital expenditures	(1,091)	(823)
Other assets	8	2
<b>Net cash used in investing activities</b>	<b>(1,083)</b>	<b>(821)</b>
<b>Net change in cash and cash equivalents</b>	<b>17</b>	<b>(20)</b>
Cash and cash equivalents, January 1	(29)	(9)
<b>Cash and cash equivalents, December 31 (Note 14)</b>	<b>(12)</b>	<b>(29)</b>

*See accompanying notes to Consolidated Financial Statements.*

## HYDRO ONE INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. DESCRIPTION OF THE BUSINESS

Hydro One Inc. (Hydro One or the Company) was incorporated on December 1, 1998, under the *Business Corporations Act* (Ontario) and is wholly owned by the Province of Ontario (the Province). The principal businesses of Hydro One are the transmission and distribution of electricity to customers within Ontario. These businesses are regulated by the Ontario Energy Board (OEB).

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### *Basis of Consolidation*

The Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries: Hydro One Networks Inc. (Hydro One Networks), Hydro One Remote Communities Inc., Hydro One Brampton Inc., Hydro One Brampton Networks Inc. (Hydro One Brampton), Hydro One Telecom Inc., Hydro One Delivery Services Company Inc. and Hydro One Network Services Inc.

Hydro One Brampton Inc. was dissolved on January 30, 2007. Hydro One Network Services Inc. was dissolved on December 14, 2006. Hydro One Delivery Services Inc. will be dissolved pursuant to the *Business Corporations Act* (Ontario).

#### *Basis of Accounting*

The Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in Canada (Canadian GAAP).

#### *Rate-setting*

The rates of the Company's electricity transmission and distribution businesses are subject to regulation by the OEB. In October 2005, the OEB initiated a proceeding to review Hydro One Network's transmission rates and to approve revenue requirements for 2006, 2007 and 2008 based on cost of service regulation. On February 21, 2006, the OEB announced a decision to apply an earnings sharing mechanism (ESM) to equally share, between Hydro One's shareholder and its customers, any transmission earnings in excess of the approved rate of return of 9.88% for the period January 1, 2006 until new transmission rates were set.

In September 2006, Hydro One Networks filed a transmission rate application. On March 30, 2007, prior to their decision on our transmission rate application, the OEB issued a decision ordering that the transmission ESM cease effective December 31, 2006. The decision also approved the concept of establishing a new revenue difference deferral account (RDDA) to record the revenue differential between existing transmission rates and the new rates that were anticipated to be approved later in the year, for the period commencing January 1, 2007.

On August 16, 2007, the OEB issued its decision in respect of Hydro One Networks' 2007 and 2008 transmission rate application. The decision, which was effective January 1, 2007, approved all operating and capital expenditures for 2007 and 2008. However, the decision resulted in a reduction in the approved return on equity from 9.88% to 8.35%. The OEB also approved final amounts and disposition treatments for certain regulatory liabilities including: the RDDA, the ESM and export and wheeling fees, as well as the transmission market ready regulatory asset.

The Company's distribution rates are also based on a revenue requirement that includes a rate of return. On April 12, 2006, the OEB announced its decision regarding the Company's rate applications in respect of the distribution businesses of Hydro One Networks and Hydro One Brampton. On the basis of the written evidence submitted, the OEB approved the requested increase in the revenue requirement based on a reduction in the approved rate of return, from a targeted 9.88% to 9.00%, effective May 1, 2006.

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

In 2006, the OEB commenced a process of establishing an Incentive Regulation Mechanism (IRM) for the years 2007 to 2010. The process includes a formulaic approach to establishing 2007 rates with a rate rebasing approach to be staggered across all Ontario distributors between 2008 and 2010. Hydro One Networks and Hydro One Brampton applied for marginal distribution rate adjustments in February 2007, based on an OEB-approved formula that considers inflation, efficiency targets and significant events outside the control of management. In April 2007, the OEB approved the Company's submissions on the basis of its cost of capital and second generation IRM policies, and the revised rates were implemented effective May 1, 2007.

Hydro One Networks submitted the revenue requirement portion of its 2008 cost of service application in accordance with the OEB's multi-year distribution rate-setting plan on August 15, 2007. This application seeks the approval of a revenue requirement of \$1,067 million based on a return of 8.64% for 2008. On December 18, 2007, Hydro One Networks filed the details of its cost allocation and rate design proposals, which include a plan to reduce the number of rate classes for its customers and consolidate or harmonize the rates for its existing rate classes to the new proposed rate classes. Based on the OEB's processing guidelines, a decision is anticipated in the Fall of 2008. On November 1, 2007, Hydro One Brampton filed an application for 2008 rates on the basis of the OEB's cost of capital and second generation IRM policies.

The OEB has the general power to include or exclude costs, revenues, losses or gains in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have applied in an unregulated company. Such change in timing involves the application of rate regulated accounting, giving rise to the recognition of regulatory assets and liabilities. The Company's regulatory assets represent certain amounts receivable from future customers and costs that have been deferred for accounting purposes because it is probable that they will be recovered in future rates. In addition, the Company has recorded regulatory liabilities which represent amounts for expenses incurred in different periods than would be the case had the Company been unregulated. The Company continually assesses the likelihood of recovery of each of its regulatory assets and continues to believe that it is probable that the OEB will factor its regulatory assets and liabilities into the setting of future rates. If, at some future date, the Company judges that it is no longer probable that the OEB will include a regulatory asset or liability in future rates, the appropriate carrying amount will be reflected in results of operations in the period that the assessment is made. Specific regulatory assets and liabilities are disclosed in Note 7.

***Revenue Recognition and Allocation***

Transmission revenues are collected through OEB-approved rates, which are based on an approved revenue requirement that includes a rate of return. Such revenue is recognized as power is transmitted and delivered to customers.

Distribution revenues attributable to the delivery of electricity are based on OEB-approved distribution rates and are recognized as electricity is delivered to customers. The Company estimates the monthly revenue for the period based on wholesale power purchases because customer meters are not generally read at the end of each month. Unbilled revenue included within accounts receivable as at December 31, 2007 amounted to \$413 million (2006 - \$386 million).

Distribution revenue also includes an amount relating to rate protection for rural residential and remote customers, which is received from the Independent Electricity System Operator (IESO) based on a standardized customer rate that is approved by the OEB. The current legislation provides rate protection for prescribed classes of rural residential and remote consumers by reducing the electricity rates that would otherwise apply.

Segment revenues for transmission, distribution and other also include revenue related to sales of other services and equipment. Such revenue is recognized as services are rendered or as equipment is delivered.

***Corporate Income and Capital Taxes***

Under the *Electricity Act, 1998*, Hydro One is required to make payments in lieu of corporate taxes to the Ontario Electricity Financial Corporation (OEFC). These payments are calculated in accordance with the rules for

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

computing income and taxable capital and other relevant amounts contained in the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario) as modified by the *Electricity Act, 1998*, and related regulations.

The Company provides for payments in lieu of corporate income taxes relating to its regulated businesses using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of Hydro One at that time. The Company provides for payments in lieu of corporate income taxes relating to its unregulated businesses using the liability method.

***Materials and Supplies***

Materials and supplies represent spare parts and construction material held for internal construction and maintenance of fixed assets. These assets are carried at lower of average cost or net realizable value.

***Fixed Assets***

Fixed assets are capitalized at cost which comprises materials, labour, engineering costs, overheads, depreciation on service equipment and the OEB-approved allowance for funds used during construction applicable to capital construction activities within regulated businesses, or interest applicable to capital construction activities within unregulated businesses.

Fixed assets in service consist of transmission, distribution, communication, administration and service assets and easements. Fixed assets also include future use assets such as land and capitalized development costs associated with deferred capital projects.

Some of the Company's transmission and distribution assets, particularly those located on unowned easements and rights-of-way, may have asset retirement obligations, conditional or otherwise. The majority of the Company's easements and rights-of-way are either of perpetual duration or are automatically renewed annually. Land rights with finite terms are generally subject to extension or renewal. As the Company expects to use the majority of its installed assets for an indefinite period, no removal date can be determined and consequently a reasonable estimate of the fair value of most asset retirement obligations cannot be made at this time. If, at some future date, it becomes possible to estimate the fair value cost of disposing of assets that the Company is legally required to remove, a related asset retirement obligation will be recognized at that time.

***Transmission***

Transmission assets include assets used for the transmission of high-voltage electricity, such as transmission lines, support structures, foundations, insulators, connecting hardware and grounding systems, and assets used to step up the voltage of electricity from generating stations for transmission and to step down voltages for distribution, such as transformers, circuit breakers and switches.

***Distribution***

Distribution assets comprise assets related to the distribution of low-voltage electricity, including lines, poles, switches, transformers, protective devices and metering systems.

***Communication***

Communication assets include the fibre-optic and microwave radio system, optical ground wire, towers, telephone equipment and associated buildings.

***Administration and Service***

Administration and service assets include administrative buildings, major computer systems, personal computers, transport and work equipment, tools, vehicles and minor fixed assets.



**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)***Easements*

Easements include statutory rights of use to transmission corridors and abutting lands granted under the *Reliable Energy and Consumer Protection Act, 2002*, as well as other amounts related to access rights.

*Construction in Progress*

Overhead costs, including corporate functions and services costs, are capitalized on a fully allocated basis, consistent with an OEB-approved methodology. Financing costs are capitalized on fixed assets under construction based on the OEB's approved allowance for funds used during construction (2007 – 5.20%; 2006 – 6.39%).

*Depreciation*

The capital costs of fixed assets are depreciated on a straight-line basis, except for transport and work equipment, which are depreciated on a declining balance basis.

Effective January 1, 2007, the Company prospectively revised its fixed asset depreciation rates resulting from a periodic external review required by the OEB. The estimated impact of the change in rates is a reduction in depreciation expense of approximately \$7 million per annum. A summary of the new rates for the various classes of assets is included below:

	Depreciation rates (%)	
	Range	Average
Transmission	1% - 4%	2%
Distribution	1% - 13%	2%
Communication	1% - 13%	5%
Administration and service	1% - 20%	8%

Depreciation rates for easements are based on their contract life. The majority of easements are held in perpetuity and are not depreciated.

In accordance with group depreciation practices, the original cost of normal fixed asset retirements is charged to accumulated depreciation, with no gain or loss reflected in results of operations. Gains and losses on sales of fixed assets and losses on premature retirements are charged to results of operations as adjustments to depreciation expense. Depreciation expense also includes the costs incurred to remove fixed assets.

The estimated service lives of fixed assets are subject to periodic review. Any changes arising from such a review are implemented on a remaining service life basis consistent with their inclusion in rates.

*Goodwill*

Goodwill represents the cost of acquired local distribution companies in excess of fair value of the net identifiable assets purchased and is evaluated for impairment on an annual basis, or more frequently if circumstances require. Goodwill impairment is assessed based on a comparison of the fair value of the reporting unit to the underlying carrying value of the reporting unit's net assets, including goodwill, with any write-down of the carrying value of goodwill being charged against the results of operations.

The Company has determined that goodwill is not impaired. All of the goodwill is attributable to the distribution business segment.

*Discounts and Premiums on Debt*

Discounts and premiums are amortized over the period of the related debt using the effective interest method.

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)***Financial Instruments*

Effective January 1, 2007, the Company adopted four new accounting standards comprising the following sections of the Handbook of the Canadian Institute of Chartered Accountants (CICA): 1530, *Comprehensive Income*; 3855, *Financial Instruments – Recognition and Measurement*; 3861, *Financial Instruments – Disclosure and Presentation*; and 3865, *Hedges*. The adoption of these new standards required changes in the accounting for financial instruments and hedges, and the recognition of certain transition adjustments that were recorded in opening accumulated other comprehensive income (AOCI) as described below, consistent with the CICA Handbook sections. The comparative annual Consolidated Financial Statements have not been restated. The principal changes in the accounting for financial instruments and hedges due to the adoption of these accounting standards are described below.

*Comprehensive Income*

Comprehensive income is composed of the Company's net income and other comprehensive income (OCI). OCI includes the amortization of net unamortized hedging losses on discontinued cash flow hedges, and the change in fair value on existing cash flow hedges. The impact of the amortization of net hedging losses that were discontinued prior to the transition date was immaterial to the Statement of Operations.

*Financial Assets and Liabilities*

Under the new standards, all financial instruments are classified into one of the following five categories: held-to-maturity investments, loans and receivables, held-for-trading, other liabilities or available-for-sale. All financial instruments, including derivatives, are carried at fair value on the Consolidated Balance Sheet except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in financing charges in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in OCI until the instrument is derecognized or impaired. The Company has classified its financial instruments as follows:

Short-term investments	Held-to-maturity
Long-term accounts receivable	Loans and receivables
Bank indebtedness	Other liabilities
Short-term notes payable	Other liabilities
Long-term debt (excluding MTN Series 8 Note)	Other liabilities
MTN Series 8 Note	Designated as held-for-trading

The MTN Series 8 Note is a step-up coupon note with extendable maturity dates up to 2011. (See Notes 8 and 9)

Where there is an economic hedge, as in the case of the MTN Series 8 note and associated interest rate swap, the Company has applied the fair value option without hedge accounting. The impact was not material.

All financial instrument transactions are recorded at trade date.

*Derivatives and Hedge Accounting*

All derivative instruments, including embedded derivatives, are carried at fair value on the Consolidated Balance Sheet unless exempted from derivative treatment as a normal purchase and sale. All changes in fair value are recorded in financing charges unless cash flow hedge accounting is used, in which case changes in fair value are recorded in OCI to the extent that the hedge is effective. The impact of the change in the accounting policy related to embedded derivatives was not material.

The Company does not engage in derivative trading or speculative activities.

The Company periodically develops hedging strategies for execution taking into account risk management objectives. At the inception of a hedging relationship, the Company documents the relationship between the hedging instrument and the hedged item. This would include linking all derivatives to specific assets and liabilities on the Consolidated Balance Sheet or to specific firm commitments or forecasted transactions. The Company would also

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

assess, both at the inception of the hedge and on an ongoing basis, whether the derivatives that are used are effective in offsetting changes in fair values or cash flows of hedged items.

Upon adoption of the new standards, the Company reclassified unamortized hedging losses on cash flow hedges that had been discontinued prior to the transition date to AOCI. The hedging losses are amortized to financing charges using the effective interest method over the term of the hedged debt.

*Transaction Costs*

Transaction costs for financial assets and liabilities that are other than held-for-trading, are added to the carrying value of the asset or liability and then amortized over the expected life of the instrument using the effective interest method. The impact of the change in amortization basis from an annuity method to the effective interest method was not material.

*Employee Future Benefits*

Employee future benefits provided by Hydro One include pension, group life insurance, health care and long-term disability.

In accordance with the OEB's rate orders, pension costs are recorded when employer contributions are paid to the pension fund in accordance with the *Pension Benefits Act* (Ontario). Actuarial valuations are conducted at least every three years. Pension costs are also calculated on an accrual basis. Pension costs are actuarially determined using the projected benefit method prorated on service and based on assumptions that reflect management's best estimate of the effect of future events, including future compensation increases, on the actuarial present value of accrued pension benefits. Pension plan assets, consisting primarily of listed equity securities as well as corporate and government debt securities, are valued using fair values. Past service costs from plan amendments and all actuarial gains or losses are amortized on a straight-line basis over the expected average remaining service life of the employees covered.

Employee future benefits other than pension are recorded on an accrual basis. Costs are determined by independent actuaries using the projected benefit method prorated on service and based on assumptions that reflect management's best estimates. Past service costs from plan amendments and actuarial gains or losses are amortized on a straight-line basis over the expected average remaining service life of the employees covered.

Employee future benefit costs are attributed to labour and charged to operations or capitalized as part of the cost of fixed assets.

*Environmental Costs*

Hydro One recognizes a liability for estimated future expenditures associated with the assessment and remediation of contaminated lands and for the phase-out and destruction of polychlorinated biphenyl (PCB) contaminated mineral oil from electrical equipment, based on the net present value of these estimated future expenditures. As the Company anticipates that the related expenditures will continue to be recoverable in future rates, a regulatory asset has been recognized to reflect the future recovery of these costs from customers. Hydro One reviews its estimates of future environmental expenditures on an ongoing basis.

*Use of Estimates*

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the year. Actual results could differ from estimates, including changes as a result of future decisions made by the OEB or the Province.

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)****3. DEPRECIATION AND AMORTIZATION**

<i>Year ended December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
Depreciation of fixed assets in service	384	379
Fixed asset removal costs	39	41
Amortization of regulatory and other assets	98	95
	<b>521</b>	<b>515</b>

**4. FINANCING CHARGES**

<i>Year ended December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
Interest on short-term notes payable	4	2
Interest on long-term debt payable	308	296
Amortization of debt discount	5	27
Other	7	9
Less: Interest capitalized on construction in progress	(24)	(28)
Interest accreted on regulatory accounts	-	(7)
Interest earned on investments	(5)	(4)
	<b>295</b>	<b>295</b>

**5. PROVISION FOR PAYMENTS IN LIEU OF CORPORATE INCOME TAXES**

The provision for payments in lieu of corporate income taxes (PILs) differs from the amount that would have been recorded using the combined Canadian Federal and Ontario statutory income tax rate. A reconciliation between the statutory and effective tax rates is provided as follows:

<i>Year ended December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
Income before provision for PILs	604	634
Federal and Ontario statutory income tax rate	36.12%	36.12%
Provision for PILs at statutory rate	218	229
Increase (decrease) resulting from:		
Net temporary differences:		
Transmission amounts received but not recognized for accounting purposes	25	12
Retail settlement variance accounts	17	2
Pension contributions in excess of pension expense	(13)	(16)
Overheads capitalized for accounting but deducted for tax purposes	(12)	(11)
Interest capitalized for accounting purposes but deducted for tax purposes	(9)	(13)
Capital cost allowance in excess of depreciation and amortization	(9)	(3)
Employee future benefits other than pension expense in excess of cash payments	7	14
Environmental expenditures	(4)	(6)
Recovery of PILs related to prior years	-	(30)
Other	(5)	2
Net temporary differences	(3)	(49)
Net permanent differences	(10)	(1)
Provision for PILs	205	179
Effective income tax rate	33.94%	28.23%

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

In 2006, Hydro One recognized a tax benefit of approximately \$30 million in respect of a recovery of PILs from prior years following a successful appeal allowing a deduction for certain overhead costs that had been previously capitalized.

Future income taxes relating to the regulated businesses have not been recorded in the accounts as they are expected to be recovered through future revenues. As at December 31, 2007, future income tax liabilities of \$253 million (2006 - \$281 million), based on substantively enacted income tax rates, have not been recorded. In the absence of rate regulated accounting, the Company's provision for PILs would have been recognized using the liability method rather than the taxes payable method. As a result, the provision for PILs would have been lower by approximately \$28 million (2006 – higher by \$16 million), including the impact of a change in substantively enacted tax rates.

Future income taxes relating to the non-regulated businesses have also not been recorded in the accounts as they have not met the criterion of “more likely than not” to be realized. As at December 31, 2007, future income tax assets of \$4 million (2006 - \$4 million), based on substantively enacted income tax rates, have not been recorded.

**6. FIXED ASSETS**

<i>December 31 (Canadian dollars in millions)</i>	Fixed Assets in Service	Accumulated Depreciation	Construction in Progress	Total
<b>2007</b>				
Transmission	8,708	3,152	370	5,926
Distribution	5,902	2,133	115	3,884
Communication	739	305	58	492
Administration and service	978	556	79	501
Easements	485	74	-	411
	16,812	6,220	622	11,214
<b>2006</b>				
Transmission	8,293	3,024	359	5,628
Distribution	5,651	2,129	86	3,608
Communication	822	383	18	457
Administration and service	989	583	5	411
Easements	483	61	-	422
	16,238	6,180	468	10,526

Financing costs are capitalized on fixed assets under construction, including allowance for funds used during construction on regulated assets and interest on unregulated assets, and were \$24 million in 2007 (2006 - \$28 million).

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)****7. REGULATORY ASSETS AND LIABILITIES**

Regulatory assets and liabilities arise as a result of the rate-making process. Hydro One has recorded the following regulatory assets and liabilities:

<i>December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
<b>Regulatory assets:</b>		
Regulatory asset recovery account II	66	87
Environmental	65	70
Employee future benefits other than pension	42	84
Regulatory asset recovery account I	19	58
Market ready	13	-
Smart meters	4	10
Other	4	2
Total regulatory assets	213	311
Less: current portion	103	121
	110	190
<b>Regulatory liabilities:</b>		
Deferred pension	380	382
Revenue difference deferral account	73	-
Retail settlement variance accounts	50	2
Export and wheeling fees	38	49
Transmission earnings sharing mechanism	28	34
Other	14	6
Total regulatory liabilities	583	473
Less: current portion	114	-
	469	473

***Regulatory assets******Regulatory asset recovery account II (RARA II)***

On April 12, 2006, the OEB announced its decision regarding the Company's rate application in respect of the distribution business of Hydro One Networks. As part of this decision, the OEB also approved the distribution-related deferral account balances sought by Hydro One. The OEB ordered that the approved balances be recovered on a straight-line basis over a four year period from May 1, 2006 to April 30, 2010. The RARA II includes retail settlement and cost variance amounts and distribution low-voltage service amounts, plus accrued interest. In the absence of rate regulated accounting, amortization expense in 2007 would have been lower by \$23 million (2006 - \$16 million). In addition, related financing charges would have been higher by \$3 million (2006 - \$5 million).

***Environmental***

Hydro One records a liability for the estimated future expenditures required to remediate past environmental contamination. Because such expenditures are expected to be recoverable in future rates, the Company has recognized an equivalent amount as a regulatory asset. This regulatory asset is expected to be amortized to results of operations on a basis consistent with the pattern of actual expenditures expected to be incurred up to the year 2030. The OEB has the discretion to examine and assess the prudence and the timing of recovery of all of Hydro One's future regulatory expenditures. In the absence of rate regulated accounting, amortization expense in 2007 would have been lower by \$12 million (2006 - \$17 million).

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)***Employee future benefits other than pension*

Employee future benefits other than pension are recorded using the accrual method as required by Canadian GAAP. The OEB has allowed for the recovery of past service costs, which arose on the adoption of the accrual method, in the revenue requirement on a straight-line basis over a 10-year period. As a result, in 1999 Hydro One recorded a regulatory asset, with an original balance of \$419 million, to reflect this regulatory treatment. This regulatory asset has a remaining recovery period of 1 year (2006 - 2 years) and does not earn a return. In the absence of rate regulated accounting, amortization expense in 2007 would have been lower by \$42 million (2006 - \$42 million).

*Regulatory asset recovery account I (RARA I)*

On December 9, 2004, the OEB issued a decision on the prudence of the distribution related deferral account balances for which recovery was sought by Hydro One in its May 31, 2004 application. Amounts for which recovery was approved represented balances incurred prior to December 31, 2003, plus associated interest. The OEB ordered that the approved amounts be aggregated into a single regulatory account to be recovered on a straight-line basis over the period ending April 30, 2008. Hydro One Networks has requested an extension of the period for the RARA I recovery until such time as new rates are implemented. The RARA I includes distribution business low-voltage services amounts, deferred environmental expenditures incurred in 2001 and 2002, deferred market ready expenditures, retail settlement variance amounts, and other amounts primarily consisting of accrued interest. Any over or under recovery of the RARA I due to continuance of the rate rider will be tracked for disposition at a future date. In the absence of rate regulated accounting, amortization expense in 2007 would have been lower by \$20 million (2006 - \$20 million). In addition, related financing charges would have been higher by \$1 million (2006 - \$3 million).

*Market ready*

In September 2006, as part of its transmission rate application, Hydro One Networks applied for the recovery of various regulatory deferral accounts including the transmission market ready costs incurred in connection with market opening. The transmission related transition-costs were incurred to meet IESO requirement associated with registration and authorization activities. On August 16, 2007, as a result of the oral and written evidence the OEB approved the recovery of substantially all of these costs. Consequently, the market ready regulatory asset was established and recovery is being factored into rates over the four-year period ending December 31, 2010. In the absence of rate regulated accounting, operation, maintenance and administration expense would have been higher by \$16 million (2006 - \$nil) and revenue would have been higher by \$4 million (2006 - \$nil).

*Smart meters*

On March 21, 2006, the OEB approved the establishment of regulatory deferral accounts for smart meter-related expenditures and a monthly customer charge of 27 cents and 28 cents per metered customer for Hydro One Networks and Hydro One Brampton, respectively, was reflected in Hydro One's revenue requirement. Consistent with the OEB's direction and pending further guidance, the Company recognized a regulatory asset consisting of the net balance of capital and operating expenditures for smart meters less recoveries received from customers. In April 2007, as part of its decision regarding the Company's 2007 distribution rate applications, the OEB increased the monthly customer charge effective May 1, 2007 to 93 cents and 67 cents per metered customer for Hydro One Networks and Hydro One Brampton, respectively.

On August 8, 2007, the OEB issued a decision on its combined proceeding to determine recoverability of expenditures incurred by distributors. Expenditures associated with the minimum functionality for advanced metering infrastructure incurred by Hydro One Networks and Hydro One Brampton were approved for recovery. As a result of this decision, smart meter expenditures are no longer deferred as regulatory assets. Such expenditures are now classified as capital or are charged to results of operations consistent with the Company's standard accounting practices. Expenditures determined to be above the minimum functionality have been brought forward for review in Hydro One Networks cost of service rate application filed in 2007.

The OEB decision also required that related revenues be based upon a calculated revenue requirement specific to smart meters. As a result, the carrying value of the smart meter regulatory asset account represents the difference



**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

between revenue recorded on this basis and actual recoveries received under existing rate adders. In the absence of rate regulated accounting, year-to-date operation, maintenance and administration expense would have been lower by \$3 million (2006 – higher by \$4 million) and revenues would have been lower by \$2 million (2006 – higher by \$2 million).

***Regulatory liabilities******Deferred pension***

In accordance with the OEB's 1999 transitional rate order, pension costs are recorded in results of operations when employer contributions are paid into the pension plan. The Company's deferred pension asset represents the cumulative difference between employer contributions and pension costs and the deferred pension regulatory liability results from the Company's recognition, as the result of OEB direction, of revenues and expenses in different periods than would be the case for an unregulated enterprise. In the absence of rate regulated accounting, operating, maintenance and administration expense would have been higher by \$1 million (2006 - \$50 million).

***Revenue difference deferral account (RDDA)***

On March 30, 2007, the OEB issued a decision approving the establishment of the RDDA to record the revenue differential between existing transmission rates and the new rates that were anticipated to be approved later in the year. The new deferral account was to represent the revenue differential between existing and future rates for the period commencing January 1, 2007. On August 16, 2007, in its decision on Hydro One Networks' 2007 and 2008 transmission rates, the OEB approved final amounts and disposition treatments for the RDDA liability, which will be returned to customers over the fourteen-month period ending December 31, 2008.

***Retail settlement variance accounts (RSVA)***

Hydro One has deferred certain retail settlement variance amounts under the provisions of Article 490 of the OEB's *Accounting Procedures Handbook*. The OEB's December 9, 2004 decision allowed for recovery of retail settlement variance amounts accumulated prior to December 31, 2003, inclusive of interest, within the RARA I. The OEB's April 12, 2006 decision allowed for recovery of retail settlement variance amounts accumulated since January 1, 2004 and forecasted through to April 30, 2006, inclusive of interest, within the RARA II. The Company has accumulated a net liability in its RSVA since May 1, 2006 which was taken into consideration in the revenue requirement of Hydro One Networks as part of the 2008 distribution rate application filed with the OEB in December 2007.

***Export and wheeling fees***

Consistent with the IESO's Market Rules, an export and wheeling fee is collected by the IESO and remitted to Hydro One at the rate of \$1 per MWh on electricity exported outside of Ontario. The amounts collected in respect of these export and wheeling fees, plus interest, were taken into consideration in the revenue requirement of Hydro One's transmission business as part of the Company's transmission rate application filed with the OEB in September 2006. On August 16, 2007, the OEB issued its decision in respect of the Company's transmission rate application and approved final amounts and disposition treatments for the export wheeling fees. The export wheeling fees will be factored into rates over a four-year period ending December 31, 2010.

***Transmission earnings sharing mechanism (ESM)***

On February 21, 2006, the OEB issued a decision that established an ESM to equally share, between the Company's shareholder and ratepayers, any transmission earnings in excess of the approved rate of return of 9.88%, for the period January 1, 2006 until new transmission rates were set. Consequently, 50% of the Company's excess earnings were deferred as a regulatory liability. On March 30, 2007, the OEB issued a decision ordering that the transmission ESM cease effective December 31, 2006. The ESM was taken into consideration in setting the revenue requirement of Hydro One Networks for 2007 and 2008. On August 16, 2007, in its decision on Hydro One Networks 2007 and



**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

2008 transmission rates, the OEB approved final amounts and disposition treatments for the ESM which will be returned to customers over a fourteen-month period ending December 31, 2008.

**8. DEBT**

<i>December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
Short-term notes payable	-	60
Long-term debt:		
4.45% notes due 2007	-	282
4.55% notes due 2007	-	73
4.70% (2006 – 4.10%) notes due 2008 <sup>1</sup>	40	40
4.00% notes due 2008	500	500
3.95% notes due 2009	400	400
7.15% debentures due 2010	400	400
6.40% notes due 2011	250	250
5.77% notes due 2012	600	600
4.64% notes due 2016	450	450
5.18% notes due 2017	300	-
7.35% debentures due 2030	400	400
6.93% notes due 2032	500	500
6.35% notes due 2034	385	385
5.36% notes due 2036	600	600
4.89% notes due 2037	400	-
6.59% notes due 2043	315	315
5.00% notes due 2046	75	75
	5,615	5,270
Less: Long-term debt payable within one year	(540)	(395)
Net unamortized premiums	13	9
Unamortized hedging losses <sup>2</sup>	-	(12)
Unamortized debt issuance costs	(25)	(24)
Long-term debt	5,063	4,848

<sup>1</sup> Step-up coupon from 4.10% to 6.40%, extendable to 2011.

<sup>2</sup> Unamortized net losses relating to settled swap agreements were reclassified to AOCI on January 1, 2007 without prior year reclassification.

Short-term debt represents promissory notes issued pursuant to the Company's Commercial Paper Program. The notes are denominated in Canadian dollars with varying maturities not exceeding 365 days. In 2007, the notes had a weighted-average interest rate of 5.7%.

Hydro One has a \$750 million committed and unused revolving standby credit facility with a syndicate of banks maturing in August 2010. If used, interest on the facility would apply based on Canadian benchmark rates. This credit facility supports the Company's Commercial Paper Program.

The Company issues notes for long-term financing under the Medium-Term Note Program. The maximum authorized principal amount of medium-term notes issuable under this program is \$2,500 million of which \$2,200 million is remaining and is currently available until July 2009.

The long-term debt is subject to covenants that, among other things, limit permissible debt as a percentage of total capitalization, limit ability to sell assets and impose a negative pledge provision, subject to customary exceptions. At December 31, 2007, the Company was in compliance with these covenants.

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The long-term debt is unsecured and denominated in Canadian dollars. Such debt is summarized by the number of years to maturity in the following table:

Years to Maturity	Principal Outstanding on Notes and Debentures (Canadian dollars in millions)	Weighted Average Interest Rate (Percent)
1 year	540	4.1
2 years	400	4.0
3 years	400	7.2
4 years	250	6.4
5 years	600	5.8
	2,190	5.3
6 – 10 years	750	4.9
Over 10 years	2,675	6.2
	5,615	5.7

**9. FAIR VALUE OF FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

The carrying amounts of all financial instruments, except long-term debt, approximate fair value. The fair value of derivative financial instruments reflects the estimated amount that the Company, if required to settle an outstanding contract, would have been required to pay or would be entitled to receive at year end. The fair value of long-term debt, based on year end quoted market prices for the same or similar debt of the same remaining maturities, is provided in the following table:

<i>December 31 (Canadian dollars in millions)</i>	<b>2007</b>		<b>2006</b>	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt <sup>1</sup>	5,615	6,005	5,270	5,831

<sup>1</sup> The carrying value of long-term debt represents the par value of the notes and debentures, other than the step-up note, which is marked to market.

Hydro One may enter into derivative agreements, such as forward starting pay fixed interest rate swap agreements, to hedge against the effect of future interest rate movements on long-term fixed rate borrowing requirements. These transactions are accounted for as cash flow hedges of anticipated transactions. In October 2007, upon issuance of debt under the Company's medium term note program, Hydro One terminated two forward interest rate swap agreements having a total notional principal amount of \$200 million, resulting in a net gain of \$0.4 million. The net gain was recorded as other comprehensive income and is being amortized to financing charges over the term of the related debt. In late 2007, Hydro One entered into two new forward starting pay fixed interest rate swap agreements with a notional amount of \$140 million.

As at December 31, 2007, the Company had a pay floating interest rate swap agreement related to a step-up coupon note issuance with an initial maturity date in 2007, and with extended maturity dates up to 2011. In 2006, the interest rate swap was accounted for as a fair value hedge. In 2007, the interest rate swap was accounted for using the fair value option without hedge accounting. This agreement has a notional principal amount of \$40 million and a fair value of \$nil (2006 - \$nil).

The Company has no significant counter-party credit risk exposure as the fair value of the interest rate swap contracts was not significant in 2007 or in 2006.

Financial assets create a risk that a counter-party will fail to discharge an obligation, causing a financial loss. As at December 31, 2007, there were no significant concentrations of credit risk with respect to any class of financial assets. The Company's revenue is earned from a broad base of customers. As a result, Hydro One did not earn a

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

significant amount of revenue from any single customer. As at December 31, 2007, there were no significant balances of accounts receivable due from any single customer.

The Company will continue to use derivative instruments to manage interest rate risk. Derivative financial instruments result in exposure to credit risk, since there is a risk of counter-party default. Hydro One monitors and minimizes credit risk through various techniques including dealing with highly rated counter-parties, limiting total exposure levels with individual counter-parties and entering into master agreements which enable net settlement.

**10. EMPLOYEE FUTURE BENEFITS**

Hydro One has a contributory defined benefit pension plan covering all regular employees of Hydro One and its subsidiaries, except Hydro One Brampton. Employees of Hydro One Brampton participate in the Ontario Municipal Employees Retirement System (OMERS), a multi-employer public sector pension fund. Current contributions by Hydro One Brampton are approximately \$1 million annually.

***Plan Asset Mix***

Hydro One's pension plan asset mix at December 31, 2007 and 2006 was as follows:

<i>December 31</i>	% of Plan Assets	
	<b>2007</b>	<b>2006</b>
Equity securities	62.5	64.6
Debt securities	34.1	32.0
Other	3.4	3.4
	100.0	100.0

***Supplementary Information***

The Hydro One pension plan does not hold any direct securities of the Company, but did hold debt securities of the Province of \$90 million and \$92 million at December 31, 2007 and 2006 respectively.

The Company's pension plan provides benefits based on highest three-year average pensionable earnings. For new management employees who commenced employment on or after January 1, 2004, and for new Society of Energy Professionals hired after November 17, 2005, benefits are based on highest five-year average pensionable earnings. After retirement, pensions are indexed to inflation. The measurement date used to determine plan assets and the accrued benefit obligation is December 31. Based on the actuarial valuation filed with the Financial Services Commission of Ontario on September 20, 2007, effective for December 31, 2006, the Company contributed \$95 million to its pension plan in respect of 2007 (2006 - \$86 million), all of which is required to satisfy minimum funding requirements. Contributions are payable one month in arrears. All of the contributions are expected to be in the form of cash. Contributions after 2009 will be based on an actuarial valuation effective December 31, 2009 and will depend on future investment returns, and changes in benefits or actuarial assumptions.

Total cash payments for employee future benefits made in 2007, consisting of cash contributed by the Company to its funded pension plan and cash payments directly to beneficiaries for its unfunded other benefit plans was \$137 million in 2007 (2006 - \$122 million).

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

<i>Year ended December 31 (Canadian dollars in millions)</i>	Pension		Employee Future Benefits other than Pension	
	2007	2006	2007	2006
<b>Change in accrued benefit obligation</b>				
Accrued benefit obligation, January 1	5,411	5,355	1,100	1,143
Current service cost	105	106	23	33
Interest cost	282	267	57	58
Benefits paid	(264)	(253)	(42)	(36)
Plan amendments	-	6	-	22
Net actuarial gain	(457)	(70)	(44)	(120)
Accrued benefit obligation, December 31	5,077	5,411	1,094	1,100
<b>Change in plan assets</b>				
Fair value of plan assets, January 1	5,123	4,713	-	-
Actual return on plan assets	142	571	-	-
Benefits paid	(264)	(253)	-	-
Employer's contributions <sup>1</sup>	95	86	-	-
Employees' contributions	17	17	-	-
Administrative expenses	(13)	(11)	-	-
Fair value of plan assets, December 31	5,100	5,123	-	-
<b>Funded status</b>				
Funded excess (Unfunded benefit obligation)	23	(288)	(1,094)	(1,100)
Unamortized net actuarial losses	336	645	178	236
Unamortized past service costs	21	25	21	25
Deferred pension asset (accrued benefit liability)	380	382	(895)	(839)
Less: current portion	-	-	40	36
Deferred pension asset (long-term liability)	380	382	(855)	(803)

<sup>1</sup> In January, 2008, the Company made a contribution of \$8 million in respect of 2007 (2007 - \$8 million in respect of 2006).

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

<i>Year ended December 31 (Canadian dollars in millions)</i>	Pension		Employee Future Benefits other than Pension	
	2007	2006	2007	2006
<b>Components of net periodic benefit cost</b>				
Current service cost, net of employee contributions	88	89	23	33
Interest cost	282	267	57	58
Actual return on plan asset net of expenses	(129)	(560)	-	-
Actuarial gain	(457)	(70)	(44)	(120)
Plan amendments	-	6	-	22
Other	-	(1)	-	(1)
<b>Costs arising in the period</b>	(216)	(269)	36	(8)
Differences between costs arising in the period and costs recognized in the period in respect of:				
Return on plan assets	(212)	248	-	-
Actuarial loss (gain)	522	177	59	149
Plan amendments	3	(3)	4	(19)
<b>Net periodic benefit cost<sup>2</sup></b>	<b>97</b>	<b>153</b>	<b>99</b>	<b>122</b>
<b>Charged to results of operations<sup>2</sup></b>	<b>58</b>	<b>42</b>	<b>60</b>	<b>75</b>
<b>Effect of 1% increase in health care cost trends on:</b>				
Accrued benefit obligation, December 31	-	-	167	156
Service cost and interest cost	-	-	12	13
<b>Effect of 1% decrease in health care cost trends on:</b>				
Accrued benefit obligation, December 31	-	-	(132)	(124)
Service cost and interest cost	-	-	(9)	(10)
<b>Significant assumptions</b>				
For net periodic benefit cost:				
Expected rate of return on plan assets	6.75%	6.75%	-	-
Weighted-average discount rate	5.25%	5.00%	5.24%	4.98%
Rate of compensation scale escalation (without merit)	3.25%	3.25%	3.25%	3.25%
Rate of cost of living increase	2.50%	2.50%	2.50%	2.50%
Average remaining service life of employees (years)	10	10	9	10
Rate of increase in health care cost trend <sup>3</sup>	-	-	4.40%	4.40%
For accrued benefit obligation, December 31:				
Weighted-average discount rate	5.50%	5.25%	5.50%	5.24%
Rate of compensation scale escalation (without merit)	3.00%	3.25%	3.00%	3.25%
Rate of cost of living increase	2.25%	2.50%	2.25%	2.50%
Rate of increase in health care cost trend <sup>4</sup>	-	-	4.40%	4.40%

<sup>2</sup> The Company follows the cash basis of accounting. During 2007, pension costs of \$95 million (2006 - \$86 million) were attributed to labour, of which \$58 million (2006 - \$42 million) was charged to operations, \$37 million (2006 - \$34 million) was capitalized as part of the cost of fixed assets, and \$nil (2006- \$10 million) was attributed to a regulatory asset.

<sup>3</sup> 8.69% in 2007 grading down to 4.40% per annum in and after 2018 (2006 – 7.87% in 2006 grading down to 4.40% per annum in and after 2014).

<sup>4</sup> 8.33% in 2008 grading down to 4.40% per annum in and after 2018 (2006 – 8.69% in 2007 grading down to 4.40% per annum in and after 2014).

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)****11. ENVIRONMENTAL LIABILITIES**

<i>December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
Environmental liabilities, January 1	70	79
Interest accretion	4	5
Expenditures	(12)	(17)
Revaluation adjustment	3	3
Environmental liabilities, December 31	65	70
Less: current portion	(13)	(15)
	52	55

Estimated future environmental expenditures for each of the five years subsequent to December 31, 2007 and in total thereafter are as follows: 2008 - \$13 million; 2009 - \$12 million; 2010 - \$10 million; 2011 - \$8 million; 2012 - \$6 million and thereafter - \$35 million.

There are uncertainties in estimating future environmental costs due to potential external events such as changing regulations and advances in remediation technologies. Hydro One continuously reviews factors affecting its cost estimates as well as the environmental condition of the various properties. The actual cost of investigation or remediation may differ from current estimates.

**12. SHARE CAPITAL*****Common and Preferred Shares***

On March 31, 2000, the Company issued to the Province 12,920,000 5.5% cumulative preferred shares with a redemption value of \$25.00 per share, and 99,990 common shares, bringing the total number of outstanding common shares to 100,000. The Company is authorized to issue an unlimited number of preferred and common shares.

The preferred shares are entitled to an annual cumulative dividend of \$18 million, which is payable on a quarterly basis. The preferred shares are redeemable at the option of the Province at a price of \$25 per share, representing the stated value, plus any accrued and unpaid dividends if the Province sells a number of the common shares which it owns to the public such that the Province's holdings are reduced to less than 50% of the common shares of the Company. Hydro One may elect, without condition, to pay all or part of this redemption price by issuing additional common shares to the Province. If the Province does not exercise its redemption right, the Company would have the ability to adjust the dividend on the preferred shares to produce a yield that is 0.50% less than the then-current dividend market yield for similarly rated preferred shares. The preferred shares do not carry voting rights, except in limited circumstances, and would rank in priority over the common shares upon liquidation.

***Dividends***

Common dividends are declared at the sole discretion of the Hydro One Board of Directors, and are recommended by management based on results of operations, financial condition, cash requirements and other relevant factors such as industry practice and shareholder expectations.

In 2007, preferred dividends in the amount of \$18 million (2006 - \$18 million) and common dividends in the amount of \$307 million (2006 - \$332 million) were declared.

***Earnings per Share***

Earnings per share is calculated as net income during the year, after cumulative preferred dividends, divided by the weighted-average number of common shares outstanding during the year.

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)****13. RELATED PARTY TRANSACTIONS**

The Province, OEFC, IESO, OPA and Ontario Power Generation Inc. (OPG) are related parties of Hydro One. In addition the OEB is related to the Company by virtue of its status as a Provincial Crown Corporation. Transactions between these parties and Hydro One were as follows:

Hydro One received revenue for transmission services from IESO, based on uniform transmission rates approved by the OEB. Transmission revenue for 2007 includes \$1,203 million (2006 - \$1,206 million) related to these services.

Hydro One receives amounts for rural rate protection from the IESO. Distribution revenue for 2007 includes \$127 million (2006 - \$127 million) related to this program. Hydro One also received revenue related to the supply of electricity to remote northern communities from the IESO. Distribution revenue for 2007 includes \$21 million (2006 - \$21 million) related to these services.

In 2007, Hydro One purchased power in the amount of \$2,213 million (2006 - \$2,183 million) from the IESO administered electricity market and \$27 million (2006 - \$38 million) from OPG.

Under the *Ontario Energy Board Act, 1998*, the OEB is required to recover all of its annual operating costs from gas and electricity distributors and electricity transmitters. In 2007, Hydro One incurred \$10 million (2006 - \$9 million) in OEB fees.

Hydro One has service level agreements with the other successor corporations. These services include field, engineering, logistics and telecommunications services. Revenues related to the provision of construction and equipment maintenance services to the other successor corporations were \$12 million (2006 - \$15 million), primarily for the transmission business. Operation, maintenance and administration costs related to the purchase of services from the other successor corporations were less than \$1 million in each of 2007 and 2006.

Consistent with the OPA mandate, the OPA is responsible for some of our CDM programs. The funding includes program costs, incentives and management fees and bonuses. In 2007, Hydro One received \$3 million (2006 - \$nil) from the OPA in respect of the CDM programs and had a net accounts receivable of \$3 million (2006 - \$nil).

The provision for payments in lieu of corporate income taxes was paid or payable to the OEFC and dividends were paid or payable to the Province.

The amounts due to and from related parties as a result of the transactions referred to above are as follows:

<i>December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
Accounts receivable	97	114
Accounts payable and accrued charges	(234)	(230)

Included in accounts payable and accrued charges are amounts owing to the IESO in respect of power purchases of \$202 million (2006 - \$195 million).

**14. CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the purposes of the Consolidated Statements of Cash Flows, “cash and cash equivalents” refers to the Balance Sheet item “bank indebtedness.”



**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The changes in non-cash balances related to operations consist of the following:

<i>Year ended December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
Accounts receivable decrease (increase)	18	(149)
Materials and supplies increase	(11)	-
Accounts payable and accrued charges increase (decrease)	70	(39)
Accrued interest increase	6	6
Long-term accounts payable and accrued charges decrease	(3)	(7)
Employee future benefits other than pension increase	52	87
Other	3	(4)
	<b>135</b>	<b>(106)</b>
<b>Supplementary information:</b>		
Interest paid	306	302
Payments in lieu of corporate income taxes	230	252

**15. CONTINGENCIES*****Legal Proceedings***

Hydro One is involved in various lawsuits, claims and regulatory proceedings in the normal course of business. In the opinion of management, the outcome of such matters, except as noted below, will not have a materially adverse effect on the Company's consolidated financial position, results of operations or cash flows.

On March 29, 1999, the Whitesand First Nation Band commenced an action in the Ontario Court (General Division), now the Superior Court Justice, naming as defendants the Province, the Attorney General of Canada, Ontario Hydro, OEFC, OPG and the Company. On May 24, 2001, the Whitesand First Nation Band issued an almost identical claim against the same parties. The reason for the second claim is the procedural defence of the Province that proper notice of the first claim was not given under the *Proceedings Against the Crown Act* (Ontario). These actions seek declaratory relief, injunctive relief and damages in an unspecified amount. The Whitesand Band alleges that since at least the first half of the twentieth century, Ontario Hydro has erected dams, generating stations and other facilities within or affecting the band's traditional lands and that those facilities have caused damage to band members and the lands, including substantial flooding and erosion. The Whitesand Band also claims treaty rights to a share of the profits arising from the activities of these Ontario Hydro facilities, an entitlement to increases in annuity payments established by treaty and for breach of an alleged contract to reimburse the band for negotiation costs with Ontario Hydro. The Whitesand Band asserts multiple causes of action, including trespass, breach of fiduciary duty, nuisance and negligence. The May 24, 2001 case was consolidated in 2004 with a similar claim by Red Rock First Nation Band which commenced on September 7, 2001 as all procedural issues in both matters were the same. There is now one action in which the claims of both Whitesand and Red Rock are set out. The claims relating to activities of Ontario Hydro (i.e., flooding) are the matters for which OPG would have responsibility pursuant to Transfer Orders under the *Electricity Act, 1998*. In the consolidated claim, Whitesand and Red Rock seek to tie Hydro One into the flooding allegations on the alleged basis of the integrated nature of the transmission system with the entire electricity system, which includes the method of generating power. To date, Hydro One has not filed a defence. Hydro One believes that it is unlikely that the outcome of this litigation will have a material adverse effect on its consolidated financial position, results of operations or cash flows.

***Transfer of Assets***

The transfer orders by which Hydro One acquired certain of Ontario Hydro's businesses as of April 1, 1999 did not transfer title to some assets located on lands held for bands or bodies of Indians under the *Indian Act* (Canada). Currently, the OEFC holds these assets. Under the terms of the transfer orders, Hydro One is required to manage these assets until it has obtained all consents necessary to complete the transfer of title of these assets to itself. The



**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

Company cannot predict the aggregate amount that it may have to pay, either on an annual or one-time basis, to obtain the required consents. However, it anticipates having to pay more than the approximately \$900,000 per year than it currently is paying to these Indian bands and bodies. If the Company cannot obtain consents from the Indian bands and bodies, OEFC will continue to hold these assets for an indefinite period of time. If the Company cannot reach a satisfactory settlement, it may have to relocate these assets from the Indian lands to other locations at a cost that could be substantial or, in a limited number of cases, to abandon a line and replace it with diesel generation facilities. The costs relating to these assets could have a material adverse effect on the Company's results of operations if it is not able to recover them in future rate orders.

***Draft PCB regulations***

Future changes in environmental regulations may result in material changes to the Company's estimated liability related to the management of PCBs. On November 4, 2006, Environment Canada published new draft regulations governing the management of PCBs. These draft regulations may be finalized in 2008. The Company has estimated its operating expenditures for complying with these draft regulations to be between \$250 million and \$375 million in excess of amounts already recorded as environmental liabilities on its Balance Sheet. If required, most of these additional expenditures are expected to be incurred between 2013 and 2025. No obligation has been recorded in the financial statements for these increased expenditures due to continued uncertainty regarding the timing and content of the final regulations. In the event that an obligation related to new regulations is recorded, the Company expects to simultaneously record a regulatory asset of equivalent value.

**16. COMMITMENTS*****Agreement with Inergi***

Effective March 1, 2002, Cap Gemini Canada Inc. began providing services to Hydro One through Inergi. As a result of this initiative, Hydro One receives from Inergi a range of services including information technology, customer care, supply chain and certain human resources and finance services for a ten-year period. The initial service level price ranged between \$90 million and \$130 million per year, subject to external benchmarking every three years to ensure Hydro One is receiving a defined competitive and continuously improved price. In connection with this agreement, on March 1, 2002 the Company transferred approximately 900 employees to Inergi, including about 130 non-regular employees.

The annual commitments under the agreement in each of the five years subsequent to December 31, 2007, and in total thereafter are as follows: 2008 - \$100 million, 2009 - \$97 million; 2010 - \$93 million; 2011 - \$90 million; 2012 - \$16 million and thereafter - \$nil.

***Prudential Support***

Purchasers of electricity in Ontario, through the IESO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. The IESO could draw on these guarantees if Hydro One Networks or Hydro One Brampton fails to make a payment required by a default notice issued by the IESO. The maximum potential payment is the face value of any bank letters of credit plus the nominal amount of the parental guarantee. As at December 31, 2007, the Company provided prudential support using only parental guarantees, reflecting a change from 2006. If Hydro One's highest long term credit rating deteriorated to below the "Aa" category, the Company would be required to resume providing letters of credit as prudential support. Prudential support at December 31, 2007 was provided using bank letters of credit of \$nil million (2006 - \$22 million) and parental guarantees of \$325 million (2006 - \$275 million).

***Retirement Compensation Arrangements***

Bank letters of credit have been issued to provide security for the Company's liability under the terms of a trust fund established pursuant to the supplementary pension plan for the employees of Hydro One and its subsidiaries. The trustee is required to draw upon the letters of credit if Hydro One is in default of its obligations under the terms of this plan. Such obligations include the requirement to provide the trustee with an annual actuarial report as well as letters of credit sufficient to secure the Company's liability under the plan, to pay benefits payable under the plan and to pay the

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

letter of credit fee. The maximum potential payment is the face value of the bank letters of credit. As at December 31, 2007, Hydro One had bank letters of credit of \$95 million (2006 - \$93 million) outstanding relating to retirement compensation arrangements.

***Operating Leases***

The future minimum lease payments under operating leases for each of the five years subsequent to December 31, 2007 and in total thereafter are as follows: 2008 - \$6 million; 2009 - \$5 million; 2010 - \$2 million; 2011 - \$1 million; 2012 - \$1 million and thereafter - \$1 million.

**17. SEGMENT REPORTING**

Hydro One has three reportable segments:

- The transmission business, which comprises the core business of providing transportation and connection services, is responsible for transmitting electricity throughout the Ontario electricity grid;
- The distribution business, which comprises the core business of delivering and selling electricity to customers; and
- The “other” segment, which primarily consists of the telecommunications business.

The designation of segments is based on a combination of regulatory status and the nature of the products and services provided. The accounting policies followed by the segments are the same as those described in the summary of significant accounting policies (see Note 2). Segment information on the above basis is as follows:

<i>Year ended December 31 (Canadian dollars in millions)</i>	<b>Transmission</b>	<b>Distribution</b>	<b>Other</b>	<b>Consolidated</b>
<b>2007</b>				
<b>Segment profit</b>				
Revenues	1,242	3,382	31	4,655
Purchased power	-	2,240	-	2,240
Operation, maintenance and administration	415	549	31	995
Depreciation and amortization	242	273	6	521
Income (loss) before financing charges and provision for payments in lieu of corporate income taxes	585	320	(6)	899
Financing charges				295
<b>Income before provision for payments in lieu of corporate income taxes</b>				<b>604</b>
<b>Capital expenditures</b>	<b>560</b>	<b>511</b>	<b>20</b>	<b>1,091</b>
<b>2006</b>				
<b>Segment profit</b>				
Revenues	1,245	3,273	27	4,545
Purchased power	-	2,221	-	2,221
Operation, maintenance and administration	390	460	30	880
Depreciation and amortization	241	269	5	515
Income (loss) before financing charges and provision for payments in lieu of corporate income taxes	614	323	(8)	929
Financing charges				295
<b>Income before provision for payments in lieu of corporate income taxes</b>				<b>634</b>
<b>Capital expenditures</b>	<b>402</b>	<b>417</b>	<b>4</b>	<b>823</b>

**HYDRO ONE INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

<i>December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>
<b>Total assets</b>		
Transmission	7,273	6,950
Distribution	5,411	5,161
Other	106	99
	<b>12,790</b>	<b>12,210</b>

All revenues, costs and assets, as the case may be, are earned, incurred or held in Canada.

**18. SUBSEQUENT EVENTS**

On January 21, 2008, the Company entered into a forward starting pay fixed interest rate swap agreement to hedge against the effect of future interest rate movements on long-term fixed rate borrowing requirements. This transaction had a notional amount of \$60 million and is used to lock in the interest rate of a forecasted debt issuance planned for later in 2008. This transaction is being accounted for as a cash flow hedge of a forecasted transaction.

On January 28, 2008 the Company increased its committed revolving credit facility, which supports its commercial paper program, by \$250 million to \$1,000 million. The maturity date remains unchanged at August 10, 2010.

**19. COMPARATIVE FIGURES**

The comparative Consolidated Financial Statements have been reclassified from statements previously presented to conform to the presentation of the December 31, 2007 Consolidated Financial Statements.

# HYDRO ONE INC.

## FIVE-YEAR SUMMARY OF FINANCIAL AND OPERATING STATISTICS

<i>Year ended December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Statement of operations data</b>					
<b>Revenues</b>					
Transmission	1,242	1,245	1,310	1,262	1,298
Distribution	3,382	3,273	3,085	2,874	2,734
Other	31	27	21	17	26
	4,655	4,545	4,416	4,153	4,058
<b>Costs</b>					
Purchased power	2,240	2,221	2,131	1,987	1,872
Operation, maintenance and administration	995	880	792	771	795
Depreciation and amortization	521	515	487	480	454
	3,756	3,616	3,410	3,238	3,121
Regulatory recovery <sup>1</sup>	-	-	-	91	-
<b>Income before financing charges and provision for payments in lieu of corporate income taxes</b>	899	929	1,006	1,006	937
Financing charges	295	295	325	331	348
<b>Income before provision for payments in lieu of corporate income taxes</b>	604	634	681	675	589
Provision for payments in lieu of corporate income taxes	205	179	198	177	193
<b>Net income</b>	399	455	483	498	396
<b>Basic and fully diluted earnings per common share (Canadian dollars)</b>	3,809	4,366	4,652	4,798	3,779
<i>December 31 (Canadian dollars in millions)</i>					
<b>Balance sheet data</b>					
<b>Assets</b>					
Transmission	7,273	6,950	6,813	6,771	6,576
Distribution	5,411	5,161	4,893	4,836	4,614
Other	106	99	92	95	94
<b>Total assets</b>	12,790	12,210	11,798	11,702	11,284
<b>Liabilities</b>					
Current liabilities (including current portion of long-term debt)	1,452	1,194	1,341	1,262	1,192
Long-term debt	5,063	4,848	4,443	4,590	4,517
Other long-term liabilities	1,389	1,347	1,298	1,326	1,284
<b>Shareholder's equity</b>					
Share capital	3,637	3,637	3,637	3,637	3,637
Retained earnings	1,258	1,184	1,079	887	654
Accumulated Other Comprehensive Income	(9)	-	-	-	-
<b>Total liabilities and shareholder's equity</b>	12,790	12,210	11,798	11,702	11,284

**HYDRO ONE INC.****FIVE-YEAR SUMMARY OF FINANCIAL AND OPERATING STATISTICS (continued)**

<i>Year ended December 31 (Canadian dollars in millions)</i>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Other financial data</b>					
Capital expenditures					
Transmission	560	402	349	432	289
Distribution	511	417	338	288	292
Other	20	4	4	7	16
<b>Total capital expenditures</b>	<b>1,091</b>	<b>823</b>	<b>691</b>	<b>727</b>	<b>597</b>
<b>Ratios</b>					
Net asset coverage on long-term debt <sup>2</sup>	1.87	1.92	1.93	1.88	1.86
Earnings coverage ratio <sup>3</sup>	2.67	2.67	2.69	2.70	2.43
<b>Operating statistics</b>					
Transmission					
Units transmitted (TWh) <sup>4</sup>	152.2	151.1	157.0	153.4	151.7
Ontario 20-minute system peak demand (MW) <sup>4</sup>	25,809	27,056	26,219	25,204	24,849
Ontario 60-minute system peak demand (MW) <sup>4</sup>	25,737	27,005	26,160	24,979	24,753
Total transmission lines (circuit-kilometres)	28,915	28,600	28,547	28,643	28,621
Distribution					
Units distributed to Hydro One customers (TWh) <sup>4</sup>	30.2	29.0	29.7	28.5	27.9
Units distributed through Hydro One lines (TWh) <sup>4,5</sup>	45.7	44.7	45.6	44.8	44.7
Total distribution lines (circuit-kilometres)	122,933	122,460	122,118	121,736	121,285
Customers	1,311,714	1,293,396	1,273,768	1,258,925	1,238,748
<b>Total regular employees</b>	<b>4,602</b>	<b>4,295</b>	<b>4,189</b>	<b>4,118</b>	<b>3,967</b>

<sup>1</sup>As a result of the oral and written evidence submitted by Hydro One, on December 9, 2004 the OEB issued a ruling, citing prudence, and approving recovery of amounts previously delayed by the *Electricity Pricing, Conservation and Supply Act, 2002*, relating to regulatory deferral account balances sought by Hydro One in its May 31, 2004 submission. Consequently, a one-time regulatory recovery of \$91 million was recorded.

<sup>2</sup>The net asset coverage on long-term debt ratio is calculated as total assets minus total liabilities excluding long-term debt (including current portion) divided by long-term debt (including current portion).

<sup>3</sup>The earnings coverage ratio has been calculated as the sum of net income, financing charges and provision for payments in lieu of corporate income taxes divided by the sum of financing charges, capitalized interest and cumulative preferred dividends.

<sup>4</sup>System related statistics include preliminary figures for December.

<sup>5</sup>Units distributed through Hydro One lines represent total distribution system requirements and include electricity distributed to consumers who purchased power directly from the IESO.

## Liquor Control Board of Ontario

# Responsibility for Financial Reporting

The preparation, presentation and integrity of the financial statements are the responsibility of management. The accompanying financial statements of the Liquor Control Board of Ontario have been prepared in accordance with Canadian generally accepted accounting principles and include amounts that are based on management's best estimates and judgment.

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. An internal audit function 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.

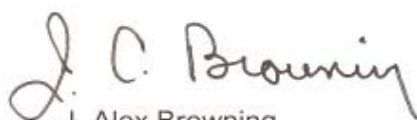
The Board, through the Audit Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Audit Committee, comprised of three Members who are not employees/officers of the LCBO, generally meets periodically with management, the internal auditors and the Office of the Auditor General to satisfy itself that each group has properly discharged its respective responsibility.

The financial statements have been audited by the Office of the Auditor General. The Auditor's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with Canadian generally accepted accounting principles. The Auditor's Report outlines the scope of the Auditor's examination and opinion.

On behalf of management:



N. Robert Peter  
*President & Chief Executive Officer*



J. Alex Browning  
*Senior Vice President, Finance & Administration, and Chief Financial Officer*  
June 11, 2008



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

### *Auditor's Report*

To the Liquor Control Board of Ontario  
and to the Minister of Finance

I have audited the balance sheet of the Liquor Control Board of Ontario as at March 31, 2008 and the statements of income and retained income and cash flows for the year then ended. These financial statements are the responsibility of the Board'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 Board as at March 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Jim McCarter, CA  
Auditor General  
Licensed Public Accountant

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# Liquor Control Board of Ontario

## Balance Sheet

As at March 31, 2008

	2008 (\$ 000)	2007 (\$ 000)
<b><u>ASSETS</u></b>		
<b>Current</b>		
Cash and cash equivalents	141,652	135,785
Accounts receivable, trade and others	26,124	24,042
Inventories	335,355	320,675
Prepaid expenses	18,403	20,017
	<u>521,534</u>	<u>500,519</u>
<b>Long-term</b>		
Capital assets (Note 5)	247,559	233,073
	<u>769,093</u>	<u>733,592</u>
<b><u>LIABILITIES AND RETAINED INCOME</u></b>		
<b>Current</b>		
Accounts payable and accrued liabilities	363,421	361,785
Current portion of accrued benefit obligation (Note 3)	12,825	11,943
	<u>376,246</u>	<u>373,728</u>
<b>Long-term</b>		
Accrued benefit obligation (Note 3)	52,609	48,983
<b>Retained income</b>	<u>340,238</u>	<u>310,881</u>
	<u>769,093</u>	<u>733,592</u>

Commitments and Contingencies (Notes 6 and 8)

See accompanying notes to financial statements.

Approved by:

  
Chair

  
Board Member, Chair  
Audit Committee



**Liquor Control Board of Ontario**  
**Statement of Income and Retained Income**  
**Year Ended March 31, 2008**

	2008 (\$ 000)	2007 (\$ 000)
Sales and other income	4,133,191	3,922,648
<b>Cost and expenses</b>		
Cost of sales	2,099,405	1,989,297
Retail stores and marketing	433,093	423,276
Warehousing and distribution	84,023	79,553
Administration	93,556	80,688
Amortization	48,757	49,233
	<u>2,758,834</u>	<u>2,622,047</u>
<b>Net income for the year</b>	1,374,357	1,300,601
<b>Retained income, beginning of year</b>	310,881	289,980
	<u>1,685,238</u>	<u>1,590,581</u>
<b>Deduct</b>		
Dividend paid to the Province of Ontario	1,340,000	1,275,000
Payment to municipalities on behalf of the Province of Ontario (Note 9)	5,000	4,700
	<u>1,345,000</u>	<u>1,279,700</u>
<b>Retained income, end of year</b>	<u>340,238</u>	<u>310,881</u>

See accompanying notes to financial statements.

# Liquor Control Board of Ontario

## Statement of Cash Flows

Year Ended March 31, 2008

	2008 (\$ 000)	2007 (\$ 000)
<b>Cash provided from operations</b>		
Net income	1,374,357	1,300,601
Amortization	48,757	49,233
Loss (Gain) on sale of capital assets	407	(2,060)
	<u>1,423,521</u>	<u>1,347,774</u>
<b>Net change in non-cash items</b>		
Working capital	(13,512)	(3,767)
Accrued benefit obligation	4,508	14,492
	<u>1,414,517</u>	<u>1,358,499</u>
<b>Cash used for investment activities</b>		
Purchase of capital assets	(63,659)	(54,217)
Proceeds from sale of capital assets	9	2,673
	<u>(63,650)</u>	<u>(51,544)</u>
<b>Cash used for financing activities</b>		
Dividend paid to the Province of Ontario	(1,340,000)	(1,275,000)
Payment to municipalities on behalf of the Province of Ontario	(5,000)	(4,700)
	<u>(1,345,000)</u>	<u>(1,279,700)</u>
<b>Increase in cash during the year</b>	5,867	27,255
<b>Cash and cash equivalents, beginning of year</b>	135,785	108,530
<b>Cash and cash equivalents, end of year</b>	<u>141,652</u>	<u>135,785</u>

See accompanying notes to financial statements.

# Liquor Control Board of Ontario

## Notes to Financial Statements

March 31, 2008

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### 1. NATURE OF THE CORPORATION

The Liquor Control Board of Ontario (Board) is a corporation without share capital incorporated under the *Liquor Control Act*, R.S.O. 1990, Chapter L.18. The corporation is a government enterprise responsible for regulating the production, importation, distribution and sale of alcoholic beverages in the Province of Ontario. As an Ontario Crown Corporation, the Board is exempt from income taxes under Section 149(1)(d) of the *Canadian Income Tax Act*. The Board transfers most of its profits to the Province of Ontario's Consolidated Revenue Fund in the form of a dividend.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### (a) Basis of Accounting

The Board's financial statements are prepared in accordance with Canadian generally accepted accounting principles.

#### (b) Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### (c) Financial Instruments

The Board has adopted the new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA) pertaining to financial instruments. These standards establish guidance for the recognition and measurement of financial assets and liabilities and how financial instruments gains and losses should be accounted for. Under these new standards all financial instruments are classified into one of the following five categories: held-for-trading; held-to-maturity; loans and receivables; available-for-sale financial assets or other financial liabilities.

Under the new standards all financial instruments are required to be measured at fair value upon initial recognition except for certain related party transactions. After initial recognition, financial instruments should be measured at their fair values, except for financial assets classified as held-to-maturity, loans and receivables and other financial liabilities, which are measured at cost or amortized cost, using the effective interest rate method.

In accordance with the new standards, the Board's financial assets and liabilities are generally classified as follows:

- Cash and cash equivalents are classified as held-for-trading and recorded at fair value;
- Accounts receivable, trade and others are classified as loans and receivables and are measured at amortized cost, which approximates fair value given their short-term nature; and
- Accounts payable and accrued liabilities are classified as other financial liabilities and are recorded at amortized cost.

#### (d) Cash and Cash Equivalents

Cash and cash equivalents comprise cash and highly liquid investments with original maturity dates of less than 90 days.

The Board's investment policy restricts short-term investments to high-liquidity, high-grade money market instruments such as federal/provincial treasury bills, banker's acceptances and term deposits.

# Liquor Control Board of Ontario

## Notes to Financial Statements

March 31, 2008

(e) **Inventories**

Inventories are valued at the lower of cost and net realizable value with cost being determined by the moving average cost method.

(f) **Capital Assets**

Major capital expenditures with a future useful life beyond the current year are capitalized at cost and are amortized on a straight-line basis according to their estimated useful lives, as follows:

Buildings	20 years
Furniture and Fixtures	5 years
Leasehold Improvements	5 years or 10 years
Computer Equipment	3 years or 4 years

Minor capital expenditures and expenditures for repairs and maintenance are charged to income.

(g) **Revenue Recognition**

Revenue is recognized when the sale of products is made to customers.

(h) **Expense Recognition**

Expenses are recognized as incurred, on an accrual basis, in the period to which they relate.

### 3. ACCRUED BENEFIT OBLIGATION

The accrued benefit obligation includes accruals for employee termination payments and unfunded workers compensation obligation and unused vacation entitlements.

For the year ended March 31, 2008 the cost of these employee future benefits was \$13.3 million (2007 – \$23.2 million) and is included in Cost and expenses in the Statement of Income and Retained Income. The accrued benefit obligation as at March 31, 2008, is \$65.4 million (2007 – \$60.9 million) of which \$12.8 million (2007 – \$11.9 million) is classified as a current liability.

The cost of post-retirement, non-pension employee benefits is paid by the Ministry of Government and Consumer Services and is not included in the Statement of Income and Retained Income.

### 4. PENSION PLAN

The Board provides pension benefits for all its permanent employees (and to non-permanent employees who elect to participate) through the Public Service Pension Fund (PSPF) and the Ontario Public Service Employees' Union Pension Fund (OPSEU Pension Fund) which are multi-employer defined benefit pension plans established by the Province of Ontario. These plans are accounted for as defined contribution pension plans as the Board has insufficient information to apply defined benefit plan accounting. The expense represents the Board's contributions to the plans during the year.

For the year ended March 31, 2008 the expense was \$17.1 million (2007 – \$15.9 million) and is included in Cost and expenses in the Statement of Income and Retained Income.

# Liquor Control Board of Ontario

## Notes to Financial Statements

March 31, 2008

### 5. CAPITAL ASSETS

	2008 (\$000)			2007 (\$000)
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Land	13,139	—	13,139	13,139
Buildings	342,356	239,496	102,860	101,968
Furniture and fixtures	97,581	59,899	37,682	30,858
Leasehold improvements	247,524	190,670	56,854	58,732
Computer equipment	119,281	82,257	37,024	28,376
	819,881	572,322	247,559	233,073

### 6. LEASE COMMITMENTS

The Board is committed under operating leases on leased premises with future minimum rental payments due as follows:

	(\$000)
2009	47,457
2010	46,121
2011	44,059
2012	40,749
2013	37,672
Thereafter	287,309
	<u>503,367</u>

### 7. FINANCIAL INSTRUMENTS

The Board's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities. The carrying values of these instruments approximate fair value due to the short-term maturities of these instruments.

In management's opinion, the Board is not exposed to significant interest, foreign exchange or credit risks arising from these financial instruments. To manage foreign exchange risk associated with its purchases from foreign suppliers, the Board is authorized to enter into foreign exchange forward contracts, which are commitments to purchase foreign currencies at a specified date in the future at a fixed rate. As at March 31, 2008, the Board had foreign exchange forward contracts valued at \$5.2 million (2007 – nil).

Credit risk is the risk that a party to a foreign exchange forward contract will fail to discharge its obligation and cause the Board to incur financial loss. The Board minimizes credit risks by dealing only with major Canadian chartered banks and Canadian subsidiaries of major foreign banks.

# Liquor Control Board of Ontario

## Notes to Financial Statements

March 31, 2008

Embedded derivatives (elements of contracts whose cash flows move independently from the host contract) are required to be separated and measured at their respective fair values except under certain circumstances. When the Board enters into inventory purchase contracts in a functional currency other than the Canadian dollar or that of the supplier, an embedded derivative may exist. For the year ended March 31, 2008, management reviewed these contracts and has determined that the Board does not have any significant embedded derivatives that require separate accounting and disclosure.

### 8. CONTINGENCIES

The Board is involved in various legal actions arising out of the ordinary course and conduct of business. The outcome and ultimate disposition of these actions are not determinable at this time. Accordingly, no provision for these actions is reflected in the financial statements. Settlements, if any, concerning these contingencies will be accounted for in the period in which the settlement occurs.

### 9. PAYMENT TO MUNICIPALITIES

In prior years, the Board was directed by the Province to assist municipalities with their container recycling costs. The Board contributed \$4.7 million for the year ended March 31, 2007. For the year ended March 31, 2008, the Board was directed by the Province to contribute \$5 million to assist municipalities with their transition costs associated with the implementation of the Ontario Deposit Return Program. The Board has been similarly directed to contribute \$5 million to municipalities for the year ending March 31, 2009.

### 10. ONTARIO DEPOSIT RETURN PROGRAM

On November 6, 2006, the Province of Ontario entered into an agreement with Brewers Retail Inc. for management of a province-wide container deposit return program on wine, liquor and beer containers sold through the Board and Winery, on-site Microbrewery and Distillery Retail Stores. Brewers Retail Inc. was appointed the exclusive service provider for a period of five years effective February 5, 2007.

Under the program, the Board collects a deposit of 10 cents or 20 cents on wine, liquor and beer containers. The Board reimburses Brewers Retail Inc. for deposits it pays to customers who return containers to locations it operates, plus a service fee. In addition, the government directed the Board to spend \$7.5 million over the first two years of the agreement to promote the program.

For the year ended March 31, 2008, the Board collected \$55.7 million (2007 - \$6.3 million) of deposits on containers and was invoiced \$37 million (2007 - \$3.8 million) by Brewers Retail Inc. for refunds to the customers.

Expenditures in connection with this program for the year ended March 31, 2008, amounted to \$24.6 million (2007 - \$2.5 million) for service fees to Brewers Retail Inc. and \$0.8 million (2007 - \$5.8 million) for promoting the program. These expenditures are included in Administration in the Statement of Income and Retained Income.

The Board's experience indicates that not all container deposits are redeemed. Based upon its redemption data and research of industry experience, part of the container deposits collected would not be redeemed. Accordingly, for the year ended March 31, 2008 the Board applied \$8.2 million (2007 - nil) of unredeemed deposits as a reduction to expenditures in connection with the program.

# Liquor Control Board of Ontario

## Notes to Financial Statements

March 31, 2008

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### 11. FUTURE CHANGES IN ACCOUNTING POLICIES

#### *International Financial Reporting Standards*

In February 2008, the Accounting Standards Board confirmed that Canadian generally accepted accounting principles (GAAP) for publicly accountable enterprises will be converged with International Financial Reporting Standards (IFRS) effective in calendar year 2011, with early adoption allowed starting in calendar year 2009. IFRS uses a conceptual framework similar to Canadian GAAP, but there are differences on recognition, measurement and disclosures. The Board is currently evaluating the impact of the adoption of IFRS on its financial statements.

In addition, the following standards will be effective for the year ended March 31, 2009:

#### *Financial Instruments – Disclosures and Presentation*

The new standards require increased disclosure regarding the risks associated with financial instruments and how these risks are managed. In addition, they will provide for additional guidance for the classification and presentation of financial instruments and non-financial derivatives.

#### *Inventories*

The new standard provides guidance on the determination of cost and requires inventories to be measured at the lower of cost and net realizable value. The cost of inventories should be determined using either a first-in first-out or weighted average cost formula; and includes product and other costs incurred in bringing the inventories to their present location and condition. Reversal of previous write-downs to net realizable value are now required when there is a subsequent increase in the value of such inventories. The new standard also requires additional disclosure.

#### *Capital Disclosures*

The CICA issued new accounting standards for disclosing information about an entity's capital and how it is managed. This section requires the disclosure of an entity's objectives, policies and processes for managing capital and information regarding an entity's compliance or non-compliance with any capital requirements.

The Board is currently evaluating the impact of these standards on its financial statements.

# The Niagara Parks Commission

## MANAGEMENT REPORT

The accompanying financial statements are the responsibility of the management of The Niagara Parks Commission.

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. Financial statements are not precise since they include certain amounts based on estimates and judgements. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects.

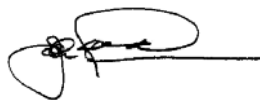
The Commission maintains a system of internal accounting and administrative control that is designed to provide reasonable assurance the financial information is relevant, reliable and accurate and that the Commission's assets are properly accounted for and adequately safeguarded.

The Commission is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements.

The Commission meets periodically with management to discuss internal controls over the financial reporting process, auditing matters

and financial reporting issues, and to satisfy itself that each party is properly discharging its responsibilities.

The financial statements have been audited by Crawford, Smith and Swallow Chartered Accountants LLP, the external auditors, in accordance with Canadian generally accepted auditing standards on behalf of the Commission, the Minister of Tourism and the Auditor General. Crawford, Smith and Swallow Chartered Accountants LLP has full and free access to the records of the Commission.



John A. M. Kernahan  
General Manager  
December 14, 2007



Robert J. McIlveen  
Executive Director, Corporate Services  
December 14, 2007

## AUDITORS' REPORT

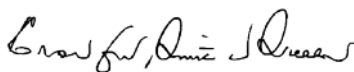
### *To The Niagara Parks Commission, the Minister of Tourism and the Auditor General*

Pursuant to the Niagara Parks Act which provides that The Niagara Parks Commission, an agency of the Crown, shall be audited by the Auditor General or an auditor designated by the Lieutenant Governor in Council, we have audited the balance sheet of The Niagara Parks Commission as at October 31, 2007 and the statements of operations, equity and cash flows for the year then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we 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 our opinion, these financial statements present fairly, in all material respects, the financial position of the Commission as at October 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.



**Crawford, Smith and Swallow**  
Chartered Accountants LLP  
Licensed Public Accountants  
Niagara Falls, Ontario  
December 14, 2007



# The Niagara Parks Commission

## Balance Sheet ~ October 31, 2007



### STATEMENT 1

(In thousands of dollars)

Assets	2007	2006
	\$	\$
<b>Current Assets</b>		
Cash	26,830	3,768
Accounts receivable	1,763	2,257
Inventories		
Saleable merchandise	3,330	3,432
Maintenance and other supplies	1,282	1,215
Prepaid expenses	400	480
	33,605	11,152
<b>Fixed Assets</b> - notes 3 and 4	142,542	133,005
	<b>176,147</b>	<b>144,157</b>
<b>Liabilities and Equity</b>		
<b>Current Liabilities</b>		
Accounts payable	8,783	5,646
Accrued payroll	1,027	1,854
Current portion of long-term financing	1,190	1,109
	11,000	8,609
<b>Long-Term Financing</b> - note 4	33,818	3,008
<b>Post-Employment Benefits</b> - note 5	3,457	3,294
<b>Commitments</b> - note 7		
<b>Contingencies</b> - note 8		
<b>Equity</b> - Statement 2	127,872	129,246
	<b>176,147</b>	<b>144,157</b>

see accompanying notes

Signed on behalf of the Commission:

Chairman

Commissioner

# The Niagara Parks Commission

## Statement of Equity ~ for the year ended October 31, 2007

### STATEMENT 2

	<i>(In thousands of dollars)</i>	
	2007	2006
	\$	\$
<b>Equity, Beginning of Year</b>	129,246	129,898
<b>Net Loss for the Year</b> - Statement 3	(1,374)	(652)
<b>Equity, End of Year</b>	<b>127,872</b>	<b>129,246</b>

see accompanying notes

# The Niagara Parks Commission

## Statement of Operations ~ for the year ended October 31, 2007

### STATEMENT 3

	<i>(In thousands of dollars)</i>	
	2007	2006
	\$	\$
<b>Income</b>		
Gift shops, restaurants and attractions	68,813	68,659
Land rent	6,037	5,914
Commissions, rentals and fees	2,535	3,425
Premium (loss) on United States funds – net	(360)	460
Gain (loss) on disposal of fixed assets – net	40	(3)
Sundry income	464	202
	77,529	78,657
<b>Expenses</b>		
Gift shops, restaurants and attractions		
Cost of goods sold	12,518	12,733
Operating expenses	30,969	31,075
Maintenance	13,216	13,178
Administrative and police	9,681	9,819
Marketing and promotion	4,004	3,860
	70,388	70,665
<b>Net Income for the Year before Undernoted Items</b>	7,141	7,992
<b>Other Items</b>		
Interest expense – net – note 9	331	305
Depreciation – note 10	8,184	8,339
	8,515	8,644
<b>Net Income Loss for the Year</b>	<b>(1,374)</b>	<b>(652)</b>

see accompanying notes

# The Niagara Parks Commission

## Statement of Cash Flows ~ for the year ended October 31, 2007

### STATEMENT 4

	<i>(In thousands of dollars)</i>	
	2007	2006
	\$	\$
<b>Operating Activities</b>		
Net loss for the year	(1,374)	(652)
Charges against income not requiring an outlay of funds		
- post-employment benefits	356	376
- depreciation	8,184	8,339
- loss (gain) on disposal of fixed assets - net	(5)	216
	7,161	8,279
Net change in non-cash working capital balances related to operations - note 12	2,919	(1,059)
Funds provided by operating activities	10,080	7,220
<b>Investing Activities</b>		
Fixed asset acquisitions - note 12	(17,799)	(9,764)
Proceeds on sale of fixed assets	83	32
Funds used by investing activities	(17,716)	(9,732)
<b>Financing Activities</b>		
Net increase (decrease) in long-term financing	30,891	(1,244)
Cash outlay related to post-employment benefits	(193)	(198)
Funds provided (used) by financing activities	30,698	(1,442)
<b>Increase (Decrease) in Cash Position</b>	23,062	(3,954)
<b>Cash Position, Beginning of Year</b>	3,768	7,722
<b>Cash Position, End of Year</b>	26,830	3,768

see accompanying notes

# The Niagara Parks Commission

## Notes to Financial Statements ~ for the year ended October 31, 2007

### Organization

The Niagara Parks Commission is governed by the Niagara Parks Act. Initially established in 1885, the Commission is an "Operational Enterprise" of the Province of Ontario and is responsible for maintaining, protecting and showcasing over 1,700 hectares of parkland stretching some 56 kilometres along the Niagara River from Lake Erie to Lake Ontario. The Commission is exempt from corporate income taxes under the Income Tax Act (Canada) and Ontario Corporations Tax Act.

### 1. Significant Accounting Policies

#### Basis of accounting

The financial statements of The Niagara Parks Commission (the "Commission") are the representations of management prepared in accordance with Canadian generally accepted accounting principles, consistently applied. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of estimates and approximations. These have been made using careful judgement in the light of available information. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below:

#### Revenue recognition

Income from gift shops, restaurants and attractions are recognized when merchandise has been transferred or services have been rendered. Income from land rent, commissions, rentals, fees and sundry are recognized over the life of the agreement or when earned.

#### Inventories

Inventories of saleable merchandise are valued at the lower of average cost and net realizable value.

#### Fixed assets

All fixed assets are recorded at cost. Depreciation has been recorded using the straight-line method, with rates from 2.5 to 33 per cent for buildings, roadways and structures, 10 to 33 per cent for equipment and furnishings and from 8 to 33 per cent for vehicles.

#### Foreign currency translation

These financial statements are presented in Canadian dollars. Assets and liabilities denominated in foreign currencies are translated at the exchange rates in effect at the balance sheet date. Gains and losses on translation are reflected in net earnings of the period.

#### Capitalized interest

The Commission capitalizes an amount of interest on all funds expended for those capital works in progress and financed via long-term financing.

# The Niagara Parks Commission

## Notes to Financial Statements ~ for the year ended October 31, 2007

### 2. Accounting Changes

*Financial Instruments - Recognition and Measurement and Financial Instruments - Disclosure and Presentation.* These new standards prescribe when a financial instrument is to be recognized and derecognized from the balance sheet and at what amount these financial instruments should be recognized. It also specifies how financial instrument gains and losses are accounted for. Under these new standards, all financial assets are classified as held-for-trading, held-to-maturity, loans and receivables or available-for-sale and all financial liabilities must be classified as held-for-trading or other financial liabilities. In addition, an entity has the option to designate financial assets or liabilities as held-for-trading or financial assets as available-for-sale on initial recognition or upon adoption of those standards, even if the financial instrument was not acquired or incurred for the purpose of selling or repurchasing it in the near term.

All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. After initial recognition, financial instruments should be measured at their fair values, except for financial assets classified as held-to-maturity or loans and receivables and other financial liabilities, which are measured at cost or amortized cost using the effective interest method. Financial assets classified as available-for-sale that do not have a quoted market price in an active market are measured at cost. Amortization related to financial assets classified as held-to-maturity or loans and receivables and other financial liabilities and unrealized gains and losses related to financial assets and liabilities classified as held-for-trading are recorded in net earnings for the period in which it arises. If a financial asset is classified as available-for-sale, the cumulative unrealized gain or loss is recognized in accumulated other comprehensive income and recognized in earnings upon the sale or other-than-temporary impairment.

The Commission has adopted the following classification for financial assets and financial liabilities:

- Cash and cash equivalents are classified as held-for-trading.
- Accounts and other receivables are classified as loans and receivables.
- Accounts payable and other accrued liabilities and long-term financing are classified as other financial liabilities.

The new standards require all derivative financial instruments to be measured at fair value on the balance sheet, even when they are part of an effective hedging relationship. An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract, with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. If certain conditions are met, an embedded derivative is separated from the host contract and accounted for as a derivative in the balance sheet and measured at fair value. Upon adoption, entities have the option to recognize as an asset or liability all embedded derivative instruments that are required to be separated from their host contracts. As at October 31, 2007, the Commission does not have any material outstanding contracts or financial instruments with embedded derivatives that require bifurcation.

## The Niagara Parks Commission

### Notes to Financial Statements ~ for the year ended October 31, 2007

#### 3. Fixed Assets

*(In thousands of dollars)*

	Cost	Accumulated Depreciation	2007	2006
	\$	\$	\$	\$
Land	13,555	—	13,555	13,555
Land improvements	17,135	—	17,135	17,135
Buildings, roadways and structures	154,661	68,094	86,567	88,647
Equipment and furnishings	35,536	27,122	8,414	9,933
Vehicles	9,164	7,572	1,592	1,917
	230,051	102,788	127,263	131,187
Capital works in progress	15,279	—	15,279	1,818
	<b>245,330</b>	<b>102,788</b>	<b>142,542</b>	<b>133,005</b>

# The Niagara Parks Commission

## Notes to Financial Statements ~ for the year ended October 31, 2007

### 4. Long-Term Financing

(In thousands of dollars)

	2007	2006
	\$	\$
Fixed rate term loan requiring principal payments of \$2,640,907 per annum, bearing interest at 5.06% through to April, 2027	32,000	-
Fixed rate term loan requiring principal payments of \$1,000,000 per annum, bearing interest at 4.01% through to December, 2009	3,000	4,000
The Commission has an obligation under capital lease, bearing interest of nil, requiring monthly payments of \$ 489 to October, 2009, secured by equipment with a net book value of \$ 11,670	8	14
The Commission has an obligation under capital lease, bearing interest of nil, requiring one payment of \$ 81,363 to November, 2006	-	81
The Commission has an obligation under capital lease, bearing interest of nil, requiring monthly payments of \$ 2,779 to March, 2007	-	13
The Commission has an obligation under capital lease, bearing interest of nil, requiring monthly payments of \$ 875 to September, 2007	-	9
	35,008	4,117
Less portion due within one year	1,190	1,109
	<b>33,818</b>	<b>3,008</b>

The principal payments of the long-term financing obligations are due in the next five fiscal periods are as follows:

(In thousands of dollars)

	\$
2008	1,190
2009	2,034
2010	2,084
2011	1,139
2012	1,196



# The Niagara Parks Commission

## Notes to Financial Statements ~ for the year ended October 31, 2007

### 5. Post-Employment Benefits

#### Defined Termination Benefit

The Commission provides a defined employee future benefit, payable on termination to certain full-time employees with a minimum of five years of service. The benefit is calculated on the basis of one week's remuneration, at the time of termination, for every year of full-time service provided to the Commission to a maximum of 26 weeks. The accrued benefit liability as at October 31, 2007 is \$ 3,456,833 (2006 - \$ 3,294,058).

As a result of an actuarial valuation conducted in 2007 for the year ending October 31, 2007, it was determined that an actuarial gain of \$ 242,488 existed. The actual obligation as at October 31, 2007 is \$ 3,214,345 (2006 - \$ 3,359,635). Since the actuarial gain is less than 10% of the actual obligation, no minimum amortization has been recorded for the year.

The Commission requires that an actuarial valuation of the post employment benefits be conducted every three years. Therefore, the next valuation required would be for the year ending October 31, 2010.

#### Defined Benefit Plan Information

(In thousands of dollars)

	2007	2006
	\$	\$
Employee benefit plan assets	—	—
Employee benefit plan liabilities	3,457	3,294
Employee benefit plan deficit	<b>3,457</b>	<b>3,294</b>
Benefit obligation recognized on the balance sheet		
Benefit obligation, beginning of year	3,294	3,116
Expense for the year	356	376
Benefits paid during the year	(193)	(198)
Benefit obligation, end of year	<b>3,457</b>	<b>3,294</b>

The main actuarial assumptions applied in the valuation of the defined benefit plan are as follows:

**Interest (Discount) Rate** - The accrued obligation and the expense for the year were determined using a discount rate of 5%.

**Salary Levels** - Future salary and wage levels were assumed to increase at 3% per annum.

#### Pension Benefits

The Commission provides pension benefits for all its permanent employees (and to non-permanent employees who elect to participate) through the Public Service Pension Fund (PSPF) and the Ontario Public Service Employees' Union Pension Fund (OPSEU Pension Fund). These are multi-employer plans established by the Province of Ontario. These plans are accounted for as defined contribution plans, as the Commission has insufficient information to apply defined benefit plan accounting to these pension plans.

The Commission's obligations related to the PSPF and OPSEU Pension Fund was \$ 1,541,361 (2006 - \$ 1,522,827) and are included in the administrative and general expenses in the Statement of Operations.

The cost of post-employment, non-pension benefits are paid by the Management Board Secretariat and are not included in the Statement of Operations.

# The Niagara Parks Commission

## Notes to Financial Statements ~ for the year ended October 31, 2007

### 6. Credit Facilities

The credit facilities, which have a maximum borrowing capacity of \$ 15,000,000, provide for two types of loans. There is a variable rate option with a rate which varies with the Bank of Montreal's prime rate and there is a fixed rate operating loan facility available for terms of 30/60/90/180 or 364 days at rates which are set relative to Banker's Acceptance rates.

### 7. Commitments

The Commission is committed to spending approximately \$ 25,000,000 on capital projects in the next year.

### 8. Contingencies

The Commission is in litigation pertaining to certain claims for which the likelihood of loss is not determinable and the amount not reasonably estimable. Accordingly, no provision for these claims is reflected in the financial statements.

### 9. Interest Expense

(In thousands of dollars)

	2007	2006
	\$	\$
Interest income	(582)	(135)
Loan interest expense	913	440
	<b>331</b>	<b>305</b>

### 10. Depreciation

(In thousands of dollars)

	2007	2006
	\$	\$
Depreciation of income producing assets	4,748	4,894
Depreciation of non-income producing assets	3,436	3,445
	<b>8,184</b>	<b>8,339</b>

### 11. Operating Leases

The Commission leases vehicles, equipment and premises under operating leases expiring in various years through 2011. The total obligation under operating leases amounts to approximately \$ 846,691.

Future payments for each of the next four years are as follows:

(In thousands of dollars)

	\$
2008	370
2009	290
2010	186
2011	1

# The Niagara Parks Commission

## Notes to Financial Statements ~ for the year ended October 31, 2007

### 12. Statement of Cash Flows

Changes in working capital components include:

	<i>(In thousands of dollars)</i>	
	2007	2006
	\$	\$
Accounts receivable	494	(311)
Inventories	35	(1)
Prepaid expenses	80	49
Accounts payable and accrued payroll	2,310	(796)
	<b>2,919</b>	<b>(1,059)</b>

#### Acquisition of fixed assets

During the year, fixed assets were acquired at an aggregate cost of \$ 17,799,000 (2006 - \$ 9,764,000) of which nil (2006 - \$ 17,000) was acquired by means of capital leases. Cash payments of \$ 17,799,000 (2006 - \$ 9,747,000) were made to purchase fixed assets.

	<i>(In thousands of dollars)</i>	
	2007	2006
	\$	\$
Interest received	<b>523</b>	<b>135</b>
Interest paid	<b>306</b>	<b>398</b>

### 13. Financial Instruments and Risk Management

#### Credit Risk

The Commission is exposed to a credit risk by its customers. However, because of the large number of customers, credit risk concentration is reduced to a minimum.

#### Currency Risk

The Commission has cash of \$ 5,255,465 that is denominated in US dollars. This account has been converted to the Canadian equivalent at the rate of \$ 0.9325 US equals \$ 1 Canadian. The Commission realizes approximately 18.1% (2006 - 17.04%) of its sales in foreign currency. Consequently, some assets and revenues are exposed to foreign exchange fluctuations.

#### Cash Flow Risk

The Commission has a variable rate bank overdraft facilities bearing interest which varies with the prime interest rate. Accordingly, the Commission is exposed to cash flow risks relating to potential fluctuations in market interest rates.

### 14. Capitalized Interest

The Commission has capitalized \$232,301 of interest related to the expansion of the Table Rock Complex which is likely to be completed in June 2008.

### 15. Surplus Funds

Pursuant to Section 16(2) of the Niagara Parks Act any surplus moneys shall, on the order of the Lieutenant Governor in Council, be paid to the Minister of Finance and shall form part of the Consolidated Revenue Fund.

### 16. Comparative Figures

Certain comparative figures have been restated to conform with the current year's presentation.

## Management's Responsibility for Financial Information

The Ontario Clean Water Agency is dedicated to the highest standards of integrity in its business. To safeguard assets, the Agency has a sound set of internal financial controls and procedures that balance benefits and costs. Management has developed and maintains financial and management controls, information systems and management practices to provide reasonable assurance of the reliability of financial information in accordance with the bylaws of the Agency. Internal audits are conducted to assess management systems and practices and reports are issued to the Senior Management Committee.

The Board of Directors ensures that management fulfills its responsibilities for financial information and internal control. The Board of Directors meets quarterly to oversee the financial activities of the Agency and at least annually to review the financial statements and the external auditor's report thereon, and recommend them to the Minister of Environment for approval.

The Auditor General has examined the financial statements. The Auditor General's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles. The Auditor's Report outlines the scope of the Auditor's examination and opinion.

Signed by

**Dante Pontone**

President and Chief Executive Officer

Signed by

**Brenda Baker**

Vice President, Finance and Corporate Services

## Auditor's Report

To the Ontario Clean Water Agency,  
the Minister of the Environment  
and to the Minister of Finance

I have audited the balance sheet of the Ontario Clean Water Agency as at December 31, 2007 and the statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Agency'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 Agency as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Ontario  
March 26, 2008



Jim McCarter, CA  
Auditor General  
Licensed Public Accountant

## Balance Sheet — Assets

As at December 31, 2007

<i>(in thousands of dollars)</i>	2007	2006 (as restated — note 15)
<b>Current assets:</b>		
Cash and short-term investments	46,178	34,617
Accounts receivable, net		
Municipalities and other customers	23,848	22,318
Ministry of the Environment	380	60
Goods and services tax receivable	1,429	982
Prepaid Expenses	3,153	3,390
Current portion of investments receivable:		
Water and wastewater facilities (note 2)	1,232	2,683
Facilities under construction (note 3)	164	1,241
Note receivable (note 5)	203	211
	76,587	65,502
<b>Non-current assets</b>		
Investments receivable for water and wastewater facilities (note 2 and note 15a)	7,356	9,127
Loan receivable - Infrastructure Ontario (note 4)	120,000	120,000
Fixed assets, net (note 6)	4,542	4,662
	131,898	133,789
<b>Total Assets</b>	<b>208,485</b>	<b>199,291</b>

See accompanying notes to financial statements

### On behalf of the Board

Signed by  
**John Burke**  
Director

Signed by  
**John Bergsma**  
Director

## Balance Sheet — Liabilities and Equity

As at December 31, 2007

<i>(in thousands of dollars)</i>	2007	2006 (as restated — note 15)
<b>Current liabilities:</b>		
Accounts payable and accrued liabilities	18,634	16,248
Current portion of employee future benefits (note 9)	2,848	2,714
Provision for restructuring costs	0	172
	21,482	19,134
<b>Long-term liabilities:</b>		
Municipal contributions payable (note 8)	252	271
Employee future benefits (note 9)	8,244	8,061
	8,496	8,332
<b>Equity of Ontario:</b>		
Contributed surplus (note 11)	95,820	95,872
Retained earnings (note 15)	82,687	75,953
	178,507	171,825
Contingencies (note 12)		
<b>Total Liabilities and Equity</b>	<b>208,485</b>	<b>199,291</b>

See accompanying notes to financial statements

# Statement of Income and Retained Earnings

For the Year Ended December 31, 2007

<i>(in thousands of dollars)</i>	2007	2006 (as restated — note 15)
<b>Utility Operations Revenues:</b>		
Utility operations	119,987	110,098
Fees	2,314	2,710
<b>Total Operating Revenues</b>	<b>122,301</b>	<b>112,808</b>
<b>Operating Expenses:</b>		
Salaries and benefits (note 9 and note 10)	50,948	49,426
Other operating expenses	70,956	65,518
Amortization of fixed assets	1,650	1,673
<b>Total Operating Expenses</b>	<b>123,554</b>	<b>116,617</b>
<b>Net Loss - Utility Operations</b>	<b>(1,253)</b>	<b>(3,809)</b>
<b>Financing Revenues:</b>		
Interest from investments, loans receivable and facilities under construction	8,017	7,115
<b>Total Financing Revenues</b>	<b>8,017</b>	<b>7,115</b>
<b>Financing Expenses:</b>		
Interest	12	30
Loan administration expenses	80	32
Amortization of fixed assets	60	60
<b>Total Financing Expenses</b>	<b>152</b>	<b>122</b>
<b>Net Income - Financing</b>	<b>7,865</b>	<b>6,993</b>
Net Income for the Year Before Property Transfer Initiative	6,612	3,184
Property Transfer Initiative (note 13)	(55)	(50)
<b>Net Income for the Year</b>	<b>6,557</b>	<b>3,134</b>
Retained earnings, opening balance	75,953	72,819
Adjustment for new standards on financial instruments (note 15a)	177	0
Revised retained earnings, opening balance	76,130	72,819
<b>Retained earnings, ending balance</b>	<b>82,687</b>	<b>75,953</b>

See accompanying notes to financial statements



# Statement of Cash Flows

For the Year Ended December 31, 2007

<i>(in thousands of dollars)</i>	2007	2006 (as restated — note 15)
<b>Cash provided by (used for)</b>		
<b>Operating activities:</b>		
Net Income	6,557	3,134
Items not affecting cash:		
- Amortization of fixed assets	1,710	1,733
	8,267	4,867
Changes in non-cash operating working capital		
- Accounts receivable	(2,297)	(1,615)
- Prepaid Expenses	237	(265)
- Accounts payable and accrued liabilities	2,386	(4,101)
- Provision for restructuring costs	(172)	(89)
	154	(6,070)
<b>Net cash flows from operating activities</b>	<b>8,421</b>	<b>(1,203)</b>
<b>Financing Activities:</b>		
Decrease in investments receivable for water and wastewater facilities	3,399	2,362
Decrease in investments receivable for facilities under construction	1,077	2,056
Decrease in municipal contributions payable	(19)	(837)
Increase in future employee benefits payable	317	974
Decrease (increase) in note receivable	8	(211)
Changes in contributed surplus	(52)	(255)
<b>Net cash flows from financing activities</b>	<b>4,730</b>	<b>4,089</b>
Fixed assets - acquired	(1,590)	(1,329)
Increase in Cash	11,561	1,557
Cash and Short-Term Investments, Opening Balance	34,617	33,060
<b>Cash and Short-Term Investments, Ending Balance</b>	<b>46,178</b>	<b>34,617</b>

See accompanying notes to financial statements

# Notes to Financial Statements

## General

The Ontario Clean Water Agency (The "Agency") was established on November 15, 1993, under the authority of *The Capital Investment Plan Act, 1993* (the "Act").

In accordance with the Act, the Agency's objectives include:

- assisting municipalities to provide water and wastewater services on a cost-recovery basis by financing, planning, developing, building and operating such works and services;
- financing, building and operating water and wastewater facilities on behalf of Ontario on a cost-recovery basis; and
- providing these services to protect human health and the environment, encouraging conservation of water resources and supporting Provincial policies for land use and settlement.

The Agency is exempt from Federal and Provincial income taxes.

### 1. Significant Accounting Policies

These financial statements are prepared in accordance with Canadian generally accepted accounting principles as prescribed by the Canadian Institute of Chartered Accountants. Included below are those accounting policies that are of significance to the Agency.

#### (a) Cash and Short-term Investments

Cash and short-term investments are highly liquid investments with original maturities of three months or less when purchased.

#### (b) Fixed Assets

During fiscal 2007 the Agency changed its method of amortizing fixed assets from that of a declining balance, to straight line basis in order to better reflect the useful economic life of the Agency's assets. Major capital expenditures with a future useful life beyond the current year are capitalized at cost. Fixed assets are being amortized as follows:

Automotive equipment	4 years
Furniture and fixtures	5 years
Computer hardware	3 years
Computer software	2 years
Machinery and equipment	5 years
Financial information system	7 years
Leasehold improvements	Life of the lease

#### (c) Revenue Recognition

A portion of the contractual arrangements with clients for the operation of water and wastewater treatment facilities provides for the recovery of all costs incurred in their operations plus a management fee. Revenue is recognized at the time such costs are incurred.

(d) **Financial Instruments**

On January 1, 2007, the Agency adopted the new CICA standards pertaining to financial instruments. These standards provide accounting guidelines for recognition and measurement of financial assets and liabilities. All financial instruments are classified into one of the following five categories: held-for-trading, held to maturity, loans and receivables, available for sale financial assets, or other financial liabilities. Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification. At the Agency, the following classifications have been made:

- Cash and short-term investments and notes receivable are classified as held for trading and recorded at fair market value, and changes in value during the period are recorded in net income.
- Accounts Receivable and Facilities Under Construction are classified as loans and receivables, and are valued at face value because they are due within one year.
- Investments Receivable for water and wastewater facilities are classified as loans and receivables, are initially measured at fair market value and subsequently valued at amortized cost using the straight line amortization method. Amortization is charged to the Statement of Income and Retained Earnings.
- The Loan Receivable from Infrastructure Ontario is classified as an available-for-sale financial asset and is valued at face value, which is essentially the same as fair market value because of the nature of variable-rate financial instruments.
- Accounts payable and accrued liabilities are classified as other financial liabilities and are recorded at face value because they are due within a year.

(e) **Use of Estimates**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenditures for the period. Actual amounts could differ from these estimates.

2. **Investments Receivable for Water and Wastewater Facilities**

- (a) These investments represent the outstanding principal portion of amounts receivable from clients for capital expenditures undertaken by the Agency on their behalf, and recoverable operating costs, if any, not billed. In addition, they include capitalized interest on certain facilities that will be collected from clients during future years.
- (b) The investments receivable are supported by agreements that bear interest at rates between 5.32% and 10.52%. Scheduled principal repayments of the investments are as follows:

(12 Months Beginning January ) (in thousands of dollars)	
2008	1,232
2009	1,101
2010	767
2011	786
2012	813
Thereafter	3,759
	8,458
Less: Current portion	1,232
	7,226
Adjustment to Amortized Cost (Note 15a)	130
	7,356

### 3. Facilities Under Construction

Facilities under construction represent water and wastewater facilities or major capital improvements to existing facilities that have been undertaken by the Agency on behalf of its clients.

### 4. Loan Receivable — Infrastructure Ontario

The Agency has a loan of \$120 million with Infrastructure Ontario, an agency of the provincial government, which matures on March 1, 2023. The interest on the note is paid quarterly, with a rate set at four basis points below the average monthly Canadian Dollar Offered Rate. The market value of the note approximates cost.

### 5. Note Receivable — Stelco Inc.

The Agency received a Secured Floating Rate Note from Stelco Inc. as part of the consideration for services provided by the Agency. The note has a face value of US\$183,000 and a maturity date of March 31, 2016.

### 6. Fixed Assets

<i>(in thousands of dollars)</i>	Cost	Accumulated Amortization	<b>December 31, 2007</b>	December 31, 2006
Furniture and fixtures	1,762	1,479	<b>283</b>	371
Automotive equipment	167	145	<b>22</b>	35
Computer hardware	7,761	6,586	<b>1,175</b>	1,360
Computer software	4,124	3,682	<b>442</b>	928
Machinery and equipment	571	424	<b>147</b>	169
Financial information system	1,397	95	<b>1,302</b>	0
Leasehold improvements	6,694	5,523	<b>1,171</b>	1,799
	<b>22,476</b>	<b>17,934</b>	<b>4,542</b>	<b>4,662</b>

### 7. Lease Commitments

Annual lease payments under operating leases for rental of office equipment, premises and vehicles in aggregate are as follows:

<i>(in thousands of dollars)</i>	
2008	2,069
2009	1,271
2010	764
2011	464
2012	233
Thereafter	9
	<b>4,810</b>

### 8. Municipal Contributions Payable

At December 31, 2007, the Agency held funds on behalf of the municipalities amounting to \$0.3 million (2006 — \$0.3 million). These funds are included in cash and short-term investments.

## 9. Non-Pension Employee Future Benefits

The Agency is responsible for its accrued legislated severance, unpaid vacation, and workers compensation obligations.

The costs of these employee future benefits have been estimated at \$11.1 million (2006 — \$10.8 million, as restated) of which \$2.8 million has been classified as current liability. The amount accrued in 2007 was \$1.4 million (2006 — \$1.9 million, as restated) and is included in salaries and benefits expense in the Statement of Income and Retained Earnings.

Included in employee future benefits is an estimated workers compensation obligation in the amount of \$1.6 million (2006 — \$1.7 million). This amount has been determined from the most recent available actuarial calculations provided by the Workplace Safety and Insurance Board (WSIB) as at December 31, 2006.

It is management's opinion that the balance at December 31, 2007 will not be materially different. Adjustment to the estimated WSIB obligation cumulative balance, if any, will be made in the year the actual balance is provided by WSIB.

The cost of other post-retirement, non-pension employee benefits is paid by the Ministry of Government and Consumer Services and therefore is not included in the financial statements.

## 10. Pension Plan

The Agency provides pension benefits for all its full-time employees through participation in the Public Service Pension Fund (PSPF) and the Ontario Public Service Employees' Union Pension Fund (OPSEU Pension Fund) that are both multiemployer defined benefit pension plans established by the Province of Ontario. These plans are accounted for as defined contribution plans, as the Agency has insufficient information to apply defined benefit accounting to these pension plans. The Agency's contribution related to the pension plans for the period was \$2.3 million (2006 — \$2.3 million) and is included in salaries and benefits in the Statement of Income and Retained Earnings.

## 11. Contributed Surplus

When the Agency was first established, the opening contributed surplus was received from the Province of Ontario in the form of the book value of net assets in excess of obligations assumed.

The adjustments to the opening balance relate to repairs and maintenance, legal costs and the write off of provincial assistance advances that were agreed to prior to the establishment of the Agency. The funds committed for such repairs and maintenance are spent on various undertakings. The largest of these undertakings has a spending limit of \$7.5 million for capital repairs as approved by the Agency's Board of Directors. Of the \$7.5 million approved, a cumulated \$6.0 million has been spent. On other undertakings, a cumulated \$5.6 million has been spent.

<i>(in thousands of dollars)</i>	<b>December 31, 2007</b>	December 31, 2006
Opening balance, January 1	<b>95,872</b>	96,127
Adjustments to opening balance	<b>(52)</b>	(255)
	<b>95,820</b>	95,872

## 12. Contingencies

### (a) Litigation

The Agency is the defendant in a number of lawsuits. Most of these claims are covered by insurance after the application of a deductible, ranging from \$5,000 to \$100,000, depending on when the event giving rise to the claim occurred and the nature of the claim. The outcome of the lawsuits cannot be determined at this time. Losses, if any, will be accounted for in the period of settlement. The Agency's insurers have denied coverage with respect to several related multi-million dollar lawsuits in which the Agency has been named as a defendant by the same plaintiff. These lawsuits are currently being held in abeyance and it is believed that the Agency's exposure is significantly less than the amounts claimed, although the exact amount of the Agency's exposure cannot be determined at this time. In the event the litigation proceeds, the Agency's exposure will need to be re-evaluated periodically.

### (b) Investments Receivable for Water and Wastewater Facilities

In August of 1999, the Agency entered into a loan agreement to finance the construction of a water pipeline, which was completed in May 2000. The outstanding loan balance including accumulated interest was \$18.6 million at December 31, 2005. The loan agreement specified that repayment would be through sales of water, rather than according to a predetermined schedule. As of December 31, 2007, no principal or interest payments have been made. Currently, the pipeline and the payments of the outstanding loan is the subject of ongoing discussions amongst various levels of government. Given the significant uncertainty regarding future water sales, in December 2005, the Agency provided for this loan in the full amount of \$18.6 million. Beginning January 1, 2006, the Agency stopped recognizing interest on the loan and will recognize that interest revenue when payment is received. At December 31, 2007, the outstanding loan balance including accumulated interest is \$21.3 million.

## 13. Property Transfer Initiative

In 1997, the Province passed legislation requiring the transfer of ownership of water and wastewater facilities from the Agency to municipalities. The Property Transfer Initiative captures all real estate conveyance costs associated with the title transfers. During 2007, \$0.055 million (2006 – \$0.050 million) was spent on this initiative. The transfers have been substantially completed and \$4.7 million has been spent.

## 14. Related Party Transactions

As a result of the relationship of the Agency with the Province, the following related party transactions exist and have been disclosed in the notes to the financial statements:

- (a) The Agency received revenue of \$2.3 million (2006 – \$0.7 million) from the Ontario Realty Corporation for water and wastewater treatment services OCWA provided. The services were provided at competitive rates similar to those of other OCWA clients.
- (b) The Agency received revenue of \$1.9 million (2006 – \$2.3 million) from the Ministry of the Environment for water and wastewater treatment services OCWA provided. The services were provided at competitive rates similar to those of other OCWA clients.
- (c) The Agency provided a \$120 million loan to Infrastructure Ontario, as described in note 4.
- (d) The Agency relies on the Ministry of Government and Consumer Services to process its payroll and administer its benefits. The Ministry of Government and Consumer Services absorbs some of these administrative costs.

### 15. Changes in Accounting Policy

There were two changes in accounting policies implemented during 2007, as follows:

- (a) A new accounting standard regarding financial instruments became effective at the Agency commencing in 2007. The standard requires all financial instruments to be included on the balance sheet, and measured at fair market value or, in certain circumstances when fair market value may not be considered the most relevant, at cost or amortized cost.

Any changes to the fair value of assets and liabilities prior to January 1, 2007 were recognized by adjusting opening retained earnings. Opening retained earnings was increased \$0.2 million to reflect the corresponding increase in the investments receivable for water and wastewater facilities valued at its amortized cost value. This amount will be amortized to expense over the term of the loan (2007 – \$0.047 million).

- (b) Effective January 1, 2007, the Agency retroactively adopted a policy whereby the costs of any unused vacation entitlements earned by employees would be recognized when earned by eligible employees. The following table summarizes the effect of the change in accounting on the financial statements as at December 31, 2006.

	Restated Amount	Previously Reported	Increase/ (Decrease)
<b>Balance Sheet Effect</b>			
Employee Future Benefits – Current	2,714	1,000	1,714
Employee Future Benefits – Long Term	8,061	7,014	1,047
Retained Earnings	75,953	78,714	(2,761)
<b>Income and Retained Earnings Effect</b>			
Operating Expenses-Salaries and Benefits	49,426	48,929	497
Net Income for the Year	3,134	3,631	(497)
Retained Earnings-January 1, 2006	72,819	75,083	(2,264)

## 16. Salaries

The “*Public Sector Salary Disclosure Act, 1996*” requires disclosure of Ontario public-sector employees paid an annual remuneration in excess of \$100,000. The salary portion of an individual’s compensation includes base salary, overtime payments, vacation/lieu time payouts, and incentive and/or lump sum merit payments. Listed below — by name, position, salary paid and taxable benefits — are those within OCWA whose salary exceeded \$100,000 for the year 2007.

Name	Position	Salary Paid	Other Benefits
Atkinson, Daniel	Vice President, Operations, Southern Ontario	126,469.74	219.76
Baker, Brenda	Vice President, Finance and Corporate Services	124,960.24	219.52
Cameron, Kirk	Director, Information Technology	102,334.73	178.76
Clappison, Stephen	Thermal Operator 4	101,755.60	152.34
Dormer, Robert	Project Manager	105,611.42	190.55
Edwards, David	Regional Manager, South Peel	104,578.32	184.06
Ethier, Marc	Regional Manager, Waterloo	103,956.34	184.04
Jenkins, Robert	Project Manager	106,057.95	186.78
Kempenaar, Gary	Regional Manager, Operational Efficiency & Innovation	106,941.85	184.04
Kind, Robin	General Counsel	190,274.53	326.28
Komulainen, Ilmari	Regional Manager, Eastern Region	106,941.85	184.04
Lang, Glen	Manager, Corporate Planning and Communications	103,132.62	161.96
Love, Steven	Legal Counsel	107,464.46	193.50
Pontone, Dante	President and Chief Executive Officer	164,471.98	279.08
Reid, Nicholas	Vice President, Business Development	111,364.95	194.76
Rinas, Wilhelm	Legal Counsel	146,418.68	261.48
Terry, George	Vice President, Operations, Northern Ontario and First Nations	114,857.07	196.94
Valickis, Andy	Project Manager	107,698.19	189.69
West, Philip	Thermal Operator 3	100,117.16	143.58
Williams, Gordon	Regional Manager, Northern Region	106,941.85	184.04







## ***MANAGEMENT'S RESPONSIBILITY FOR ANNUAL REPORTING***

The accompanying consolidated financial statements of the Ontario Lottery and Gaming Corporation and all information in this annual report are the responsibility of management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. Where required, management has made informed judgements and estimates in accordance with Canadian generally accepted accounting principles.

The Board of Directors oversees management's responsibilities for financial reporting through its Audit and Risk Management Committee, which is composed entirely of directors who are neither officers nor employees of the Corporation. The Audit and Risk Management Committee reviews the financial statements and recommends them to the Board for approval. This Committee meets periodically with management, internal audit and the external auditors.

To discharge its responsibility, management maintains an appropriate system of internal control to provide reasonable assurance that relevant and reliable consolidated financial statements are produced and that the Corporation's assets are properly safeguarded. The Corporation maintains a staff of internal auditors whose functions include reviewing internal controls and their applications, on an ongoing basis. The reports prepared by the internal auditors are reviewed by the Committee. The Chief Risk Officer, responsible for Internal Audit and Enterprise Risk Management, reports directly to the Audit and Risk Management Committee.

Grant Thornton LLP and KPMG LLP, the independent auditors appointed by the Board of Directors upon the recommendation of the Audit and Risk Management Committee, have examined the consolidated financial statements. Their report outlines the scope of their examination and their opinion on the consolidated financial statements. The independent auditors have full and unrestricted access to the Committee.

A handwritten signature in blue ink, appearing to read 'Kelly McDougald'.

Kelly McDougald  
Chief Executive Officer

A handwritten signature in blue ink, appearing to read 'John Black'.

John Black  
Chief Financial Officer



**KPMG LLP**  
**Chartered Accountants**  
Yonge Corporate Centre  
4100 Yonge St.  
Suite 200  
North York, ON M2P 2H3



**Grant Thornton LLP**  
**Chartered Accountants**  
**Management Consultants**  
5<sup>th</sup> Floor  
421 Bay Street  
Sault Ste. Marie, ON P6A 1X3

## AUDITORS' REPORT

To the Board of Directors of the Ontario Lottery and Gaming Corporation and to the Minister of Public Infrastructure Renewal:

We have audited the consolidated balance sheet of the Ontario Lottery and Gaming Corporation as at March 31, 2008 and the consolidated statements of income and other comprehensive income, retained earnings, contributed surplus and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we 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 our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at March 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants,  
Licensed Public Accountants

Toronto, Canada

May 16, 2008, except as to  
notes 8 and 13 f, which are as  
of June 10, 2008

Chartered Accountants,  
Licensed Public Accountants

Sault Ste. Marie, Canada

May 16, 2008, except as to  
notes 8 and 13 f, which are as  
of June 10, 2008

**Ontario Lottery and Gaming Corporation****Consolidated Balance Sheet**

As at March 31, 2008, with comparative figures for 2007  
(in thousands of dollars)

	2008	2007
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 361,152	\$ 408,076
Accounts receivable	78,899	78,699
Prepaid expenses and other	53,658	59,276
Current portion of loans receivable (Note 4)	7,892	7,482
	501,601	553,533
Restricted cash (Note 2)	183,491	122,400
Pre-opening and deferred expenditures (Note 3)	4,593	5,550
Loans receivable (Note 4)	37,604	49,760
Property, plant and equipment (Note 5)	2,500,217	2,412,353
Goodwill	1,776	1,776
Assets contributed to Chippewas of Mnjikaning (Note 7)	13,975	15,057
Cash and short-term investments held for First Nations (Note 8)	208,048	173,113
	<b>\$ 3,451,305</b>	<b>\$ 3,333,542</b>
<b>Liabilities and Equity</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 366,671	\$ 366,436
Due to operators (Note 9)	42,337	50,754
Due to Chippewas of Mnjikaning (Note 9)	1,957	2,534
Due to Government of Canada (Note 18)	8,534	6,042
Deferred revenues	16,131	13,366
Current portion of due to First Nations (Note 8)	47,374	-
Current portion of long-term debt (Note 10)	191,381	176,974
	674,385	616,106
Due to First Nations (Note 8)	160,674	173,113
Long-term debt (Note 10)	105,781	214,747
Accrued future benefit costs (Note 16)	26,072	17,902
Asset retirement obligation	1,352	1,165
<b>Equity</b>		
Retained earnings	2,251,737	2,127,773
Contributed surplus	62,345	60,645
Reserves (Note 2)	168,959	122,091
	2,483,041	2,310,509
	<b>\$ 3,451,305</b>	<b>\$ 3,333,542</b>

Commitments (Notes 2, 4, 9 and 12)

Contingencies (Notes 9 and 13)

Subsequent events (Notes 8 and 13)

See accompanying notes to consolidated financial statements.

On behalf of the Board



Michael Gough, Chair



Marlene McGraw, Director

**Ontario Lottery and Gaming Corporation****Consolidated Statement of Income and Other Comprehensive Income**

Year ended March 31, 2008, with comparative figures for 2007

(in thousands of dollars)

	2008	2007
<b>Revenues</b>		
Lotteries and bingo	\$ 2,773,125	\$ 2,655,607
Resort casinos	1,395,319	1,463,676
Casinos and slots at racetracks	2,050,831	1,965,510
	<b>6,219,275</b>	<b>6,084,793</b>
<b>Operating expenses</b>		
Lotteries and bingo	2,090,635	1,919,744
Resort casinos	1,470,586	1,489,268
Casinos and slots at racetracks	1,095,599	1,043,755
	<b>4,656,820</b>	<b>4,452,767</b>
<b>Income before the undernoted</b>	<b>1,562,455</b>	<b>1,632,026</b>
Interest and other income	48,141	46,175
Interest on long-term debt	-14,204	-26,864
Foreign exchange gain	11,039	16,784
<b>Net income and other comprehensive income</b>	<b>\$ 1,607,431</b>	<b>\$ 1,668,121</b>

Segmented information (Note 14)

See accompanying notes to consolidated financial statements.

**Ontario Lottery and Gaming Corporation****Consolidated Statement of Retained Earnings**

Year ended March 31, 2008, with comparative figures for 2007

(in thousands of dollars)

	2008	2007
Retained earnings, beginning of year	\$ 2,127,773	\$ 1,751,103
Net income	1,607,431	1,668,121
Transfers (to) from reserves, net	(46,868)	111,524
Distribution to First Nations on behalf of the Province of Ontario	(54,672)	(40,409)
Payments to the Province of Ontario	(1,381,927)	(1,362,566)
<b>Retained earnings, end of year</b>	<b>\$ 2,251,737</b>	<b>\$ 2,127,773</b>

**Consolidated Statement of Contributed Surplus**

Year ended March 31, 2008, with comparative figures for 2007

(in thousands of dollars)

	2008	2007
Contributed surplus, beginning of year	\$ 60,645	\$ 60,645
Contributed property, plant and equipment	1,700	-
<b>Contributed surplus, end of year</b>	<b>\$ 62,345</b>	<b>\$ 60,645</b>

See accompanying notes to consolidated financial statements.

**Ontario Lottery and Gaming Corporation****Consolidated Statement of Cash Flows**

Year ended March 31, 2008, with comparative figures for 2007

(in thousands of dollars)

	2008	2007
<b>Cash derived from (used in):</b>		
<b>Operations</b>		
Net income	\$ 1,607,431	\$ 1,668,121
Amortization of property, plant and equipment and asset retirement obligation	255,190	230,333
Amortization of non-property, plant and equipment	4,317	8,098
Accretion expense	186	84
Loss on disposal of property, plant and equipment	7,415	10,559
Change in non-cash working capital:		
Accounts receivable	(200)	(30,058)
Prepaid expenses and other	5,618	(2,532)
Accounts payable and accrued liabilities	235	48,546
Due to operators	(8,417)	1,883
Due to Chippewas of Mnjikaning	(577)	1,396
Due to Government of Canada	2,492	(320)
Deferred revenues	2,765	(3,509)
Accrued future benefit costs	8,170	7,101
Due to First Nations	(12,293)	5,635
<b>Net cash from operations</b>	<b>1,872,332</b>	<b>1,945,337</b>
<b>Financing</b>		
Increase in long-term debt	82,415	-
Repayments of long-term debt	(176,973)	(250,742)
Payments to Province of Ontario	(1,381,927)	(1,362,566)
Distributions to First Nations	(42,379)	(46,044)
<b>Net cash used in financing activities</b>	<b>(1,518,864)</b>	<b>(1,659,352)</b>
<b>Investing</b>		
Pre-opening and deferred expenditures	(2,278)	(486)
Issuance of loans receivable	(814)	(7,555)
Repayment of loans receivable	12,560	10,051
Capital expenditures	(352,234)	(362,062)
Proceeds on disposal of property, plant and equipment	3,465	3,374
Business acquisition	-	(2,500)
Decrease (increase) in restricted cash	(61,091)	160,451
<b>Net cash used in investing activities</b>	<b>(400,392)</b>	<b>(198,727)</b>
Increase (decrease) in cash and cash equivalents	(46,924)	87,258
Cash and cash equivalents, beginning of year	408,076	320,818
<b>Cash and cash equivalents, end of year</b>	<b>\$ 361,152</b>	<b>\$ 408,076</b>
<b>Cash and cash equivalents are comprised of:</b>		
Cash	\$ 325,342	\$ 329,376
Cash equivalents	35,810	78,700
	<b>\$ 361,152</b>	<b>\$ 408,076</b>
<b>Supplemental disclosure of cash flow information:</b>		
Cash interest received	\$ 15,507	\$ 19,042
Cash paid for interest	14,585	25,847

See accompanying notes to consolidated financial statements.

## Ontario Lottery and Gaming Corporation

### Notes to Consolidated Financial Statements

Year ended March 31, 2008, with comparative figures for 2007  
(tabular amounts in thousands of dollars)

The Ontario Lottery and Gaming Corporation (Corporation) was established without share capital on April 1, 2000 pursuant to the *Ontario Lottery and Gaming Corporation Act*, 1999. The Corporation is a Crown agency of the Ontario government and is responsible for conducting and managing lottery games, five casinos and the Great Blue Heron Charity Casino Slot Machine Facility, seventeen slot operations at racetracks and four resort casinos in the Province of Ontario.

The Corporation has entered into operating agreements with Windsor Casino Limited, CHC Casinos Canada Limited, Falls Management Group, L.P. and Great Blue Heron Gaming Company for the operation of Casino Windsor, Casino Rama, Casino Niagara and Niagara Fallsview Casino Resort (Fallsview) and the Great Blue Heron Charity Casino Slot Machine Facility, respectively.

#### 1. Significant accounting policies

##### a. Basis of consolidation

The consolidated financial statements include the accounts of the Corporation and its 100 per cent owned subsidiary.

In addition, the consolidated financial statements combine the financial position and results of operations of the resort casinos at Casino Windsor, Casino Rama, Casino Niagara and Fallsview, and of the Great Blue Heron Charity Casino Slot Machine Facility.

The assets, liabilities and operations of the Great Blue Heron Charity Casino Slot Machine Facility are included in these consolidated financial statements. The operating results are included with the results of the casinos and slots at racetracks. These consolidated financial statements do not include other operations carried out at the Great Blue Heron Charity Casino.

##### b. Revenue recognition

Lottery and bingo games are sold to the public by contracted lottery retailers and bingo service providers. Revenue from lottery games, for which results are determined based on a draw, is recognized when tickets are sold to consumers and the related draw occurs. Revenue from instant games is recognized when retailers make them available for sale to the public, as indicated by the retailer's activation of tickets. Revenue from sports wagering games and bingo gaming is recognized when the ticket, paper, or electronic game is sold to the consumer. Tickets issued as a result of the redemption of free ticket prizes are not recorded as revenue.

Gaming revenue from slot and table game operations represents the difference between amounts earned through gaming wagers less the payouts from those wagers, with liabilities recognized for funds deposited by customers before gaming play occurs, for chips, and 'ticket-in, ticket-out' coupons in the customers' possession, and for accruals related to the anticipated payout of progressive jackpots. Base jackpots for progressive slot machines are charged to revenue over the estimated jackpot life cycle. Progressive slot machines, which contain base jackpots that increase at a progressive rate based on the number of coins or credits played, are charged to revenue as the amount of the jackpots increase.

Discretionary and non-discretionary incentive programs are recorded in accordance with the Canadian Institute of Chartered Accountants Emerging Issues Committee Abstract 156, 'Accounting by a Vendor for Consideration Given to a Customer (Including a Reseller of the Vendor's Products)' (EIC 156). EIC 156 requires that sales incentives and points earned in loyalty programs be recorded as a reduction of revenue. The Corporation recognizes incentives related to gaming play and points earned in loyalty programs as a promotional allowance.

Discretionary incentive programs, such as non-cashable free play, are offered based on past levels of play or to induce future play. Discretionary, non-cashable free play is not recorded as revenue. Non-



## Ontario Lottery and Gaming Corporation

### Notes to Consolidated Financial Statements

Year ended March 31, 2008, with comparative figures for 2007

(tabular amounts in thousands of dollars)

discretionary incentive programs, such as point-based loyalty programs, are offered based on past levels of play.

Non-gaming revenue includes revenue from hotel, food and beverage, entertainment centre and other services and is recognized at the time the services are rendered to patrons. This also includes the retail value of accommodations, food and beverage and other services provided to patrons on a complimentary basis.

c. Promotional allowances

Promotional allowances include the retail value of accommodation, food and beverage and other goods and services provided on a complimentary basis to patrons.

The players' loyalty programs at the casinos and slots at racetracks allow patrons to earn points based on the volume of play. These points are accrued as a liability based on estimated redemption and are redeemable for complimentary goods and services and/or cash rebates. Promotional allowances include the value of the points as they are earned.

Promotional allowances also include the retail value of coupons (hotel, food and beverage and other goods and services) and other incentives provided to the patrons when these coupons are redeemed. The retail value of these coupons is included in revenue.

The estimated costs of providing these promotional allowances have been included as expenses in the consolidated statement of income and other comprehensive income.

d. Total Rewards point liability program

In June 2007, Casino Windsor implemented Harrah's Entertainment Inc.'s (Harrah's) Total Rewards customer loyalty program. Total Rewards offers incentives to customers who game at the Casino as well as at any of Harrah's casinos throughout the United States. Under the program, customers are able to accumulate, or bank, reward credits over time, which they may redeem at their discretion under the terms of the program. The reward credit balance will be forfeited if the customer does not earn a reward credit over the prior six-month period. Non-gaming expenses include the expense of reward credits as they are earned. In addition to reward credits, customers can earn points based on play that are redeemable in cash ('cash-back points'). Promotional allowances include the cost of cash-back points as they are earned.

e. Lottery prizes

Prize expense for lottery and bingo games is recognized based on the predetermined prize structure for each game in the period revenue is recognized. Prize expense for annuity-based top prizes is based on the cost of the annuity purchased by the Corporation from a third party. An estimate for lottery prizes that will not be claimed is recognized as unclaimed prizes in the period revenue is recognized. Periodically, prize expense is adjusted to reflect amounts actually won and/or unclaimed.

f. Commissions and bonuses

Lottery retailers receive a commission of 8 per cent on all instant tickets and a commission of 5 per cent on all on-line tickets sold. Where commission has been paid to retailers for deferred revenue ticket sales, this fee is recorded as a prepaid expense until the related revenue is recognized. Lottery retailers also receive a 3 per cent commission on instant tickets redemptions and a commission of 2 per cent on on-line ticket redemptions. A \$1,000 bonus is paid to any retailer who sells a major prize winning on-line ticket, excluding sports and daily games.

Bingo service providers receive a commission based on a percentage of total revenue, plus or minus incentive adjustments for achieving sales, prize payout, and cost of goods sold targets. Municipalities who host the Corporation's bingo halls receive a commission based on a percentage of total revenue.

# Ontario Lottery and Gaming Corporation

## Notes to Consolidated Financial Statements

Year ended March 31, 2008, with comparative figures for 2007  
(tabular amounts in thousands of dollars)

Racetrack owners and horse people each receive 10 per cent of revenue from slots. Municipalities who host an OLG Casino or Slots at Racetrack facility receive 5 per cent of revenue from slots up to 450 machines and 2 per cent of revenue from slot machines over 450. As the host community of the slot machines at Great Blue Heron Charity Casino, the Mississaugas of Scugog Island First Nation receive 5 per cent of the revenue from the slot machines.

g. Cash and cash equivalents

Cash equivalents are defined as liquid investments that have a term to maturity at the time of purchase of less than 90 days. As at March 31, 2008, cash and cash equivalents include bank term deposits amounting to \$35,810,000 (2007 - \$78,700,000) at an interest rate of 2.2 to 3.5 per cent (2007 - 4.1 to 4.2 per cent).

h. Retailer accounts receivable

Retailer accounts receivable represents lottery and bingo proceeds due from lottery retailers and bingo service providers for lottery ticket and bingo sales net of commissions due to and prizes paid by the retailers and service providers, and allowance for bad debt.

i. Pre-opening and deferred expenditures

Certain expenditures, consisting of compensation, consulting and other direct costs incurred in connection with the development and opening of gaming sites, are deferred and amortized over three years, commencing with site opening.

Expenditures, consisting of compensation, consulting and other costs incurred with the development of a management information system, are deferred and amortized over a period not exceeding five years.

j. Property, plant and equipment

Major capital expenditures with a future useful life beyond the current year are capitalized at cost and are amortized on a straight-line basis according to their estimated useful lives, as follows:

Buildings	10 to 50 years
Furniture and fixtures	2 to 10 years
Leasehold improvements	Over term of lease
Lottery gaming assets	3 to 7 years
Casino and racetrack slot operations gaming assets	2 to 10 years

Property, plant and equipment are amortized when put into use.

Construction in progress and assets not in use are stated at cost. Costs will be amortized commencing upon completion of the related project.

Interest charges incurred during the construction and development of property, plant and equipment is capitalized and amortized over the estimated useful life of the associated property, plant and equipment.

k. Impairment of long-lived assets

Long-lived assets, including pre-opening and deferred expenditures, assets contributed to Chippewas of Mnjikaning, and property, plant and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of

## Ontario Lottery and Gaming Corporation

### Notes to Consolidated Financial Statements

Year ended March 31, 2008, with comparative figures for 2007  
(tabular amounts in thousands of dollars)

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assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset, including cash flows that accrue to the Province of Ontario. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

Assets to be disposed of would be separately presented in the consolidated balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer amortized. The asset and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheet.

As at March 31, 2008 and March 31, 2007, no impairments in the carrying value of these assets existed, except as disclosed in Note 6.

l. Deferred revenues

Funds collected from retailers for lottery games for which results are determined based on a draw, sold in advance of the game draw, are recorded as deferred revenue and recognized as revenue once the related draw occurs.

m. Asset retirement obligations

The Corporation records the fair value of an asset retirement obligation as a liability in the year in which it is incurred and can be reasonably estimated. This liability is associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. The Corporation also records a corresponding asset that is amortized over the life of the asset. The Corporation has recognized a discounted liability associated with obligations arising from provisions in certain lease agreements regarding the exiting of leased properties at the end of the respective lease terms. The adjustment to leasehold improvements in respect of asset retirement costs is amortized into income on a straight-line basis over the remaining life of the leases.

Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The resultant changes to the obligation that result from the passage of time are expensed in the period as accretion expense and any changes resulting from changes in the estimated future cash flows are capitalized to the cost of the leasehold improvements.

For the year ended March 31, 2008, the Corporation recorded amortization expense of \$306,000 (2007 - \$227,000) in the consolidated statement of income and other comprehensive income. The Corporation recorded a liability of \$1,352,000 (2007 - \$1,165,000) for the estimated present value of the costs of retiring leasehold improvements at the maturity of the leases and recorded deferred asset retirement costs of \$366,000 (2007 - \$564,000).

The gross amount of the obligation is \$1,431,000 (2007 - \$1,299,000), which is expected to be paid out in one to eight years. The credit adjusted risk-free rate is 7 per cent. The accretion expense for the year was \$186,000 (2007 - \$84,000).

n. Goodwill

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the tangible and intangible assets acquired, less liabilities assumed, based on their fair values. When the Corporation enters into a business combination, the purchase method of accounting is used. Goodwill is assigned as of the date of the business combination to reporting units that are expected to benefit from the business combination.

## Ontario Lottery and Gaming Corporation

### Notes to Consolidated Financial Statements

Year ended March 31, 2008, with comparative figures for 2007  
(tabular amounts in thousands of dollars)

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Goodwill is not amortized but instead is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit, including goodwill, is compared with its fair value. When the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of a reporting unit exceeds its fair value, in which case, the implied fair value of the reporting unit's goodwill, determined in the same manner as the value of goodwill is determined in a business combination, is compared with its carrying amount to measure the amount of the impairment loss, if any. As at March 31, 2008 and March 31, 2007, no impairment in the carrying value of this asset existed.

o. Assets contributed to Chippewas of Mnjikaning

Assets contributed to Chippewas of Mnjikaning, consisting primarily of funding for the construction of a community centre, seniors' centre and certain infrastructure facilities, are amortized over the term of the Casino Rama ground lease, which expires in March 2021.

p. Foreign currency translation

Monetary assets and liabilities denominated in a foreign currency are translated into Canadian dollars at the year-end exchange rates. Non-monetary assets and liabilities are translated at historical exchange rates. Consolidated statement of income and other comprehensive income items are translated at the rate of exchange in effect at the transaction date. Translation gains and losses are included in the consolidated statement of income and other comprehensive income in the period in which they arise.

q. Guarantees

The Corporation has adopted the disclosure provisions related to the Canadian Institute of Chartered Accountants' Accounting Guideline No. 14, "Disclosure of Guarantees." There are no guarantees that require disclosure in the consolidated financial statements.

r. Use of estimates

The preparation of consolidated financial statements requires the Corporation to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses for the year. Significant estimates are used in determining, but are not limited to, the valuation of markers receivable, valuation of loans receivable, the useful lives of all depreciable assets, the recoverability of property, plant and equipment and goodwill, unclaimed prize liability, employee future benefit obligations, asset retirement obligations, the players' loyalty program provision, the amount due to Government of Canada and the outstanding chip, ticket and token liability. Actual results could differ from those estimates.

s. Change in accounting policies

I. Accounting changes

On April 1, 2007, the Corporation adopted a new accounting policy for accounting changes by adopting the new standards of the CICA Handbook Section 1506, Accounting Changes. The Section prescribes the criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and correction of errors. The adoption of the new policy had no material impact on the Corporation's consolidated financial statements at March 31, 2008.

## Ontario Lottery and Gaming Corporation

### Notes to Consolidated Financial Statements

Year ended March 31, 2008, with comparative figures for 2007  
(tabular amounts in thousands of dollars)

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#### II. Financial instruments

##### i) Adoption of new financial instruments standards

On April 1, 2007, the Corporation adopted CICA Handbook Section 1530, Comprehensive Income, CICA Handbook Section 3251, Equity, CICA Handbook Section 3855, Financial Instruments – Recognition and Measurement, CICA Handbook Section 3861, Financial Instruments – Disclosure and Presentation, and CICA Section 3865, Hedges. These new handbook sections provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied. Prior period results are not required to be restated, except in connection with the presentation of the statement of comprehensive income relating to the changes in the foreign currency translation adjustment account.

The consolidated statement of income includes net income as well as other comprehensive income, where applicable. Accumulated other comprehensive income forms part of equity.

Under these new standards, all financial instruments have been classified into one of the following categories: available-for-sale, held-to-maturity, held-for-trading, loans and receivables or other financial liabilities. All financial instruments, including derivatives, are recorded on the consolidated balance sheet and are measured at fair value with the exception of loans and receivables, and other financial liabilities, which are measured at amortized cost. Subsequent measurement and recognition of changes in fair value of financial instruments depend upon their initial classification.

All derivatives, including embedded derivatives that must be separately accounted for, are measured at fair value, with changes in fair value recorded in the consolidated statement of income unless they are effective cash flow hedging instruments. The changes in fair value of cash flow hedging derivatives are recorded in other comprehensive income, to the extent effective, until the hedged asset or liability is recognized in the consolidated statement of income and other comprehensive income. Any hedge ineffectiveness is recognized in net income immediately. There were no hedging derivatives that were outstanding as at April 1, 2007. As part of the process of implementing these new standards, all contracts signed after April 1, 2003 were reviewed to identify embedded derivatives requiring separation from the host contract. No material embedded derivatives requiring separation were identified.

Effective April 1, 2007, the Corporation began recording all transaction costs and loan fees for financial assets and liabilities as a component of the related asset or liability and amortizing the costs using the effective interest rate method to interest expense over the life of the related asset or liability. Upon adoption, there was no impact to the Corporation's consolidated financial statements.

##### ii) Derivative instruments

The Corporation uses derivative financial instruments to manage risks from market price fluctuations for energy. These instruments include forward pricing agreements. The Corporation does not enter into financial instruments for trading or speculative purposes. Changes in the fair value of derivatives are recorded in the consolidated statement of income and other comprehensive income.

#### t. Recent Canadian accounting pronouncements

##### I. Financial instruments:

In 2006, the CICA issued Handbook Section 3862, Financial Instruments – Disclosures, and Handbook Section 3863, Financial Instruments – Presentation. These standards enhance existing disclosure requirements and place greater emphasis on disclosures related to recognized and unrecognized financial instruments and how those risks are managed. The Corporation will adopt these new standards effective April 1, 2008 and is assessing the impact of the new standards on its consolidated financial statements.

# Ontario Lottery and Gaming Corporation

## Notes to Consolidated Financial Statements

Year ended March 31, 2008, with comparative figures for 2007  
(tabular amounts in thousands of dollars)

### II. Capital disclosures:

In 2006, the CICA issued Handbook Section 1535, Capital Disclosures ("CICA 1535"). CICA 1535 requires that an entity disclose information that enables users of its financial statements to evaluate an entity's objectives, policies and processes for managing capital including disclosures of any externally imposed capital requirements and the consequences for non-compliance. The Corporation will adopt this new standard effective April 1, 2008 and is assessing the impact of the new standard on its consolidated financial statements.

### III. Inventories:

In 2007, the CICA issued Handbook Section 3031, Inventories, which establishes the principles for measurement, recognition and disclosure of inventories. The Corporation will adopt this new standard effective April 1, 2008, and is assessing the impact of the new standard on its consolidated financial statements.

### IV. Goodwill and intangible assets:

In 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets ("CICA 3064"). CICA 3064, which replaces Section 3062, Goodwill and Intangible Assets, and Section 3450, Research and Development Costs, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. The Corporation will adopt this new standard effective April 1, 2009 and is assessing the impact of the new standard on its consolidated financial statements.

## 2. Restricted cash and reserves

Included in restricted cash are the below-noted amounts, which are held in separate accounts.

	2008	2007
Reserves		
Capital renewals	\$45,416	\$65,348
Operating	87,063	23,729
Severance	36,480	33,014
	168,959	122,091
Less unrestricted capital renewals and operating	43,339	36,827
Funded reserves balance	125,620	85,264
Prize funds on deposit	41,900	28,602
Term loan proceeds	15,971	8,534
	\$183,491	\$122,400

The Corporation has established reserves at the resort casinos in accordance with their respective operating agreements, or other terms as otherwise agreed to, for the following purposes:

- i) Capital renewals reserves - For property, plant and equipment additions other than normal repairs, and to satisfy specified obligations in the event that cash flows will be insufficient to meet such obligations;
- ii) Operating reserves - To satisfy specified obligations in the event that cash flows will be insufficient to meet such obligations; and
- iii) Severance reserve - To satisfy certain obligations of the Corporation arising from the termination or layoff of employees of an operator in connection with the termination of an operator



## Ontario Lottery and Gaming Corporation

### Notes to Consolidated Financial Statements

Year ended March 31, 2008, with comparative figures for 2007

(tabular amounts in thousands of dollars)

In fiscal 2008, the Corporation transferred cash of \$95,000,000 and \$14,000,000 to Casino Windsor's operating and capital renewals reserves, respectively, to replenish the reserve accounts to the balances specified by the terms of the operating agreement. The Corporation and the Operator have agreed that both the operating and capital renewals reserves, although contractually set aside for the above uses, are available to fund current operations, given the Casino's continuing negative cash flows. The Corporation has committed to transferring additional amounts of up to \$63,000,000 to Casino Windsor in fiscal 2009.

Prize funds on deposit are funds set aside representing the estimate of gross prizes outstanding less an estimate for prizes not expected to be claimed by consumers.

Term loan proceeds represent restricted cash that was to be used for construction purposes at Niagara Fallsview Casino Resort and Casino Windsor.

### 3. Pre-opening and deferred expenditures

	<b>2008</b>		<b>2007</b>	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Pre-opening expenditures				
Resort casinos	\$16,588	\$14,506	\$2,082	\$1,162
Casinos and slots at racetracks	4,594	3,035	1,559	2,786
	21,182	17,541	3,641	3,948
Deferred expenditures	22,097	21,145	952	1,602
	\$43,279	\$38,686	\$4,593	\$5,550

Amortization of pre-opening and deferred expenditures for the year ended March 31, 2008 was \$3,235,000 (2007 - \$7,016,000).

### 4. Loans receivable

	<b>2008</b>	<b>2007</b>
Loans receivable	\$48,329	\$60,442
Less allowance for loans receivable	2,833	3,200
	45,496	57,242
Less current portion of loans receivable	7,892	7,482
	\$37,604	\$49,760

The Corporation has loaned and is committed to loan funds to certain racetrack operators for the purposes of renovating or constructing buildings to accommodate the Corporation's slot machine facilities. Security is provided by mortgages and general security agreements covering the racetrack operators' assets. The loans bear interest based on the Royal Bank of Canada's prime rate and are repayable over periods ranging from one to fifteen years. The amounts will be repaid under an agreed upon formula by withholding from commissions that would otherwise be payable to the racetrack operators. The Corporation has also advanced funds to certain municipalities for purposes of infrastructure improvements. The amounts will be recovered from the municipal commissions otherwise payable.

During the fiscal year, additional funds were advanced to a racetrack operator for which the repayment is conditional upon obtaining government approval for the expansion of this property. The borrower's requirement to repay the conditional loan is dependant upon the Corporation providing written notice, within five years of the date of opening of the site (i.e. by March 2011), that an expansion will proceed. As at March 31, 2008 \$14,509,000 (2007 - \$14,092,000) had been advanced and has been included in loans receivable based on the Corporation's assessment that governmental approval will be obtained and written notice will be provided to the borrower.

# Ontario Lottery and Gaming Corporation

## Notes to Consolidated Financial Statements

Year ended March 31, 2008, with comparative figures for 2007  
(tabular amounts in thousands of dollars)

The Corporation's maximum remaining commitment as at March 31, 2008 is \$15,691,000 to two racetrack operators of which \$1,491,000 relates to the conditional loan referred to in the preceding paragraph.

### 5. Property, plant and equipment

			2008	2007
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Land	\$137,343	\$ –	\$137,343	\$137,008
Buildings	1,498,366	200,989	1,297,377	1,305,492
Furniture and fixtures	613,464	432,109	181,355	194,419
Leasehold improvements	569,797	321,483	248,314	275,453
Lottery gaming assets	119,968	82,886	37,082	59,479
Casino and racetrack slot operation gaming assets	617,587	390,210	227,377	252,016
Construction in progress and assets not in use	371,369	–	371,369	188,486
	\$3,927,894	\$1,427,677	\$2,500,217	\$2,412,353

Amortization for the year was \$254,884,000 (2007 - \$230,106,000). During the year, net interest of \$490,000 (2007 – nil) was capitalized.

### 6. Asset impairment charges

As a result of the review of carrying values, as compared to undiscounted future net cash flows, as set out in Note 1k to the consolidated financial statements, in 2007, the Corporation recorded an impairment charge of \$1,320,000 for certain Bingo revitalization pilot assets. Future cash flows are based on the Corporation's estimate of the operating results of these sites. The charge is included in General and Administration expenses in Note 14 to the consolidated financial statements.

### 7. Assets contributed to Chippewas of Mnjikaning

			2008	2007
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Assets contributed to Chippewas of Mnjikaning	\$32,337	\$18,362	\$13,975	\$15,057

Amortization for the year was \$1,082,000 (2007 - \$1,082,000).

### 8. Cash and short-term investments held for First Nations

	2008	2007
Segregated bank account, beginning of year	\$173,113	\$150,077
Distributions to the segregated bank account during the year	14,687	16,250
Interest earned during the year	7,955	6,786
Segregated bank account, end of year	195,755	173,113
Current distribution due to First Nations	12,293	–
	\$208,048	\$173,113
Less current portion of due to First Nations	47,374	–
	\$160,674	\$173,113



## Ontario Lottery and Gaming Corporation

### Notes to Consolidated Financial Statements

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On June 9, 2000, the Corporation, the First Nations of Ontario and the Province of Ontario entered into the Casino Rama Revenue Agreement (the Agreement) which entitles the Ontario First Nations to the net revenues, as defined, from the operation of Casino Rama. Under the Agreement, the Corporation is required to distribute the net revenues from the operation on a monthly basis.

The Agreement requires that, commencing July 31, 2001, the Corporation retain 35 per cent of the net distributions from Casino Rama in a segregated bank account if the Corporation has not received a joint direction from the Ontario First Nations Limited Partnership (OFNLP) and the Chippewas of Mnjikaning with respect to a new revenue distribution formula. As at March 31, 2008, the Corporation has not received this direction and accordingly has retained 35 per cent of the net distributions in a segregated interest-bearing bank account. This matter is currently the subject of an action brought by the Chippewas of Mnjikaning against the Province of Ontario and until the matter is decided by the Courts or, alternatively, the Chippewas of Mnjikaning and the OFNLP reach an agreement on a new revenue distribution formula, the Corporation is required to retain these funds. On June 10, 2008 the Corporation, pursuant to an Order of the Superior Court Justice of Ontario, released \$47,374,000 from the segregated bank account to the OFNLP. The balance of funds will continue to be retained in a segregated interest-bearing bank account until the matter is decided by the Courts or, alternatively, the Chippewas of Mnjikaning and the OFNLP reach agreement on a new revenue distribution formula.

On February 19, 2008, Her Majesty the Queen in Right of Ontario, the Corporation and OFNLP, among others, entered into a Gaming Revenue Sharing and Financial Agreement. The key terms of this new agreement are outlined in Note 9 f to the consolidated financial statements.

The payment related to the monthly distribution of the net revenue for March 2008 is included above as a current distribution due to First Nations.

#### 9. Related party transactions

Related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

- a. The Corporation is related to various other government agencies, ministries and Crown corporations. All transactions with these related parties are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.
- b. Under the terms of the development and operating agreements for each of the resort casinos and the Great Blue Heron Slot Machine Facility each operator is entitled to receive an operator's fee calculated as a percentage of gross revenues and as a percentage of net operating margin, both as defined in each of the related development and operating agreements. The operators of the casinos are as follows: Casino Niagara and Fallsview - Falls Management Group, L.P., the general partner of which is Falls Management Company (owned by Niagara Casino Group, L.P., Highland Gaming, Inc., Shiplake Gaming Corporation, Olympic V, Inc. and 3048505 Nova Scotia Company) and the sole limited partner of which is Falls Entertainment Corporation; Casino Rama - CHC Casinos Canada Limited, an indirectly wholly owned subsidiary of Penn National Gaming, Inc.; the Great Blue Heron Slot Machine Facility - Great Blue Heron Gaming Company; and Casino Windsor - Windsor Casino Limited (WCL), which is owned equally by Harrah's Entertainment, Inc. and Hilton Hotels Corporation, in each case through wholly-owned subsidiaries.

On December 14, 2006, the Corporation entered into a new operating agreement with Caesars Entertainment Windsor Holding, Inc. (CEWH), one of the shareholders of WCL. Under the terms of the new operating agreement, commencing on the expiry or termination of the current operating agreement, CEWH will succeed WCL as the operator of Casino Windsor until July 31, 2020, subject to earlier termination of the new operating agreement by the Corporation or CEWH upon the occurrence of certain events. The terms of the new operating agreement are substantially similar to those contained in the current operating agreement.

# Ontario Lottery and Gaming Corporation

## Notes to Consolidated Financial Statements

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At each of the resort casinos, the operator is the employer of the employees working at that resort casino. All payroll and payroll-related costs are charged to the Corporation on a monthly basis, and are expensed in the Corporation's consolidated statement of income and other comprehensive income.

- c. Under the terms of the development and operating agreement for Casino Rama, the Chippewas of Mnjikaning receive an annual fee, adjusted for inflation, relating to the provision of ongoing operating services. During the year, \$5,616,000 (2007 - \$5,514,000) was expensed. Other Chippewas of Mnjikaning charges amounting to \$6,884,000 (2007 - \$7,429,000) were also incurred during the year in connection with snow removal, water, sewer and emergency services. In addition, under the terms of a five-year lease renewal ending July 2011, for the rental of office space, \$674,000 (2007 - \$659,000) was expensed to a company related to the Chippewas of Mnjikaning. Also, under the terms of an eight-year lease ending July 2011, an annual rental, adjusted for inflation, for warehouse space is paid to a company related to the Chippewas of Mnjikaning. During the year, \$342,000 was expensed (2007 - \$334,000).

On April 30, 2002, an agreement was signed with the Chippewas of Mnjikaning, whereby the Corporation will reimburse the Chippewas of Mnjikaning 75 per cent of the annual operating budget of the fire department, in exchange for fire protection services to the casino complex. This amount is included in other Chippewas of Mnjikaning charges noted above and is defined in the agreement for the period April 1, 2000 to July 31, 2011.

The lands used for the Casino Rama complex are leased by Casino Rama Inc. from Her Majesty the Queen in the Right of Canada under a 25-year lease, which expires in March 2021. Annual rent payable under this lease, adjusted for inflation, is paid out of the gross revenues of the Casino Rama complex to the Chippewas of Mnjikaning in accordance with instructions from Indian and Northern Affairs Canada as representative for Her Majesty the Queen. During the year, \$4,402,000 (2007 - \$4,309,000) was expensed.

The terms of various agreements provide for the designation and leasing of Additional Parking Lands, as defined, by the Chippewas of Mnjikaning to Casino Rama with an annual rent payable of approximately \$1,700,000, adjusted for inflation. While the designation and leases are not yet complete, the lands are permitted and currently in use at Casino Rama. During the year, \$1,977,000 (2007 - \$1,932,000) was expensed.

Under the terms of a Letter of Agreement entered into by the Corporation in January 2007 regarding the management and administration of leasehold improvement projects at Casino Rama, the Chippewas of Mnjikaning contract directly with the contractors selected by the Corporation. During the year, \$3,696,000 (2007 - \$3,369,000) was paid to the Chippewas of Mnjikaning under this Letter of Agreement to pay contractors involved in the acquisition of leasehold improvements.

- d. Under the terms of the development and operating agreement, the Mississaugas of Scugog Island First Nation receive an amount equal to five per cent of the gross revenue of the Great Blue Heron Slot Machine Facility in consideration for provision of the lands used for the Slot Machine Facility. During the year, \$4,498,000 (2007 - \$4,836,000) was paid to the Mississaugas of Scugog Island First Nation.
- e. Under the terms of the Niagara Falls Permanent Casino Operating Agreement, in a Competitive Environment, as defined, the Operator is entitled to receive additional Operator services fees and an Attractor fee. The Attractor fee is calculated, as defined, to allow for the amortization of the total capital contributions of the Operator to external attractors, to a maximum contribution of \$30,000,000. As at March 31, 2008, the Operator's fees, due to the Operator, included an Attractor fee accrual of \$5,088,000 (2007 - \$8,237,000).
- f. Casino Rama is located on reserve lands of the Chippewas of Mnjikaning First Nation under the authority of a 25-year lease (expiring in March 2021) between the Corporation and Casino Rama Inc., a wholly owned subsidiary of the Chippewas of Mnjikaning First Nation.

Under the terms of the Casino Rama Revenue Agreement dated June 9, 2000, Ontario First Nations are entitled to the ongoing net revenues, as defined, of Casino Rama, as well as the proceeds from the

## Ontario Lottery and Gaming Corporation

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disposition of the moveable assets, as defined, and remaining undistributed earnings upon the dissolution or wind up of Casino Rama.

On February 19, 2008, Her Majesty the Queen in Right of Ontario, the Corporation and the OFNLP entered into a Gaming Revenue Sharing and Financial Agreement (Agreement). The key terms of the Agreement, relevant to OLG, are as follows:

- i) The Province of Ontario shall pay, or require the Corporation to pay, to the Ontario First Nations Limited Partnership, commencing with fiscal year 2012 and in each fiscal year during the remainder thereafter of the 20-year term, an amount equal to 1.7 per cent of the Gross Revenues of the Corporation, as defined. These payments will take the place of the net revenues that the OFNLP would otherwise have been entitled to under the Casino Rama Revenue Agreement; and,
- ii) The Chiefs of Ontario and the Ontario First Nations Limited Partnership shall, subject to acceptance by the Courts, discontinue the litigation related to the 20 per cent win contribution (Note 13a) and release her Majesty the Queen in Right of Ontario and the Corporation.

The Notice of Discontinuance of the litigation related to the 20 per cent win contribution was filed with the court on February 26, 2008.

#### 10. Long-term debt

	2008	2007
Niagara Fallsview Casino Resort loan	\$214,747	\$391,721
Casino Windsor non-revolving term loan	82,415	-
	297,162	391,721
Less current portion	191,381	176,974
	\$105,781	\$214,747

##### a. Niagara Fallsview Casino Resort loan

In June 2004, the Corporation entered into a loan agreement with the Ontario Financing Authority (Province of Ontario, a related party) for the purchase of the Niagara Fallsview Casino Resort from Falls Management Corporation. The initial loan balance of \$794,000,000 plus interest is repayable over five years. The loan bears interest at a rate of 4.4 per cent per annum and is unsecured.

The principal loan repayments expected to be made over the next two years are approximately:

2009	\$170,867
2010	43,880

##### b. Casino Windsor non-revolving term loan

In October 2007, the Corporation entered into a loan agreement with the Ontario Financing Authority (Province of Ontario, a related party) for purposes of financing a portion of the renovation and expansion of Casino Windsor and for financing a portion of the construction of the Windsor Clean Energy Centre (the Energy Centre). The Energy Centre was constructed to provide electricity, heating and cooling to the expanded Casino Windsor facilities. It is expected that the Energy Centre will also be able to provide excess electricity to the Windsor energy market. The loan agreement provided for a non-revolving term credit facility up to \$250,000,000 for the project. On the earlier date of a) sixty days after the date of substantial completion of the project or b) August 15, 2008, the principal sum is to be converted to a five year term loan. A mandatory prepayment of the proceeds from the sale of the Energy Centre (net of the costs associated with the sale) is required if and when it is sold. The interest charged during construction is tied to the Province of Ontario's 90-day Treasury Bill rate. After construction is complete and the facility is

## Ontario Lottery and Gaming Corporation

### Notes to Consolidated Financial Statements

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opened to the public, the construction loan will convert into a 5 year term loan. The loan will bear interest at a rate equivalent to the Province of Ontario's five-year cost of borrowing plus 0.07 per cent.

During the year, total funds of \$82,415,000 were advanced under the loan agreement. The principal loan repayments expected to be made in the upcoming fiscal year, based on the amounts advanced to March 31, 2008, are \$20,514,000.

On March 25, 2008, the Province of Ontario introduced a bill which, if passed, would amend the *Ontario Lottery and Gaming Corporation Act, 1999*, to require the Corporation to finance certain of its capital expenditures with debt obtained from the Ontario Financing Authority. The approval of the Minister of Public Infrastructure Renewal and the Minister of Finance is required for the Corporation to borrow funds for major capital expenditures.

#### 11. Financial instruments

##### a. Financial Instruments

All of the Corporation's financial assets have been classified as either held-for-trading or loans and receivables. All of the Corporation's financial liabilities have been classified as other financial liabilities. Upon adoption, the Corporation determined that none of its financial assets are classified as held-to-maturity or available-for-sale and none of its financial liabilities are classified as held-for-trading.

The Corporation has determined the fair values of its financial instruments as follows:

- i) The carrying amounts in the consolidated balance sheet of cash and cash equivalents, accounts receivable, restricted cash, cash and short-term investments held for First Nations, accounts payable and accrued liabilities, due to operators, due to Chippewas of Mnjikaning and due to First Nations approximate fair values because of the short-term nature of these financial instruments.
- ii) Loans and receivables are carried at amortized cost using the effective interest method.
- iii) The fair value of each of the Corporation's long-term liabilities approximates its carrying value as the interest rates approximate current market rates.
- iv) The fair value of the Corporation's forward pricing agreements is based on values quoted by the counterparties to the agreements.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

##### b. Credit Risk

The Corporation has financial instruments that potentially expose it to a concentration of credit risk. The instruments consist of accounts receivable and loans receivable. Accounts receivable include credit provided to retailers of lottery products and patrons of resort casinos. Loans receivable consist of loans to racetrack operators and municipalities. The Corporation performs ongoing credit evaluations of retailers, patrons, racetrack operators and municipalities and maintains reserves for potential credit losses, which when realized have been within the range of the Corporation's expectations. The carrying amount of these financial assets represents the maximum credit exposure.

##### c. Interest Rate Risk

The Corporation has financial assets and liabilities that potentially expose it to interest rate risk.

Loans receivable consist of loans to racetrack operators and municipalities and interest earned on these

## Ontario Lottery and Gaming Corporation

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loans is tied to changes in the prime interest rate. The interest rate risk is limited to the interest earned on the assets and the underlying value of the asset is not at risk due to fluctuations in interest rates.

Long term debt currently consists of loan agreements entered into with the Ontario Financing Authority. The non-revolving term credit facility, approved up to \$250,000,000, is to finance a portion of the renovation and expansion of Casino Windsor which is currently in the construction stage. The long term debt is subject to interest rate risk as disclosed in Note 10b. The term loan agreement financed by the Ontario Financing Authority for the purchase of the Niagara Fallsview Casino Resort has a fixed interest rate for the entire term and is not currently subject to interest rate risk.

#### 12. Commitments

##### a. Obligations under operating leases

The Corporation has entered into several leases for property and equipment. The future minimum lease payments are approximately:

2009	\$22,801
2010	18,418
2011	12,094
2012	5,383
2013	266
	58,962
Thereafter	6,951
	<u>\$65,913</u>

##### b. Suppliers

The Corporation has computer hardware maintenance agreements with future payments of approximately:

2009	\$15,608
2010	13,462
2011	11,779
2012	10,973
2013	10,715
	62,537
Thereafter	3,510
	<u>\$66,047</u>

##### c. Casino Windsor

In connection with the terms of an agreement between Casino Windsor and the City of Windsor, the Corporation agreed to provide the City of Windsor with a fixed return over 20 years with payments commencing May 1, 1998 in the amount of \$2,600,000 per annum for the first ten years and \$3,000,000 per annum for the last ten years.

The Corporation is committed to a redevelopment project at Casino Windsor which includes the construction of a 22-storey hotel tower and a 5,000-seat entertainment centre along with the addition of new non-gaming amenities. The project is anticipated to be completed in June 2008. The Corporation currently estimates the total costs of this project to be in the range of \$430,000,000 to \$439,000,000. As at March 31, 2008, \$379,500,000 (2007 - \$216,482,000) has been expended. In December 2006, the Corporation entered into a trademark licence agreement with Caesars World, Inc. (Caesars), a wholly-owned indirect subsidiary of Harrah's. Under the terms of the trademark licence agreement, Casino Windsor has acquired the rights, systems and processes for the use of the Caesar's brand, and be re-branded as Caesars Windsor upon the completion of construction relating to the project. The estimated total cost of the re-branding project is



## Ontario Lottery and Gaming Corporation

### Notes to Consolidated Financial Statements

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\$40,700,000 and includes costs associated with the implementation of 'Total Rewards', the Caesars customer loyalty program. As at March 31, 2008 \$36,772,000 (2007 - \$22,923,000) has been expended. The Caesars trademark licence agreement will terminate on July 31, 2020 or on such earlier date as Caesars, or its subsidiary, ceases to be the operator of the Windsor casino complex. Caesars will be paid a licence fee that will be calculated as a percentage of revenue and operating results, as defined, for the Windsor casino complex.

The Corporation is committed to the design, construction and commissioning of the Energy Centre on Casino Windsor property with total costs currently estimated to be in the range of \$65,000,000 to \$70,000,000. As at March 31, 2008, \$50,555,000 (2007 - \$11,899,000) has been expended.

d. Niagara Fallsview Casino Resort

In connection with the terms of an agreement between Fallsview and the City of Niagara Falls (the City), the Corporation agreed to provide the City with payments commencing December 7, 2000 in the amount of \$2,600,000 per annum for the first ten years, \$3,000,000 per annum for the next ten years and then \$3,000,000 per annum thereafter, adjusted for Consumer Price Index as defined in the agreement.

e. Casinos and Slots at Racetracks

The Corporation is committed to the establishment of an additional Slots at Racetrack operation in eastern Ontario at an estimated cost of \$18,940,000 and the expansion of an existing Slots at Racetrack operations in the Province at a total estimated cost of \$46,264,000. In addition, the Corporation has committed to the construction of a water treatment facility at a Casino located in eastern Ontario. The Corporation's share of these construction costs is estimated at \$5,000,000.

### 13. Contingencies

- a. In November 2003, the Ontario First Nations Limited Partnership (the Plaintiff) delivered a statement of claim against the Corporation, Her Majesty the Queen in Right of Ontario and the Chippewas of Mnjikaning First Nation, as defendant parties. The statement of claim alleges that the Province of Ontario wrongfully withheld 20 per cent of the gross revenues from Casino Rama operations. The Plaintiff claims damages in an amount equivalent to 20 per cent of the gross revenues of Casino Rama from the time that it opened for operations to the date of judgment plus damages in the amount of \$300,000,000. On February 19, 2008, an agreement was signed with the Plaintiff which provided for a full and final mutual release of this litigation, as described in Note 9f to the consolidated financial statements. The Notice of Discontinuance of the litigation was filed with the court on February 26, 2008.
- b. In November 2003, the Chippewas of Mnjikaning First Nation (the Plaintiff) delivered a notice of claim against the Corporation, her Majesty the Queen in Right of Ontario and CHC Casinos Canada Limited, as defendant parties. The Plaintiff alleges to be the legal and beneficial owner of all property, plant and equipment purchased for use in the development and operation of Casino Rama and requires all amounts of retail sales tax that have been paid or accrued in respect of purchases of property, plant and equipment be reimbursed. The Plaintiff claims damages in the amount of \$21,000,000 against the defendant parties, excluding CHC Casinos Canada Limited, and claims that title to all property, plant and equipment purchased for use in the development and operation of Casino Rama be transferred to the Plaintiff. If the Plaintiff was successful in this claim, reimbursement of retail sales tax that has been paid or accrued in respect of purchases of property, plant and equipment would be made by her Majesty the Queen in Right of Ontario, not by the Corporation. The outcome is undeterminable at this time and no amounts have been accrued in these consolidated financial statements.
- c. The Corporation has signed four Bingo Centre Service Provider Agreements (Service Providers) for Bingo Revitalization Project pilot site operations in Barrie, Peterborough, Kingston, and Sudbury, Ontario. The contracts provide that, in the event of notification of termination of the Bingo Revitalization Project pilot by the Corporation, or if the Service Providers and the Corporation mutually agree to not renew or extend the

# Ontario Lottery and Gaming Corporation

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Agreement, the Corporation will be required to pay the Service Providers an amount not to exceed \$3,013,000 in respect of the Service Providers' capital investments in the Bingo Centres. No events have taken place to indicate that the pilot sites will not continue, and as such, no amounts have been accrued in these consolidated financial statements.

- d. On April 27, 2007, the Corporation and the Interprovincial Lottery Corporation were served with a statement of claim, related to a class action for general damages of \$1,000,000,000 and punitive damages of \$100,000,000. The statement of claim alleges the Corporation was negligent in the operation and management of its lottery business and that it breached fiduciary and other duties. The action is at a very early stage, no class has been certified by the Courts, and the Corporation intends to vigorously defend itself. The outcome is undeterminable at this time and no amounts have been accrued in these consolidated financial statements.
- e. On June 10, 2008, the Corporation was served with a statement of claim, related to a class action for general damages and punitive damages totaling \$3,500,000,000. The statement of claim alleges that the Corporation was negligent in its duty of care to prohibit self-excluded patrons from gaming at the Corporation's gaming sites. The action is at a very early stage, no class has been certified by the Courts, and the Corporation intends to vigorously defend itself. The outcome is undeterminable at this time and no amounts have been accrued in these consolidated financial statements.
- f. The Corporation is, from time to time, involved in various legal proceedings of a character normally incidental to its business. The Corporation believes that the outcome of these outstanding claims will not have a material impact on its consolidated financial statements. Estimates, where appropriate, have been included in these consolidated financial statements, however additional settlements, if any, concerning these contingencies will be accounted for as a charge to the consolidated statement of income and other comprehensive income in the period in which the settlement occurs.

### 14. Segmented information

2008	Lotteries and Bingo	Resort Casinos	Casinos and Slots at Racetracks	Total
Revenues				
Lotteries and bingo	\$2,773,125	\$ —	\$ —	\$2,773,125
Slots	—	1,025,188	2,040,137	3,065,325
Tables	—	401,380	54,593	455,973
Non-gaming	—	245,087	28,874	273,961
	2,773,125	1,671,655	2,123,604	6,568,384
Less promotional allowances	—	276,336	72,773	349,109
	<b>2,773,125</b>	<b>1,395,319</b>	<b>2,050,831</b>	<b>6,219,275</b>
Operating expenses				
Non-gaming	—	236,352	31,613	267,965
Gaming and lottery operations	122,090	306,537	278,623	707,250
Lottery prizes	1,566,091	—	—	1,566,091
Commissions	203,254	—	413,431	616,685
Marketing and promotion	58,619	150,610	76,108	285,337
Operators' fees (Note 9b)	—	63,145	4,929	68,074
Amortization	33,211	137,679	88,617	259,507
General and administration (Notes 6 and 16)	42,390	104,077	68,703	215,170
Facilities	8,129	145,150	81,424	234,703
Win contribution (Note 17)	—	285,304	17,939	303,243
Payments to Government of Canada (Note 18)	56,851	41,732	34,212	132,795
	<b>2,090,635</b>	<b>1,470,586</b>	<b>1,095,599</b>	<b>4,656,820</b>
<b>Income before the undernoted</b>	<b>682,490</b>	<b>(75,267)</b>	<b>955,232</b>	<b>1,562,455</b>
Interest and other income	5,678	23,051	19,412	48,141
Interest on long-term debt	(976)	(13,228)	—	(14,204)
Foreign exchange gain	37	9,545	1,457	11,039
	<b>4,739</b>	<b>19,368</b>	<b>20,869</b>	<b>44,976</b>
<b>Net income (loss)</b>	<b>\$687,229</b>	<b>(\$55,899)</b>	<b>\$976,101</b>	<b>\$1,607,431</b>

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2007	Lotteries and Bingo	Resort Casinos	Casinos and Slots at Racetracks	Total
Revenues				
Lotteries and bingo	\$2,655,607	\$ —	\$ —	\$2,655,607
Slots	—	1,062,784	1,956,998	3,019,782
Tables	—	426,094	55,437	481,531
Non-gaming	—	240,684	28,593	269,277
	2,655,607	1,729,562	2,041,028	6,426,197
Less promotional allowances	—	265,886	75,518	341,404
	<b>2,655,607</b>	<b>1,463,676</b>	<b>1,965,510</b>	<b>6,084,793</b>
Operating expenses				
Non-gaming	—	224,678	30,872	255,550
Gaming and lottery operations	101,858	325,913	283,393	711,164
Lottery prizes	1,444,145	—	—	1,444,145
Commissions	192,670	—	392,924	585,594
Marketing and promotion	51,998	143,980	72,894	268,872
Operators' fees (Note 9b)	—	64,500	5,404	69,904
Amortization	30,449	136,669	71,312	238,430
General and administration (Notes 6 and 16)	34,374	108,973	64,341	207,688
Facilities	7,692	145,408	74,416	227,516
Win contribution (Note 17)	—	297,663	19,266	316,929
Payments to Government of Canada (Note 18)	56,558	41,484	28,933	126,975
	<b>1,919,744</b>	<b>1,489,268</b>	<b>1,043,755</b>	<b>4,452,767</b>
<b>Income before the undernoted</b>	<b>735,863</b>	<b>(25,592)</b>	<b>921,755</b>	<b>1,632,026</b>
Interest and other income	5,175	22,795	18,205	46,175
Interest on long-term debt	—	(26,864)	—	(26,864)
Foreign exchange gain	3	13,361	3,420	16,784
	<b>5,178</b>	<b>9,292</b>	<b>21,625</b>	<b>36,095</b>
<b>Net income (loss)</b>	<b>\$741,041</b>	<b>(\$16,300)</b>	<b>\$943,380</b>	<b>\$1,668,121</b>

### 15. Post employment plans

The Corporation contributes pension benefits for all its permanent employees and to non-permanent employees who elect to participate through the Public Service Pension Fund (PSPF) and the Ontario Public Service Employee's Union Pension Fund (OPSEU Pension Fund), which are multi-employer defined benefit pension plans established by the Province of Ontario. The cost of post-employment benefits is included in the pension contributions made by the Corporation to the PSPF and OPSEU Pension Fund and accordingly the Corporation treats these post-employment benefits as defined contributions and has no additional liability for these future costs. The Corporation's contribution and pension expense during the year was \$17,926,000 (2007 - \$17,019,000).

The operators of the resort casinos and the Great Blue Heron Slot Machine Facility have created defined contribution pension plans for their employees. The pension expense for the year amounted to \$22,452,000 (2007 - \$22,670,000).

### 16. Future benefit costs

As a Schedule 2 employer under the Workplace Safety and Insurance Act, 1997, (Act) the Corporation is individually responsible for the full cost of accident claims filed by its workers. The Workplace Safety and Insurance Board (WSIB) maintains full authority over the claims entitlement process, administers, and processes claims payments on the Corporation's behalf. CICA Handbook Section 3461, Employee Future Benefits, requires that WSIB liabilities for self-insured employers be reported on the financial statements.

In fiscal 2008, the cost of claim payments were \$3,586,000 (2007 - \$4,679,000) and is included in General and Administration expenses in the Consolidated Statement of Income and Other Comprehensive Income. The accrued future benefit costs as at March 31, 2008 is \$28,339,000 (2007 - \$19,387,000) of which \$2,267,000 (2007 - \$1,485,000) is classified as a current liability. The accrued benefit costs are based on actuarial assumptions.



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The operators of the resort casinos and the Great Blue Heron Slot Machine Facility are Schedule 1 employers under the Act and are not subject to the financial reporting requirements that self-insured employers are.

#### 17. Win contribution

The Corporation remits a contribution to the Province of Ontario equal to 20 per cent of gaming revenue from resort casinos and the Great Blue Heron Charity Casino Slot Machine Facility.

#### 18. Payments to Government of Canada

The Corporation made the following payments to the Government of Canada:

	2008	2007
Payments on behalf of the Province of Ontario	\$24,921	\$24,748
Goods and Services Tax	107,874	102,227
	\$132,795	\$126,975

##### a. Payments on behalf of the Province of Ontario

The provincial lottery corporations make payments to the Government of Canada under an agreement dated August 1979 between the provincial governments and the Government of Canada. The agreement stipulates that the Government of Canada will not participate in the sale of lottery tickets.

##### b. Goods and Services Tax

As a prescribed Goods and Services Tax (GST) Registrant, the Corporation makes GST remittances to the Federal Government pursuant to the Games of Chance (*GST/HST*) Regulations of the *Excise Tax Act*. The Corporation's net tax for a reporting period is calculated using net tax attributable to both gaming and non-gaming activities. The net tax attributable to gaming activities results in a 12 per cent (10 per cent effective January 1, 2008) tax burden on most taxable gaming expenditures incurred by the Corporation. The net tax attributable to non-gaming activities is calculated similar to any other GST registrant in Canada.

#### 19. Comparative amounts

Certain prior year amounts have been reclassified to conform with current year consolidated financial statement presentation.

These reclassifications include a modification to the presentation of equity in the Consolidated Balance Sheet. Amounts previously reported as Due to Province of Ontario and Equity in Property, Plant and Equipment have been combined and are now reported as Retained Earnings and Contributed Surplus. In addition, the Consolidated Statement of Changes in Due to Province of Ontario and Consolidated Statement of Equity in Property, Plant and Equipment have been removed from the Consolidated Financial Statements and replaced with a Consolidated Statement of Retained Earnings and a Consolidated Statement of Contributed Surplus.

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## Management's Responsibility

### Ontario Northland Transportation Commission

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The Ontario Northland Transportation Commission's management is responsible for the integrity and fair presentation of the consolidated financial statements and other information included in the annual report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements necessarily involves the use of management's judgment and best estimates, particularly when transactions affecting the current accounting period cannot be determined with certainty until future periods. All financial information in the annual report is consistent with the consolidated financial statements.

The Commission maintains systems of internal accounting controls designed to provide reasonable assurance that the financial information is accurate and reliable and that company assets and liabilities are adequately accounted for and assets safeguarded.

The consolidated financial statements have been reviewed by the Commission's Audit and Finance Committee and have been approved by its Governing Board of commissioners. In addition, the consolidated financial statements have been audited by the Auditor General of Ontario, whose report follows.



T. Hargreaves  
Chair



S. Carmichael  
President and CEO

North Bay, Ontario  
May 30, 2008



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

### *Auditor's Report*

To the Ontario Northland Transportation Commission  
and to the Minister of Northern Development and Mines

I have audited the consolidated balance sheet of the Ontario Northland Transportation Commission as at March 31, 2008 and the consolidated statements of investment by the Province of Ontario, operations and retained earnings and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Commission's management. My responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Commission as at March 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Ontario  
May 30, 2008

Jim McCarter, CA  
Auditor General  
Licensed Public Accountant

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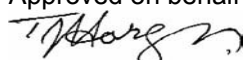
# Ontario Northland Transportation Commission

## Consolidated Balance Sheet

(dollars in thousands)

	March 31 2008	March 31 2007
<b>Assets</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 4,467	\$ -
Accounts receivable (Net of allowance - \$1,526; 2007 - \$1,452)	18,976	17,831
Inventory	18,000	18,876
Prepaid expenses	960	1,219
	<b>42,403</b>	37,926
Development costs (Note 1)	5,178	5,649
Self-Insurance Fund (Note 2)		
- Market value \$4,288; (2007 - \$6,294)	4,288	6,294
Investment in property, plant and equipment (Schedule 1)	263,793	261,425
Accrued pension benefit asset (Note 4)	73,167	74,343
	<b>\$ 388,829</b>	<b>\$ 385,637</b>
<b>Liabilities and Province of Ontario Equity</b>		
<b>Current</b>		
Bank indebtedness	\$ -	\$ 505
Operating line of credit (Note 3)	15,000	15,000
Accounts payable and accrued liabilities	25,779	29,419
Current portion of long-term debt (Note 5a)	4,712	4,509
Current portion of capital lease obligations (Note 5b)	195	276
Current portion of deferred revenue	2,315	2,726
	<b>48,001</b>	52,435
Deferred revenue (Note 6)	1,346	2,939
Provision for Self-Insurance (Note 2)	4,288	6,294
Long-term debt (Note 5a)	28,979	27,769
Capital lease obligations (Note 5b)	107	292
Accrued Non-Pension Benefit Obligation (Note 4)	61,177	57,969
	<b>143,898</b>	147,698
<b>Contingencies (Note 10) / Commitments (Note 11)</b>		
<b>Province of Ontario Equity</b>		
Investment by the Province of Ontario	132,202	109,583
Retained earnings	112,729	128,356
	<b>244,931</b>	237,939
	<b>\$ 388,829</b>	<b>\$ 385,637</b>

Approved on behalf of the Commission:



Chair



President and CEO

**Ontario Northland Transportation Commission**  
**Consolidated Statement of Investment by the Province of Ontario**  
(dollars in thousands)

<b>For the year ended March 31</b>	<b>2008</b>	<b>2007</b>
<b>Balance, beginning of period</b>		
Net investment in property, plant and equipment	\$ 40,357	\$ 34,753
Net investment other than share capital	<u>69,226</u>	<u>69,226</u>
	<u><b>109,583</b></u>	<u>103,979</u>
<b>Net changes during the period</b>		
Investment from Province of Ontario (Note 13)	<b>17,400</b>	-
Contributions from Province of Ontario	<b>7,995</b>	7,397
Retirements	<b>(362)</b>	-
Amortization	<u><b>(2,414)</b></u>	<u>(1,793)</u>
	<u><b>22,619</b></u>	<u>5,604</u>
<b>Balance, end of period</b>		
Net investment in property, plant and equipment	<b>45,576</b>	40,357
Net investment other than share capital	<u><b>86,626</b></u>	<u>69,226</u>
	<u><b>\$ 132,202</b></u>	<u>\$ 109,583</u>

The accompanying summary of significant accounting policies and notes are an integral part of these consolidated financial statements.

**Ontario Northland Transportation Commission**  
**Consolidated Statement of Operations and Retained Earnings**  
(dollars in thousands)

<b>For the year ended March 31</b>	<b>2008</b>	<b>2007</b>
<b>Revenues</b> (Schedule 2)	\$ 140,347	\$ 144,471
<b>Expenses</b> (Schedule 2)	<u>134,657</u>	<u>133,534</u>
<b>Income from operations, before other revenues and expenses</b>	<u>5,690</u>	<u>10,937</u>
<b>Other revenues and expenses</b>		
Amortization (Schedule 2)	12,409	12,916
Pension/non-pension expense (Schedule 2 and Note 4)	6,627	6,654
Interest expense (Schedule 2)	2,851	2,699
Investment and other income	(2)	(9)
Gain on sale of property, plant and equipment (Schedule 2)	(568)	(655)
<b>Net expenses</b>	<u>21,317</u>	<u>21,605</u>
<b>Net loss for the period</b>	<u>(15,627)</u>	<u>(10,668)</u>
<b>Retained earnings, beginning of period</b>	128,356	139,024
<b>Retained earnings, end of period</b>	<u>\$ 112,729</u>	<u>\$ 128,356</u>

The accompanying summary of significant accounting policies and notes are an integral part of these consolidated financial statements.

# Ontario Northland Transportation Commission

## Consolidated Statement of Cash Flows

(dollars in thousands)

For the year ended March 31	2008	2007
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Loss	\$ (15,627)	\$ (10,668)
Items not affecting cash		
Amortization (Schedule 2)	12,409	12,916
Gain on disposal of property, plant and equipment	(568)	(655)
Development costs	471	446
Deferred revenue	(1,593)	(2,181)
Pension/non-pension expense (Note 4)	6,627	6,654
	1,719	6,512
Changes in non-cash working capital balances		
Accounts receivable	(1,145)	3,023
Inventory	876	(262)
Prepaid expenses	259	(121)
Accounts payable and accrued liabilities	(3,640)	(2,380)
Deferred revenue	(411)	(375)
	(2,342)	6,397
<b>Investing activities</b>		
Investment in property, plant and equipment	(17,618)	(12,347)
Proceeds from sale of property, plant and equipment	633	1,711
Decrease in other assets	(187)	(180)
	(17,172)	(10,816)
<b>Financing activities</b>		
Bank Indebtedness	(505)	505
Long-term debt (Note 5a)	1,413	(2,570)
Capital lease obligations (Note 5b)	(266)	(314)
Contributions from the Province of Ontario	25,395	7,397
Other liabilities	(2,056)	(1,939)
	23,981	3,079
<b>Change in cash and cash equivalents during the period</b>	<b>4,467</b>	<b>(1,340)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>-</b>	<b>1,340</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 4,467</b>	<b>\$ -</b>
<b>Supplemental disclosure of cash flow information:</b>		
Interest paid during the period and included in net loss	\$ 2,851	\$ 2,699

The accompanying summary of significant accounting policies and notes are an integral part of these consolidated financial statements.

**Ontario Northland Transportation Commission**  
**Consolidated Schedule of Investment**  
**in Property, Plant and Equipment**  
**Schedule 1**  
(dollars in thousands)

<b>For the year ended March 31</b>		<b>2008</b>		<b>2007</b>	
	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>		<b>Net Book Value</b>
<b>Rail Services</b>					
Roadway	\$ 247,062	\$ 102,708	\$ 144,354	\$	144,163
Buildings	39,800	16,404	23,396		23,979
Equipment	73,524	45,056	28,468		30,460
Equipment under capital lease	1,022	98	924		977
Under construction	7,675	-	7,675		4,336
<b>Telecommunications (Ontera)</b>					
Equipment	143,851	106,763	37,088		42,227
Buildings	5,750	3,907	1,843		1,931
Under construction	7,764	-	7,764		303
<b>Motor Coach Services</b>					
Coaches	9,650	5,312	4,338		4,987
Buildings	2,696	97	2,599		2,649
<b>Refurbishment</b>					
Equipment	558	45	513		519
Buildings	3,305	216	3,089		3,155
<b>Marine Services (Moosonee)</b>					
Vessels	385	347	38		48
Under construction	92	-	92		42
<b>Development</b>					
Land and buildings	2,851	1,239	1,612		1,649
	<b>\$ 545,985</b>	<b>\$ 282,192</b>	<b>\$ 263,793</b>	<b>\$</b>	<b>261,425</b>

The accompanying summary of significant accounting policies and notes are an integral part of these consolidated financial statements.



**Ontario Northland Transportation Commission**  
**Consolidated Schedule of Operating Revenues and Expenses**  
**Schedule 2**  
(dollars in thousands)

<b>For the year ended March 31</b>	<b>2008</b>	<b>2007</b>
<b>Rail Services</b>		
Sales revenue (Notes 9 and 15)	\$ 63,057	\$ 72,737
Government reimbursement (Note 7)	22,123	18,551
	<hr/>	<hr/>
Operating revenue	85,180	91,288
Operating expense	76,691	76,048
	<hr/>	<hr/>
Operating income	8,489	15,240
Amortization	7,626	7,699
Pension/non-pension expense (Note 4)	4,001	4,297
Gain on sale of property, plant and equipment	(585)	(647)
Interest expense	1,112	1,278
	<hr/>	<hr/>
(Loss) income from operations	(3,665)	2,613
	<hr/>	<hr/>
<b>Telecommunications (Ontera)</b>		
Sales revenue (Note 8)	31,253	30,074
Operating expense	27,416	28,206
	<hr/>	<hr/>
Operating income	3,837	1,868
Amortization	3,778	4,194
Pension/non-pension expense (Note 4)	1,089	1,065
Interest expense	195	-
	<hr/>	<hr/>
Loss from operations	(1,225)	(3,391)
	<hr/>	<hr/>
<b>Motor Coach Services</b>		
Sales revenue	9,452	11,530
Operating expense	9,148	9,415
	<hr/>	<hr/>
Operating income	304	2,115
Amortization	651	616
Pension/non-pension expense (Note 4)	363	399
Loss on sale of property, plant and equipment	57	-
Interest expense	183	140
	<hr/>	<hr/>
(Loss) income from operations	(950)	960
	<hr/>	<hr/>
<b>Refurbishment</b>		
Sales revenue	13,780	10,870
Operating expense	14,791	13,470
	<hr/>	<hr/>
Operating (loss) income	(1,011)	(2,600)
Amortization	84	82
Pension/non-pension expense (Note 4)	704	427
Interest expense	456	466
	<hr/>	<hr/>
Loss from operations	(2,255)	(3,575)
	<hr/>	<hr/>

The accompanying summary of significant accounting policies and notes are an integral part of these consolidated financial statements.

**Ontario Northland Transportation Commission**  
**Consolidated Schedule of Operating Revenues and Expenses**  
**Schedule 2 (continued)**  
(dollars in thousands)

<b>For the year ended March 31</b>	<b>2008</b>	<b>2007</b>
<b>Marine Services (Moosonee)</b>		
Sales revenue	129	146
Government reimbursement (Note 7)	44	49
	<u>173</u>	<u>195</u>
Operating revenue	173	195
Operating expense	208	270
	<u>(35)</u>	<u>(75)</u>
Loss from operations	(35)	(75)
<b>Rental Properties</b>		
Sales revenue	509	514
Operating expense	306	281
	<u>203</u>	<u>233</u>
Operating income	203	233
Amortization	37	37
Gain on sale of property, plant and equipment	(40)	(8)
	<u>206</u>	<u>204</u>
Income from operations	206	204
<b>Administration</b>		
Operating revenue	-	-
Operating expense	6,097	5,844
	<u>(6,097)</u>	<u>(5,844)</u>
Operating loss	(6,097)	(5,844)
Amortization	233	288
Pension/non-pension expense (Note 4)	470	466
Interest expense	905	815
	<u>(7,705)</u>	<u>(7,413)</u>
Loss from operations	(7,705)	(7,413)
<b>Total Operations</b>		
Sales revenue	118,180	125,871
Government reimbursement (Note 7)	22,167	18,600
	<u>140,347</u>	<u>144,471</u>
Total revenues	140,347	144,471
Expenses	134,657	133,534
	<u>5,690</u>	<u>10,937</u>
Income from operations	5,690	10,937
Amortization	12,409	12,916
Pension/non-pension expense (Note 4)	6,627	6,654
Interest expense	2,851	2,699
Gain on sale of property, plant and equipment	(568)	(655)
	<u>(15,629)</u>	<u>(10,677)</u>
<b>Loss from operations</b>	\$ (15,629)	\$ (10,677)

## Ontario Northland Transportation Commission Summary of Significant Accounting Policies

March 31, 2008

<b>Nature of Business</b>	The Ontario Northland Transportation Commission, an Operational Enterprise of the Ontario government, delivers a variety of commercial and non-commercial services, including rail freight, passenger rail, motor coach and telecommunications primarily in the northeastern portion of Northern Ontario.																
<b>Basis of Accounting</b>	These consolidated financial statements are prepared by management in accordance with Canadian generally accepted accounting principles. They include the accounts of the Commission and its wholly-owned subsidiaries, Ontario Northland International Consulting Services Inc, O.N. Tel Inc. (o/a Ontera), Air-Dale Limited and Nipissing Central Railway Company.																
<b>Inventory</b>	With the exception of used rail, all materials and supplies are valued at average cost. Used rail is shown at unamortized book value determined at the time of retirement.																
<b>Investment in Property, Plant and Equipment and Amortization</b>	<p>Property, plant and equipment are stated at acquisition cost. Amortization is calculated using the straight-line method over the estimated service lives of the assets.</p> <p>The estimated service lives for principal categories of assets are as follows:</p> <table style="margin-left: 40px;"> <tr> <td>Roadway - main line and branches</td><td>20 to 50 years</td></tr> <tr> <td>Railway diesel locomotives</td><td>25 years</td></tr> <tr> <td>Railway cars</td><td>33 years</td></tr> <tr> <td>Buildings</td><td>50 years</td></tr> <tr> <td>Telecommunications equipment</td><td>15 to 25 years</td></tr> <tr> <td>Vehicles</td><td>3 years</td></tr> <tr> <td>Computer equipment</td><td>5 years</td></tr> <tr> <td>Coaches</td><td>12 years</td></tr> </table> <p>The Province of Ontario reimburses the Commission for the cost of certain property, plant and equipment purchased for use in operations designated as non-commercial by the Province. The Commission records these assets at their original cost together with an offsetting credit to Net Investment in Property, Plant and Equipment (Province of Ontario). Annual amortization on these property, plant and equipment is recorded as a reduction of the Net Investment in Property, Plant and Equipment (see page 5).</p>	Roadway - main line and branches	20 to 50 years	Railway diesel locomotives	25 years	Railway cars	33 years	Buildings	50 years	Telecommunications equipment	15 to 25 years	Vehicles	3 years	Computer equipment	5 years	Coaches	12 years
Roadway - main line and branches	20 to 50 years																
Railway diesel locomotives	25 years																
Railway cars	33 years																
Buildings	50 years																
Telecommunications equipment	15 to 25 years																
Vehicles	3 years																
Computer equipment	5 years																
Coaches	12 years																

## Ontario Northland Transportation Commission Summary of Significant Accounting Policies

March 31, 2008

### Employee Future benefits

#### Pension Plans

The Commission maintains a defined benefit pension plan for its employees. It provides for pensions based on years of service and average pensionable earnings and is generally applicable from the first day of the month following employment. The plan is not indexed; however, there have been a variety of ad hoc increases made to pensioners.

The obligations under the plan are determined using the accrued benefit method reflecting projected benefits for services rendered to date. Pension fund assets are valued using current market values. The Accrued Pension Benefit Asset or Obligation and expenses are determined annually by independent actuaries in accordance with accepted actuarial practice using management's best estimates. The date of the last actuarial valuation for funding purposes was January 1, 2006. The date of the next actuarial valuation for funding purposes is expected to be January 1, 2009.

#### Non-Pension Benefit Plans

The Commission offers non-pension post retirement benefits such as group life, health care and long-term disability to employees through defined benefit plans. The costs associated with these future benefits are actuarially determined using the projected benefits method prorated on service and best estimate assumptions. In addition, as a Schedule 2 employer under the Workplace Safety and Insurance Board (WSIB), the Commission recognizes workers compensation benefits on an accrual basis using actuarial calculations provided by the WSIB for benefits in force, benefits not yet awarded and administrative loading costs.

Both Pension and Non-Pension expenses consist of current service costs, interest and adjustments arising from plan amendments, changes in assumptions and experience gains or losses. Experience gains or losses are amortized on a straight-line basis over the expected average remaining service life of the employees covered by the plans. These expenses are recorded in the year in which employees render services to the Commission (See Note 4).

## Ontario Northland Transportation Commission Summary of Significant Accounting Policies

**March 31, 2008**

### **Development Costs**

The Commission incurred certain costs related to its development of a new line of business (Refurbishment). The development costs are expensed, beginning in fiscal 2006-2007. Development costs that meet generally accepted criteria, including reasonable assurance regarding future benefits, are deferred and amortized on a straight line, completed-unit basis over the life of the expected benefit. In fiscal 2008, the Commission early adopted CICA Section 3064 "Goodwill and intangible assets". Section 3064 replaces Section 3062 "Goodwill and other intangible assets" and Section 3450 "Research and development costs". The adoption of Section 3064 does not have a material impact on the financial position and results of operations of the Commission.

### **Revenue Recognition**

Transportation revenues are generally recognized on completion of movements, with interline movements being treated as complete when the shipment is turned over to the connecting carrier. Contract revenues are generally recorded on a percentage of completion basis. Revenues from other sources including Government reimbursement are recognized when earned. Telecommunications toll revenue adjustments are recognized when measurement can be reasonably estimated (see Note 8).

### **Income Taxes**

As an Operational Enterprise of the Province of Ontario, the Commission is exempt from income taxes. This exemption extends to its wholly-owned subsidiaries, and accordingly no tax provision is recorded in these financial statements.

### **Foreign Currency Translation**

Revenues and expenses arising from foreign currency transactions are translated to their Canadian equivalent at the rates of exchange in effect at the transaction date. Resulting gains or losses on settlement or translation are included in the determination of net income for the current period. Included in Rail revenue is a foreign currency gain of \$290,000 (2007 - \$470,000) arising mainly from Rail traffic settlements between Canada and the U.S.A.

## Ontario Northland Transportation Commission Summary of Significant Accounting Policies

March 31, 2008

### Accounting Estimates

The preparation of the financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the useful lives of assets for amortization. By their nature, these estimates are subject to measurement uncertainty. The effect of changes in such estimates on the financial statements in future periods could be significant. Accounts specifically affected by estimates in the financial statements are development costs, property, plant and equipment, accrued pension benefit asset, accrued liabilities and non-pension benefit obligation.

### Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and balances with banks.

### New Accounting Policies

Effective April 1, 2007 the Commission adopted new accounting standards related to financial instruments, comprehensive income and accounting changes that were issued by the Canadian Institute of Chartered Accountants ("CICA"). The new CICA standards are as follows:

Section 3855 – Financial Instruments – Recognition and Measurement. This section establishes standards for recognizing and measuring financial assets and liabilities and derivative financial instruments. All financial instruments are required to be measured at fair value on initial recognition, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other liabilities.

Financial assets and liabilities classified as held-for-trading are required to be measured at fair value, with gains and losses recognized in net earnings.

Financial assets classified as held-to-maturity, loans and receivables and financial liabilities (other than those held-for-trading) are required to be measured at amortized costs using the effective interest method of amortization.

## Ontario Northland Transportation Commission Summary of Significant Accounting Policies

March 31, 2008

### New Accounting Policies (Continued)

Available-for-sale financial assets are required to be measured at fair value with unrealized gains and losses recognized in Other Comprehensive Income. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market should be measured at cost.

The Commission has implemented the following classification:

- Cash and cash equivalents and Self Insurance Fund are classified as held-for-trading.
- Accounts receivables are classified as loans and receivables.
- Accounts payable and accrued liabilities, bank indebtedness, operating line of credit, long-term debt and capital lease obligations are classified as other liabilities.

#### Section 1530 – Comprehensive Income

This section established standards for reporting and presenting comprehensive income which is defined as the change in equity for transactions and other events from non-owner sources. Other Comprehensive Income refers to items recognized in comprehensive income that are excluded from net earnings.

The classification of the Commission's financial instruments as at April 1, 2007 and their subsequent changes to March 31, 2008 have resulted in no gains or losses that require separate presentation in Other Comprehensive Income. There was no effect on opening equity as of April 1, 2007 or on subsequent measurements as a result of applying these new standards.

#### Section 1506 – Accounting Changes

Effective April 1, 2007, the Commission adopted the revised CICA Section 1506 "Accounting Changes", which requires that a) a voluntary change in accounting principles can be made if the changes result in reliable and more relevant information, b) changes in accounting policies are accompanied with disclosures of prior period amounts and justification for the change, and c) for changes in estimates, the nature and the amount of the change should be disclosed. Furthermore, this section requires disclosure of when an entity has not applied a new source of GAAP that has been issued but is not yet effective. Such disclosures are provided below.

## Ontario Northland Transportation Commission Summary of Significant Accounting Policies

March 31, 2008

### New Accounting Policies (Continued)

The Commission has not made any voluntary change in accounting principles since the adoption of the revised standard.

### Accounting standards issued but not yet adopted

The CICA has issued the following new Handbook Sections and/or new recommendations which will be adopted by the Commission on April 1, 2008:

- a) Section 3862, "Financial Instruments – Disclosures", describes the required disclosure for the assessment of the significance of financial instruments for an entity's financial position and performance and of the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. The Commission is currently evaluating the impact on the adoption of this new section on the consolidated financial statements.
- b) Section 1400, "General Standards of Financial Statement Presentation", was amended to include requirements to assess and disclose an entity's ability to continue as a going concern. The new requirements are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. These new requirements will not have any impact on the consolidated financial statements as the Commission is already assessing and disclosing its ability to continue as a going concern.
- c) Effective January 1, 2008, the CICA has issued accounting standard Section 3031 "Inventories". Section 3031 "Inventories" will provide guidance on the method of determining the cost of the Commission's materials and supplies. The new accounting standard specifies that inventories are to be valued at the lower of cost and net realizable value. The Commission currently reflects materials and supplies at average cost. The standard requires the reversal of previously recorded write downs to realizable value when there is clear evidence that the net realizable value has increased. Additional disclosures will also be required. It is not anticipated that the adoption of Section 3031 "Inventories" will have a material impact on the Commission's financial statements. Any adjustment on the adoption of Section 3031 "Inventories" will be recognized in 2009 as an adjustment to opening inventory and opening retained earnings.



## Ontario Northland Transportation Commission Notes to Consolidated Financial Statements

March 31, 2008

### 1. Development costs

	2008	2007
<b>Development costs</b> - beginning of year	\$ 5,649,000	\$ 6,095,000
Amortization	471,000	446,000
<b>Development costs</b> - end of year	<b>\$ 5,178,000</b>	<b>\$ 5,649,000</b>

### 2. Self-Insurance Fund

	2008	2007
<b>Self Insurance Fund</b> - beginning of year	\$ 6,294,000	\$ 6,004,000
Interest earned	300,000	246,000
Annual premium	100,000	100,000
Claims	(2,406,000)	(56,000)
<b>Self Insurance Fund</b> - end of year	<b>\$ 4,288,000</b>	<b>\$ 6,294,000</b>

The Commission follows the policy of self-insuring for damages from rolling stock derailments and for cargo damage. Fund assets include cash in the amount of \$4,288,000 (2007 - \$ 2,066,000) plus \$NIL (2007 - \$ 4,228,000) receivable from the Commission.

Periodically, the Commission borrows cash from the fund for its temporary use. The Commission pays interest to the Fund at the bank's prime rate less 1.75% on these temporary borrowings.

The claims in the year were incurred for costs associated with the March 30, 2007 derailment of one of the Commission's freight trains in a remote area of Northeastern Ontario.

## **Ontario Northland Transportation Commission Notes to Consolidated Financial Statements**

**March 31, 2008**

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### **3. Operating Line of Credit**

The Commission currently holds an operating line of credit with the Ontario Financing Authority (OFA) in the amount of \$8,000,000, of which \$8,000,000 was being utilized as at March 31, 2008 (2007 - \$8,000,000) which bears interest at the Province of Ontario's cost of borrowing plus 5 basis points on the date of each advance. In addition, the Commission has a revolving operating line of credit with the OFA in the amount of \$7,000,000, of which \$7,000,000 was being utilized as at March 31, 2008 (2007 - \$7,000,000) which bears interest at the Province of Ontario's cost of borrowing plus 40 basis points based on the date of each advance.

The Commission also holds a demand operating line of credit with the Canadian Imperial Bank of Commerce in the amount of \$1,500,000 which is available for letters of guarantee and is secured by the Commission's accounts receivable. As of March 31, 2008, two letters of guarantee totalling \$1,428,000 (2007 - \$ 1,428,000) have been issued with an annual renewal commission of .375%.

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## Ontario Northland Transportation Commission Notes to Consolidated Financial Statements

March 31, 2008

### 4. Employee Future Benefits

The Commission is the administrator of its contributory pension plan which covers all permanent staff. The pension fund assets primarily include marketable securities, real estate and corporate and government bonds, which are invested by professional investment managers. The ONTC pension plan has an annual measurement date of December 31<sup>st</sup>.

The pension fund's target percentage allocation and average asset allocations as at March 31, 2008 and March 31, 2007, by asset category are as follows:

	Target	2008	2007
Equity securities – Domestic	20% - 30%	25%	25%
– Foreign	10% - 30%	22%	22%
Debt securities	35% - 55%	49%	49%
Real estate	0% - 15%	3%	3%
Short term and other	0% - 15%	1%	1%
Total		<b>100%</b>	100%

### a. Accrued Pension Benefit Asset

	2008	2007
Projected benefit obligations	\$ 456,899,000	\$ 495,452,000
Market value of plan assets	<b>503,660,000</b>	510,034,000
<b>Surplus</b>	<b>\$ 46,761,000</b>	<b>\$ 14,582,000</b>
<b>Accrued benefit asset - beginning of year</b>	<b>\$ 74,343,000</b>	\$ 77,278,000
Expense	<b>(1,363,000)</b>	(3,115,000)
Funding contributions	<b>187,000</b>	180,000
<b>Accrued benefit asset - end of year</b>	<b>\$ 73,167,000</b>	\$ 74,343,000

## Ontario Northland Transportation Commission

### Notes to Consolidated Financial Statements

March 31, 2008

#### 4. Employee Future Benefits (continued)

##### b. Accrued Non-Pension Benefit Obligation

	2008	2007
<b>Accrued benefit liability</b> - beginning of year	<b>\$ 57,969,000</b>	\$ 56,369,000
Expense – Non-WSIB	<b>3,636,000</b>	3,464,000
Expense – WSIB	<b>1,628,000</b>	75,000
Funding contributions – Non-WSIB	<b>(2,056,000)</b>	(1,939,000)
<b>Accrued benefit liability</b> - end of year	<b>\$ 61,177,000</b>	\$ 57,969,000

Included in the accrued non-pension benefit liability is worker's compensation benefits in the amount of \$12,934,000 (2007 - \$11,306,000). This amount has been determined from the most recent available actuarial calculations provided by the Workplace Safety and Insurance Board as at December 31, 2007.

##### c. Components of Net Periodic Pension Benefit expense

	2008	2007
Current service cost less employee contributions	<b>\$ 9,520,000</b>	\$ 9,470,000
Interest cost on accrued benefit obligation	<b>24,689,000</b>	25,630,000
Expected return on plan assets	<b>(34,681,000)</b>	(35,295,000)
Amortization of initial obligation	<b>197,000</b>	197,000
Amortization of past service costs	<b>1,638,000</b>	1,195,000
Amortization of net actuarial gain	<b>-</b>	1,918,000
	<b>\$ 1,363,000</b>	\$ 3,115,000

##### d. Components of Net Periodic Non-Pension Benefit Expense

	2008	2007
Current service cost	<b>\$ 2,665,000</b>	\$ 1,001,000
Interest on accrued benefit obligation	<b>2,595,000</b>	2,538,000
Amortization of net actuarial gain	<b>4,000</b>	-
	<b>\$ 5,264,000</b>	\$ 3,539,000

## Ontario Northland Transportation Commission Notes to Consolidated Financial Statements

March 31, 2008

### 4. Employee Future Benefits (continued) e. Weighted Average Assumptions

Discount rate - pension	5.75	5.00
Discount rate - non pension	5.75	5.00
Expected long-term rate of return on plan assets	7.00	7.50
Rate of compensation increase	4.00	4.00
Medical cost increases	4.5% to 9.0%	4.5% to 10.0%

### 5. Long-term Debt and Capital Lease Obligations

	2008	2007
a. Loan from Ontario Financing Authority, bearing interest at 5.22% per annum, blended monthly payments of \$30,000 for 15 years beginning February 1, 2005	\$ 3,224,000	\$ 3,415,000
Loan from Ontario Financing Authority, bearing interest at 5.64% per annum, blended monthly payments of \$43,000 for 10 years beginning May 1, 1998.	43,000	541,000
Loan from Ontario Financing Authority, bearing interest at 5.60% per annum, blended monthly payments of \$156,000 for 15 years beginning January 1, 2000.	10,505,000	11,754,000
Loan from Ontario Financing Authority, bearing interest at 6.37% per annum, blended monthly payments of \$109,000 for 15 years beginning September 1, 1999.	6,901,000	7,748,000
Loan from Ontario Financing Authority, bearing interest at 4.717% per annum, blended annual payments of \$1,681,000 for 4 years beginning March 31, 2007.	3,138,000	6,000,000
Loan from Ontario Financing Authority, bearing interest at 4.90% per annum, blended monthly payments of \$13,000 for 25 years beginning February 1, 2006.	2,193,000	2,244,000
Loan from Bank of Montreal, bearing interest at 5.11% per annum, blended monthly payments of \$64,000 for 10 years beginning April 30, 2008. Secured by assets of Ontera.	6,000,000	250,000
Construction advance from the Bank of Montreal, bearing interest at the bank's prime rate less .75%. Further advances will be made up to \$17,000,000 then converted to a fixed term loan, term not to exceed 10 years, bearing interest at bank cost of funds plus 40 basis points. Secured by assets of Ontera.	1,500,000	-
Vendor take back loan on an asset purchase that bears 0% interest, repayable over 8 years in accordance with the terms of the purchase agreement beginning December 1, 2000.	187,000	326,000
	33,691,000	32,278,000
Less current portion	4,712,000	4,509,000
	\$ 28,979,000	\$ 27,769,000

## Ontario Northland Transportation Commission Notes to Consolidated Financial Statements

March 31, 2008

### 5. Long-term Debt and Capital Lease Obligations (continued)

Payments required in the next five years and thereafter are as follows:

2008-2009	\$ 4,712,000
2009-2010	4,918,000
2010-2011	3,495,000
2011-2012	3,687,000
2012-2013	3,890,000
Thereafter	<u>12,989,000</u>
	<u>\$ 33,691,000</u>

	<u>2008</u>	<u>2007</u>
b. Capital lease bearing interest at 5.93% per annum, blended monthly payments of \$7,000 for 4 years beginning January 24, 2006	\$ 139,000	\$ 211,000
Capital lease bearing interest at 5% per annum, blended monthly payments of \$10,000 for 3 years beginning March 1, 2006.	108,000	219,000
Capital lease bearing interest at 10% per annum, blended monthly payments of \$11,000 for 2 years beginning November 27, 2005.	-	73,000
Capital lease bearing interest at 7% per annum, blended monthly payments of \$1,000 for 5 years beginning September 22, 2006.	55,000	65,000
	<u>302,000</u>	<u>568,000</u>
Less current portion	195,000	276,000
	<u>\$ 107,000</u>	<u>\$ 292,000</u>

## Ontario Northland Transportation Commission Notes to Consolidated Financial Statements

March 31, 2008

### 5. Long-term Debt and Capital Lease Obligations (continued)

Payments under capital leases included above are as follows:

2008-2009	\$ 207,000
2009-2010	76,000
2010-2011	13,000
2011-2012	<u>25,000</u>
Total minimum payments	321,000
Less: amount representing interest	<u>19,000</u>
Obligations under capital lease	<u>\$ 302,000</u>

### 6. Deferred Revenue

Included in Deferred Revenue are the following two significant items:

In 2004, the Commission entered into a multi-year contract to refurbish commuter cars. Under the terms of the contract, the Commission received an advance from the customer of \$4,030,000 in 2005-2006 in addition to the \$2,627,000 received in 2004 to defray contract costs. An amount of \$2,265,000 (2007 - \$3,961,000) has been included as deferred revenue, of which \$370,000 relates to periods after March 31, 2009. The deferred revenue will be recognized based on the percentage of completion method. During 2008, \$1,696,000 (2007 - \$1,762,000) of the advance was recognized as revenue.

Hydro One has entered into a 20-year agreement for the use of the Commission's fibre optic cable, expiring in March 2022. The total contract value is \$1,380,000. The remaining balance of \$1,035,000 has been included as deferred revenue, of which \$966,000 relates to periods after March 31, 2009. The deferred revenue will be recognized on a straight line basis over the life of the agreement. During 2008 \$69,000 (2007 - \$69,000) was included as revenue.

### 7. Government Reimbursement

In accordance with a Memorandum of Understanding between the Commission and the Ministry of Northern Development and Mines, certain operations of the Commission have been designated as non-commercial. The Commission and the Ministry have entered into annual contribution agreements which define the amount of compensation which the Province of Ontario would provide in each fiscal year.

## Ontario Northland Transportation Commission Notes to Consolidated Financial Statements

March 31, 2008

### 7. Government Reimbursement (continued)

A portion of the operating loss of the weekday passenger train service between North Bay and Toronto is reimbursed by the National Transportation Agency of Canada under Section 270 of the Railway Act. The federal government revoked the Railway Act during 1996 and replaced it with the Canada Transportation Act. An annual reimbursement of \$2,500,000 was received until the expiration of the agreement on March 31, 2008.

Details of Government reimbursement are as follows:

	<u>2008</u>	<u>2007</u>
<b>From Province of Ontario:</b>		
Rail - Passenger Service and Moosonee Branch	\$ 19,623,000	\$ 16,051,000
Marine Services (Moosonee)	<u>44,000</u>	<u>49,000</u>
	19,667,000	16,100,000
<b>From Transport Canada:</b>		
Current period's operations	<u>2,500,000</u>	<u>2,500,000</u>
	<b><u>\$ 22,167,000</u></b>	<b><u>\$ 18,600,000</u></b>

The Commission is dependent on these reimbursements to carry out its non-commercial operations.

### 8. Telecommunications Revenue

The Commission's Telecommunications Division has telecommunications interconnection and traffic settlement agreements with Bell Canada that permits the two companies to exchange and settle on toll traffic and data circuits that traverse their respective networks. The Access Tariffs charged by Local Exchange Carriers are regularly reviewed by the CRTC and are not subject to any retroactive adjustments. In keeping with the Commission's accounting policy, any revenue or cost adjustments whether positive or negative are recognized in the year in which they become known and estimable.



## Ontario Northland Transportation Commission Notes to Consolidated Financial Statements

March 31, 2008

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### 9. Passenger Revenue

In compliance with the Travel Industry Act, the 2008 gross retail sales were \$766,000 (2007 - \$547,000) and the 2008 gross wholesale sales were \$41,000 (2007 - \$61,000).

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### 10. Contingencies

#### a. Ontera assets

O.N.Tel Inc. (operating as Ontera) has sustained losses from operations over the current and the past five periods (see Schedule 2). In response to the situation, management developed a business plan in 2007 that required a significant investment in Ontera's property, plant and equipment along with associated financing. The Province approved the plan in 2007 including the underlying capital investment component. Financing of \$7,500,000 from the Bank of Montreal to support the plan was obtained in the year (see Note 5a).

#### b. Statement of claim

Various statements of claim have been issued against the Commission claiming damages. Damages, if any, cannot be estimated at this time and in any event the Commission is of the opinion that these claims would be unfounded or covered by insurance after application of a \$2,000,000 deductible. Should any loss result, it would be charged to operations when the amount is ascertained.

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### 11. Commitments

The Commission has contractual obligations on a number of operating leases for such items as rail cars, computer equipment, automotive equipment and other. It is management's opinion that in aggregate the annual cost of these leases is not significant to the Commission as a whole.

The Commission is also obligated to certain job guarantee agreements with a significant number of its unionized employees. To the extent of any actual claims under these agreements, the Commission would maintain provisions for such items. Due to the nature of these agreements, the maximum exposure for future payments may be material. However, such exposure cannot be reasonably determined and no provision has been made as at the year-end date.

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## Ontario Northland Transportation Commission Notes to Consolidated Financial Statements

March 31, 2008

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### 12. Financial Instruments

The Commission's financial instruments consist of cash and cash equivalents, accounts receivable, Self Insurance Fund, bank indebtedness, operating line of credit, accounts payable and accrued liabilities, long-term debt and, capital lease obligations.

#### **Fair value**

The fair value of cash and cash equivalents, accounts receivable, Self Insurance Fund, bank indebtedness, operating line of credit, and accounts payable and accrued liabilities, are comparable to their carrying value due to their short-term maturity date. The fair value of long-term debt and capital lease obligations is approximately equal to its carrying value since the applicable interest rates are comparable to the market rates.

#### **Credit risk**

The Commission operates in Canada. It performs on a continuing basis credit checks on its customers and maintains provisions for contingent credit losses which, once they materialize, are accounting to management's estimates.

#### **Currency risk**

The Commission undertakes transactions denominated in United States dollars and as such is exposed to fluctuations in foreign exchange rates. The Commission generates revenues and incurs expenses in Canadian and United States dollars. The Commission does not use derivative instruments to reduce its exposure to foreign currency risk.

#### **Interest rate risk**

The Commission manages its cash according to its operational needs. The Commission is exposed to interest rate cash flow risk to the extent that the credit facility has a floating rate of interest.

The Commission's long-term debts and capital lease obligations have fixed interest rates. Also, the Commission will repay its long-term debts and capital lease obligations at maturity. As a result, management is of the opinion that the risks associated with long-term debt and capital lease obligations are minimal.

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### 13. Contribution by the Province of Ontario

In 2008, the Province of Ontario contributed \$17,400,000 as an equity investment without operating restrictions. It has been the practice of the Commission to classify transactions of this nature as investment by the Province of Ontario.

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## **Ontario Northland Transportation Commission Notes to Consolidated Financial Statements**

**March 31, 2008**

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### **14. Related Party Transactions**

During the period, the Commission charged the ONTC Contributory Pension Fund \$166,000 (2007 - \$177,000) for financial and administrative support.

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### **15. Economic Dependence**

During 2008, the Rail Services Division derived 83% (2007 - 35%) of its revenue from three major customers.

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### **16. Comparative Figures**

Prior year's figures have been reclassified where necessary to conform to current year's presentation.

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## Statement of Management's Responsibility for Financial Information

Ontario Power Generation Inc.'s ("OPG") management is responsible for presentation and preparation of the annual consolidated financial statements and Management's Discussion and Analysis ("MD&A").

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and the requirements of the Ontario Securities Commission ("OSC"), as applicable. The MD&A has been prepared in accordance with the requirements of securities regulators, including National Instrument 51-102 of the Canadian Securities Administrators and its related published requirements.

The consolidated financial statements and information in the MD&A necessarily include amounts based on informed judgments and estimates of the expected effects of current events and transactions with appropriate consideration to materiality. Something is considered material if it is reasonably expected to have a significant impact on the Company's earnings, cash flow, value of an asset or liability, or reputation. In addition, in preparing the financial information we must interpret the requirements described above, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. The MD&A also includes information regarding the impact of current transactions and events, sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from our present assessment of this information because future events and circumstances may not occur as expected.

In meeting our responsibility for the reliability of financial information, we maintain and rely on a comprehensive system of internal controls and internal audit, including organizational and procedural controls and internal controls over financial reporting. Our system of internal controls includes written communication of our policies and procedures governing corporate conduct and risk management; comprehensive business planning; effective segregation of duties; delegation of authority and personal accountability; careful selection and training of personnel; and sound and conservative accounting policies, which we regularly update. This structure ensures appropriate internal control over transactions, assets and records. We also regularly audit internal controls. These controls and audits are designed to provide us with reasonable assurance that the financial records are reliable for preparing financial statements and other financial information, assets are safeguarded against unauthorized use or disposition, liabilities are recognized, and we are in compliance with all regulatory requirements.

Management, including the President and Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of OPG's disclosure controls and procedures (as defined in Multilateral Instrument 52-109 of the Canadian Securities Administrators) as of December 31, 2007. Management concluded that, as of December 31, 2007, OPG's disclosure controls and procedures were effective to provide reasonable assurance that material information relating to OPG and its consolidated subsidiaries and interests in jointly controlled entities would be made known to them by others within those entities, particularly during the period in which this report was being prepared.

Management has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Accordingly, we, as OPG's Chief Executive Officer and Chief Financial Officer, will certify OPG's annual disclosure documents filed with the OSC, which includes attesting to the design and effectiveness of OPG's disclosure controls and procedures and the design of internal control over financial reporting.

The Board of Directors, based on recommendations from its Audit/Risk Committee, reviews and approves the consolidated financial statements and the MD&A, and oversees management's responsibilities for the presentation and preparation of financial information, maintenance of appropriate internal controls, management and control of major risk areas and assessment of significant and related party transactions.

The consolidated financial statements have been audited by Ernst & Young LLP, independent external auditors appointed by the Board of Directors. The Auditors' Report outlines the auditors' responsibilities and the scope of their examination and their opinion on OPG's consolidated financial statements. The independent external auditors, as confirmed by the Audit and Risk Committee, had direct and full access to the Audit and Risk Committee, with and without the presence of management, to discuss their audit and their findings therefrom, as to the integrity of OPG's financial reporting and the effectiveness of the system of internal controls.



**Jim Hankinson**

*President and Chief Executive Officer*  
February 27, 2008



**Donn W. J. Hanbidge**

*Chief Financial Officer*

**ONTARIOPOWER**  
GENERATION

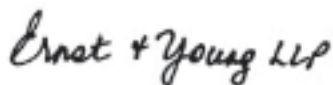
## Auditors' Report

### To the Shareholder of Ontario Power Generation Inc.

We have audited the consolidated balance sheets of Ontario Power Generation Inc. as at December 31, 2007 and 2006 and the consolidated statements of income, changes in shareholder's equity, comprehensive income and cash flows for the years then ended. These consolidated financial statements are the responsibility of Ontario Power Generation Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Ontario Power Generation Inc. as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



### Ernst & Young LLP

Chartered Accountants

Licensed Public Accountants

Toronto, Canada

February 27, 2008

**Consolidated Statements of Income****Years Ended December 31**

(millions of dollars except where noted)

	<b>2007</b>	2006
<b>Revenue</b> (Note 19)		
Revenue before revenue limit rebate	<b>5,887</b>	5,725
Revenue limit rebate (Note 16)	<b>(227)</b>	(161)
	<b>5,660</b>	5,564
Fuel expense	<b>1,270</b>	1,098
<b>Gross margin</b>	<b>4,390</b>	4,466
<b>Expenses</b> (Note 19)		
Operations, maintenance and administration	<b>2,974</b>	2,752
Depreciation and amortization (Note 5)	<b>695</b>	689
Accretion on fixed asset removal and nuclear waste management liabilities (Note 10)	<b>507</b>	499
Earnings on nuclear fixed asset removal and nuclear waste management funds (Note 10)	<b>(481)</b>	(371)
Property and capital taxes	<b>85</b>	106
	<b>610</b>	791
<b>Income before the following:</b>		
Other (gains) and losses (Note 17)	<b>(10)</b>	22
<b>Income before interest and income taxes</b>	<b>620</b>	769
Net interest expense	<b>143</b>	193
<b>Income before income taxes</b>	<b>477</b>	576
Income tax (recovery) expense (Note 11)		
Current	<b>1</b>	60
Future	<b>(52)</b>	26
	<b>(51)</b>	86
<b>Net income</b>	<b>528</b>	490
<b>Basic and diluted income per common share</b> (dollars)	<b>2.06</b>	1.91
<b>Common shares outstanding</b> (millions)	<b>256.3</b>	256.3

See accompanying notes to the consolidated financial statements

**Consolidated Statements of Cash Flows****Years Ended December 31**

(millions of dollars)

	2007	2006
<b>Operating activities</b>		
Net income	528	490
Adjust for non-cash items:		
Depreciation and amortization (Note 5)	695	689
Accretion on fixed asset removal and nuclear waste management liabilities (Note 10)	507	499
Earnings on nuclear fixed asset removal and nuclear waste management funds (Note 10)	(481)	(371)
Pension cost (Note 12)	243	218
Other post employment benefits and supplementary pension plans (Note 12)	244	255
Future income taxes (Note 11)	(52)	26
Transition rate option contracts	–	(12)
Mark-to-market on derivative instruments	1	(29)
Provision for used nuclear fuel	30	33
Regulatory assets and liabilities (Note 7)	(11)	2
Other (gains) and losses (Note 17)	(10)	22
Provision for other liabilities	54	22
Other	25	(11)
	1,773	1,833
Contributions to nuclear fixed asset removal and nuclear waste management funds (Note 10)	(788)	(454)
Expenditures on fixed asset removal and nuclear waste management (Note 10)	(200)	(164)
Reimbursement of expenditures on nuclear fixed asset removal and nuclear waste management (Note 10)	119	19
Contributions to pension fund (Note 12)	(268)	(261)
Expenditures on other post employment benefits and supplementary pension plans (Note 12)	(73)	(69)
Revenue limit rebate (Note 16)	(167)	(860)
Expenditures on restructuring	(2)	(8)
Net changes to other long-term assets and liabilities	(56)	(116)
Changes in non-cash working capital balances (Note 23)	69	477
<b>Cash flow provided by operating activities</b>	<b>407</b>	<b>397</b>
<b>Investing activities</b>		
Increase in regulatory assets (Note 7)	(58)	(13)
Investment in fixed assets (Notes 5 and 18)	(666)	(637)
Cash and cash equivalents transferred to long-term investments (Note 6)	(58)	–
<b>Cash flow used in investing activities</b>	<b>(782)</b>	<b>(650)</b>
<b>Financing activities</b>		
Issuance of long-term debt (Note 9)	900	270
Repayment of long-term debt (Note 9)	(406)	(806)
Dividend paid	–	(128)
Net (decrease) increase in short-term notes (Note 8)	(15)	15
<b>Cash flow provided by (used in) financing activities</b>	<b>479</b>	<b>(649)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>104</b>	<b>(902)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>6</b>	<b>908</b>
<b>Cash and cash equivalents, end of year</b>	<b>110</b>	<b>6</b>

See accompanying notes to the consolidated financial statements

**Consolidated Balance Sheets****As at December 31**

(millions of dollars)

	2007	2006
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	110	6
Accounts receivable (Notes 4 and 19)	315	230
Fuel inventory (Note 18)	604	669
Prepaid expenses	35	26
Future income taxes (Note 11)	12	–
Materials and supplies (Note 18)	125	112
	<b>1,201</b>	1,043
<b>Fixed assets</b> (Notes 5 and 18)		
Property, plant and equipment	17,772	17,136
Less: accumulated depreciation	4,995	4,375
	<b>12,777</b>	12,761
<b>Other long-term assets</b>		
Deferred pension asset (Note 12)	731	706
Nuclear fixed asset removal and nuclear waste management funds (Note 10)	9,263	7,594
Long-term investments (Notes 6 and 21)	93	32
Long-term materials and supplies (Note 18)	353	326
Regulatory assets (Note 7)	356	251
Long-term accounts receivable and other assets	65	37
	<b>10,861</b>	8,946
	<b>24,839</b>	22,750

See accompanying notes to the consolidated financial statements



**Consolidated Balance Sheets****As at December 31**

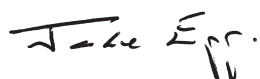
(millions of dollars)

	2007	2006
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued charges (Notes 12 and 19)	953	989
Revenue limit rebate payable (Note 16)	100	40
Short-term notes payable (Note 8)	–	15
Long-term debt due within one year (Note 9)	407	406
Future income taxes (Note 11)	–	3
Deferred revenue due within one year	12	12
Income and capital taxes payable (Note 11)	66	128
	<b>1,538</b>	1,593
<b>Long-term debt</b> (Note 9)	<b>3,446</b>	2,953
<b>Other long-term liabilities</b>		
Fixed asset removal and nuclear waste management (Note 10)	10,957	10,520
Other post employment benefits and supplementary pension plans (Note 12)	1,556	1,396
Long-term accounts payable and accrued charges	184	150
Deferred revenue	120	132
Future income taxes (Note 11)	217	246
Regulatory liabilities (Note 7)	14	11
	<b>13,048</b>	12,455
<b>Shareholder's equity</b>		
Common shares (Note 14)	5,126	5,126
Retained earnings	1,664	623
Accumulated other comprehensive income	17	–
	<b>6,807</b>	5,749
	<b>24,839</b>	22,750

Commitments and Contingencies (Notes 2, 8, 9, 10, 11, 13, 15, and 18)

See accompanying notes to the consolidated financial statements

On behalf of the Board of Directors:


**Honourable Jake Epp**

Chairman


**M. George Lewis**

Director

## Notes to the Consolidated Financial Statements

**Consolidated Statements of Changes in Shareholder's Equity****Years Ended December 31**

(millions of dollars)

	<b>2007</b>	2006
<b>Common shares</b> (Note 14)	<b>5,126</b>	5,126
<b>Retained earnings</b>		
Balance at beginning of year	<b>623</b>	261
Transition adjustment on adoption of financial instruments accounting standards (Note 3)	<b>513</b>	–
Net income	<b>528</b>	490
Dividends	–	(128)
Balance at end of year	<b>1,664</b>	623
<b>Accumulated other comprehensive income, net of income taxes</b>		
Balance at beginning of year	–	
Transition adjustment on adoption of financial instruments accounting standards (Note 3)	<b>21</b>	
Other comprehensive income for the year	<b>(4)</b>	
Balance at end of year	<b>17</b>	
<b>Total shareholder's equity at end of year</b>	<b>6,807</b>	

**Consolidated Statement of Comprehensive Income****Year Ended December 31, 2007**

(millions of dollars)

<b>Net income</b>	<b>528</b>
<b>Other comprehensive loss, net of income tax</b>	
Net gain on derivatives designated as cash flow hedges <sup>1</sup>	<b>11</b>
Reclassification to income of gains on derivatives designated as cash flow hedges <sup>2</sup>	<b>(15)</b>
<b>Other comprehensive loss for the year</b>	<b>(4)</b>
<b>Comprehensive income</b>	<b>524</b>

1 Net of income tax of \$1 million for the year ended December 31, 2007.

2 Net of income tax benefit of \$9 million for the year ended December 31, 2007.

See accompanying notes to the consolidated financial statements

## Notes to the consolidated financial statements for the years ended December 31, 2007 and 2006

### 1 Description of Business

Ontario Power Generation Inc. (" " or the "Company") was incorporated on December 1, 1998 pursuant to the Business Corporations Act (Ontario). As part of the reorganization of Ontario Hydro, under the Electricity Act, 1998 and the related restructuring of the electricity industry in Ontario, Ontario Power Generation Inc. and its subsidiaries (collectively "OPG" or the "Company") purchased and assumed certain assets, liabilities, employees, rights and obligations of the electricity generation business of Ontario Hydro on April 1, 1999 and commenced operations on that date. Ontario Hydro has continued as Ontario Electricity Financial Corporation ("OEFC"), responsible for managing and retiring Ontario Hydro's outstanding debt and other obligations.

### 2 Basis of Presentation

These consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

The consolidated financial statements include the accounts of OPG and its subsidiaries. OPG accounts for its interests in jointly controlled entities using the proportionate consolidation method. All significant intercompany transactions have been eliminated on consolidation.

Certain of the 2006 comparative amounts have been reclassified from financial statements previously presented to conform to the 2007 financial statement presentation.

### 3 Summary of Significant Accounting Policies

#### Cash and Cash Equivalents and Short-Term Investments

Cash and cash equivalents include cash on deposit and money market securities with a maturity of less than 90 days on the date of purchase. All other money market securities with a maturity on the date of purchase that is greater than 90 days, but less than one year, are recorded as short-term investments. These securities are valued at the lower of cost or market.

Interest earned on cash and cash equivalents and short-term investments of \$5 million (2006 – \$21 million) at an average effective rate of 4.4 per cent (2006 – 4.0 per cent) is offset against interest expense in the consolidated statements of income.

#### Sales of Accounts Receivable

Asset securitization involves selling assets such as accounts receivable to independent entities or trusts, which buy the receivables and then issue interests in them to investors. These transactions are accounted for as sales, given that control has been surrendered over these assets in return for net cash consideration. For each transfer, the excess of the carrying value of the receivables transferred over the estimated fair value of the proceeds received is reflected as a loss on the date of the transfer, and is included in net interest expense. The carrying value of the interests transferred is allocated to accounts receivable sold or interests retained according to their relative fair values on the day the transfer is made.

Fair value is determined based on the present value of future cash flows. Cash flows are projected using OPG's best estimates of key assumptions, such as discount rates, weighted average life of accounts receivable and credit loss ratios.

As part of the sales of accounts receivable, certain financial assets are retained and consist of interests in the receivables transferred. Any retained interests held in the receivables are accounted for at cost. The receivables are transferred on a fully serviced basis and do not create a servicing asset or liability.

## Notes to the Consolidated Financial Statements

**Inventories**

Fuel inventory is valued at weighted average cost.

Materials and supplies are valued at the lower of average cost and net realizable value. The determination of net realizable value of materials and supplies takes into account various factors including the remaining useful life of the related facilities in which the materials and supplies are expected to be used.

**Fixed Assets and Depreciation**

Property, plant and equipment are recorded at cost. Interest costs incurred during construction are capitalized as part of the cost of the asset based on the interest rate on OPG's long-term debt. Expenditures for replacements of major components are capitalized.

Depreciation rates for the various classes of assets are based on their estimated service lives. Any asset removal costs that have not been specifically provided for in current or previous periods are also charged to depreciation expense. Repairs and maintenance are expensed when incurred.

Fixed assets are depreciated on a straight-line basis except for computers, and transport and work equipment, which are depreciated on a declining balance basis as noted below:

Nuclear generating stations and major components	15 to 49 years <sup>1</sup>
Fossil generating stations and major components	25 to 40 years <sup>2</sup>
Hydroelectric generating stations and major components	25 to 100 years
Administration and service facilities	10 to 50 years
Computers, and transport and work equipment assets – declining balance	9% to 40% per year
Major application software	5 years
Service equipment	5 to 10 years

1 The end of station life for depreciation purposes for the Darlington, Pickering A, Pickering B, and Bruce B nuclear generating stations ranges between 2012 and 2021. Major components are depreciated over the lesser of the station life and the life of the components. The Bruce A nuclear generating station was fully depreciated in 2003. Bruce Power decided to refurbish the Bruce A generating station contributing to an increase in the asset retirement obligation at December 31, 2006 and an increase in the carrying value of the Bruce A station. For the year ended December 31, 2007, the depreciation of the Bruce A station was calculated based on the end-of-life date of 2030.

2 Commencing July 1, 2006, the end of station life for depreciation purposes for the coal-fired generating stations was changed to 2012, due to the expected shutdown of these stations by the end of 2012.

3 The end of station life for depreciation purposes disclosed above excludes the impact of life extensions commencing January 1, 2008, which are described under the heading, *Changes in Accounting Policies and Estimates*.

**Impairment of Fixed Assets**

OPG evaluates its property, plant and equipment for impairment whenever conditions indicate that estimated undiscounted future net cash flows may be less than the net carrying amount of assets. In cases where the undiscounted expected future cash flows are less than the carrying amount, an impairment loss is recognized equal to the amount by which the carrying amount exceeds the fair value. Fair value is determined using expected discounted cash flows when quoted market prices are not available.

**Rate Regulated Accounting**

In December 2004, the Electricity Restructuring Act, 2004 (Ontario) received Royal Assent. A regulation made pursuant to that statute by the Province of Ontario (the "Province") in February 2005 provides that OPG receives regulated prices beginning April 1, 2005 for electricity generated from most of OPG's baseload hydroelectric facilities and all of the nuclear facilities that it operates. This includes electricity generated from Sir Adam Beck 1, 2 and Pump generating stations, DeCew Falls 1 and 2, and R.H. Saunders hydroelectric facilities, and Pickering A and B, and Darlington nuclear facilities. The regulation was amended in February 2007. The amendment clarified certain aspects of the regulation and directed OPG to establish a deferral account related to certain changes in its liabilities for nuclear used fuel management and nuclear decommissioning and low and intermediate level waste management.

The amendment issued in February 2007 also clarified that the OEB must ensure that OPG recovers, through future regulated prices, all capital and non-capital costs incurred in order to increase the output of, refurbish or add operating capacity to a regulated facility. The amendment requires these costs be within budgets approved by OPG's Board of Directors prior to the OEB's first order establishing regulated prices or that the OEB is satisfied that these costs were prudently incurred.

In February 2008, a second amendment to the regulation was made by the Province. This amendment directs OPG to establish a deferral account to record, for the period up to the effective date of the OEB's first order, the costs incurred and firm financial commitments made on or after June 13, 2006, in the course of planning and preparation for the development of proposed new nuclear generation facilities. This amendment further directs OPG to establish a variance account to record, for the period on

or after the effective date of the OEB's first order, the differences between actual non-capital costs incurred and firm financial commitments made, and the amounts included in the approved regulated price related to planning and preparation for the development of proposed new nuclear generation facilities. In addition, the amendment states that the OEB must ensure that OPG recovers these costs to the extent the OEB is satisfied that the costs were prudently incurred or commitments prudently made.

OPG's regulated prices were established by the Province based on a forecast of production volumes and total operating costs, and a return on rate base, which assumed an average five per cent rate of return on equity. Rate base is a regulatory construct that represents the average net level of investment in regulated fixed assets and an allowance for working capital. The initial prices took effect April 1, 2005, and are expected to remain in effect until at least March 31, 2008, at which time the Ontario Energy Board (the "OEB") will assume responsibility for establishing new regulated prices.

The OEB is a self-funding crown corporation. Its mandate and authority come from the *Ontario Energy Board Act, 1998*, the *Electricity Act, 1998*, and a number of other provincial statutes. The OEB is an independent, quasi-judicial tribunal that reports to the Legislature of the Province through the Minister of Energy. It regulates all market participants in the Province's natural gas and electricity industries and carries out its regulatory functions through public hearings and other more informal processes such as consultations.

Accounting standards recognize that rate regulation can create economic benefits and obligations, which are reported in the consolidated financial statements as regulatory assets and liabilities. When the regulation provides assurance that incurred expenses will be recovered in the future, then OPG may defer those expenses and report them as a regulatory asset. If current recovery is provided for expenses expected to be incurred in the future, then OPG reports a regulatory liability. Also, if the regulation provides for lesser or greater than planned revenue to be received or returned by OPG through future regulated prices, then OPG recognizes a regulatory asset or liability, respectively. The measurement of such regulatory assets and liabilities is subject to certain estimates and assumptions, including assumptions made in the interpretation of the regulation. See Notes 7 and 11 to the audited consolidated financial statements for additional disclosure related to rate regulated accounting.

#### **Investments in OPG Ventures**

In accordance with Accounting Guideline 18, *Investment Companies* ("AcG-18"), investments owned by the Company's wholly owned subsidiary OPG Ventures Inc. ("OPGV") are recorded at fair value, and changes to the fair value of the investments are included in revenue in the period in which the change occurs. The fair values of these investments are estimated based on readily available market information or using estimation techniques based on historical performance.

#### **Fixed Asset Removal and Nuclear Waste Management Liability**

OPG recognizes asset retirement obligations for fixed asset removal and nuclear waste management, discounted for the time value of money. OPG has estimated both the amount and timing of future cash expenditures based on current plans for fixed asset removal and nuclear waste management. The liabilities are initially recorded at their estimated fair value, which is based on a discounted value of the expected costs to be paid.

On an ongoing basis, the liability is increased by the present value of the variable cost portion of the nuclear waste generated each year, with the corresponding amounts charged to operating expenses. Expenses relating to low and intermediate level waste are charged to depreciation and amortization expense. Expenses relating to the disposal or storage of nuclear used fuel are charged to fuel expense. The liability may also be adjusted due to any changes in the estimated amount or timing of the underlying future cash flows. Upon settlement of the liability, a gain or loss would be recorded.

Accretion arises because liabilities for fixed asset removal and nuclear waste management are reported on a net present value basis. Accretion expense is the increase in the carrying amount of the liabilities due to the passage of time. The resulting expense is included in operating expenses.

The asset retirement cost is capitalized by increasing the carrying value of the related fixed assets. The capitalized cost is depreciated over the remaining useful life of the related fixed assets and is included in depreciation expense.

#### **Nuclear Fixed Asset Removal and Nuclear Waste Management Funds**

Pursuant to the Ontario Nuclear Funds Agreement ("ONFA") between OPG and the Province of Ontario, OPG established a Used Fuel Segregated Fund ("Used Fuel Fund") and a Decommissioning Segregated Fund ("Decommissioning Fund") (together the "Nuclear Funds"). The Used Fuel Fund is intended to fund expenditures associated with the disposal of highly radioactive used nuclear fuel bundles, while the Decommissioning Fund was established to fund expenditures associated with nuclear fixed asset removal and the disposal of low and intermediate level nuclear waste materials. OPG maintains the Nuclear Funds in third party custodial accounts that are segregated from the rest of OPG's assets.

The Nuclear Funds are invested in fixed income and equity securities. Prior to 2007, OPG recorded the investments in the Nuclear Funds as long-term investments and accounted for the investments at their amortized cost value. Therefore, gains and losses were recognized only upon the sale of an underlying security. As such, there may have been unrealized gains and losses associated with the investments in the Nuclear Funds, which OPG had not recognized in its consolidated financial statements.

**Notes to the Consolidated Financial Statements**

Effective January 1, 2007, OPG adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3855, Financial Instruments – Recognition and Measurement. As a result of the adoption of this new section, the investments in the Nuclear Funds and the corresponding payables to the Province are classified as held-for-trading. Accordingly, the Nuclear Funds and the corresponding payables to the Province are measured at fair value based on the bid prices of the underlying securities with gains and losses recognized in net income. More details on the impact of the new accounting standards are provided in the Accounting Changes section.

**Revenue Recognition**

All of OPG's electricity generation is sold into the real-time energy spot market administered by the Independent Electricity System Operator ("IESO"). Prior to April 1, 2005, revenue was recorded as electricity was generated and metered based on the spot market sales price, net of the Market Power Mitigation Agreement rebate and hedging activities. At each balance sheet date, OPG computed the average spot energy price that prevailed since the beginning of the current settlement period and recognized a Market Power Mitigation Agreement rebate if the average price exceeded 3.8¢/kilowatt hour ("kWh"), based on the amount of energy subject to the rebate.

Effective April 1, 2005, the generation from most of OPG's baseload hydroelectric facilities and all of the nuclear facilities that OPG operates became rate regulated. As a result, energy revenue generated from the nuclear facilities is recognized based on a regulated price of 4.95¢/kWh. The regulated price received by OPG for the first 1,900 megawatt hours ("MWh") of production from the regulated hydroelectric facilities in any hour is 3.3¢/kWh. Any production from these regulated hydroelectric facilities above 1,900 MWh in any hour receives the Ontario electricity spot market price.

The production from OPG's remaining hydroelectric, fossil-fuelled and wind generating stations remains unregulated and continues to be sold at the Ontario electricity spot market price. However, 85 per cent of the generation output from these other generating assets, excluding the Lennox generating station, stations whose generation output is subject to a Hydroelectric Energy Supply Agreement ("HESA") with the Ontario Power Authority ("OPA") pursuant to a ministerial directive, and forward sales as of January 1, 2005, is subject to a revenue limit. The output from a generating unit where there has been a fuel conversion and the incremental output from a generating station where there has been a refurbishment or expansion of these assets are also excluded from the output covered by the revenue limit. In addition, until the Transition – Generation Corporation Designated Rate Options ("TRO") expired on April 30, 2006, volumes sold under such options were also excluded from the revenue limit rebate. This revenue limit, which was originally established for a period of 13 months ending April 30, 2006, was subsequently extended for an additional three years. Starting May 1, 2006, the revenue limit decreased to 4.6¢/kWh from the previous limit of 4.7¢/kWh. On May 1, 2007, the revenue limit returned to 4.7¢/kWh and will increase to 4.8¢/kWh effective May 1, 2008. In addition, beginning April 1, 2006, volumes sold under a Pilot Auction administered by the OPA are subject to a revenue limit that is 0.5¢/kWh higher than the revenue limit applicable to OPG's other generating assets. Revenues above these two revenue limits are returned to the IESO for the benefit of consumers.

OPG also sells into, and purchases from, interconnected markets of other provinces and the U.S. northeast and midwest. All contracts that are not designated as hedges are recorded in the consolidated balance sheets at market value with gains or losses recorded in the consolidated statements of income. Gains and losses on energy trading contracts (including those to be physically settled) are recorded on a net basis in the consolidated statements of income. Accordingly, power purchases of \$120 million in 2007 and \$163 million in 2006 were netted against revenue.

OPG derives non-energy revenue under the terms of a lease arrangement with Bruce Power L.P. ("Bruce Power") related to the Bruce nuclear generating stations. This includes lease revenues and revenues for engineering analysis and design, technical and ancillary services. OPG also earns revenue from its joint venture share of the Brighton Beach Power Limited Partnership ("Brighton Beach") related to an energy conversion agreement between Brighton Beach and Coral Energy Canada Inc. ("Coral"). In addition, non-energy revenue includes isotope sales and real estate rentals. Revenues from these activities are recognized as services are provided or as products are delivered.

**Derivatives**

OPG is exposed to changes in electricity prices associated with a wholesale spot market for electricity in Ontario. To hedge the commodity price risk exposure associated with changes in the wholesale price of electricity, OPG enters into various energy and related sales contracts. These contracts are expected to be effective as hedges of the commodity price exposure on OPG's generation portfolio. Gains or losses on hedging instruments are recognized in unregulated revenue over the term of the contract when the underlying hedged transactions occur. All contracts not designated as hedges are recorded as assets or liabilities at fair value with changes in fair value recorded in other revenue.

OPG also enters into derivative contracts with major financial institutions to manage the Company's exposure to foreign currency movements. Foreign exchange translation gains and losses on these foreign currency denominated derivative contracts are recognized as an adjustment to the purchase price of the commodity or goods received.

OPG is exposed to changes in market interest rates on debt expected to be issued in the future. OPG uses interest rate derivative contracts to hedge this exposure. Gains and losses on interest rate hedges are recorded as an adjustment to interest expense for the debt being hedged. Gains and losses that do not meet the effectiveness criteria are recorded through net income in the period incurred.

OPG utilizes emission reduction credits ("ERCs") and allowances to manage emissions within the prescribed regulatory limits. ERCs are purchased from trading partners in Canada and the United States. Emission allowances are obtained from the Province and purchased from trading partners in Ontario. The cost of ERCs and allowances are held in inventory and charged to OPG's operations at average cost as part of fuel expense as required. Options to purchase ERCs are accounted for as derivatives and are recorded at estimated market value.

Hedge accounting is applied when the derivative instrument is designated as a hedge and is expected to be effective throughout the life of the hedged item. The fair value of such derivative instrument is included in accumulated other comprehensive income ("AOCI") on a net of tax basis and changes to the fair value are recorded on the consolidated statement of comprehensive income. When a derivative hedging relationship is expired, the designation of a hedging relationship is terminated, or a portion of the hedging instrument is no longer effective, any associated gains or losses included in AOCI are recognized in the current period's consolidated statement of income.

### **Foreign Currency Translation**

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian currency at year end exchange rates. Any resulting gain or loss is reflected in revenue.

### **Research and Development**

Research and development costs are charged to operations in the year incurred. Research and development costs incurred to discharge long-term obligations such as the nuclear waste management liabilities, for which specific provisions have already been made, are charged to the related liability.

### **Pension and Other Post Employment Benefits**

OPG's post employment benefit programs include a contributory defined benefit registered pension plan, a defined benefit supplementary pension plan, group life insurance, health care and long-term disability benefits. OPG accrues its obligations under pension and other post employment benefit ("OPEB") plans. The obligations for pension and other post retirement benefit costs are determined using the projected benefit method pro-rated on service. The obligation for long-term disability benefits is determined using the projected benefit method on a terminal basis. The obligations are affected by salary levels, inflation, and cost escalation. Pension and OPEB costs and obligations are determined annually by independent actuaries using management's best estimate assumptions. The discount rates used by OPG in determining projected benefit obligations and the costs for the Company's employee benefit plans are based on representative AA corporate bond yields.

Pension fund assets are valued using market-related values for purposes of determining actuarial gains or losses and the expected return on plan assets. The market-related value recognizes gains and losses on equity assets relative to a six per cent assumed real return over a five-year period.

Pension and OPEB costs include current service costs, interest costs on the obligations, the expected return on pension plan assets, adjustments for plan amendments and adjustments for actuarial gains or losses, which result from changes in assumptions and experience gains and losses. Past service costs arising from pension and OPEB plan amendments are amortized on a straight-line basis over the expected average remaining service life of the employees covered by the plan, since OPG will realize the economic benefit over that period. Due to the long-term nature of post-employment liabilities, the excess of the net cumulative unamortized gain or loss, over 10 per cent of the greater of the benefit obligation and the market-related value of the plan assets, is also amortized over the expected average remaining service life.

When the recognition of the transfer of employees and employee-related benefits gives rise to both a curtailment and a settlement, the curtailment is accounted for prior to the settlement. A curtailment is the loss by employees of the right to earn future benefits under the plan. A settlement is the discharge of a plan's liability.

### **Taxes**

Under the *Electricity Act, 1998*, OPG is responsible for making payments in lieu of corporate income and capital taxes to the OEFC. These payments are calculated in accordance with the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario), and are modified by the *Electricity Act, 1998* and related regulations. This effectively results in OPG paying taxes similar to what would be imposed under the federal and Ontario tax acts.

OPG follows the liability method of accounting for income taxes of its unregulated operations. Under the liability method, future tax assets and liabilities are determined based on differences between the accounting and tax bases of assets and liabilities and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.



**Notes to the Consolidated Financial Statements**

The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period the change is substantively enacted. Future income tax assets are evaluated and if realization is not considered more likely than not, a valuation allowance is established.

Commencing April 1, 2005, with the introduction of rate regulation, OPG accounts for income taxes relating to the rate regulated segments of its business using the taxes payable method. Under the taxes payable method, OPG does not recognize future income taxes relating to the rate regulated segments of its business to the extent those future income taxes are expected to be recovered or refunded in future regulated prices charged to customers.

OPG makes payments in lieu of property tax on its nuclear and fossil-fuelled generating assets to the OEFC, and also pays property taxes to municipalities.

OPG pays charges on gross revenue derived from the annual generation of electricity from its hydroelectric generating assets. The gross revenue charge ("GRC") includes a fixed percentage charge applied to the annual hydroelectric generation derived from stations located on provincial Crown lands, in addition to graduated rate charges applicable to all hydroelectric stations. GRC costs are included in fuel expense.

**Changes in Accounting Policies and Estimates*****Depreciation of Long-Lived Assets***

The accounting estimates related to the depreciation of long-lived assets require significant management judgment to assess the appropriate useful lives of OPG's long-lived assets, including consideration of various technological and other factors.

Effective January 1, 2006, following the completion of a review of the life limiting components of the Pickering B nuclear generating station, OPG revised and extended, for the purpose of calculating depreciation, the estimated remaining service life of the Pickering B nuclear generating station to 2014 from 2009. The extension reduced depreciation expense by \$36 million in 2006 and in 2007.

The Province accepted the advice of the IESO in their June 2006 report that indicated a need for 2,500 to 3,000 MW of additional capacity to maintain system reliability. Therefore, further delays were necessary in the Province's plan to replace coal-fired generation by 2009. As a result of delays in the plan to replace coal-fired generation by 2009, effective July 1, 2006, OPG extended the life for all of the coal-fired generating stations, for purposes of calculating depreciation, to December 31, 2012. The extension reduced depreciation expense by \$64 million in 2006, \$126 million in 2007, and \$46 million in 2008. From 2009 to 2012, the depreciation expense will increase by \$59 million in each year. OPG will reassess the service life of the coal-fired generating stations upon release of the submitted Integrated Power System Plan, and as subsequently approved by the OEB. Any change to the estimated service life of the coal-fired generating stations, for purposes of calculating depreciation, could have a material impact on OPG's consolidated financial statements.

Effective January 1, 2008, the service life of the Darlington nuclear generating station, for the purposes of calculating depreciation, was extended by two years to 2019 after a review of the technical analysis for life limiting components. The life extension will reduce depreciation expense by \$18 million annually.

The Company has extended the service life of Bruce B nuclear generating station to 2014 for depreciation purposes effective January 1, 2008 after reviewing future capacity plans in the OPA's Integrated Power System Plan, which was filed with the OEB in August 2007, and historical information regarding the service lives of major life limiting components of the station. As a result of the extension, depreciation expense will be reduced by \$7 million annually. In addition, effective January 1, 2008, OPG extended the service life of Bruce A nuclear generating station to 2035 for depreciation purposes after the review of future capacity plans filed with the OPA and other publicly available information. The extension of the service life to the Bruce A nuclear generating station for depreciation purposes will decrease depreciation expense by \$8 million annually.

***Financial Instruments***

On January 1, 2007, OPG adopted three new accounting standards that were issued by the Canadian Institute of Chartered Accountants ("CICA"): Handbook Section 1530, *Comprehensive Income*; Handbook Section 3855, *Financial Instruments – Recognition and Measurement*; and Handbook Section 3865, *Hedges*. Comparative amounts for prior periods have not been restated.

**Comprehensive Income**

As a result of adopting these standards, a new category, accumulated other comprehensive income, was added to shareholder's equity in the consolidated balance sheets. Comprehensive income consists of net income and other comprehensive income. This category includes changes in the fair value of the effective portion of cash flow hedging instruments. Amounts are recorded in other comprehensive income until the criteria for recognition in the consolidated statements of income are met.



### Financial Instruments – Recognition and Measurement

Under the new standard, for accounting purposes, financial assets are classified as one of the following: held-to-maturity, loans and receivables, held-for-trading or available-for-sale, and financial liabilities are classified as held-for-trading or other than held-for-trading. Financial assets and liabilities held-for-trading are measured at fair value with gains and losses recognized in net income. Financial assets held-to-maturity, loans and receivables, and financial liabilities other than those held-for-trading, are measured at amortized cost. Financial assets available-for-sale are measured at fair value with unrealized gains and losses due to fluctuations in fair value recognized in accumulated other comprehensive income. Financial assets purchased and sold, where the contract requires the asset to be delivered within an established timeframe, are recognized on a trade-date basis. All derivatives, including embedded derivatives that must be separately accounted for, generally must be classified as held-for-trading and recorded at fair value in the consolidated balance sheets. Transaction costs are expensed as incurred for financial instruments classified or designated as held-for-trading.

The new standard permits designation of any financial instrument as held-for-trading (the fair value option) upon initial recognition. This designation by OPG requires that the financial instrument be reliably measurable, and eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities.

### Hedges

The new standard specifies the criteria under which hedge accounting can be applied and how hedge accounting is to be executed for each of the permitted hedging strategies: fair value hedges, cash flow hedges and hedges of a foreign currency exposure of a net investment in a self-sustaining foreign operation. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is recognized in other comprehensive income. The ineffective portion is recognized in net income. The amounts recognized in accumulated other comprehensive income are reclassified to net income in the periods in which net income is affected by the variability in the cash flows of the hedged item.

### Impact of Adoption

Upon adoption of the financial instruments accounting standards, the assets in the Nuclear Funds that were carried at amortized cost until the end of 2006 were classified as held-for-trading and reported at fair value. The transition adjustment related to the change in accounting for the Nuclear Funds was recognized in the opening balance of retained earnings at January 1, 2007. The transition adjustment for embedded derivatives within long-term contracts was also recognized in the opening balance of retained earnings at January 1, 2007. OPG elected January 1, 2004 as the transition date for embedded derivatives. Prior to January 1, 2007, OPG disclosed the fair value of securities in the Nuclear Funds based on the closing price of the securities. Starting January 1, 2007, OPG applied bid pricing to determine the fair value of the securities.

The fair value of the Nuclear Funds based on bid pricing is lower than that reported in the 2006 comparative period. The change in pricing methodology does not have any impact to the overall balance on the consolidated balance sheets since the reduction in fair value is offset by the corresponding change in the due to Province balance.

The fair values of hedging instruments designated as cash flow hedges were recognized in the opening accumulated other comprehensive income on a net of tax basis. The fair values of these hedges are disclosed in Note 13 to the audited consolidated financial statements.

The transition amounts that were recorded in the opening retained earnings or in the opening accumulated other comprehensive income balance on January 1, 2007 were as follows:

Transition Amounts – January 1, 2007				
	At Cost December 31, 2006	At Fair Value January 1, 2007	Opening Retained Earnings	Opening Accumulated Other Comprehensive Income
(millions of dollars)				
Nuclear Funds balance	7,694	9,041	1,347	–
Due to Province	(100)	(928)	(828)	–
	7,594	8,113	519	–
Accounts receivable and other assets	325	372	–	47
Accounts payable and accrued charges	(989)	(1,005)	(6)	(10)
Net future income tax liability	(249)	(265)	–	(16)
Transition adjustments			513	21

## Notes to the Consolidated Financial Statements

**Future Changes in Accounting Policies*****Capital Disclosures and Financial Instruments***

In December 2006, the CICA issued three new accounting standards: Handbook Section 1535, *Capital Disclosures* ("Section 1535"), Handbook Section 3862, *Financial Instruments – Disclosures* ("Section 3862"), and Handbook Section 3863, *Financial Instruments – Presentation* ("Section 3863"). These new standards are effective for the Company beginning January 1, 2008.

Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance.

Sections 3862 and 3863 replace Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

***Inventories***

The CICA issued a new accounting standard, Section 3031, *Inventories*, in March 2007, which is based on International Accounting Standard ("IAS") 2. The new section replaced the existing Section 3030, *Inventories*. Under the new section, inventories are required to be measured at the "lower of cost and net realizable value," which is different from the existing guidance of "lower of cost and market." The new section also allows the reversal of any write-downs previously recognized. Further, due to the changes in the section and the consequential amendments, some of OPG's critical spare parts currently reported as materials and supplies on OPG's consolidated balance sheets will be accounted for as property, plant and equipment. The new accounting standard and the consequential amendments are effective for OPG beginning January 1, 2008. OPG reclassified significant critical spare parts of \$19 million, net of accumulated depreciation, to property, plant and equipment in 2008.

***Accounting for Regulatory Operations***

In December 2007, the CICA revised its guidance on accounting for rate regulated operations. The revision resulted in amendments to Handbook Sections 1100, *Generally Accepted Accounting Principles*, and 3465, *Income Taxes*, and Accounting Guideline 19 ("AcG-19"), *Disclosures by Entities Subject to Rate Regulation*, as follows:

- to remove the temporary exemption pertaining to the application of Section 1100 to rate regulated operations, including the elimination of the opportunity to use industry practice as an acceptable basis for recognition and measurement of assets and liabilities arising from rate regulation;
- to amend Section 3465 to require the recognition of future income tax assets and liabilities as well as a separate regulatory asset or liability for the amount of future income taxes expected to be included in future rates and recovered from or paid to customers; and
- to amend AcG-19, as necessary, as a result of amendments to Sections 1100 and 3465.

As a result of the changes to Section 3465, OPG will be required to recognize future income taxes associated with its rate regulated operations in the same manner as it currently recognizes future income taxes for its unregulated operations. OPG will apply the changes prospectively to interim and annual consolidated financial statements beginning January 1, 2009. OPG is currently evaluating the impact of implementing these changes on its consolidated financial statements.

## 4 Sale of Accounts Receivable

In October 2003, the Company signed an agreement to sell an undivided co-ownership interest in its current and future accounts receivable (the "receivables") to an independent trust. The Company also retains an undivided co-ownership interest in the receivables sold to the trust. Under the agreement, OPG continues to service the receivables. The transfer provides the trust with ownership of a share of the payments generated by the receivables, computed on a monthly basis. The trust's recourse to the Company is generally limited to its income earned on the receivables. In December 2005, the Company extended this agreement to August 2009.

OPG reflected the initial transfer to the trust of the co-ownership interest, and subsequent transfers required by the revolving nature of the securitization, as sales in accordance with CICA Accounting Guideline 12, *Transfer of Receivables*. In accordance with this Guideline, the proceeds of each sale to the trust were deemed to be the cash received from the trust, net of the undivided co-ownership interest retained by the Company. For 2007, OPG has recognized pre-tax charges of \$15 million (2006 – \$13 million) on such sales at an average cost of funds of 5.1 per cent (2006 – 4.4 per cent). As at December 31, 2007, OPG had sold receivables of \$300 million from its total portfolio of \$479 million (2006 – \$392 million).

The accounts receivable reported and securitized by the Company are as follows:

	Principal Amount of Receivables as at December 31		Average Balance of Receivables for Year Ended December 31	
(millions of dollars)	2007	2006	2007	2006
Total receivables portfolio <sup>1</sup>	479	392	454	445
Receivables sold	300	300	300	300
Receivables retained	179	92	154	145
Average cost of funds			5.1%	4.4%

1 Amount represents receivables outstanding, including receivables that have been securitized, which the Company continues to service.

An immediate 10 per cent or 20 per cent adverse change in the discount rate would not have a material effect on the current fair value of the retained interest. There were no credit losses for the years ended December 31, 2007 and 2006.

Details of cash flows from securitizations for the years ended December 31, 2007 and 2006 are as follows:

(millions of dollars)	2007	2006
Collections reinvested in revolving sales <sup>1</sup>	3,600	3,600
Cash flows from retained interest	1,759	2,020

1 Given the revolving nature of the securitization, the cash collections received on the receivables securitized are immediately reinvested in additional receivables resulting in no further cash proceeds to the Company over and above the initial cash amount of \$300 million. The amounts reflect the total of 12 monthly amounts.

## 5 Depreciation and Amortization and Fixed Assets

Depreciation and amortization expense consists of the following:

(millions of dollars)	2007	2006
Depreciation and amortization	587	659
Amortization of deferred Pickering A return to service costs (Note 7)	96	25
Nuclear waste management costs	12	5
	695	689

Fixed assets consist of the following:

(millions of dollars)	2007	2006
Property, plant and equipment		
Nuclear generating stations	6,466	6,275
Regulated hydroelectric generating stations	4,411	4,384
Unregulated hydroelectric generating stations	3,525	3,481
Fossil-fuelled generating stations	1,553	1,465
Other fixed assets	867	854
Construction in progress	950	677
	17,772	17,136
Less: accumulated depreciation		
Generating stations	4,636	4,066
Other fixed assets	359	309
	4,995	4,375
	12,777	12,761

Interest capitalized to construction in progress at six per cent during the years ended December 31, 2007 and 2006 was \$42 million and \$21 million, respectively.

**Impairment of Long-Lived Assets**

The accounting estimates related to asset impairment require significant management judgment to identify factors such as short and long-term forecasts for future sales prices, the supply of electricity in Ontario, inflation, fuel prices, and station lives. The amount of the future cash flow that OPG will ultimately realize with respect to these assets could differ materially from the carrying values recorded in the consolidated financial statements.

***Thunder Bay and Atikokan Generating Stations***

OPG recognized an impairment loss on the Thunder Bay and Atikokan coal-fired generating stations in 2006 of \$22 million, which represented the carrying amount or net book value of these stations. OPG tested the recoverability of the carrying amounts of the coal-fired stations as a result of changes in circumstance, which included a decrease in forecast Ontario spot market prices and the extension of the lives of the coal-fired stations. The fair value of the coal-fired generating stations, which was determined using a discounted cash flow method, was compared to the carrying value of the generating assets to determine the impairment loss. It was determined that the Thunder Bay and Atikokan coal-fired generating stations would not be able to recover their operating and capital expenditures and carrying amount, over their remaining service lives.

**6 Investments in Asset-Backed Commercial Paper**

In August 2007, a number of Canadian third-party Trusts, as issuers of asset-backed commercial paper ("ABCP"), experienced difficulty in accessing the liquidity required to repay maturing ABCP debt. OPG's original exposure to third-party ABCP notes was \$103 million. Of that total, \$45 million consisted of notes held with Skeena Capital Trust ("Skeena"). In December 2007, OPG received payment of approximately \$44 million against these notes and recognized an impairment loss of \$1 million. The settlement amount represented 98.65 per cent of the original investment including interest up to the maturity date.

Following the settlement of investments in Skeena, OPG's holdings of third-party ABCP was reduced to \$58 million.

On December 23, 2007, a restructuring plan was announced for the remaining third-party ABCP Trusts. Documentation of the restructuring plan for these trusts is expected in March 2008. Approval for any restructuring is required by note holders representing not less than 66 and two-thirds of the value of the Trusts.

OPG performed a valuation analysis as at December 31, 2007 to assess the amount of any impairment, taking into account the limited information available. The assessment considered the likelihood of achieving a successful restructuring based on the current proposal announced on December 23, 2007. OPG used a probability weighted cash flow model to determine the fair value of its third-party ABCP holdings. Since the majority of OPG's remaining ABCP is made up of combined traditional and synthetic assets such as Collateralized Debt Obligations ("CDO's"), the recoverability was estimated to be 85 per cent. An insignificant amount of OPG's remaining third-party ABCP is made up of ineligible assets, where the underlying assets or the collateral provided is supported by United States ("U.S.") sub-prime assets. The recoverability of these ineligible assets was estimated to be 70 per cent. OPG also considered alternative methods to assess the fair value of the investments. As a result of the analysis, OPG recorded an impairment loss of \$9 million against the remaining holdings of \$58 million, in addition to the \$1 million loss related to the Skeena investments. The impairment loss is included in other gains and losses.

OPG reviewed the classification of its third-party ABCP holdings and has determined that a long-term classification is appropriate, based on the restructuring information available. OPG will continue to monitor developments with respect to ABCP and will continue to assess its position.

OPG has sufficient credit facilities to satisfy its financial obligations as they come due and does not expect any material adverse impact on its operations as a result of this current third-party ABCP liquidity issue.

## 7 Regulatory Assets and Liabilities and Summary of Rate Regulated Accounting

The regulatory assets and liabilities as at December 31, 2007 and 2006 are as follows:

(millions of dollars)	2007	2006
Regulatory assets		
Pickering A return to service costs	183	249
Nuclear liabilities deferral account	131	–
Nuclear generation development costs	28	–
Hydroelectric production variance	7	–
Ancillary service revenue variance	5	–
Transmission outages and transmission restrictions variance	2	2
Total regulatory assets	356	251
Regulatory liabilities		
Hydroelectric production variance	–	4
Other	14	7
Total regulatory liabilities	14	11

The changes in the regulatory assets and liabilities for 2007 and 2006 are as follows:

(millions of dollars)	Pickering A Return to Service Costs	Nuclear Liabilities Deferral Account	Nuclear Generation Development Costs	Transmission Outages and Transmission Restrictions Variance	Hydro- electric Production Variance	Ancillary Services Revenue Variance	Other
Regulatory assets (liabilities), January 1, 2006	261	–	–	–	(4)	5	(8)
Change during the year	13	–	–	2	–	(5)	1
Amortization during the year	(25)	–	–	–	–	–	–
Regulatory assets (liabilities), December 31, 2006	249	–	–	2	(4)	–	(7)
Change during the period	30	131	28	–	11	5	(7)
Amortization during the period	96	–	–	–	–	–	–
Regulatory assets (liabilities), December 31, 2007	183	131	28	2	7	5	(14)

### Pickering A Return to Service Costs

Effective January 1, 2005, in accordance with a regulation made under the *Electricity Restructuring Act, 2004*

OPG was required to establish a deferral account in connection with non-capital costs incurred on or after January 1, 2005 that were associated with the planned return to service of all units at the Pickering A nuclear generating station. The regulation, as amended in February 2007, also requires OPG to record interest at an annual rate of six per cent on the balance in the deferral account. As at December 31, 2007, the balance in the deferral account was \$183 million, consisting of non-capital costs of \$232 million relating to Unit 1 and \$19 million relating to Units 2 and 3, \$20 million of general return to service non-capital costs and interest of \$37 million, net of the accumulated amortization of \$125 million. As at December 31, 2006, the balance in the deferral account was \$249 million, consisting of non-capital costs of \$232 million relating to Unit 1 and \$19 million relating to Units 2 and 3, \$20 million of general return to service non-capital costs and interest of \$7 million, net of the accumulated amortization of \$29 million.

There were no operations, maintenance and administration ("OM&A") costs charged to the deferral account during 2007. During 2006, OM&A expenses of \$13 million were charged to the deferral account. Had OPG not charged these costs to the deferral account, OM&A expenses would have increased by \$13 million for 2006.

## Notes to the Consolidated Financial Statements

During 2007, OPG deferred applied interest related to the Pickering A return to service deferral account of \$30 million. Had OPG not applied interest to this account, the net interest expense would have increased by \$30 million for 2007 (2006 – nil).

The costs accumulated in the deferral account are charged to operations in accordance with the terms of the regulation. Under the regulation, the OEB is directed to ensure that OPG recovers any balance in the deferral account on a straight-line basis over a period not to exceed 15 years. Had OPG not amortized the costs in the deferral account, depreciation and amortization expense for 2007 would have been reduced by \$96 million (2006 – \$25 million).

**Nuclear Liabilities Deferral Account**

In February 2007, the Province amended a regulation pursuant to the *Electricity Restructuring Act, 2004* (Ontario) to direct OPG to establish a deferral account in connection with certain changes to its liabilities for nuclear used fuel management and nuclear decommissioning and low and intermediate level waste management. The deferral account represents the revenue requirement impact associated with the changes in the nuclear liabilities arising from an approved reference plan, approved after April 1, 2005, as reflected in OPG's audited consolidated financial statements. Revenue requirement is a regulatory construct, which represents all allowed costs and a return on rate base at a rate of return that the regulator determines to be appropriate. The regulation also requires OPG to record interest at an annual rate of six per cent on the balance in the deferral account.

On December 31, 2006, OPG recorded an increase in its nuclear liabilities of \$1,386 million arising from an update to the approved reference plan in accordance with the terms of the Ontario Nuclear Funds Agreement ("2006 Approved Reference Plan"). Commencing January 1, 2007 and up to the effective date of OEB's first order establishing regulated prices, which is expected to be after March 31, 2008, OPG records a regulatory asset associated with the increase in the nuclear liabilities arising from the 2006 Approved Reference Plan.

The OEB is directed by the regulation to ensure that OPG recovers the balance recorded in the deferral account on a straight-line basis over a period not to exceed three years, to the extent that the OEB is satisfied that the revenue requirement impacts are accurately recorded.

As at December 31, 2007, the following items have been recorded as components of the regulatory asset relating to the increase in the nuclear liabilities arising from the 2006 Approved Reference Plan:

(millions of dollars)	<b>2007</b>
Return on rate base	<b>75</b>
Depreciation expense	<b>54</b>
Fuel expense	<b>(5)</b>
Capital tax	<b>3</b>
Interest expense	<b>4</b>
	<b>131</b>

The return on rate base component of \$75 million was recorded as a reduction to the accretion expense on fixed asset removal and nuclear waste management expense for the year ended December 31, 2007.

For the year ended December 31, 2007, had OPG not established the deferral account as required by the regulation, accretion expense would have increased by \$75 million, depreciation expense would have increased by \$54 million, property and capital taxes expense would have been higher by \$3 million, net interest expense would have increased by \$4 million, and fuel expense would have been lower by \$5 million.

The regulation also provides for the recovery of an amount relating to additional income taxes that OPG will be subject to as a result of recovering the regulatory asset through future regulated prices charged to customers. Since OPG has not yet incurred a related income tax expense, no amounts related to income taxes have been recorded as part of the regulatory asset.

**Nuclear Generation Development Costs**

The amendment to the regulation pursuant to the *Electricity Restructuring Act, 2004* (Ontario) made in February 2007 clarified that the OEB must ensure that OPG recovers, through future regulated prices, all capital and non-capital costs incurred in order to increase the output of, refurbish or add operating capacity to a regulated facility, if these costs are either within budgets approved by OPG's Board of Directors prior to the OEB's first order establishing regulated prices or if the OEB is satisfied that these costs were prudently incurred. A further amendment in February 2008, clarified that the OEB must ensure that OPG recovers the costs incurred and firm financial commitments made in the course of planning and preparing for the development of proposed new nuclear facilities. As a result of these amendments, OPG has recorded a regulatory asset of \$28 million for the year ended December 31, 2007, which represents non-capital costs incurred for its nuclear generation development initiatives. Non-capital costs are recorded as a regulatory asset to the extent that they were incurred after April 1, 2005 and were not included in the forecast information provided to the Province for the purposes of establishing regulated prices.

Had OPG not recorded the above costs as a regulatory asset, OM&A expenses would have increased by \$27 million and net interest expense would have increased by \$1 million for the year ended December 31, 2007.

#### Variance Accounts and Other Regulatory Balances

Effective April 1, 2005, in accordance with a regulation made under the Electricity Restructuring Act, 2004 (Ontario), OPG was directed to establish variance accounts for capital and non-capital costs incurred and revenues earned or foregone on or after April 1, 2005 due to deviations from the forecast information provided to the Province for the purposes of establishing regulated prices. Variance accounts have been established for differences in hydroelectric electricity production due to differences between forecast and actual water conditions, unforeseen changes to nuclear regulatory requirements or unforeseen technological changes which directly affect the nuclear facilities, changes to revenues for ancillary services from the regulated facilities, acts of God (including severe weather events), and transmission outages and transmission restrictions.

OPG recorded an increase in revenue during the year ended December 31, 2007 of \$5 million reflecting ancillary services revenue that was unfavourable compared to the forecast provided to the Province for the purposes of establishing regulated prices. In addition, OPG recorded an increase in revenue of \$11 million in 2007 as a result of actual water conditions that were unfavourable to those forecast.

OPG recorded a decrease in revenue during the year ended December 31, 2006 of \$5 million reflecting ancillary services revenue that was favourable compared to the forecast provided to the Province for the purposes of establishing regulated prices.

The OEB is directed by the regulation to ensure recovery of amounts recorded in the variance accounts to the extent that the OEB is satisfied that revenues recorded in the accounts were earned or foregone, that costs recorded in the accounts were prudently incurred, and that both revenues and costs are accurately recorded. Any balances approved by the OEB will be amortized over a period not to exceed three years. The amortization will commence when OPG starts to recover or return the balances through new prices that will be set by the OEB. Any balances in the accounts disallowed by the OEB will be reflected in the results of operations in the period that the OEB decision occurs.

The other regulatory liability consists of a portion of non-regulated revenue earned by OPG's regulated assets and interest on the account balance, which OPG expects to apply as a reduction to future regulated prices to be established by the OEB. OPG recorded an additional regulatory liability of \$7 million in 2007 (2006 – an asset of \$1 million), including \$1 million of interest expense (2006 – nil).

Had OPG not accounted for the variance accounts and other regulatory balances as regulatory assets and liabilities, revenue for 2007 would have been lower by \$12 million (2006 – higher by \$2 million). Had OPG not accounted for the variance accounts and other regulatory balances as regulatory assets and liabilities, net interest expense for 2007 would have decreased by \$1 million (2006 – nil).

#### Summary of Rate Regulated Accounting

The following tables summarize the impact of applying rate regulated accounting for selected income statement information:

##### Years Ended December 31

	2007			2006		
		Impact of Rate Regulated Accounting	Financial Statements without Rate Regulated Accounting		Impact of Rate Regulated Accounting	Financial Statements without Rate Regulated Accounting
(millions of dollars)	As Stated			As Stated		
Revenue	5,660	9	5,669	5,564	30	5,594
Fuel expense	1,270	(5)	1,265	1,098	–	1,098
Operations, maintenance and administration	2,974	27	3,001	2,752	13	2,765
Depreciation and amortization	695	(42)	653	689	(25)	664
Accretion on fixed asset removal and nuclear waste management liabilities	507	75	582	499	–	499
Property and capital taxes	85	3	88	106	–	106
Net interest expense	143	33	176	193	–	193



## Notes to the Consolidated Financial Statements

**Accounting for Certain Leases**

OPG accounts for certain lease revenues relating to the regulated business using the cash basis of accounting. Under the cash basis of accounting, OPG recognizes lease income as stipulated in the lease agreement to the extent that the lease payments are expected to be included in future regulated prices charged to customers. If OPG did not apply the cash basis of accounting for leases, the revenue would have increased by \$21 million (2006 – \$21 million). As at December 31, 2007, had OPG accounted for the leases related to the regulated business using a straight-line basis, OPG would have reported a deferred lease receivable of \$57 million (2006 – \$36 million).

**8 Short-Term Credit Facilities**

OPG's \$1 billion revolving committed bank credit facility is divided into two tranches – a \$500 million 364-day term tranche maturing May 21, 2008, and a \$500 million five-year term tranche maturing May 22, 2012. The longer term tranche was extended from a three-year term to a five-year term, upon renewal of the bank credit facility in May 2007. The total credit facility will continue to be used primarily as credit support for notes issued under OPG's commercial paper program. As at December 31, 2007, there was no commercial paper outstanding (2006 – \$15 million). OPG had no other outstanding borrowing under its bank credit facility as at December 31, 2007.

OPG also maintains \$25 million (2006 – \$26 million) in short-term uncommitted overdraft facilities as well as \$238 million (2006 – \$240 million) of short-term uncommitted credit facilities, which support the issuance of Letters of Credit. OPG uses Letters of Credit to support its supplementary pension plans and for other purposes. At December 31, 2007, there was a total of \$205 million (2006 – \$185 million) of Letters of Credit issued, which included \$175 million (2006 – \$159 million) relating to the supplementary pension plans and \$16 million (2006 – \$16 million) relating to the construction of the Portlands Energy Centre.

**9 Long-Term Debt**

Long-term debt consists of the following:

(millions of dollars)	2007	2006
Notes payable to the OEFC	3,665	3,165
Share of non-recourse limited partnership debt	188	194
	3,853	3,359
Less: due within one year		
Notes payable to the OEFC	400	400
Share of limited partnership debt	7	6
	407	406
<b>Long-term debt</b>	<b>3,446</b>	<b>2,953</b>

Holders of the senior debt are entitled to receive, in full, amounts owing in respect of the senior debt before holders of the subordinated debt are entitled to receive any payments. The OEFC currently holds all of OPG's outstanding senior and subordinated notes.



The maturity dates as at December 31, 2007 for notes payable to the OEFC are as follows:

Year of Maturity	Principal Outstanding			
	Interest Rate (%)	Senior Notes	Subordinated Notes	Total
2008	5.90%	400	–	400
2009	6.01%	350	–	350
2010	6.00%	595	375	970
2011	6.65%	–	375	375
2012	5.72%	400	–	400
2016	4.91%	270	–	270
2017	5.35%	900	–	900
		2,915	750	3,665

In September 2005, OPG reached an agreement with the OEFC to provide debt financing for the Niagara Tunnel project. The funding, which is up to \$1 billion over the duration of the project, will be in the form of 10-year notes, which will be issued quarterly to meet the project's obligations. Interest will be fixed for each note issued at the time of advance at a rate equal to the prevailing Benchmark Government of Canada 10-Year Bond, plus a credit spread determined by the OEFC based on a survey of market rates. As at December 31, 2007, OPG issued \$240 million against this facility, which included new borrowing of \$80 million under the facility in 2007. In January 2008, \$40 million of new borrowing was issued under the facility.

In December 2006, OPG reached an agreement with the OEFC to provide debt financing for the Lac Seul Hydroelectric Generating Station and the Portlands Energy Centre projects. There will be up to \$50 million available for the Lac Seul project and up to \$400 million available for the Portlands Energy Centre project under each credit facility. The credit facilities will be drawn as needed to fund the respective projects over the construction period. The funding will be in the form of 10-year notes with interest rates fixed for each note issued at the time of advance at a rate equal to the prevailing Benchmark Government of Canada 10-Year Bond, plus a credit spread determined by the OEFC based on a survey of market rates. As at December 31, 2007, OPG issued \$20 million against the Lac Seul project credit facility and \$210 million against the Portlands Energy Centre credit facility, which included new borrowing of \$120 million under the Portlands Energy Centre facility in 2007. In January 2008, \$35 million of new borrowing was issued under the Portlands Energy Centre facility.

In 2007, OPG reached an agreement with the OEFC for a \$500 million general corporate facility that is available for the period June 1, 2007 to March 31, 2008, and for a \$950 million credit agreement to refinance senior notes as they mature over the period September 22, 2007 to September 22, 2009. In 2007, OPG borrowed \$500 million under its general corporate facility and refinanced \$200 million senior notes under the \$950 million credit facility. These borrowings will mature in 2017.

The non-recourse limited partnership debt is secured by a first charge on the assets of one of the joint venture limited partnerships, an assignment of the joint venture's bank accounts, and an assignment of the joint venture's project agreements. OPG's share of the total assets was \$284 million as at December 31, 2007. The minimum principal repayments of the non-recourse limited partnership debt for the next five calendar years range from \$7 million to \$9 million annually. OPG's share of the non-recourse limited partnership debt included a note payable of \$131 million at an interest rate of 6.9 per cent, with an effective interest rate of 7.0 per cent. This note payable is repayable in quarterly payments commencing March 31, 2006 to March 31, 2024. The remaining non-recourse limited partnership debt is at various floating rates. The interest rates of the floating rate debt are referenced to various interest rate indices, such as the bankers' acceptance rate and the London Interbank Offered Rate, plus a margin. The joint venture has entered into floating to fixed interest rate hedges to manage the risks arising from fluctuation in interest rates. These hedges were described under note 13 of the audited consolidated financial statements.

Interest paid in 2007 was \$224 million (2006 – \$247 million), of which \$203 million relates to interest paid on long-term debt (2006 – \$230 million).

## Notes to the Consolidated Financial Statements

**10 Fixed Asset Removal and Nuclear Waste Management**

The liabilities for fixed asset removal and nuclear waste management on a present value basis consists of the following:

(millions of dollars)	2007	2006
Liability for nuclear used fuel management	5,938	5,669
Liability for nuclear decommissioning and low and intermediate level waste management	4,843	4,659
Liability for non-nuclear fixed asset removal	176	192
Fixed asset removal and nuclear waste management liabilities	10,957	10,520

The changes in the fixed asset removal and nuclear waste management liabilities for the years ended December 31, 2007 and 2006 are as follows:

(millions of dollars)	2007	2006
Liabilities, beginning of year	10,520	8,759
Increase in liabilities due to accretion	582	499
Increase in liabilities due to nuclear used fuel and nuclear waste management variable expenses	76	38
Liabilities settled by expenditures on waste management	(200)	(164)
(Increase) decrease in the liability for non-nuclear fixed asset removal	(21)	2
Increase in the liability for nuclear used fuel management and the liability for nuclear decommissioning and low and intermediate level waste management to reflect the change in cost estimates	–	1,386
Liabilities, end of year	10,957	10,520

OPG's fixed asset removal and nuclear waste management liabilities are comprised of expected costs to be incurred up to and beyond termination of operations and the closure of nuclear and fossil-fuelled generating plant facilities. Costs will be incurred for activities such as dismantling, demolition and disposal of facilities and equipment, remediation and restoration of sites and the ongoing and long-term management of nuclear used fuel and low and intermediate level waste material. Nuclear station decommissioning consists of original placement of stations into a safe store condition followed by a nominal 30-year store period prior to station dismantling.

The following costs are recognized as a liability:

- The present value of the costs of dismantling the nuclear and fossil-fuelled production facilities at the end of their useful lives;
- The present value of the fixed cost portion of any nuclear waste management programs that are required based on the total volume of waste expected to be generated over the assumed life of the stations; and
- The present value of the variable cost portion of any nuclear waste management program taking into account actual waste volumes generated to date.

The determination of the accrual for fixed asset removal and nuclear waste management costs requires significant assumptions, since these programs run for many years. As at December 31, 2006, OPG updated the estimates for the nuclear used fuel management and nuclear decommissioning and low and intermediate level waste management liabilities. The resulting updated Reference Plan, the 2006 Approved Reference Plan, was approved by the Province in accordance with the terms of the ONFA. The increase in cost estimates reflected in the 2006 Approved Reference Plan was mainly due to additional used fuel and waste quantities resulting from station life extensions, recent experience in decommissioning reactors, and changes in economic indices. The increase is partially offset by the impact of later end of life dates for some stations such as the Bruce A nuclear generating station and Units 1 and 4 at the Pickering nuclear generating station, which results in a later decommissioning dates and a reduced present value of decommissioning costs.

As a result of the approval of the 2006 Approved Reference Plan, OPG will recognize additional expenses including accretion on the fixed asset removal and nuclear waste management liabilities and depreciation of the carrying value of the related fixed assets. The impact of these additional expenses will be reduced by the recognition of a regulatory asset to be recovered through future prices charged to customers, as prescribed by the amended regulation pursuant to the *Electricity Restructuring Act, 2004* (Ontario). This is discussed in Note 7 to the consolidated financial statements.

For the purposes of calculating OPG's fixed asset removal and nuclear management liabilities, nuclear and fossil-fuelled plant closures are projected to occur over the next five to 29 years. End of life dates may change as decisions on life extensions are made. The 2006 Approved Reference Plan includes cash flow estimates for decommissioning nuclear stations for approximately 40 years after station shutdown and to 2065 for placement of used fuel into the long-term disposal repository followed by extended monitoring. The undiscounted amount of estimated future cash flows associated with the liabilities is approximately \$24 billion in December 31, 2007 dollars. The discount rate used to calculate the present value of the liabilities was 5.75 per cent for liabilities established prior to December 31, 2006. The increase in cost estimates related to the 2006 Approved Reference Plan and subsequent increases to the value of the undiscounted estimated cash flows for OPG's liability for nuclear waste management and decommissioning are discounted at 4.6 per cent. The cost escalation rates ranged from 1.8 per cent to 3.6 per cent. Under the terms of the lease agreement with Bruce Power, OPG continues to be responsible for the nuclear fixed asset removal and nuclear waste management liabilities associated with the Bruce nuclear generating stations.

The significant assumptions underlying operational and technical factors used in the calculation of the accrued liabilities are subject to periodic review. Changes to these assumptions, including changes to assumptions on the timing of the programs, financial indicators or the technology employed may result in significant changes to the value of the accrued liabilities. With programs of this duration and the evolving technology to handle the nuclear waste, there is a significant degree of uncertainty surrounding the measurement accuracy of the costs for these programs, which may increase or decrease over time.

#### **Liability for Nuclear Used Fuel Management Costs**

The liability for nuclear used fuel management represents the cost of managing the highly radioactive used nuclear fuel bundles. The federal Nuclear Fuel Waste Act ("NFWA") released in 2002 required that Canada's nuclear fuel waste owners form a Nuclear Waste Management Organization ("NWMO") and that each waste owner establish a trust fund for used fuel management costs. The NWMO studied alternatives for used fuel management and submitted an options study to the federal government in November 2005. The submission included a proposal titled Adaptive Phased Management for used fuel with an end-point being a deep geologic repository. In June 2007, the Government of Canada announced its decision to accept the NWMO proposal. To estimate its liability for nuclear used fuel management costs, OPG has adopted a conservative approach consistent with the approved Adaptive Phased Management concept approved by the Government of Canada, which assumes a deep geologic repository in-service date in 2035.

#### **Liability for Nuclear Decommissioning and Low and Intermediate Level Waste Management Costs**

The liability for nuclear decommissioning and low and intermediate level waste management represents the estimated costs of decommissioning nuclear generating stations after the end of their service lives, as well as the cost of managing low and intermediate level radioactive wastes generated by the nuclear stations. The significant assumptions used in estimating future nuclear fixed asset removal costs include decommissioning of nuclear generating stations on a deferred dismantlement basis where the reactors will remain in a safe storage state for a 30-year period prior to a 10-year dismantlement period.

The life cycle costs of low and intermediate level waste management include the costs of processing and storage of such radioactive wastes during and following the operation of the nuclear stations, as well as the costs of ultimate long-term management of these wastes. The current assumptions used to establish the accrued low and intermediate level waste management costs include a disposal facility for low and intermediate level waste with a targeted in-service date of year end 2017. Agreement has been reached with local municipalities for OPG to develop a deep geologic repository for the long-term management of low and intermediate level waste adjacent to the Western Waste Management Facility. OPG has initiated a federal environmental assessment process in respect of this proposed facility.

#### **Liability for Non-Nuclear Fixed Asset Removal Costs**

The liability for non-nuclear fixed asset removal is based on third-party cost estimates after an in-depth review of active plant sites and an assessment of required clean-up and restoration activities. This liability represents the estimated costs of decommissioning fossil-fuelled generating stations at the end of their service lives. The estimated retirement date of these stations is between 2012 and 2034.

In addition to the \$107 million liability for active sites, OPG also has an asset retirement obligation liability of \$69 million for decommissioning and restoration costs associated with plant sites that have been divested or are no longer in use.

OPG has no legal obligation associated with the decommissioning of its hydroelectric generating facilities. Also, the costs cannot be reasonably estimated because of the long service life of these assets. With either maintenance efforts or rebuilding, the water control structures are assumed to be used for the foreseeable future. Accordingly, OPG has not recognized a liability for the decommissioning of its hydroelectric generating facilities.

**Ontario Nuclear Funds Agreement**

OPG sets aside funds to be used specifically for discharging its nuclear fixed asset removal and nuclear waste management liabilities. In July 2003, OPG and the Province completed arrangements, pursuant to the ONFA. To comply with the ONFA, OPG established the Nuclear Funds. OPG jointly oversees the investment management of the Nuclear Funds with the Province. The assets of the Nuclear Funds are maintained in third party custodian accounts that are segregated from the rest of OPG's assets.

The Decommissioning Fund was established to fund the future costs of nuclear fixed asset removal and long-term low and intermediate level nuclear waste management and a portion of used fuel storage costs after station life. As at December 31, 2007, the Decommissioning Fund was in an overfunded position. OPG bears the risk and liability for cost estimate increases and fund earnings in the Decommissioning Fund.

The Used Fuel Fund will be used to fund future costs of long-term nuclear used fuel waste management. OPG is responsible for the risk and liability for cost increases for used fuel waste management, subject to graduated liability thresholds specified in the ONFA, which limit OPG's total financial exposure at approximately \$9.6 billion in December 31, 2007 dollars based on used fuel bundle projections of 2.23 million bundles consistent with the station lives included within the initial financial reference plan. The graduated liability thresholds do not apply to additional used fuel bundles beyond 2.23 million as projected in the 2006 Approved Reference Plan.

OPG makes quarterly payments to the Used Fuel Fund over the life of its nuclear generating stations, as specified in the ONFA. Required funding for 2007 under the ONFA was \$454 million, including a contribution to The Ontario NFWA Trust (the "Trust") of \$100 million. In 2007, OPG also made a one-time contribution of approximately \$334 million to the Used Fuel Fund to satisfy the extraordinary payment specified within the ONFA and related to the Bruce Lease transaction with Bruce Power as discussed in Note 18 to the audited consolidated financial statements. This payment constitutes a Triggering Event under the ONFA which results in the need to further update the Amended Payment Schedule approved by the Province earlier in 2007 as part of the initial update to the 2006 Approved Reference Plan. The update to the payment schedule is currently in progress.

The NFWA was proclaimed into force in November 2002. In accordance with the NFWA, the Nuclear Waste Management Organization was formed. The NWMO prepared and reviewed alternatives, and provided recommendations to the federal government for long-term management of nuclear fuel waste in November 2005. The federal government selected the recommended option titled Adaptive Phased Management in June 2007. As required under the NFWA, OPG established the Trust in November 2002 and made an initial deposit of \$500 million into the Trust. The NFWA also required OPG to make annual contributions of \$100 million to the Trust. These contributions are to be deposited into the Trust no later than the November anniversary of the NFWA. The deposit amounts will be adjusted when the Minister of Natural Resources approves the funding formula to be proposed by the NWMO in the first quarter of 2008. Given that the Trust forms part of the Used Fuel Fund, contributions to the Trust, as required by the NFWA, are applied towards the ONFA payment obligations.

As required by the *Nuclear Safety and Control Act* (Canada), and under the terms of the ONFA, the Province provided a Provincial Guarantee to the Canadian Nuclear Safety Commission ("CNSC") since 2003, on behalf of OPG. The Nuclear Safety and Control Act requires OPG to have sufficient funds available to discharge the current nuclear decommissioning and waste management liabilities. The Provincial Guarantee will supplement the Used Fuel Fund and the Decommissioning Fund until they have accumulated sufficient funds to cover the accumulated liabilities for nuclear decommissioning and waste management. The current value of this guarantee is for \$760 million for years 2008 to 2010. Current plans indicate the Provincial Guarantee will not be required beyond 2010. The guarantee, taken together with the Used Fuel Fund and Decommissioning Fund, was in satisfaction of OPG's nuclear licensing requirements with the CNSC. OPG pays the Province an annual guarantee fee of 0.5 per cent of the amount guaranteed by the Province. In 2007, OPG paid the annual guarantee fee of \$8 million (2006 – \$8 million). These fees are associated with the Provincial Guarantee of \$1,510 million, which was required at that time.

Effective January 1, 2007, OPG adopted the CICA Handbook Section 3855, Financial Instruments – Recognition and Measurement. As a result of the adoption of this new section, the investments in the Nuclear Funds and the corresponding payables to the Province are classified as held-for-trading and are measured at fair value with realized and unrealized gains and losses recognized in OPG's consolidated financial statements.

***Decommissioning Fund***

Upon termination of the ONFA, the Province has a right to any excess funding in the Decommissioning Fund, which is the excess of the fair market value of the Decommissioning Fund over the estimated completion costs as per the most recently approved ONFA Reference Plan. When the Decommissioning Fund is overfunded, OPG limits the earnings it recognizes in its consolidated financial statements, through a charge to the Decommissioning Fund with a corresponding payable to the Province, such that the balance of the Decommissioning Fund would equal the cost estimate of the liability based on the most recently approved ONFA reference plan. The payable to the Province could be reduced in subsequent periods in the event that the Decommissioning Fund earns less than its target rate of return or in the event that a new ONFA reference plan is approved with a higher estimated decommissioning liability.

At December 31, 2006, based on the estimate of costs to complete under the 2006 Approved Reference Plan, the Decommissioning Fund was overfunded on a fair value basis, and underfunded on an amortized cost basis. As a result of the adoption of the financial instruments accounting standards on January 1, 2007, OPG adjusted the investments and the related payables in the Decommissioning Fund to fair value, and recorded a transition adjustment of \$519 million to increase opening retained earnings. Subsequently, the investments and the related payables in the Decommissioning Fund are measured at fair value and any changes to the fair values are recognized in income.

Since the Decommissioning Fund was underfunded on an amortized cost basis, no excess adjustment was reported in the Decommissioning Fund as at December 31, 2006. If the investments in the Decommissioning Fund were accounted for at fair value in the consolidated financial statements as at December 31, 2006, and the Decommissioning Fund was terminated under the ONFA, there would have been an amount due to the Province of \$294 million.

After the adjustment to reflect the investments at fair value, on January 1, 2007 the value of the investments in the Decommissioning Fund exceeded the estimated completion costs under the 2006 Approved Reference Plan, and accordingly, the Decommissioning Fund balance was reduced by the amount of the excess funding through the recording of a payable to the Province. The Province's right to any excess funding in the Decommissioning Fund upon termination of the ONFA results in OPG capping its earnings at 5.15 per cent, which is the rate of growth in the liability for the estimated completion cost, as long as the Decommissioning Fund is in an overfunded status. If the Decommissioning Fund were underfunded, the earnings for the Decommissioning Fund would reflect actual fund returns based on the market value of the assets.

At December 31, 2007, the Decommissioning Fund's asset value on a fair value basis was \$5,075 million, which continued to exceed the value of the liability as per the 2006 Approved Reference Plan. As a result of the overfunded status, OPG reported a payable to the Province of \$3 million reflecting an amount due to the Province if the Decommissioning Fund were terminated under ONFA. Under the ONFA, if there is a surplus in the Decommissioning Fund such that the liabilities, as defined by the most recently approved ONFA reference plan, are at least 120 per cent funded, OPG may direct up to 50 per cent of the surplus over 120 per cent to be treated as a contribution to the Used Fuel Fund, and the OEFC would be entitled to a distribution of an equal amount.

The assets in the Decommissioning Fund are invested primarily in publicly traded fixed income and equity investments. As a result, the value of these investments is subject to volatility in the capital markets. The volatility of the returns on these investments has increased over the past few months, which has resulted in a negative impact on the fair value and the funding status of the Decommissioning Fund. During the period January 1, 2008, to February 26, 2008, the fair value decreased by approximately two per cent, which resulted in a loss of approximately \$100 million. The Decommissioning Fund has been designed to meet long-term liability requirements, and, therefore, short-term market variations are inevitable.

#### ***Used Fuel Fund***

Under the ONFA, the Province guarantees OPG's annual return in the Used Fuel Fund at 3.25 per cent plus the change in the Ontario Consumer Price Index ("committed return") for funding related to the first 2.23 million used fuel bundles. OPG recognizes the committed return on the Used Fuel Fund and includes it in the earnings on the nuclear fixed asset removal and nuclear waste management funds. The difference between the committed return on the Used Fuel Fund and the actual market return, based on the fair value of the Used Fuel Fund's assets, which includes realized and unrealized returns, is recorded as due to or due from the Province.

Up until December 31, 2006, OPG accounted for the investments in the Used Fuel Fund on an amortized cost basis, with the amount due to or due from the Province being recorded in the consolidated financial statements as the difference between the committed return and the actual return based on realized returns. At December 31, 2006, the Used Fuel Fund included an amount due to the Province of \$100 million. The Used Fuel Fund's asset value, after taking into account the committed return and the amount due to the Province, was \$3,238 million at December 31, 2006.

In addition, under the ONFA, the Province is entitled to any surplus in the Used Fuel Fund, subject to a threshold funded ratio of 110 per cent compared to the value of the associated liabilities.

Commencing January 1, 2007, the value of the investments held in the Used Fuel Fund is measured at fair value. Accordingly, the Used Fuel Fund's balance increased to \$3,876 million to reflect the fair value measurement. The Province guarantees OPG's annual return in the Used Fuel Fund related to the initial 2.23 million used fuel bundles at the committed return, such that any difference between the committed return and the actual return based on fair value would be offset by the change in the related payable or receivable to the Province in the Used Fuel Fund. As a result, OPG did not record a transition adjustment to opening retained earnings for the Used Fuel Fund.

As at December 31, 2007, the Used Fuel Fund asset value on a fair value basis was \$4,702 million. The asset value was offset by a payable to the Province of \$511 million related to the committed return adjustment.

## Notes to the Consolidated Financial Statements

The nuclear fixed asset removal and nuclear waste management funds as at December 31, 2007 and 2006, consist of the following:

(millions of dollars)	Fair Value		Amortized Cost
	2007	2006	2006
Decommissioning Fund	<b>5,075</b>	5,169	4,356
Due to Province – Decommissioning Fund	<b>(3)</b>	(294)	–
	<b>5,072</b>	4,875	4,356
Used Fuel Fund <sup>1</sup>	<b>4,702</b>	3,879	3,338
Due to Province – Used Fuel Fund	<b>(511)</b>	(641)	(100)
	<b>4,191</b>	3,238	3,238
	<b>9,263</b>	8,113	7,594

1 The Ontario NFWA Trust represented \$1,244 million as at December 31, 2007 of the Used Fuel Fund on a fair value basis. The Ontario NFWA Trust represented \$1,102 million as at December 31, 2006 of the Used Fuel Fund on an amortized cost and fair value basis.

The amortized cost and fair value of the securities invested in the Nuclear Funds, which include the Used Fuel Fund and Decommissioning Fund, as at December 31, 2007 and 2006 are as follows:

(millions of dollars)	Fair Value		Amortized Cost
	2007	2006	2006
Cash and cash equivalents and short-term investments	<b>833</b>	553	556
Marketable equity securities	<b>5,391</b>	5,608	4,250
Bonds and debentures	<b>3,559</b>	2,305	2,306
Receivable from the OEFC	–	588	588
Administrative expense payable	<b>(6)</b>	(6)	(6)
	<b>9,777</b>	9,048	7,694
Due to Province – Decommissioning Fund	<b>(3)</b>	(294)	–
Due to Province – Used Fuel Fund	<b>(511)</b>	(641)	(100)
Total	<b>9,263</b>	8,113	7,594

The bonds and debentures held in the Used Fuel Fund and the Decommissioning Fund as at December 31, 2007 and 2006 mature according to the following schedule:

(millions of dollars)	Fair Value	
	2007	2006
Less than 1 year	–	–
1 – 5 years	<b>1,631</b>	1,167
5 – 10 years	<b>879</b>	467
More than 10 years	<b>1,049</b>	671
Total maturities of debt securities	<b>3,559</b>	2,305
Average yield	<b>4.9%</b>	4.5%

The receivable of \$588 million in 2006 from the OEFC was repaid in 2007. The effective rate of interest on the OEFC receivable was 3.9 per cent in 2006.



The change in the Nuclear Funds for the years ended December 31, 2007 and 2006 are as follows:

(millions of dollars)	Amortized Cost	
	2007	2006
Decommissioning Fund at amortized cost, beginning of year	<b>4,356</b>	4,099
Transition adjustment to fund on adoption of financial instruments accounting standards	<b>519</b>	–
Increase in fund due to return on investments	<b>5</b>	256
Decrease in fund due to reimbursement of expenditures	<b>(99)</b>	(6)
Decrease in Due to Province	<b>291</b>	7
Decommissioning Fund, end of year	<b>5,072</b>	4,356
Used Fuel Fund, beginning of year	<b>3,238</b>	2,689
Increase in fund due to contributions made	<b>788</b>	454
Increase in fund due to return on investments	<b>55</b>	204
Decrease in fund due to reimbursement of expenditures	<b>(20)</b>	(13)
Decrease (increase) in Due to Province	<b>130</b>	(96)
Used Fuel Fund, end of year	<b>4,191</b>	3,238

## 11 Income Taxes

Commencing April 1, 2005, OPG accounts for income taxes related to the rate regulated segments of its business using the taxes payable method. Under the taxes payable method, OPG does not recognize future income taxes related to the rate regulated segments of its business to the extent that the future income taxes are expected to be recovered or refunded through future regulated prices charged to customers.

A reconciliation between the statutory and the effective rate of income taxes is as follows:

(millions of dollars)	2007	2006
Income before income taxes	<b>477</b>	576
Combined Canadian federal and provincial statutory income tax rates, including surtax	<b>36.1%</b>	36.1%
Statutory income tax rates applied to accounting income	<b>172</b>	208
Decrease in income taxes resulting from:		
Lower future tax rate on temporary differences	<b>(10)</b>	(4)
Non-taxable income items	<b>(7)</b>	(5)
Unrecorded future income tax related to regulated operations	<b>(127)</b>	(89)
Change in income tax positions	<b>(13)</b>	10
Changes in future tax rate	<b>(66)</b>	(34)
	<b>(223)</b>	(122)
Income tax (recovery) expense	<b>(51)</b>	86
Effective rate of income taxes	<b>(10.7%)</b>	14.9%

The Company has revised its future income tax assets and liabilities to reflect the lower federal income tax rates recently enacted.

In the third quarter of 2006, OPG received a preliminary communication from the Provincial Tax Auditors with respect to their initial findings from their audit of OPG's 1999 taxation year. Many of the issues raised through the audit are unique to OPG and relate either to start-up matters and positions taken on April 1, 1999 upon commencement of operations, or matters that were not adequately addressed through the *Electricity Act, 1998*. Although OPG has subsequently resolved some of these issues, there is uncertainty as to how the remaining issues will be resolved. OPG expects to receive a reassessment for its 1999 taxation year. The Company would defend its position through the tax appeals process.

OPG has previously recorded income tax charges related to certain income tax positions that the Company has taken in prior years that may be disallowed. Given the uncertainty as to how these income tax matters will be resolved, OPG has not adjusted its income tax liabilities. Should the ultimate outcome materially differ from OPG's recorded income tax liabilities, the Company's effective tax rate and its earnings could be affected positively or negatively in the period in which the matters are resolved.

## Notes to the Consolidated Financial Statements

Significant components of the income tax (recovery) expense are presented in the table below:

(millions of dollars)	2007	2006
Current income tax expense	1	60
Future income tax expense (benefits):		
Change in temporary differences	(2)	–
Non-capital loss carry-forward	–	52
Changes in future tax rate	(30)	–
Other	(20)	(26)
	(52)	26
Income tax (recovery) expense	(51)	86

The income tax effects of temporary differences that give rise to future income tax assets and liabilities as at December 31, 2007 and 2006 are presented in the table below:

(millions of dollars)	2007	2006
Future income tax assets:		
Fixed asset removal and nuclear waste management liabilities	22	29
Other liabilities and assets	125	107
Non-capital loss carry-forward	–	28
Future recoverable Ontario minimum tax	87	64
	234	228
Future income tax liabilities:		
Fixed assets	263	332
Other liabilities and assets	176	145
	439	477
Net future income tax liabilities	205	249
Represented by:		
Current portion (asset) liability	(12)	3
Long-term portion	217	246
	205	249

The following table summarizes the difference in the consolidated statements of income and consolidated statements of comprehensive income under the taxes payable method used by the Company to account for income taxes for the regulated businesses compared to what would have been reported had OPG applied the liability method for the regulated businesses for 2007 and 2006:

(millions of dollars)	2007	2006
As stated:		
Future income tax expense	(52)	26
Future income tax: Other comprehensive income – upon transition	16	–
Future income tax: Other comprehensive income – for the period	(8)	–
Liability method <sup>1</sup> :		
Future income tax expense	75	115
Future income tax: Other comprehensive income – upon transition	12	–
Future income tax: Other comprehensive income – for the period	(6)	–

1 OPG accounts for certain lease revenues relating to the regulated businesses using the cash basis of accounting. The related future income tax impact is excluded from the above.



The following table summarizes the difference in the consolidated balance sheet amounts under the taxes payable method used by the Company to account for income taxes compared to what would have been reported had OPG applied the liability method for the regulated business as at December 31, 2007 and 2006:

(millions of dollars)	2007		2006	
	As Stated	Liability Method <sup>1</sup>	As Stated	Liability Method <sup>1</sup>
Current future income tax recoverable (liabilities)	12	39	(3)	(4)
Long-term future income tax liabilities	(217)	(680)	(246)	(417)

1 OPG accounts for certain lease revenues relating to the regulated businesses using the cash basis of accounting. The related future income tax impact is excluded from the above.

The amount of cash income taxes paid for 2007 was \$64 million (2006 – \$24 million).

## 12 Benefit Plans

The post employment benefit programs include pension, group life insurance, health care and long-term disability benefits. The registered pension plan is a contributory defined benefit plan covering most employees and retirees. Pension fund assets include equity securities and corporate and government debt securities, real estate and other investments which are managed by professional investment managers. The fund does not invest in equity or debt securities issued by OPG. The supplementary pension plans are defined benefit plans covering certain employees and retirees.

Pension and OPEB obligations are impacted by factors including interest rates, adjustments arising from plan amendments, changes in assumptions and experience gains or losses. The pension and OPEB obligations, and the pension fund assets, are measured at December 31, 2007.

	Registered and Supplementary Pension Plans		Other Post Employment Benefits	
	2007	2006	2007	2006
<b>Weighted Average Assumptions – Benefit Obligation at Year End</b>				
Rate used to discount future benefits	5.60%	5.25%	5.59%	5.22%
Salary schedule escalation rate	3.25%	3.00%	–	–
Rate of cost of living increase to pensions	2.25%	2.00%	–	–
Initial health care trend rate	–	–	6.91%	7.34%
Ultimate health care trend rate	–	–	4.68%	4.68%
Year ultimate rate reached	–	–	2014	2014
Rate of increase in disability benefits	–	–	2.25%	2.00%

	Registered and Supplementary Pension Plans		Other Post Employment Benefits	
	2007	2006	2007	2006
<b>Weighted Average Assumptions – Cost for the Year</b>				
Expected return on plan assets net of expenses	7.00%	7.00%	–	–
Rate used to discount future benefits	5.25%	5.00%	5.22%	4.97%
Salary schedule escalation rate	3.00%	3.00%	–	–
Rate of cost of living increase to pensions	2.00%	2.00%	–	–
Initial health care trend rate	–	–	7.34%	7.76%
Ultimate health care trend rate	–	–	4.68%	4.68%
Year ultimate rate reached	–	–	2014	2014
Rate of increase in disability benefits	–	–	2.00%	2.00%
Average remaining service life for employees (years)	11	11	11	11

## Notes to the Consolidated Financial Statements

	Registered Pension Plan		Supplementary Pension Plans		Other Post Employment Benefits	
(millions of dollars)	2007	2006	2007	2006	2007	2006
<b>Changes in Plan Assets</b>						
Fair value of plan assets at beginning of year	8,829	7,921	–	–	–	–
Contributions by employer	268	261	7	7	66	62
Contributions by employees	66	61	–	–	–	–
Actual return on plan assets net of expenses	159	945	–	–	–	–
Benefit payments	(398)	(359)	(7)	(7)	(66)	(62)
Fair value of plan assets at end of year	8,924	8,829	–	–	–	–
<b>Changes in Projected Benefit Obligation</b>						
Projected benefit obligation at beginning of year	9,313	9,095	152	144	2,067	2,065
Employer current service costs	224	212	6	6	70	71
Contributions by employees	66	61	–	–	–	–
Interest on projected benefit obligation	493	459	8	7	109	104
Past service costs	–	–	–	–	–	13
Benefit payments	(398)	(359)	(7)	(7)	(66)	(62)
Net actuarial loss (gain)	(95)	(155)	3	2	(116)	(124)
Projected benefit obligation at end of year	9,603	9,313	162	152	2,064	2,067
Funded Status – Deficit at end of year	(679)	(484)	(162)	(152)	(2,064)	(2,067)

The assets of the OPG pension fund are allocated among three principal investment categories. Furthermore, equity investments are diversified across Canadian, U.S. and non-North American stocks. The fund also has a small real estate portfolio that is less than one per cent of plan assets.

	2007	2006
Registered pension plan fund asset investment categories		
Equities	60%	67%
Fixed income	35%	30%
Cash and short-term investments	5%	3%
Total	100%	100%

Based on the most recently filed actuarial valuation, as at January 1, 2005, there was an unfunded liability on a going-concern basis of \$465 million and a deficiency on a wind-up basis of \$1,979 million. The deficit disclosed in the next filed funding valuation, which must have an effective date no later than January 1, 2008, could be significantly different.

The supplementary pension plans are not funded, but are secured by Letters of Credit totalling \$175 million (2006 – \$159 million).

	Registered Pension Plan		Supplementary Pension Plans		Other Post Employment Benefits	
(millions of dollars)	2007	2006	2007	2006	2007	2006
<b>Reconciliation of Funded Status to Accrued Benefit Asset (Liability)</b>						
Funded status – deficit at end of year	(679)	(484)	(162)	(152)	(2,064)	(2,067)
Unamortized net actuarial loss	1,346	1,108	22	20	538	699
Unamortized past service costs	64	82	3	3	20	25
Accrued benefit asset (liability) at end of year	731	706	(137)	(129)	(1,506)	(1,343)
Short-term portion	–	–	(7)	(6)	(80)	(70)
Long-term portion	731	706	(130)	(123)	(1,426)	(1,273)

	Registered Pension Plan		Supplementary Pension Plans		Other Post Employment Benefits	
(millions of dollars)	2007	2006	2007	2006	2007	2006
<b>Components of Cost Recognized</b>						
Current service costs	224	212	6	6	70	71
Interest on projected benefit obligation	493	459	8	7	109	104
Expected return on plan assets net of expenses	(569)	(551)	–	–	–	–
Amortization of past service costs	18	18	–	1	5	4
Amortization of net actuarial loss	77	80	1	–	45	62
Cost recognized	243	218	15	14	229	241

	Registered Pension Plan		Supplementary Pension Plans		Other Post Employment Benefits	
(millions of dollars)	2007	2006	2007	2006	2007	2006
<b>Components of Cost Incurred and Recognized</b>						
Current service costs	224	212	6	6	70	71
Interest on projected benefit obligation	493	459	8	7	109	104
Actual return on plan assets net of expenses	(159)	(945)	–	–	–	–
Past service costs	–	–	–	–	–	13
Net actuarial (gain) loss	(95)	(155)	3	2	(116)	(124)
Cost incurred in year	463	(429)	17	15	63	64
Differences between costs incurred and recognized in respect of:						
Actual return on plan assets net of expenses	(410)	394	–	–	–	–
service costs	18	18	–	1	5	(9)
Net actuarial loss (gain)	172	235	(2)	(2)	161	186
Cost recognized	243	218	15	14	229	241

A one per cent increase or decrease in the health care trend rate would result in an increase in the service and interest components of the 2007 OPEB cost recognized of \$37 million (2006 – \$34 million) or a decrease in the service and interest components of the 2007 OPEB cost recognized of \$29 million (2006 – \$26 million), respectively. A one per cent increase or decrease in the health care trend rate would result in an increase in the projected OPEB obligation at December 31, 2007 of \$328 million (2006 – \$342 million) or a decrease in the projected OPEB obligation at December 31, 2007 of \$256 million (2006 – \$265 million).

## 13 Financial Instruments

### Risk Management and Hedging Activities

OPG is exposed to changes in electricity prices associated with a wholesale spot market for electricity in Ontario. To hedge the commodity price risk exposure associated with changes in the wholesale price of electricity, OPG enters into various energy and related sales contracts. These contracts are expected to be effective as hedges of the commodity price exposure on OPG's generation portfolio. Gains or losses on hedging instruments are recognized in income when the underlying hedged transactions occur. These gains or losses are included in unregulated revenue and are recorded on the consolidated balance sheets. All contracts not designated as hedges are recorded as assets or liabilities at fair value with changes in fair value recorded in other revenue.

OPG also enters into derivative contracts with major financial institutions to manage the Company's exposure to foreign currency movements. Foreign exchange translation gains and losses on these foreign currency denominated derivative contracts are recognized as an adjustment to the purchase price of the commodity or goods received.

## Notes to the Consolidated Financial Statements

OPG is exposed to changes in market interest rates on debt expected to be issued in the future. OPG uses interest rate derivative contracts to hedge this exposure. Gains and losses on interest rate hedges are recorded as an adjustment to interest expense for the debt being hedged. Gains and losses that do not meet the effectiveness criteria are recorded through net income in the period incurred.

OPG utilizes ERCs and allowances to manage emissions within the prescribed regulatory limits. ERCs are purchased from trading partners in Canada and the United States. Emission allowances are obtained from the Province and purchased from trading partners in Ontario. The cost of ERCs and allowances are held in inventory and charged to OPG's operations at average cost as part of fuel expense as required. Options to purchase ERCs are accounted for as derivatives and are recorded at estimated market value.

Equity price risk is the risk of loss due to volatility in the prices of individual equity instruments and equity indices. The holdings of OPG's Nuclear Funds and pension fund include publicly traded equity investments. As a result, the value of these investments is subject to capital market volatility. This risk can impact the value of the investments held by OPG's Nuclear Funds and pension fund.

To manage this risk, OPG's Nuclear Funds and pension fund have investment policies and procedures in place to set out the investment framework of the funds, including the investment assumptions, permitted investments, and various investment constraints. Such policies and procedures are approved annually by OPG's Investment Funds Oversight Committee of the Board of Directors. For the Nuclear Funds, such policies and procedures are also agreed to jointly with the Province, under ONFA.

**Hedge Accounting**

At the inception of a hedging relationship, OPG documents the relationship between the hedging instrument and the hedged item, its risk management objective and its strategy for undertaking the hedge. OPG also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the derivatives that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items.

Hedge accounting is applied when the derivative instrument is designated as a hedge and is expected to be effective throughout the life of the hedged item. When a derivative hedging relationship is expired, the designation of a hedging relationship is terminated, or a portion of the hedging instrument is no longer effective, any associated gains or losses included in AOCI are recognized in income in the current period's consolidated statement of income.

**Determination of Fair Value**

Fair values of derivative instruments have been estimated by reference to quoted market prices for actual or similar instruments where available. Where quoted market prices are not available, OPG considers various factors to estimate forward prices, including market prices and price volatility in neighbouring electricity markets, market prices for fuel, and other factors.

Forward pricing information is inherently uncertain so that fair values of derivative instruments may not accurately represent the cost to enter into these positions. To address the impact of some of this uncertainty on trading positions, OPG established liquidity reserves against the mark-to-market gains or losses of these positions.

**Derivative Instruments Qualifying for Hedge Accounting**

The following table provides the estimated fair value of derivative instruments designated as hedges. The majority of OPG's derivative instruments are treated as hedges, with gains or losses recognized in net income upon settlement when the underlying transactions occur. OPG holds financial commodity derivatives primarily to hedge the commodity price exposure associated with changes in the price of electricity.

	Notional Quantity	Terms	Fair Value	Notional Quantity	Terms	Fair Value
(millions of dollars except where noted)	<b>2007</b>			<b>2006</b>		
<b>Gain (loss)</b>						
Electricity derivative instruments	<b>1.8 TWh</b>	<b>1-3 yrs</b>	<b>35</b>	4.3 TWh	1-4 yrs	51
Foreign exchange derivative instruments	<b>U.S. \$48</b>	<b>Sep./08</b>	<b>(1)</b>	U.S. \$2	Jan./07	–
Floating to fixed interest rate hedges	<b>43</b>	<b>1-11 yrs</b>	<b>(2)</b>	45	1-12 yrs	(3)
Forward start interest rate hedges	<b>692</b>	<b>1-12 yrs</b>	<b>(6)</b>	622	1-14 yrs	(9)

Foreign exchange derivative instruments are used to hedge the exposure to anticipated U.S. dollar denominated purchases. The weighted average fixed exchange rate for contracts outstanding at December 31, 2007 was U.S. \$1.00 (2006 – U.S. \$0.87) for every Canadian dollar.

One of the Company's joint ventures is exposed to changes in interest rates. The joint venture entered into an interest rate swap to manage the risk arising from fluctuations in interest rates by swapping the short-term floating interest rate with a fixed rate of 5.33 per cent. OPG's proportionate interest in the swap is 50 per cent and is accounted for as a hedge.

OPG entered into a number of forward start interest rate swap agreements to hedge against the effect of future interest rate movements based on the anticipated future borrowing requirement for the Niagara Tunnel and the Portlands Energy Centre projects, and OPG's general corporate facility. Although these transactions are ordinarily accounted for as hedges, a gain of approximately \$3 million was recorded to account for ineffectiveness in the hedges for 2006.

In 2007, OPG has de-designated a number of forward start interest rate hedges as the previously anticipated future borrowings associated with these instruments were no longer expected to occur. As a result of the de-designation, a gain of \$1 million was reclassified to net income in 2007.

Net gains of \$15 million related to derivative instruments qualifying for hedge accounting were recognized in net income in 2007. These amounts were previously recorded in other comprehensive income.

Existing net gains of \$20 million deferred in accumulated other comprehensive income as at December 31, 2007 are expected to be reclassified to net income within the next 12 months.

#### *Derivative Instruments Not Qualifying for Hedge Accounting*

The carrying amount (fair value) of derivative instruments not designated for hedging purposes is as follows:

	Notional Quantity	Fair Value	Notional Quantity	Fair Value
	2007		2006	
(millions of dollars except where noted)				
Foreign exchange derivative instruments	U.S.\$14	(2)	–	–
Commodity derivative instruments				
Assets	9.9 TWh	14	3.9 TWh	25
Liabilities	1.2 TWh	(10)	2.6 TWh	(25)
Market liquidity reserve		2 (2)		– (2)
Total		–		(2)

Foreign exchange derivative instruments that are not designated as hedges have a weighted average exchange rate of U.S. \$0.86 at December 31, 2007.

#### **Fair Value of Other Financial Instruments**

The carrying values of financial instruments such as in cash and cash equivalents, accounts receivable, long-term accounts receivable and other assets, accounts payable and accrued charges, and long-term accounts payable and accrued charges approximate their fair values. Fair values for other financial instruments have been estimated by reference to quoted market prices for actual or similar instruments where available.

The carrying values and fair values of these other financial instruments as at December 31, 2007 and 2006 are as follows:

	Carrying Value	Fair Value	Carrying Value	Fair Value
	2007		2006	
(millions of dollars)				
Financial Assets				
Nuclear fixed asset removal and nuclear waste management funds	9,263	9,263	7,594	8,113
Financial Liabilities				
Long-term debt due within one year	407	409	406	409
Long-term debt	3,446	3,502	2,953	3,082

## Notes to the Consolidated Financial Statements

**Credit Risk**

Credit risk is the financial risk of non-performance by contractual counterparties. Credit risk excludes any operational risk resulting from a third party failing to deliver a product or service as expected. As the majority of OPG's sales are through the IESO administered spot market, OPG management accepts this credit risk due to the IESO's primary role in the Ontario electricity market. This confidence is based on the IESO's own credit risk management policies and practices, which require all spot market participants to meet specific standards for creditworthiness. Additionally, in the event of a participant default, the loss is shared on a pro-rata basis among all participants thus reducing the specific exposure to OPG.

Credit exposure to the IESO fluctuates based on spot prices and the volume of rate regulated and unregulated generation, and is reduced each month upon settlement of the accounts. Credit exposure to the IESO peaked at \$883 million in 2007 (2006 – \$1,029 million).

OPG's second element of credit risk relates to the exposures created by companies ("counterparties") who are contracted to provide services or products. OPG manages this risk using a comprehensive credit risk management function that independently evaluates all major counterparties and provides continuous input to business units who acquire these services.

**14 Common Shares**

As at December 31, 2007 and 2006, OPG had 256,300,010 common shares issued and outstanding at a stated value of \$5,126 million. OPG is authorized to issue an unlimited number of common shares without nominal or par value.

**15 Commitments and Contingencies****Litigation**

Various legal proceedings are pending against OPG or its subsidiaries, covering a wide range of matters, that arise in the ordinary course of its business activities.

On August 9, 2006, a Notice of Action and Statement of Claim in the amount of \$500 million (the "Claim") was served on OPG and Bruce Power L.P. by British Energy Limited and British Energy International Holdings Limited ("British Energy"), claiming that OPG is liable to them for breach of contract and negligence. OPG leased the Bruce nuclear generating stations to Bruce Power L.P. in 2001. British Energy was an investor in Bruce Power L.P. In 2003, British Energy sold its interest in Bruce Power L.P. to a group of investors (the "Purchasers"). The Purchasers are claiming that British Energy is liable to them with respect to this purchase transaction. Their claim is currently the subject of an arbitration proceeding (the "Arbitration"). British Energy is therefore suing OPG in order to preserve any similar claim it may have against OPG pursuant to the 2001 lease transaction. British Energy has indicated that it does not require OPG to actively defend the Claim at this point in time as British Energy is defending the Arbitration commenced by the Purchasers. The Arbitration may narrow or eliminate the claims or damages British Energy has, so as to narrow or eliminate the need to continue the Claim against OPG. British Energy has reserved the right to require OPG to defend the Claim prior to the conclusion of the Arbitration should British Energy at some point believe there is some advantage in doing so.

Certain First Nations have commenced actions for interference with reserve and traditional land rights. The claims by some of these First Nations total approximately \$163 million and claims by others are for unspecified amounts. In 2007, OPG recorded additional expenses associated with past grievances by First Nations.

Each of these matters is subject to various uncertainties. Some of these matters may be resolved unfavourably with respect to OPG and could have a significant effect on OPG's financial position. Management has provided for contingencies that are determined to be likely and are reasonably measurable.

**Environmental**

OPG was required to assume certain environmental obligations from Ontario Hydro. A provision of \$76 million was established as at April 1, 1999 for such obligations. During 2007, OPG recorded expenditures of \$2 million (2006 – \$4 million). As at December 31, 2007, the remaining provision was \$45 million (2006 – \$52 million).

Current operations are subject to regulation with respect to air, soil and water quality and other environmental matters by federal, provincial and local authorities. The cost of obligations associated with current operations is provided for on an ongoing basis. Management believes it has made adequate provision in its interim consolidated financial statements to meet OPG's current environmental obligations.

### Guarantees

As part of normal business, OPG and certain of its subsidiaries and joint ventures enter into various agreements providing financial or performance assurance to third parties on behalf of certain subsidiaries. Such agreements include guarantees, standby Letters of Credit and surety bonds.

### Contractual and Commercial Commitments

The Company's contractual obligations and other significant commercial commitments as at December 31, 2007 are as follows:

(millions of dollars)	2008	2009	2010	2011	2012	Thereafter	Total
Contractual obligations:							
Fuel supply agreements	694	417	325	258	219	374	2,287
Contributions under the ONFA <sup>1</sup>	454	350	350	317	308	1,239	3,018
Long-term debt repayment	400	350	970	375	400	1,170	3,665
Interest on long-term debt	201	183	152	103	75	288	1,002
Unconditional purchase obligations	18	17	16	12	13	174	250
Long-term accounts payable	9	—	—	—	—	—	9
Operating lease obligations	12	12	13	13	13	2	65
Operating licence	20	19	21	22	22	—	104
Pension contributions <sup>2</sup>	260	—	—	—	—	—	260
Other	33	31	34	32	18	42	190
	2,101	1,379	1,881	1,132	1,068	3,289	10,850
Significant commercial commitments:							
Niagara Tunnel	146	258	34	—	—	—	438
Other hydroelectric projects	48	8	1	—	—	—	57
Portlands Energy Centre	59	5	3	3	3	46	119
Total	2,354	1,650	1,919	1,135	1,071	3,335	11,464

1 Contributions under the ONFA are subject to adjustment due to the 2006 Approved Reference Plan.

2 The pension contributions include additional funding requirements towards the deficit and ongoing funding requirements in accordance with the actuarial valuation as at January 1, 2005. The contributions are affected by various factors including market performance, changes in actuarial assumptions, plan experience, and the timing of funding valuations. Funding requirements after 2008 are excluded due to significant variability in the assumptions required to project the timing of future cash flows. The pension contributions are subject to change as a result of the filing of the actuarial valuation in 2008.

### Niagara Tunnel

The Niagara Tunnel project will increase the amount of water flowing to existing turbines at OPG's Sir Adam Beck generating stations in Niagara Falls, allowing the stations to more effectively utilize available water. At December 31, 2007, the tunnel boring machine had advanced 1,609 metres. The progress of the tunnel boring machine by the design-build contractor through a fractured rock formation has been slower than expected. Considerable uncertainty remains with respect to the schedule until the tunnel boring machine advances sufficiently beyond the St. David's gorge to approximately 2,300 metres, and establishes consistent tunneling performance.

The contract structure places the onus on the contractor to mitigate schedule delays, and includes liquidated damages provisions for failure to meet the contractual in-service date.

Based on the information provided by the contractor, the in-service date of the tunnel will be delayed. To mitigate the impact of the schedule delay, the contractor is investigating alternatives, including the realignment of the tunnel. The estimated in-service date will be dependent on the alternative selected by the contractor. Considerable uncertainty remains with respect to the schedule for any of the contractor's alternatives until the tunnel boring machine has advanced beyond the St. David's gorge.

There is a potential that the schedule delay could impact the project cost. The project cost estimate of \$985 million will be reviewed in conjunction with the changes to the project completion schedule and a review of actual subsurface rock conditions compared to those that were anticipated as part of the design-build contract.

The capital project expenditures for the year ended December 31, 2007 were \$60 million and life-to-date capital expenditures were \$303 million. The project is debt financed through the OEFC.



**Lac Seul**

OPG is constructing a new 12.5 MW hydroelectric generating station on the English River. The new Lac Seul generating station will utilize a majority of the spill currently passing the existing Ear Falls generating station, thus increasing the overall efficiency, capacity and energy generated from this location. A design-build contract was awarded and construction started during the first quarter of 2006. In accordance with the contractor's original schedule, the project was expected to be in-service in the fourth quarter of 2007. However, the contractor has advised OPG that the project is now expected to be in-service in the third quarter of 2008.

Life-to-date expenditures are \$41 million. Total project costs are expected to be \$47 million. The project is debt financed through the OEFC.

On December 20, 2007, the Ontario Government issued a directive to the Ontario Power Authority ("OPA") instructing the OPA to negotiate and execute a Hydroelectric Energy Supply Agreement for Lac Seul by January 31, 2008. The Lac Seul Hydroelectric Energy Supply Agreement was executed in January 2008.

**Portlands Energy Centre**

OPG entered into a partnership with TransCanada Energy Ltd., through the Portlands Energy Centre L.P. ("PEC"), to pursue the development of a 550 MW gas-fired, combined cycle station on the site of the former R.L. Hearn generating station, near downtown Toronto. OPG has a 50 per cent ownership interest in the joint venture.

Construction of the generating station started in 2006 and it is expected to be operational in a simple cycle mode with a capacity of up to 340 MW by June 1, 2008. The simple cycle mode will only operate as needed during the summer of 2008, after which the generating station will be taken out of service to enable construction to be completed on the combined cycle mode.

The plant is expected to be completed and fully operational in the second quarter of 2009, providing up to 550 MW of power in a combined cycle mode. Project costs are expected to be within the approved budget of \$730 million excluding capitalized interest. A significant proportion of this capital cost relates to an engineer-procure-construct contract to construct the facility.

OPG's share of capital project expenditures for the year ended December 31, 2007 was \$176 million. OPG's share of the life-to-date capital expenditures was \$273 million. OPG's share of the project is debt financed through the OEFC.

**Other Commitments**

In addition to the above commitments, the Company has the following commitments:

The Company maintains labour agreements with the Power Workers' Union and The Society of Energy Professionals; the agreements are effective until March 31, 2009 and December 31, 2010, respectively. As at December 31, 2007, OPG had approximately 11,700 regular employees and approximately 90 per cent of its regular labour force is covered by the collective bargaining agreements.

Contractual and commercial commitments above exclude certain purchase orders as they represent purchase authorizations rather than legally binding contracts and are subject to change without significant penalties.

**Proxy Property Taxes**

In November 2005, OPG received a letter from the Ministry of Finance indicating its intent to recommend to the Minister of Finance that an Ontario regulation covering proxy property taxes be updated retroactive to April 1, 1999 to reflect reassessments and appeal settlements of certain OPG properties since that date. OPG continues to discuss resolution to this issue with the Ministry of Finance as updates to the regulation may not occur for several years. OPG has not recorded any amounts relating to this anticipated regulation change.

**16 Revenue Limit Rebate**

Eighty-five per cent of the generation output from OPG's unregulated generation assets, excluding the Lennox generating station, stations whose generation output is subject to a HESA with the OPA pursuant to a ministerial direction, and forward sales as of January 1, 2005, is subject to a revenue limit. The output from a generating unit where there has been a fuel conversion and the incremental output from a generating station where there has been a refurbishment or expansion of these assets is also excluded from the output covered by the revenue limit. In addition, until the TRO expired on April 30, 2006, volumes sold under such options were also excluded from the revenue limit rebate.

The revenue limit, which was originally established for a period of 13 months ending April 30, 2006, was subsequently extended for an additional three years. Starting May 1, 2006, the revenue limit decreased to 4.6¢/kWh from the previous limit of 4.7¢/kWh. On May 1, 2007, the revenue limit returned to 4.7¢/kWh and it will increase to 4.8¢/kWh effective May 1, 2008. In addition,



beginning April 1, 2006, volumes sold under a Pilot Auction administered by the OPA are subject to a revenue limit that is 0.5¢/kWh higher than the revenue limit applicable to OPG's other generating assets. Revenues above these limits are returned to the IESO for the benefit of consumers.

The changes in the revenue limit rebate liability are as follows:

(millions of dollars)	2007	2006
Liability, beginning of the year	40	739
Increase to provision during the year	227	161
Payments made during the year	(167)	(860)
Liability, end of year	100	40

## 17 Other Gains and Losses

(millions of dollars)	2007	2006
Impairment loss on the Thunder Bay and Atikokan coal-fired generating stations (Note 5)	–	22
Change in estimated cost required to decommission the Lakeview generating station	(20)	–
Impairment loss on investments in ABCP (Note 6)	10	–
Other (gains) and losses	(10)	22

The demolition of the former Lakeview coal-fired generating station was substantially completed during 2007. During the fourth quarter of 2007, the Company re-estimated the costs to complete the remaining work to remediate the site in 2008. As a result, OPG recorded a recovery of \$20 million in other gains and losses to reflect a change in the estimated costs.

OPG conducted an analysis to determine the fair market value of its third-party ABCP holdings as at December 31, 2007. After reviewing this matter in detail, OPG recorded a write-down of \$10 million. Further details on OPG's investments in third-party ABCP are disclosed in Note 6 of the consolidated annual financial statements.

## 18 Business Segments

Effective April 1, 2005, the output from most of OPG's baseload hydroelectric facilities and all of the nuclear facilities that it operates became rate regulated. With the introduction of rate regulation, OPG revised its reportable business segments to separately reflect the regulated and unregulated aspects of its business. Commencing in the first quarter of 2006, OPG separated the Unregulated Generation business segment into two reportable segments identified as Unregulated – Fossil-Fuelled and Unregulated – Hydroelectric, as a result of changes in the management structure of these segments.

### Regulated – Nuclear Segment

OPG's Regulated – Nuclear business segment operates in Ontario, generating and selling electricity from the nuclear generating stations that OPG owns and operates. The business segment includes electricity generated by the Pickering A and B, and Darlington nuclear generating stations.

OPG's Regulated – Nuclear business segment includes revenue under the terms of a lease arrangement with Bruce Power related to the Bruce nuclear generating stations. The arrangement includes lease revenue, interest income and revenue from engineering analysis and design, technical and other services. The Regulated – Nuclear business segment also includes revenue earned from isotope sales and ancillary services. Ancillary revenues are earned through voltage control/reactive support. These revenues are included in the Regulated – Nuclear business segment since they were included in determining the regulated price for production from the nuclear facilities operated by OPG.

### Bruce Nuclear Generating Stations

In May 2001, the Company leased its Bruce A and Bruce B nuclear generating stations to Bruce Power until 2018, with options to renew for up to 25 years.

Under the terms of the lease, OPG agreed to transfer certain fuel and material inventory to Bruce Power, in addition to certain fixed assets. Pension assets and liabilities related to the approximately 3,000 employees were transferred to Bruce Power. Bruce Power assumed the liability for other post employment benefits for these employees. OPG makes payments to Bruce Power in respect of other post employment benefits of approximately \$2.3 million per month over a 72-month period, ending in 2008.

As part of the closing, OPG recorded deferred revenue to reflect the initial payments of \$595 million less net assets transferred to Bruce Power under the lease agreement. The deferred revenue is being amortized over the initial lease term of approximately 18 years and is recorded as revenue.

In December 2002, British Energy plc. entered into an agreement to dispose of its entire 82.4 per cent interest in Bruce Power. The transaction was completed in February 2003 and a consortium of Canadian companies assumed the lease of the Bruce A and Bruce B nuclear generating stations that was formerly held by British Energy plc. The Bruce facilities will continue to be operated by Bruce Power. Upon closing of the transaction, a \$225 million note receivable was paid to OPG, and lease payments commenced to be paid monthly. Proceeds from the note and applicable interest were to be applied by March 2008 against OPG's funding requirements with respect to the nuclear fixed asset removal and nuclear waste management liabilities. OPG made an extraordinary contribution of \$334 million to the Used Fuel Fund in December 2007.

As part of the agreement reached in October 2005 between the Province and Bruce Power, OPG received a Shareholder Declaration from the Province instructing OPG's Board of Directors to accept certain amendments to the lease agreement. These amendments included a change to the provisions regarding the transfer of Bruce Power's interest in the site and included a reduction of the annual lease payment for three of the four refurbished Bruce A units to \$5.5 million per unit (in 2002 dollars, escalated at Consumer Price Index, that will affect the three Bruce A units to be refurbished, once the planned future refurbishments are completed. These changes to the lease agreement will affect OPG when Units 1 and 2 of the Bruce A nuclear generating station are returned to service, and when Unit 3 is refurbished at the end of its current operational life. Other changes to the existing arrangements were made to address Cameco Corporation's decision not to participate in the refurbishment of the Bruce A nuclear generating station.

For 2004 through 2008, minimum payments under the lease are \$190 million annually, subject to limited exceptions. The lease revenue of \$253 million (2006 – \$251 million) was recorded in revenue. The remaining terms of the operating lease agreement will remain substantially unchanged until the planned future refurbishments are completed.

The net book value of fixed assets on lease to Bruce Power at December 31, 2007 was \$1,201 million (2006 – \$1,273 million). The net book value at December 31, 2006 includes the impact of the increase in the nuclear fixed asset removal and nuclear waste management liabilities relating to the Bruce units as a result of the 2006 Approved Reference Plan described in Note 10 to the audited consolidated financial statements.

#### **Regulated – Hydroelectric Segment**

OPG's Regulated – Hydroelectric business segment operates in Ontario, generating and selling electricity from most of OPG's baseload hydroelectric generating stations. The business segment is comprised of electricity generated by the Sir Adam Beck 1, 2 and Pump generating station, DeCew Falls 1 and 2, and the R.H. Saunders hydroelectric facilities. The Regulated – Hydroelectric business segment also includes ancillary revenues related to these stations earned through offering available generating capacity as operating reserve and through the supply of other ancillary services including voltage control/reactive support, certified black start facilities and automatic generation control.

#### **Unregulated – Hydroelectric Segment**

The Unregulated – Hydroelectric business segment operates in Ontario, generating and selling electricity from its hydroelectric generating stations that are not subject to rate regulation. The Unregulated – Hydroelectric business segment also includes ancillary revenues earned through offering available generating capacity as operating reserve, and through the supply of other ancillary services including voltage control/reactive support, certified black start facilities and automatic generation control, and revenues from other services.

#### **Unregulated – Fossil-Fuelled Segment**

The Unregulated – Fossil-Fuelled business segment operates in Ontario, generating and selling electricity from its fossil-fuelled generating stations, which are not subject to rate regulation. The Unregulated – Fossil-Fuelled business segment also includes ancillary revenues earned through offering available generating capacity as operating reserve, and through the supply of other ancillary services including voltage control/reactive support, automatic generation control, and revenues from other services.

#### **Other**

OPG earns revenue from its joint venture share of Brighton Beach related to an energy conversion agreement between Brighton Beach and Coral. In addition, the Other category includes revenue from real estate rentals.

The revenue and expenses related to OPG's trading and other non-hedging activities are also included in the Other category. As part of these activities, OPG transacts with counterparties in Ontario and neighbouring energy markets in predominantly short-term trading activities of typically one year or less in duration. These activities relate primarily to physical energy that is purchased and sold at the Ontario border, sales of financial risk management products and sales of energy-related products. All contracts that are not designated as hedges are recorded as assets or liabilities at fair value, with changes in fair value recorded in other revenue as gains or losses.

OM&A expenses of the generation business segments include an inter-segment service fee for the use of certain property, plant and equipment of the Other category. The total service fee is recorded as a reduction to the Other category's OM&A expenses. For the year ended December 31, 2007, the service fee was \$33 million for Regulated – Nuclear, \$2 million for Regulated – Hydroelectric, \$4 million for Unregulated – Hydroelectric and \$11 million for Unregulated – Fossil-Fuelled, with a corresponding reduction in OM&A expenses of \$50 million for the Other category. For the year ended December 31, 2006, the service fee was \$30 million for Regulated – Nuclear, \$3 million for Regulated – Hydroelectric, \$4 million for Unregulated – Hydroelectric and \$11 million for Unregulated – Fossil-Fuelled, with a corresponding reduction in OM&A expenses of \$48 million for the Other category.

**Segment Income (Loss) for the  
Year Ended December 31, 2007**

(millions of dollars)

	Regulated		Unregulated			
	Nuclear	Hydro-electric	Hydro-electric	Fossil-Fuelled	Other	Total
Revenue	2,581	695	763	1,713	135	5,887
Revenue limit rebate	–	–	(64)	(163)	–	(227)
	2,581	695	699	1,550	135	5,660
Fuel expense	133	244	81	812	–	1,270
Gross margin	2,448	451	618	738	135	4,390
Operations, maintenance and administration	2,061	123	207	573	10	2,974
Depreciation and amortization	426	68	68	82	51	695
Accretion on fixed asset removal and nuclear waste management liabilities	499	–	–	8	–	507
Earnings on nuclear fixed asset removal and nuclear waste management funds	(481)	–	–	–	–	(481)
Property and capital taxes	31	11	10	21	12	85
(Loss) income before other gains and losses	(88)	249	333	54	62	610
Other (gains) and losses (Note 17)	(4)	–	4	(20)	10	(10)
(Loss) income before interest and income taxes	(84)	249	329	74	52	620

**Segment Income (Loss) for the  
Year Ended December 31, 2006**

(millions of dollars)

	Regulated		Unregulated			
	Nuclear	Hydro-electric	Hydro-electric	Fossil-Fuelled	Other	Total
Revenue	2,665	685	780	1,430	165	5,725
Revenue limit rebate	–	–	(44)	(117)	–	(161)
	2,665	685	736	1,313	165	5,564
Fuel expense	122	245	88	643	–	1,098
Gross margin	2,543	440	648	670	165	4,466
Operations, maintenance and administration	1,942	92	189	524	5	2,752
Depreciation and amortization	368	66	69	133	53	689
Accretion on fixed asset removal and nuclear waste management liabilities	490	–	–	9	–	499
Earnings on nuclear fixed asset removal and nuclear waste management funds	(371)	–	–	–	–	(371)
Property and capital taxes	44	18	15	19	10	106
Income (loss) before other gains and losses	70	264	375	(15)	97	791
Other (gains) and losses (Note 17)	–	–	–	22	–	22
Income (loss) before interest and income taxes	70	264	375	(37)	97	769

## Notes to the Consolidated Financial Statements

	Regulated		Unregulated			
(millions of dollars)	Nuclear	Hydro- electric	Hydro- electric	Fossil- Fuelled	Other	Total
<b>Selected Balance Sheet Information</b>						
As at December 31, 2007						
Segment fixed assets in service, net	<b>4,030</b>	<b>3,871</b>	<b>2,996</b>	<b>422</b>	<b>508</b>	<b>11,827</b>
Segment construction work in progress	<b>210</b>	<b>299</b>	<b>88</b>	<b>322</b>	<b>31</b>	<b>950</b>
Segment property, plant and equipment, net	<b>4,240</b>	<b>4,170</b>	<b>3,084</b>	<b>744</b>	<b>539</b>	<b>12,777</b>
Segment materials and supplies inventory, net:						
Short-term	<b>73</b>	<b>1</b>	<b>–</b>	<b>51</b>	<b>–</b>	<b>125</b>
Long-term	<b>346</b>	<b>–</b>	<b>3</b>	<b>4</b>	<b>–</b>	<b>353</b>
Segment fuel inventory	<b>231</b>	<b>–</b>	<b>–</b>	<b>373</b>	<b>–</b>	<b>604</b>
As at December 31, 2006						
Segment fixed assets in service, net	4,213	3,907	3,012	408	544	12,084
Segment construction work in progress	165	252	78	145	37	677
Segment property, plant and equipment, net	4,378	4,159	3,090	553	581	12,761
Segment materials and supplies inventory, net:						
Short-term	63	1	–	48	–	112
Long-term	320	–	3	3	–	326
Segment fuel inventory	183	–	–	486	–	669
<b>Selected Cash Flow Information</b>						
Year ended December 31, 2007						
Investment in fixed assets	<b>207</b>	<b>80</b>	<b>66</b>	<b>270</b>	<b>43</b>	<b>666</b>
Year ended December 31, 2006						
Investment in fixed assets	173	171	81	71	141	637

## 19 Related Party Transactions

Given that the Province owns all of the shares of OPG, related parties include the Province, the other successor entities of Ontario Hydro, including Hydro One Inc. ("Hydro One"), the IESO, and the OEFC. OPG also enters into related party transactions with its joint ventures. The transactions between OPG and related parties are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

These transactions are summarized below:

	Revenue	Expenses	Revenue	Expenses
(millions of dollars)	2007		2006	
Hydro One				
Electricity sales	28	–	34	–
Services	–	12	–	13
Province of Ontario				
GRC water rentals and land tax	–	129	–	132
Guarantee fee	–	8	–	8
Used Fuel Fund rate of return guarantee	–	(130)	–	96
Decommissioning Fund excess funding	–	(291)	–	(7)
OEFC				
GRC and proxy property tax	–	199	–	205
Interest income on receivable	–	(6)	–	(29)
Interest expense on long-term notes	–	187	–	203
Capital tax	–	32	–	51
Income taxes	–	(51)	–	86
Indemnity fees	–	–	–	2
IESO				
Electricity sales	5,094	104	5,029	146
Revenue limit rebate	(227)	–	(161)	–
Ancillary services	145	–	132	–
Other	–	1	1	1
	5,040	194	5,035	907

During 2006, OPG's Board of Directors approved the payment of a dividend to its shareholder, the Province. The declared dividend of \$128 million represents 35 per cent of OPG's 2005 net income and was paid in November 2006.

At December 31, 2007, accounts receivable included \$2 million (2006 – \$8 million) due from Hydro One and \$211 million (2006 – \$71 million) due from the IESO. Accounts payable and accrued charges at December 31, 2007 included \$2 million (2006 – \$2 million) due to Hydro One.

## Notes to the Consolidated Financial Statements

**20 Joint Ventures**

Significant joint ventures include Brighton Beach and PEC, which are 50 per cent owned by OPG.

The following condensed information from the consolidated statements of operations, cash flows and balance sheets detail the Company's share of its investments in joint ventures and partnerships that has been proportionately consolidated:

(millions of dollars)	2007	2006
<b>Proportionate joint venture operations</b>		
Operating revenue	43	39
Operating expenses	(24)	(19)
Net income	19	20
<b>Proportionate joint venture cash flows</b>		
Operating activities	1	17
Investing activities	(165)	(109)
Financing activities	164	(6)
Share of changes in cash	–	(98)
<b>Proportionate joint venture balance sheets</b>		
Current assets	38	25
Long-term assets	533	379
Current liabilities	(24)	(25)
Long-term liabilities	(185)	(191)
Share of net assets	362	188

**21 Investment Company**

The Company applied AcG-18 for all investments owned by OPGV. OPGV is a wholly owned subsidiary of the Company and its results are included into the Company's consolidated financial statements. The carrying amount of OPGV's investments was \$45 million (2006 – \$32 million) and the amount was included as long-term accounts receivable and other assets on the consolidated balance sheets.

As a result of the application of this policy, the Company's net income and other assets for 2007 increased by \$13 million (2006 – \$2 million). The net realized gains and losses for OPGV was nil in 2007 (2006 – \$1 million).

The gross unrealized gains and losses on the investment held by OPGV as at December 31, 2007 were \$19 million and \$15 million, respectively. The gross unrealized gains and losses on the investment held by OPGV as at December 31, 2006 were \$5 million and \$14 million, respectively.

**22 Research and Development**

For the year ended December 31, 2007, \$88 million (2006 – \$66 million) of research and development expenses were charged to operations.

**23 Changes in Non-Cash Working Capital Balances**

(millions of dollars)	<b>2007</b>	2006
Accounts receivable	<b>(97)</b>	303
Prepaid expenses	<b>(9)</b>	–
Fuel inventory	<b>65</b>	(88)
Materials and supplies	<b>(13)</b>	–
Revenue limit rebate payable	<b>227</b>	161
Accounts payable and accrued charges	<b>(42)</b>	54
Income and capital taxes payable	<b>(62)</b>	47
	<b>69</b>	477

**TRUSTS AND MISCELLANEOUS  
FINANCIAL STATEMENTS**



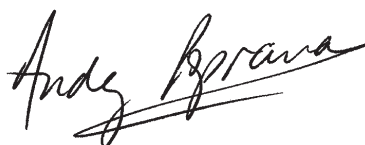


## MANAGEMENT'S RESPONSIBILITY

The Deposit Insurance Corporation of Ontario's management is responsible for the integrity and fair presentation of the financial statements included in the annual report. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

The Corporation maintains systems of internal accounting controls of high quality consistent with reasonable cost. Such systems are designed to provide reasonable assurance that the financial information is accurate and reliable and that company assets and liabilities are adequately accounted for and assets safeguarded.

The consolidated financial statements have been reviewed by the Corporation's Audit and Finance Committee and have been approved by its Board of Directors. In addition, the financial statements have been examined by KPMG LLP, the auditors, whose report follows.



Andy Poprawa, CA  
*President & CEO*



James Maxwell  
*Chief Administrative  
and Financial Officer*

Toronto, Canada  
January 25, 2008

## AUDITORS' REPORT



KPMG LLP

### To the Board of Directors of Deposit Insurance Corporation of Ontario

We have audited the Consolidated Statement of Financial Position of Deposit Insurance Corporation of Ontario as at December 31, 2007 and the Consolidated Statements of Operations and Changes in the Deposit Insurance Reserve Fund, Comprehensive Income and Cash Flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we 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 our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants, Licensed Public Accountants

Toronto, Canada  
January 25, 2008

## Deposit Insurance Corporation of Ontario

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

December 31, 2007, with comparative figures for 2006 (in thousands of dollars)

	2007	2006
<b>Assets</b>		
Cash and short-term investments (note 2)	\$ 9,376	\$ 24,599
Investments (note 3)	110,011	82,637
Loans (net of allowance of \$5,746 (2006 - \$1,642)) (note 4)	7,161	307
Premiums receivable	2,965	2,590
Interest and other receivables	631	315
Capital assets (net of accumulated amortization of \$3,619 (2006 - \$3,405))	851	239
<b>Total Assets</b>	<b>\$130,995</b>	<b>\$110,687</b>
<b>Liabilities</b>		
Payables and accruals	\$ 3,239	\$ 2,940
Member shares and deposits of institutions in liquidation (note 5)	13,324	116
Deferred premium income	3,079	2,821
Accrual for deposit insurance losses (note 6)	5,826	4,790
<b>Total Liabilities</b>	<b>25,468</b>	<b>10,667</b>
<b>Equity</b>		
Deposit insurance reserve fund	105,308	100,020
Accumulated other comprehensive income	219	-
<b>Total Equity</b>	<b>105,527</b>	<b>100,020</b>
<b>Total Liabilities and Equity</b>	<b>\$130,995</b>	<b>\$110,687</b>

Lease Commitments (note 7)

Contingencies (note 12)

See accompanying notes to consolidated financial statements.

On behalf of the Board:



Director



Director

## Deposit Insurance Corporation of Ontario

**CONSOLIDATED STATEMENT OF OPERATIONS AND CHANGES IN THE DEPOSIT INSURANCE RESERVE FUND**

Year ended December 31, 2007, with comparative figures for 2006 (in thousands of dollars)

	2007	2006
<b>Income</b>		
Premium income	\$ 17,414	\$ 16,845
Other income	5,448	4,177
	22,862	21,022
<b>Expenses</b>		
Provision for losses	10,604	288
Salaries and benefits	3,686	3,505
Operating expenses - DICO	2,057	2,015
Operating expenses - credit unions in liquidation	1,282	255
	(55)	(57)
Recovery of operating expenses	17,574	6,006
<b>Excess of income over expenses</b>	<b>5,288</b>	<b>15,016</b>
 Deposit Insurance Reserve Fund, beginning of year	 100,020	 85,004
 <b>Deposit Insurance Reserve Fund, end of year</b>	 <b>\$ 105,308</b>	 <b>\$100,020</b>

See accompanying notes to consolidated financial statements.

## Deposit Insurance Corporation of Ontario

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended December 31, 2007, with comparative figures for 2006 (in thousands of dollars)

	2007	2006
<b>Excess of income over expenses</b>	<b>\$ 5,288</b>	<b>\$ 15,016</b>
<b>Other comprehensive income:</b>		
Unrealized gains (losses) on available-for-sale investments arising during the year	(6)	0
<b>Comprehensive income</b>	<b>\$ 5,282</b>	<b>\$ 15,016</b>

## Statement of Accumulated Other Comprehensive Income

Year ended December 31, 2007, with comparative figures for 2006

	2007	2006
Accumulated other comprehensive income, beginning of year (note 3)	\$ 225	\$ 0
Sale of available-for-sale investment from opening balance of accumulated other comprehensive income	(225)	0
Unrealized gains and losses on available-for-sale investments arising during the year	219	0
Net change during the year	(6)	0
<b>Accumulated other comprehensive income, end of year</b>	<b>\$ 219</b>	<b>\$ 0</b>

See accompanying notes to consolidated financial statements.

Deposit Insurance Corporation of Ontario  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

Year ended December 31, 2007, with comparative figures for 2006 (in thousands of dollars)

	2007	2006
<b>Cash received from (applied to)</b>		
<b>Operations</b>		
Excess of income over expenses	\$ 5,288	\$ 15,016
Items charged to operations not affecting cash		
Provision for losses	10,604	288
Loss (gain) on disposal of capital assets	3	(4)
Unrealized loss (gain) on available-for-sale investments arising during the year	219	-
Amortization	152	118
Acquisitions of capital assets of institutions in liquidation	(83)	-
	<u>16,183</u>	<u>15,418</u>
Changes in		
Loans	(6,880)	38
Premiums receivable	(375)	18
Interest and other receivables	(316)	(165)
Payables and accruals	299	853
Membership shares and deposits of institutions in liquidation	13,208	(578)
Deferred premium income	258	49
	<u>6,194</u>	<u>215</u>
Changes in cash balances of institutions in liquidation	(9,547)	576
Net advances by deposit insurer	9,580	115
Net deposit insurance advances (note 6)	(9,575)	(1,060)
	<u>(9,542)</u>	<u>(369)</u>
	<u>12,835</u>	<u>15,264</u>
<b>Investing activities</b>		
Purchase of investments	(110,011)	(82,637)
Proceeds on sale of investments	82,637	88,289
Purchase of capital assets	(687)	(163)
Proceeds on sale of capital assets	3	8
	<u>(28,058)</u>	<u>5,497</u>
<b>Increase (decrease) in cash position during the year</b>	<b>(15,223)</b>	<b>20,761</b>
Cash position, beginning of year	24,599	3,838
<b>Cash position, end of year</b>	<b>\$ 9,376</b>	<b>\$ 24,599</b>
Supplementary cash flow information:		
Loan guarantee fee paid during the year	\$ 8	\$ 14
Interest received during the year	\$ 5,350	\$ 4,069

Cash position is defined as cash and short-term investments less any borrowings (note 2)

See accompanying notes to consolidated financial statements.

## Deposit Insurance Corporation of Ontario

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2007

**GENERAL**

Deposit Insurance Corporation of Ontario ("DICO" or "the Corporation") is an "Operational Enterprise" Agency of the Province of Ontario established without share capital under the provisions of the Credit Unions and Caisses Populaires Act, 1994 ("the Act").

The statutory objects of the Corporation under the Act are to:

- provide deposit insurance to depositors of member institutions;
- act as stabilization authority for the credit union and caisse populaire system;
- promote standards of sound business and financial practices;
- collect and publish statistics;
- provide financial assistance to member institutions;
- act as administrator of member institutions;
- minimize deposit insurance risk and size of claims.

On May 18, 2007 Bill 187 which included amendments to the Act that will revise the Corporation's mandate and its responsibilities received Royal Assent. The amendments are expected to be proclaimed in 2008.

The Act empowers the Corporation to assess its member institutions deposit insurance premiums to meet the Corporation's requirements for insurance funding and administrative costs. The Corporation establishes its premium rates annually. They are approved by the Government of Ontario and incorporated into the regulations through appropriate amendments as necessary.

Any borrowings of the Corporation are guaranteed by a Minister of Finance's guarantee on behalf of the Province of Ontario. The guarantee is for a maximum of \$150 million and continues until December 31, 2008. In addition to a guarantee fee of one-half of one per cent of the av-

erage end of day balance outstanding of any debt obligation subject to the Minister's guarantee, the Province of Ontario charges a fee of 5 basis points on the unused portion of any credit facility guaranteed for the period ending December 31 of each year during which the guarantee is in effect. The Corporation has in place a revolving credit facility with a Canadian chartered bank in the amount of \$10 million, approved by the Ontario Financing Authority which administers the Minister's guarantee. The standby fee charged by the Chartered bank is 3 basis points on average unused portion of the credit facility, payable in arrears quarterly.

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles "GAAP". To facilitate a better understanding of our consolidated financial statements, the Corporation has disclosed its significant accounting policies as summarized below.

**(A) BASIS OF CONSOLIDATION:**

These consolidated financial statements include the assets and liabilities and results of operations of all variable interest entities "VIEs" where the Corporation is the primary beneficiary after elimination of inter-company transactions and balances.

**(B) FINANCIAL INSTRUMENTS:***Changes in accounting policy:*

On January 1, 2007 the Corporation adopted the new financial instruments accounting standards that were issued by the Canadian Institute of Chartered Accountants "CICA". They include Handbook Section 1530, Comprehensive Income, and Handbook Section 3855, Financial Instruments - Recognition and Measurement. This change in accounting policy requires that we present a Consolidated Statement of Comprehensive Income, which is comprised of the excess of income over expenses and changes in

unrealized gains or losses related to available-for-sale investments. This change in accounting policy is applied on a prospective basis with no restatement of prior year.

**(C) VARIABLE INTEREST ENTITIES:**

In 2005, the Corporation adopted the accounting guideline on the consolidation of VIEs. VIEs include entities in which the equity investors do not have a controlling financial interest or the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support by other parties. AcG-15 requires the consolidation of a VIE by its primary beneficiary defined as the party that receives the majority of expected residual returns and/or that absorbs the majority of the entity's expected losses. As liquidator of the estates of credit unions in liquidation, it has been determined that these rules require the Corporation to consolidate credit unions in liquidation if claims by DICO against the estate represent more than 50% of the total liabilities of the credit unions during the year. The assets and liabilities of the credit unions which meet the criteria for consolidation were recorded in the Corporation's books at their respective fair values as of December 31, 2007 and 2006.

**(D) PREMIUM INCOME:**

Premiums are based on a Differential Premium Risk Classification System as defined by regulation applied to insured deposits held by member institutions. Premium income is calculated based on the Annual Member Institution Return submitted by the member institution, which is due 75 days after its fiscal year end. Premium income is recognized when earned.

**(E) PROVISION FOR LOSSES:**

The provision for losses includes allowances against deposit insurance advances to member institutions in liquidation and an accrual for losses for which advances have not been made at the date of the Consolidated Statement of Financial Position.

Funds advanced in respect of deposit insurance and loans to member institutions are initially recorded at cost. Deposit insurance advances re-

coverable are presented on the Consolidated Statement of Financial Position net of allowances thereon.

The accrual for deposit insurance losses includes both provisions for specific losses and a general accrual for losses. Specific provisions for losses in respect of insured deposits are estimated by management and recorded when conditions exist, in management's opinion, that will likely result in losses to the Corporation.

The general accrual for losses reflects management's best estimate of losses on insured deposits arising from the inherent risk in member institutions. The provision is established by assessing the aggregate risk in member institutions based on current market and economic conditions, the likelihood of losses and the application of historic loss experience. Future economic conditions are not predictable with certainty and actual losses may vary, perhaps substantially, from management's estimates.

**(F) PENSION BENEFITS:**

Pension benefits include a defined contribution pension plan covering all of its regular, non-contractual employees as well as supplemental arrangements, which provide pension benefits in excess of registered pension plan limits. Earnings are charged with the cost of pension benefits earned by employees as service is rendered. Pension expense is determined by a fixed percentage of the employees' income plus the matching of the employees' contribution to a maximum of 4%. The Corporation assumes no actuarial or investment risk.

**(G) FUTURE NON-PENSION POST-RETIREMENT BENEFITS:**

Future non-pension post-retirement benefits relate to the Corporation's extended health, dental and life benefits for both active employees for whom a full eligibility date was determined and existing qualified retirees. The Corporation accrues obligations under these plans as the employees render the service necessary to earn the future benefits. The accrued benefits obligation is actuarially determined using the projected benefit method prorated on service. Cumulative gains and losses in excess of the accrued benefit



obligation at the beginning of the year are amortized over the expected average remaining service of active members.

#### (H) INVESTMENTS:

Investments are classified, based on management's intentions, as available for sale. They are measured at fair value with unrealized gains and losses recorded in other comprehensive income until realized or sold. Interest earned is calculated using the effective interest rate.

#### (I) CAPITAL ASSETS:

Capital assets are recorded at cost less accumulated amortization. Amortization of furniture and equipment is provided by the diminishing-balance method at the rate of 20 per cent per annum. Computer and related equipment and software are amortized over three years on a straight-line basis. Leasehold improvements are amortized on a straight-line basis over the term of the lease.

#### (J) INCOME TAXES:

The Corporation uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment.

## 2. CASH AND SHORT-TERM INVESTMENTS

	December 31, 2007			December 31, 2006		
	Amount (thousands)	Weighted Average Effective Yield	Weighted Average Days to Maturity	Amount (thousands)	Weighted Average Effective Yield	Weighted Average Days to Maturity
Short-term investments	\$ -	-	-	\$ 22,984	4.35%	68
Cash	3,437			763		
Cash of institutions in liquidation	5,939			852		
<b>Total</b>	<b>\$ 9,376</b>			<b>\$ 24,599</b>		

The short-term investments have a term to maturity of less than 90 days on the date of purchase. All investments are highly liquid fixed rate contracts.

## 3. INVESTMENTS

On January 1, 2007, the Corporation adopted the CICA's new accounting requirements for financial instruments. The investments are financial instruments and, as such, classified as available-for-sale and are measured at fair value with unrealized gains and losses recorded in Consolidated Statement of Comprehensive Income until the investment is sold. On January 1, 2007, the investments were measured at fair value, as appropriate. A net unrealized gain of \$225 thousand was recorded in opening accumulated other comprehensive income on available-for-sale investments.

Investments have terms to maturity of 90 days or greater on the date of purchase. They have a weighted-average yield of 4.01% (2006: 4.20%). In compliance with the Corporation's investment policy and relevant statutes, all investments are highly liquid fixed rate contracts and are RI MID or better on the DBRS scale.

	December 31, 2007			December 31, 2006		
	Amount (thousands)	Weighted Average Effective Yield	Weighted Average Days to Maturity	Amount (thousands)	Weighted Average Effective Yield	Weighted Average Days to Maturity
Treasury Bills - Canada	\$ 72,884	3.83%	94	\$ 61,587	4.16%	95
Bankers' acceptances/ Deposit Notes	37,127	4.63%	53	12,253	4.31%	31
Structured Securities	-	-	-	8,797	4.36%	36
<b>Total</b>	<b>\$ 110,011</b>	<b>4.01%</b>	<b>80</b>	<b>\$ 82,637</b>	<b>4.20%</b>	<b>75</b>

The Corporation has contracted the Ontario Financing Authority to manage its investment portfolio. The composition of DICO's investments reflects the nature of the Corporation's potential insurance obligations and is structured to comply with the requirements under both the Income Tax Act and Regulation 78/95 of the Credit Unions and Caisses Populaires Act, 1994.

## 4. LOANS (NET OF ALLOWANCE)

Loans (net of allowance) of \$7,161,000 (2006 - \$307,000) are comprised of loans of the estates of credit unions in liquidation of \$ 7,115,000 (2006 - \$235,000) as a result of the consolidation

of these estates being treated as variable interest entities and residual loans of \$46,000 (2006 - \$72,000) purchased by DICO from the estates of credit unions in order to complete the liquidation.

The aggregate allowance of \$5,746,000 (2006 - \$1,642,000) for impaired loans was established by the management of credit unions now in liquidation based on their own analysis or based on an independent contracted advisor's recommendation prior to DICO's appointment as liquidator. DICO has accepted the allowances as established. Any subsequent adjustments to the allowance are recorded as adjustments to DICO's provision for losses. A total of 5 new institutions were placed in liquidation during 2007. The general process for determining the loan allowances by institution's management is through identification and determination of losses related to specific loan portfolios. It inherently requires the use of management's best judgements and estimates. The liquidator uses the proceeds of the realized assets of each estate, supplemented as necessary by advances from DICO, to pay all creditors of the estate. The balance of realization proceeds are used to firstly repay DICO's advances and thereafter are distributed on a pro-rata basis to the members of the estate.

## 5. MEMBER SHARES AND DEPOSITS OF INSTITUTIONS IN LIQUIDATION

Member shares and deposits of institutions in liquidation of \$13,324,000 (2006 - \$116,000) are comprised of \$778,000 (2006 - \$103,000) in member shares and \$12,546,000 (2006 - \$13,000) in deposits. DICO has an obligation to insure the amounts on deposit up to the prescribed amounts. DICO has no obligation to insure member shares but as liquidator has the responsibility to distribute any residual funds to members once the liquidation is complete.

## 6. ACCRUAL FOR DEPOSIT INSURANCE LOSSES

The provision for losses includes specific provisions for known or likely losses from specific member institutions not included in their financial statements and a general accrual for losses

not identified with specific institutions. That portion of the provision for losses recorded in the year and in previous years which has not yet required payment by the Corporation is shown in liabilities on the Consolidated Statement of Financial Position as "Accrual for deposit insurance losses".

	2007	2006
	(thousands)	
Accrual for deposit insurance losses, beginning of year	\$ 4,790	\$ 4,861
Increase in accrual for current year's deposit insurance losses	10,800	500
Decrease in accrual for prior year's deposit insurance losses	(196)	(212)
(Decrease) Increase in deposit insurance advances recoverable	(26)	10
Accrual for deposit insurance losses, end of year	(5,826)	(4,790)
Net deposit insurance advances	\$ 9,542	\$ 369

The general accrual for losses included in "Accrual for deposit insurance losses" amounted to \$1,750,000 (2006 - \$1,750,000) and is calculated in accordance with the methodology as described in note 1(E).

## 7. LEASE COMMITMENTS

The operating lease for the Corporation's reduced premises has been renewed commencing August 6, 2007 and ending August 5, 2017. The terms of the lease waive basic rent for the first twelve months. The aggregate lease obligations under the new lease are allocated over the term of the lease on a straight-line basis. Future minimum rents for the next 10 years are summarized as follows:

Years	Annual rent per annum
Aug 6, 2007 – Aug 5, 2008	\$ 0
Aug 6, 2008 – Aug 5, 2010	\$ 187,000
Aug 6, 2010 – Aug 5, 2012	\$ 206,000
Aug 6, 2012 – Aug 5, 2017	\$ 218,000

In addition, the Corporation is required to pay property taxes and common area maintenance costs which are currently approximately \$250,000 per annum.

### 8. INCOME TAXES

The Corporation is subject to income taxes on its income as defined under the Income Tax Act. It has accumulated losses for income tax purposes of \$21,535,000. They expire as follows:

Originating Taxation Year	Expiring Taxation Year	Amount (thousands)
2001	2008	\$ 4,191
2002	2009	5,161
2003	2010	4,124
2004	2014	3,790
2005	2015	2,833
2006	2026	1,102
2007	2027	334
		<u>\$ 21,535</u>

The Corporation has determined that realization of the future income tax assets does not meet the more-likely-than-not criterion for recognition and, therefore, a valuation allowance has been recorded against future income tax assets.

### 9. PENSION PLAN

The Corporation operates a defined contribution pension plan for its employees. The pension expense which included supplemental pension expenses charged to income for 2007 was \$331,000 (2006 - \$310,000).

### 10. FUTURE NON-PENSION POST-RETIREMENT BENEFITS

The Corporation accounts for the current value of future non-pension post-retirement benefits. The accrued benefit liability as at December 31, 2007, as actuarially determined, is \$1,284,000 (2006 - \$1,122,000). Current service costs, including interest, were \$198,000 (2006 - \$194,000). Actuarial valuation for the Corporation's plan is required every three years. The most recent actuarial valuation was conducted as of September 30, 2005 and the date of the next required valuation is September 30, 2008.

The assumptions used in the actuarial valuation of the future benefits obligations consisted of: interest rate of 5.5% (2006 - 5.25%), rate of compensation increase of 3.5% (2006 - 3.5%) and initial weighted average trend rate in health and dental costs of 5.8% (2006 - 6.0%), grading down to 5% per annum by 2016. The Corpora-

tion measures its accrued benefit obligations as at September 30 of each year.

RECONCILIATION OF ACCRUED BENEFIT OBLIGATION TO THE ACCRUED BENEFIT LIABILITY	FISCAL YEAR ENDING DECEMBER 31, 2007 (THOUSANDS)	FISCAL YEAR ENDING DECEMBER 31, 2006 (THOUSANDS)
Accrued benefit obligation	\$ 1,901	\$ 1,868
Employer contributions during year	(9)	(10)
Unamortized net actuarial loss	(608)	(736)
Accrued benefit liability	\$ 1,284	\$ 1,122

CHANGE IN BENEFIT OBLIGATIONS	FISCAL YEAR ENDING DECEMBER 31, 2007 (THOUSANDS)	FISCAL YEAR ENDING DECEMBER 31, 2006 (THOUSANDS)
Balance beginning of the year	\$ 1,868	\$ 1,755
Current service cost	56	53
Interest cost	100	94
Actuarial loss (gain)	(86)	4
Benefit payments	(37)	(38)
Balance end of year	\$ 1,901	\$ 1,868

### 11. DIRECTORS' EXPENSE

During the year, the directors received an aggregate remuneration of \$93,000 (2006 - \$83,000). Total directors' expenses were \$46,000 (2006 - \$35,000). The remuneration for the Chair is a minimum of \$2,000 per month which includes a per diem rate of \$500. The per diem rate for all other board members is \$350 plus an annual retainer of \$3,500.

### 12. CONTINGENCIES

The Corporation may be involved in various legal actions in the normal course of business, when acting in the capacity of administrator or liquidator. At the end of 2007 there were no actions brought against the Corporation by third parties. Accordingly, no provisions have been made in these financial statements.

### 13. FAIR VALUE DISCLOSURE

The fair value of financial assets and liabilities which include cash and short-term investments, investments, loans, premiums receivable, interest and other receivables, payables and accruals, member shares and deposits approximate their carrying amounts. The fair value of accrual for deposit insurance losses has not been determined because it is not practicable to determine fair value with sufficient reliability.

**14. COMPENSATION**

The following information is furnished in compliance with the Public Sector Salary Disclosure Act, 1996.

Employee	Position held	Compensation	Taxable benefits*
Brydges, Barry	Vice President Insurance & Risk Management	\$165,350	\$ 8,275
Burgman, John	Chief Information Officer	\$130,392	\$ 1,808
Dale, Richard	Regional Manager, Insurance & Risk Management	\$109,500	\$ 1,410
D'Errico Tony	Regional Manager, Insurance & Risk Management	\$104,869	\$ 1,399
Foster, C.William D.	Vice President Asset Management & Recoveries	\$166,200	\$ 8,668
Hutton, John	Regional Manager, Insurance & Risk Management	\$107,869	\$ 1,399
Maxwell, James	Chief Administrative & Financial Officer	\$141,820	\$14,847
McLeary, Alana	Regional Manager, Insurance & Risk Management	\$102,569	\$ 1,399
Poprawa, Andrew	President and CEO	\$220,000	\$ 7,549
White, Michael	Manager, Asset Management & Recoveries	\$102,523	\$ 3,012
White, Richard	Manager, Policy & Research	\$106,923	\$ 3,051
Yu, Winnie	Manager, Accounting & Finance	\$100,200	\$ 3,005

\* Includes taxable group life insurance, parking and use of company vehicle.

**15. COMPARATIVE FIGURES**

Certain comparative figures for 2006 have been reclassified to conform with the financial statement presentation adopted for 2007.



**Financial Services  
Commission  
of Ontario**

**Commission des  
services financiers  
de l'Ontario**



## **MOTOR VEHICLE ACCIDENT CLAIMS FUND**

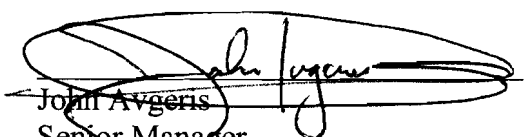
### **Management's Responsibility for Financial Information**

Management is responsible for the financial statements and all other information presented in the financial statements. Management in accordance with Canadian generally accepted accounting principles has prepared the financial statements, and, where appropriate, included amounts based on Management's best estimates and judgements.

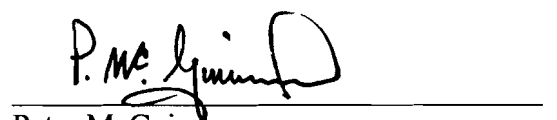
Management agrees with the work of the specialists in evaluating the Unpaid Claims amount and has adequately considered the qualifications of the specialist in determining amounts and disclosures used in the notes to financial statements. Management did not give any, nor cause any, instructions to be given to specialists with respect to values or amounts derived in an attempt to bias their work, and we are not aware of any matters that have impacted the independence or objectivity of the specialists.

The Motor Vehicle Accident Claims Fund is dedicated to the highest standards of integrity in provision of its services. Management has developed and maintains financial controls, information systems and practices to provide reasonable assurances on the reliability of financial information and that the assets were safeguarded. Internal audits are conducted to assess management systems and practices and reports are issued to the CEO and Superintendent of Financial Services of the Financial Services Commission of Ontario (the "FSCO") and the FSCO Audit Committee.

Deloitte and Touche, Chartered Accountants who are engaged under the direction of the Auditor General, have examined the financial statements. The auditor's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with Canadian generally accepted accounting principles. The auditor's report outlines the scope of the auditor's examination and report.



John Avgeris  
Senior Manager  
Motor Vehicle Accident Claims Fund



Peter McGuinness  
Manager of Accounting & Administration  
Motor Vehicle Accident Claims Fund



Deloitte & Touche LLP  
Brookfield Place  
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Canada

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## Auditors' Report

To the Audit Committee of the Financial Services Commission of Ontario and the Auditor General of Ontario

Pursuant to our appointment as auditor of the Motor Vehicle Accident Claims Fund (the "Fund"), which audit is under the direction of the Auditor General of Ontario, we have audited the statement of financial position of the Fund as at March 31, 2008 and the statements of operations and fund deficit and of cash flows for the year then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we 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 our opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

A stylized, handwritten signature of "Deloitte &amp; Touche LLP" in black ink.

Chartered Accountants  
Licensed Public Accountants  
June 13, 2008



**MOTOR VEHICLE ACCIDENT CLAIMS FUND**  
**(Established under the Motor Vehicle Accident Claims Act)**  
**STATEMENT OF FINANCIAL POSITION**

	As at March 31, 2008 \$	As at March 31, 2007 \$
<b><u>ASSETS</u></b>		
<u>CURRENT</u>		
Funds on Deposit	31,678,894	28,536,531
Accounts Receivable - License Fees	2,922,686	2,211,763
Accounts Receivable - Debtors	41,221,441	42,211,934
Less: Allowance for Doubtful Accounts	25,035,193	26,516,964
	<u>16,186,248</u>	<u>15,694,970</u>
Prepaid Expenses	4,018	-
<u>LONG TERM</u>		
Fixed Assets (Note 3)	551,387	561,861
Less: Accumulated Amortization	205,000	140,294
	<u>346,387</u>	<u>421,567</u>
Unpaid Claims Recoverable (Note 4)	6,984,679	6,867,698
<b>Total Assets</b>	<u><u>58,122,912</u></u>	<u><u>53,732,529</u></u>
 <b><u>LIABILITIES &amp; FUND DEFICIT</u></b>		
Accounts Payable and Accrued Expenses	1,343,878	1,870,762
Employee Future Benefits Obligation (Note 3)	502,094	429,720
Deferred Revenue	61,876,776	54,963,437
Unpaid Claims and Adjustment Expenses (Note 4)	185,613,817	174,545,555
	<u>249,336,565</u>	<u>231,809,474</u>
Fund Deficit	(191,213,653)	(178,076,945)
	<u>(191,213,653)</u>	<u>(178,076,945)</u>
 <b>Total Liabilities &amp; Fund Deficit</b>	<u><u>58,122,912</u></u>	<u><u>53,732,529</u></u>

APPROVED:



**Bob Christie**  
**Chief Executive Officer and**  
**Superintendent of Financial Services**  
**Financial Services Commission of Ontario**



**MOTOR VEHICLE ACCIDENT CLAIMS FUND**  
**(Established under the Motor Vehicle Accident Claims Act)**  
**STATEMENT OF OPERATIONS AND FUND DEFICIT**

	Year ended March 31, 2008 \$	Year ended March 31, 2007 \$
<b><u>REVENUE</u></b>		
Fee on Issue or Renewal of Driver's Licences	26,825,641	26,513,868
Change in Deferred Revenue	(6,913,339)	(10,337,879)
Fees Earned	19,912,302	16,175,989
Prior Year Recoveries	1,827,725	605,816
Other Revenue	372	552
<b>Total Revenue</b>	<b>21,740,399</b>	<b>16,782,357</b>
<b><u>EXPENSES</u></b>		
Change in Net Unpaid Claims and Adjustment Expenses	10,951,281	33,744,561
Accident Benefits Claims Payments	14,138,021	13,348,394
<b>Administrative Expenses</b>		
Salaries and Wages	1,544,047	1,394,221
Employees' Benefits	276,133	216,694
Transportation and Communication	28,657	27,538
Services:		
Claims (Solicitors' Fees, etc.)	2,009,649	2,048,979
Accident Benefit Claims Expense	1,674,533	1,568,127
Other Services	1,098,297	1,093,262
Bad Debts Expense	3,029,172	1,790,004
Supplies and Equipment	22,317	20,121
Amortization Expense	105,000	113,431
<b>Total Expenses</b>	<b>34,877,107</b>	<b>55,365,332</b>
<b>Excess of Expenses over Revenue</b>	<b>(13,136,708)</b>	<b>(38,582,975)</b>
<b>Fund Deficit, Beginning of Year</b>	<b>(178,076,945)</b>	<b>(139,493,970)</b>
<b>Fund Deficit, End of Year</b>	<b>(191,213,653)</b>	<b>(178,076,945)</b>

**MOTOR VEHICLE ACCIDENT CLAIMS FUND**  
**(Established under the Motor Vehicle Accident Claims Act)**  
**STATEMENT OF CASH FLOWS**

	Year ended March 31, 2008 \$	Year ended March 31, 2007 \$
<b><u>OPERATING ACTIVITIES</u></b>		
<b>Cash Inflows</b>		
Fee on Issue or Renewal of Driver's Licences	26,114,718	26,955,315
Repayment by Debtors	1,629,197	1,496,470
Prior Year Recoveries	1,824,189	605,816
Other Revenue	372	552
<b>Cash Outflows</b>		
Statutory Payments	(19,839,097)	(18,325,135)
Payments to Employees	(1,736,557)	(1,568,537)
Administrative Expenses	(4,820,639)	(4,720,898)
<b>Net Cash Inflow from Operating Activities</b>	<u>3,172,183</u>	<u>4,443,583</u>
<b><u>INVESTING ACTIVITIES</u></b>		
<b>Cash Outflows</b>		
Acquisition of Computer Equipment	(23,176)	(5,151)
Acquisition of Furniture	-	(16,416)
Acquisition of Office Equipment	(6,644)	-
<b>Net Cash Outflow from Investing Activities</b>	<u>(29,820)</u>	<u>(21,567)</u>
<b>Net Increase in Funds on Deposit with Minister of Finance</b>	3,142,363	4,422,016
<b>Funds on Deposit with Minister of Finance, Beginning of Year</b>	<u>28,536,531</u>	<u>24,114,515</u>
<b>Funds on Deposit with Minister of Finance, End of Year</b>	<u><u>31,678,894</u></u>	<u><u>28,536,531</u></u>

**Motor Vehicle Accident Claims Fund**  
**Notes to the Financial Statements**  
**March 31, 2008**

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**1. STATUTORY AUTHORITY**

The Motor Vehicle Accident Claims Fund (the "Fund") operates under the authority of the Motor Vehicle Accident Claims Act (the "Act"), R.S.O. 1990, Chapter M.41 as amended.

**2. FUND OPERATIONS**

The Fund was originally established to provide compensation to victims of motor vehicle accidents caused by uninsured or hit-and-run motorists in Ontario. Uninsured motorists were required to pay an annual fee into the Fund. However, effective March 1, 1980, with the enactment of the Compulsory Automobile Insurance Act, all motorists are required to carry compulsory third party liability insurance including uninsured motorist coverage. Since that time, the Fund only responds to claims where the eligible claimants have no access to automobile or liability insurance coverage. In 1990, legislation was enacted to expand the coverage to include a new provision to pay statutory accident benefits by the Fund, in accordance with the *Statutory Accident Benefits Schedule* (the "SABS"). In 2002, legislation was enacted to expand the Fund's role to administer and pay statutory accident benefits claims of Ontario insolvent insurers.

The Fund now pays claims under four different automobile insurance compensation systems:

- 1) Tort - prior to June 22, 1990
- 2) OMPP - between June 22, 1990 and December 31, 1993
- 3) Bill 164 - between January 1, 1994 and October 31, 1996
- 4) Bill 59 - from November 1, 1996 and forward

The coverage provided by the Fund is analogous to the minimum required coverage under the standard automobile policy (OAP1) approved by the provincial regulator. Unlike insurance companies, the Fund does not cover claims where the accidents occur outside of Ontario, except in the case of accident benefits where the Ontario insurer is insolvent. In the cases of insurance company insolvencies where the Fund pays claims for accident benefits, it has powers to assess the industry to recover for claims and adjustment expenses and also has claimant rights against the estate of the insolvent insurer.

The current maximum third party liability claims limits payable by the Fund are \$200,000, inclusive of pre-judgment interest, plus legal costs as awarded. Under the Highway Traffic Act in Ontario, a driver is responsible for an accident while the owner of the vehicle has vicarious liability. Both the owner and driver will have their driving privileges suspended and, where judgments exist, writs of seizure and sale of real property will be filed with the Sheriff in the jurisdictions where the defendants reside.

If the driver of the vehicle cannot be determined, only claims for bodily injury can be paid out of the Fund. In these civil proceedings the Superintendent of the Financial Services Commission of Ontario ("the FSCO") becomes the named defendant. In certain circumstances, the law provides that where the identity of a driver is determined at a later date, upon bringing of a motion before the court, the driver can be substituted in the judgment.

Upon the conclusion of litigation under sections 7, 12 or 15 of the Act, or through settlements under section 4 of the Act, the plaintiff(s) or claimant(s) present a request for payment to the Minister of

**Motor Vehicle Accident Claims Fund**  
**Notes to the Financial Statements**  
**March 31, 2008**

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**2. FUND OPERATIONS (continued)**

Finance out of the Fund. At that time an account receivable is created for the full amount of those payments, which may be recovered from the uninsured driver and/or owner.

The Fund operates administratively under the direction of the FSCO and reimburses the FSCO for the costs of the services it provides to the Fund.

The Lieutenant Governor in Council, having regard to the condition of the Fund and the amount paid out of the Fund during any period, may direct payment out of the Province's Consolidated Revenue Fund of such an amount as may be considered necessary or advisable to subsidize the Fund.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

These financial statements have been prepared in accordance with the accounting principles recommended by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA) and, where applicable, the recommendations of the Accounting Standards Board (AcSB) of the CICA. These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Actual results could differ from management's best estimates as additional information becomes available in the future. Fair values are not determinable for Accounts Receivable – Debtors (net) and Unpaid Claims and Adjustment Expenses (net). For all other financial instruments fair value is equal to book value.

The significant accounting policies used in the preparation of these financial statements are summarized as follows:

a) Leasehold Improvements

Leasehold Improvements are carried at cost, less accumulated amortization. The Fund provides for amortization on a straight line basis over the term of the lease.

Leasehold Improvements	5 years
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b) Computer Equipment

Computer equipment is carried at cost, less accumulated amortization. The Fund provides for amortization on a straight-line basis over the estimated useful life of the assets.

Computer equipment	3 years
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c) Furniture & Fixtures

Furniture and Fixtures are carried at cost, less accumulated amortization. The Fund provides for amortization on a straight-line basis over the estimated useful life of the assets.

Furniture & Fixtures	5 years
----------------------	---------

d) Office Equipment

Office Equipment is carried at cost, less accumulated amortization. The Fund provides for amortization on a straight-line basis over the estimated useful life of the assets.

Office Equipment	3 years
------------------	---------

**Motor Vehicle Accident Claims Fund**  
**Notes to the Financial Statements**  
**March 31, 2008**

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

Fixed Assets	2008			2007
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Leasehold Improvements	\$500,000	\$200,000	\$300,000	\$400,000
Computer Equipment	28,327	1,717	26,610	5,151
Furniture & Fixtures	16,416	3,283	13,133	16,416
Office Equipment	6,644	-	6,644	-
	<u>\$551,387</u>	<u>\$205,000</u>	<u>\$346,387</u>	<u>\$421,567</u>

e) Drivers' Licence Fees and Deferred Revenue

The amount the Fund earns changed as of September 2004 from a fee of \$5.00 to \$15.00 on the issuance or renewal of each driver's five-year licence. The income is earned on a pro-rata basis over the five-year term of the licence and the unearned portion is reflected as deferred revenue.

f) Accounts Receivable – Fees

Under the *Act* the Fund receives from the Ministry of Transportation and Serco DES a monthly internal transfer and payment representing the drivers' licence fee prescribed by *Ontario Regulation 800*. Accordingly, unremitted licence fees are reported as accounts receivable.

g) Accounts Receivable – Debtors

The Fund maintains an accounts receivable portfolio, accumulated over the years as a result of judgments and claims assigned to the Minister of Finance. The Fund will pay damages to injured, not at fault, victims who have no recourse to liability insurance, on behalf of defendant uninsured motorists. In accordance with the *Act*, these amounts are recoverable from the uninsured motorists. Total repayments received from debtors are reflected in the cash flow statement

The allowance for doubtful accounts is determined through a process that considers: the age of defendant/debtor, the defendant/debtor's current monthly installment required under the regulations, the amount paid out of the Fund and the activity on the account since the date of the judgment.

The write-off process depends on established criteria that parallel the criteria established by the Ministry of Finance. These criteria are used to select a block of accounts at the beginning of April that is reviewed by collections staff.

**Motor Vehicle Accident Claims Fund**  
**Notes to the Financial Statements**  
**March 31, 2008**

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**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

g) Accounts Receivable – Debtors (continued)

The Ministry of Finance, Internal Audit Section audits the work of the collections staff and provides a certificate of assurance to verify that the established criteria for the write-off have been met. The write-off transaction is authorized by an order-in-council under the authority set out in the *Financial Administration Act*.

In the current year, write-offs of \$5.0 million (2007 - \$6.2 million) were processed. Additionally, in the current year \$0.7 million of the Accounts Receivable was reinstated through the bad debt expense account.

h) Prior Year Recoveries

Prior year recoveries are generated from three main sources – insurance recoveries, reversionary interest (Note 5) and recoveries of court costs. The Fund is required under the *SABS* to satisfy the payment of accident benefits claims within specified periods. The timeframe does not allow for a complete investigation into available insurance coverage and in some instances information is withheld by police because of criminal investigations.

Accordingly, when new information is available, the Fund may be required to pursue private insurers for recoveries.

From time to time the Fund may also be involved in the defence of uninsured motorists or the Superintendent of the FSCO, where the legal proceedings are deemed frivolous and the Fund is awarded costs by the courts.

i) Unpaid Claims

Unpaid claims represents the estimated amounts required to settle all unpaid claims, including an amount for unreported claims and claim expenses, and is gross of estimated recoveries and subrogation. Claim liabilities are established according to accepted actuarial practice in Canada as applied to public personal injury compensation plans. They do not reflect the time value of money nor include a provision for adverse deviations, because the Fund reports no investment income.

The provision for unpaid claims and claim expenses consists of estimates that are necessarily subject to uncertainty and the variability could be material in the near term. The estimates are selected from a range of possible outcomes and are adjusted up or down, as additional information becomes known during the course of loss settlement. The estimates are principally based on historical experience but variability can be caused by changes in judicial interpretations of contracts or significant changes in severity and frequency of claims from historical trends. All changes in estimates are recorded in the current period.

The Fund has obligations to pay certain fixed amounts to claimants on a recurring basis and has purchased annuities from life insurers to provide for those payments.

Settlements occur when there is an irrevocable direction from the Fund to the life insurer to make all payments directly to the claimant. There are no rights under the non-commutable, non-assignable, non-transferable contract that would provide any current or future benefit to the Fund. The Fund remains liable to make payments only in the event that the life insurer

**Motor Vehicle Accident Claims Fund**  
**Notes to the Financial Statements**  
**March 31, 2008**

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

i) Unpaid Claims (continued)

fails and only to the extent that Assuris, the life insurance industry's insolvency compensation fund, will not cover payments due. The net risk to the Fund is any credit risk related to the life insurers. This credit risk is deemed nil at March 31, 2008. There exists the possibility of contingent gains based on the fact that the Fund has purchased insurance on some of the measured lives. Such amounts are described in Note 5 – Contingent Gains.

j) Use of Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires that the Fund's management make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent liabilities as at the date of the financial statements and the reported amounts of revenue and expenses for the period. Estimates and assumptions may change over time as new information is obtained or subsequent developments occur. Actual results could differ from these estimates.

k) a) Employee Future Benefits Obligation

Prior to 2007, the Fund did not record the liabilities pertaining to the legislative severance and compensated absences components of its employee future benefits costs because these liabilities had been determined and recognized by the Province in its financial statements. While the Province continues to accrue for these costs each year and to fund them annually when due, the Auditor General has requested and management has agreed that the Fund also recognize the liability for these costs in these financial statements.

	2008		2007
		Increase (Decrease)	
Employee Future Benefits Obligation	\$502,094	\$72,374	\$429,720

b) Employee Benefits

The Fund's employees are entitled to benefits that have been negotiated centrally for Ontario Public Service employees. The future liability for benefits earned by the Fund's employees is recognized in the Province's consolidated financial statements.

**Motor Vehicle Accident Claims Fund**  
**Notes to the Financial Statements**  
**March 31, 2008**

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

b) Employee Benefits (continued)

These benefits are accounted for by the Fund as follows:

Employee Future Benefits Obligation

The costs of any legislated severance and unused vacation entitlements earned by employees are recognized when earned by eligible employees. Legislated severance is non-actuarially estimated based on one week pay for every year of service for those employees with a minimum of five years of service.

Other Non-Pension Post-Employment Benefits

The cost of other non-pension post-employment benefits is determined and funded on an ongoing basis by the Ontario Ministry of Government Services and accordingly is not included in these financial statements.

**4. UNPAID CLAIMS AND ADJUSTMENT EXPENSES**

a) The Fund's unpaid claims and adjustment expenses consist of the following:

	March 31, 2008		March 31, 2007	
	Gross	Recoverable	Gross	Recoverable
	(000's)	(000's)	(000's)	(000's)
ACCIDENT BENEFITS				
Statutory accident benefits	\$110,578	\$ -	\$98,093	\$ -
THIRD PARTY LIABILITY (TPL)				
Property damage	1,511	81	1,115	60
Bodily injury	73,525	6,904	75,338	6,808
Total TPL	75,036	6,985	76,453	6,868
Totals	\$185,614	\$6,985	\$174,546	\$6,868



**Motor Vehicle Accident Claims Fund**  
**Notes to the Financial Statements**  
**March 31, 2008**

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**4. UNPAID CLAIMS AND ADJUSTMENT EXPENSES (continued)**

b) The change in gross provision for claims and adjustment expenses is as follows:

	<u>March 31, 2008</u> (000's)	<u>March 31, 2007</u> (000's)
Unpaid claims and adjustment expenses, beginning of year	<b>\$174,546</b>	\$141,177
Increase (decrease) in provision for losses that occurred in prior years	<b>3,280</b>	23,887
Amounts paid during the year on claims of prior years		
Statutory Payments	<b>(17,572)</b>	(17,388)
Claims Expenses	<b>(6,195)</b>	(6,130)
Amount paid during the year on claims of the current year		
Statutory Payments	<b>(392)</b>	(576)
Claims Expenses	<b>(138)</b>	(203)
Provision for losses on claims that occurred in the current year	<b>32,085</b>	33,779
Unpaid claims and adjustment expenses, end of year	<b>\$185,614</b>	\$174,546

**5. CONTINGENT GAINS**

Some payments out of the Fund are in the form of structured settlements for accident benefit claims. These claims have guarantee periods ranging from 10 to 30 years and during this period the reversionary interest will be payable to Her Majesty the Queen in right of Ontario, as represented by the Minister of Finance, should the claimant die.

Even though the range of probability that the claimant may die during the guarantee period is slight, the Fund nevertheless has calculated the approximate reversionary interest represented by insurance on the claimant lives as at March 31, 2008 for information purposes.

As at March 31, 2008, the amount paid out of the Fund for accident benefit claims in the form of structured settlements was approximately \$14.2 million (2007 - \$12.4 million) with applicable reversionary interest of approximately \$10.3 million (2007- \$8.7 million).

**Motor Vehicle Accident Claims Fund**  
**Notes to the Financial Statements**  
**March 31, 2008**

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**6. ROLE OF THE ACTUARY AND AUDITOR**

The FSCO retains the Fund's actuary. The actuary's responsibility is to carry out an annual valuation of the Fund's liabilities, which include provision for unpaid claims and adjustment expenses in accordance with accepted actuarial practice. In performing the valuation, the actuary makes assumptions as to the future rates of claims frequency and severity, inflation, recoveries, and expenses taking into consideration the circumstances of the Fund. The actuary in his verification of the underlying data used in the valuation also makes use of the work of the external auditor. The actuary's report outlines the scope of his work and opinion.

The external auditors act under the direction of the Auditor General of Ontario pursuant to agreed terms of engagement. Their responsibility is to conduct an independent and objective audit of the financial statements in accordance with Canadian generally accepted auditing standards and report thereon to the Audit Committee of the FSCO. In carrying out their audit, the auditors also consider the work of the actuary and his report on the provision for claims and claim expenses. The auditors' report outlines the scope of their audit and their opinion.



## Actuaries' Opinion to the Directors of the Ontario Pension Board

Hewitt Associates was retained by the Ontario Pension Board ("OPB") to prepare the following actuarial valuations of the Public Service Pension Plan ("PSPP"):

- An actuarial valuation as at December 31, 2006 on a funding basis, as described in Note 7 of these consolidated financial statements, prepared in accordance with the *Public Service Pension Act* and applicable pension legislation.
- An actuarial valuation as at December 31, 2007 for purposes of these consolidated financial statements, prepared in accordance with the Canadian Institute of Chartered Accountants Handbook, Section 4100.

The actuarial valuation of the PSPP as at December 31, 2006 on a funding basis was based on membership data provided by OPB as at December 31, 2006.

Using the same data as provided by OPB for the funding valuation of the PSPP, we have prepared a valuation of the liabilities as of December 31, 2006 on the basis of the accounting methodology required by the Canadian Institute of Chartered Accountants Handbook, Section 4100, as disclosed in Note 7, and extrapolated the liabilities to December 31, 2007. The valuation as at December 31, 2007 was based on assumptions that reflect OPB's best estimates of future events such as future rates of inflation, future retirement rates and future rates of return on the pension fund. The amounts are set out in the Consolidated Statement of Changes in Accrued Pension Benefits.

We hereby certify that, in our opinion:

- The data provided to us by OPB as of December 31, 2006 are sufficient and reliable;
- The actuarial assumptions used are, in aggregate, appropriate for the purposes of each valuation; emerging experience differing from the assumptions will result in gains or losses which will be revealed in future valuations; and
- The methods used are appropriate for purposes of each valuation and are consistent with the applicable regulatory requirements.

Our valuations have been prepared, and our opinions given, in accordance with accepted actuarial practice.

HEWITT ASSOCIATES



ALLAN H. SHAPIRA  
Fellow, Canadian Institute of Actuaries  
February 29, 2008

## Management's Responsibility for Financial Reporting

The consolidated financial statements of the Ontario Pension Board ("OPB") have been prepared by management, which is responsible for the integrity and fairness of the data presented. The accounting policies followed in the preparation of these consolidated financial statements are in accordance with Canadian generally accepted accounting principles. Of necessity, many amounts in the financial statements must be based on the best estimates and judgement of management with appropriate consideration as to materiality. Financial information presented throughout this annual report is consistent with the consolidated financial statements.

Systems of internal control and supporting procedures are maintained to provide assurance that transactions are authorized, assets are safeguarded against unauthorized use or disposition, and proper records are maintained. The system includes careful hiring and training of staff, the establishment of an organizational structure that provides for a well-defined division of responsibilities and the communication of policies and guidelines of business conduct throughout OPB.

The Board of Directors ("Board") is ultimately responsible for the consolidated financial statements of OPB. OPB's Audit Committee assists in this responsibility by reviewing the consolidated financial statements in detail with management and the external auditors before such statements are recommended to the Board for approval. The Audit Committee meets regularly with management and the external auditors to review the scope and timing of audits, to review their findings and suggestions for improvements in internal control, and to satisfy themselves that their responsibilities and those of management have been properly discharged.



**DONALD D. WEISS**  
*Chief Executive Officer*  
February 29, 2008



**KAREN KOJIMA, CA**  
*Treasurer & Director, Finance*

## Auditors' Report to the Directors of the Ontario Pension Board

We have audited the consolidated statement of net assets available for benefits and accrued pension benefits and excess (deficit) of Ontario Pension Board ("OPB") as at December 31, 2007, and the consolidated statements of changes in net assets available for benefits, changes in accrued pension benefits and changes in excess (deficit) for the year then ended. These consolidated financial statements are the responsibility of OPB's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of OPB as at December 31, 2007 and the results of its operations and the changes in its financial position, accrued pension benefits and excess (deficit) for the year then ended in accordance with Canadian generally accepted accounting principles.



Toronto, Canada  
February 29, 2008

Chartered Accountants  
Licensed Public Accountants

## Consolidated Statement of Net Assets Available for Benefits, and Accrued Pension Benefits and Excess (Deficit)

As at December 31  
(in thousands of dollars)

	2007	2006
<b>Assets</b>		
Investments (Note 4)	\$ 15,974,366	\$ 16,148,351
Investment-related receivables (Note 4)	34,160	60,662
Contributions receivable (Note 5)	40,564	37,510
Capital assets (Note 6)	1,211	1,265
<b>Total assets</b>	<b>16,050,301</b>	<b>16,247,788</b>
<b>Liabilities</b>		
Investment-related liabilities (Note 4)	136,293	475,870
Accounts payable and accrued charges	33,634	15,627
Income taxes withheld on pension payments	10,104	9,802
Contributions payable	1,176	1,210
<b>Total liabilities</b>	<b>181,207</b>	<b>502,509</b>
<b>Net assets available for benefits</b>	<b>15,869,094</b>	<b>15,745,279</b>
Actuarial asset value adjustment (Note 7)	379,153	487,337
<b>Actuarial value of net assets available for benefits</b>	<b>\$ 16,248,247</b>	<b>\$ 16,232,616</b>

### Accrued pension benefits and excess (deficit)

Accrued pension benefits (Note 7)	\$ 16,315,393	\$ 15,317,628
Excess (deficit) (Note 8)	(67,146)	914,988
<b>Total accrued pension benefits and excess (deficit)</b>	<b>\$ 16,248,247</b>	<b>\$ 16,232,616</b>

See accompanying notes

On behalf of the Board:



M. VINCENZA SERA  
Chair



J. URBAN JOSEPH  
Vice-Chair

## Consolidated Statement of Changes in Net Assets Available for Benefits

For the Year Ended December 31  
(in thousands of dollars)

	2007	2006
<b>Increase in net assets</b>		
Net investment income (Note 9)	\$ 472,986	\$ 1,887,015
Contributions (Note 10)	451,858	424,909
Transfers from other plans	81,754	85,337
<b>Increase in net assets</b>	<b>\$ 1,006,598</b>	<b>2,397,261</b>
<b>Decrease in net assets</b>		
Pension payments	788,798	766,144
Termination payments and transfers	66,969	55,476
Operating expenses (Note 11)	27,016	22,190
<b>Decrease in net assets</b>	<b>882,783</b>	<b>843,810</b>
<b>Net increase in net assets for the year</b>	<b>123,815</b>	<b>1,553,451</b>
<b>Net assets, at beginning of year</b>	<b>15,745,279</b>	<b>14,191,828</b>
<b>Net assets, at end of year</b>	<b>\$ 15,869,094</b>	<b>\$ 15,745,279</b>

See accompanying notes



## Consolidated Statement of Changes in Accrued Pension Benefits

For the Year Ended December 31

(in thousands of dollars)

	2007	2006
<b>Accrued pension benefits, at beginning of year</b>	<b>\$ 15,317,628</b>	<b>\$ 14,674,380</b>
<b>Increase in accrued pension benefits</b>		
Interest on accrued pension benefits	931,575	892,289
Benefits accrued		
Service accrual	420,594	394,872
Transfer of service from other plans	81,754	85,337
Past service buybacks	13,296	10,200
Experience losses	134,755	82,170
Change in actuarial assumptions (Note 7)	271,558	-
<b>Total increase</b>	<b>1,853,532</b>	<b>1,464,868</b>
<b>Decrease in accrued pension benefits</b>		
Benefits paid	855,767	821,620
<b>Total decrease</b>	<b>855,767</b>	<b>821,620</b>
<b>Net increase in accrued pension benefits</b>	<b>997,765</b>	<b>643,248</b>
<b>Accrued pension benefits, at end of year</b>	<b>\$ 16,315,393</b>	<b>\$ 15,317,628</b>

## Consolidated Statement of Changes in Excess (Deficit)

For the Year Ended December 31

(in thousands of dollars)

	2007	2006
<b>Excess, at beginning of year</b>	<b>\$ 914,988</b>	<b>\$ 123,971</b>
Net increase in net assets available for benefits	123,815	1,553,451
Change in actuarial asset value adjustment	(108,184)	(119,186)
<b>Increase in actuarial value of net assets available for benefits</b>	<b>15,631</b>	<b>1,434,265</b>
Net increase in accrued pension benefits	(997,765)	(643,248)
<b>Net increase (decrease)</b>	<b>(982,134)</b>	<b>791,017</b>
<b>Excess (deficit), at end of year</b>	<b>\$ (67,146)</b>	<b>\$ 914,988</b>

See accompanying notes

## Notes to the Consolidated Financial Statements

### Note 1 PUBLIC SERVICE PENSION ACT

Effective January 1, 1990, the Province of Ontario ("Province") enacted the *Public Service Pension Act*, 1990 ("*PSPAct*") to continue the pension plan for the employees of the Province and certain of its agencies. The terms of the Public Service Pension Plan ("PSPP" or the "Plan") are stated in Schedule 1 to the *PSPAct*. Ontario Pension Board ("OPB") is the administrator of the PSPP.

### Note 2 DESCRIPTION OF PSPP

The following is a brief description of the PSPP. For more complete information, reference should be made to the *PSPAct*.

#### a) General

The PSPP is a contributory defined benefit pension plan. Membership is mandatory for most employees who satisfy the eligibility requirements provided in the *PSPAct*. Under the PSPP, both the members and the employers make contributions. The PSPP is registered with the Financial Services Commission of Ontario and the Canada Revenue Agency (Registration Number 0208777) as a registered pension plan not subject to income taxes.

#### b) Contributions

The PSPP is integrated with the Canada Pension Plan ("CPP"). Member contributions are 6.2% of the salary on which contributions to CPP are made and 8% on the balance of salary. The employers contribute matching amounts.

Ontario Provincial Police ("OPP") officers are required to contribute to the PSPP an additional 2% of salary, which is matched by the employer. These additional contributions are used to fund the 50/30 unreduced early retirement provision available to OPP officers.

Contributions from members and employers are remitted to the OPB. The portion of these contributions that exceeds *Income Tax Act* limits is transferred to the Province's Public Service Supplementary Benefits Account ("PSSBA").

#### c) Pensions

A pension is payable at age 65 (or at age 60 for some members with pre-1966 pension credits) based on the number of years of credit in the PSPP multiplied by 2% of the average salary during the best consecutive 60-month period, less an offset for amounts received under the CPP at age 65. An unreduced pension can be received before age 65 if the member's age and years of credit total 90 ("Factor 90") or when the member reaches age 60 and has 20 or more years of credit. The Province amended the PSPP to provide for an enhanced early retirement opportunity for members of the Plan whose age and service in the Plan total at least 80 years ("Factor 80"). The Factor 80 program ended on March 31, 2002. The PSPP was again amended to permit those members who are deemed to be surplus by their employer to retire upon attaining Factor 80. To qualify, certain conditions must be satisfied by both the employer and the member. The surplus program expired March 31, 2006. OPP officers are eligible for an unreduced pension after attaining age 50 with 30 years of credit.

#### d) Death Benefits

Upon the death of the member or pensioner, benefits may be payable to a surviving eligible spouse, eligible children, a designated beneficiary or the member's or pensioner's estate.

#### e) Disability Pensions

Based on meeting all eligibility criteria, a disability pension may be available to members with a minimum of 10 years of credit in the PSPP. The amount of the disability pension is dependent on years of credit and average salary.

#### f) Termination Payments

Members terminating employment before age 55 who are eligible for a deferred pension may be entitled to transfer the commuted value of the pension to a locked-in registered retirement savings arrangement, to transfer to another pension plan, or to purchase a life annuity.

#### g) Escalation of Benefits

Current pensions and deferred pension benefits are increased for inflation based on the Consumer Price Index to a maximum of 8% in any one year. Any inflation above 8% in any one year is applied to increase the pension in subsequent years when the adjustment is less than 8%.

**Note 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****Basis of Presentation**

The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles, and present the position of the PSPP as a separate entity independent of the employers and Plan members.

**a) Use of Estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**b) Principles of Consolidation**

The accounts of the wholly-owned subsidiary, OPB Realty Inc., are included on a consolidated basis.

**c) Investments**

Investments are stated at fair value, including accrued income. For traded investments, fair value is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. For investments with fixed redemption and maturity which OPB intends to hold to maturity, fair value is cost.

Fair value of investments is determined as follows:

- (i) Short-term money market securities are recorded at cost which, together with accrued interest or discount earned, approximates fair value.
- (ii) Bonds and real estate debt are valued at quoted market prices where available. For those instruments where quoted market prices are not available, estimated values are calculated using discounted cash flows based on current market yields and comparable securities, as appropriate.
- (iii) Special Province of Ontario Debentures (the "Special Debentures"), which are non-marketable, are recorded at cost.
- (iv) Equities are valued at quoted market prices at closing.
- (v) Real estate, consisting primarily of income-producing properties, is valued at estimated fair value determined annually by independent appraisals. The purchase price approximates the fair value of properties acquired and held for less than six months.
- (vi) Participating mortgages are recorded at cost, subject to an annual assessment of recoverable value based on independent appraisals of the securitized properties.

Investment transactions are recorded as of the trade date, which is the date upon which the substantial risks and rewards have been transferred. Interest and real estate income from operations are recognized on an accrual basis. Since real estate is valued on a fair value basis, depreciation and amortization are not charged to income. Dividend income is recognized on the ex-dividend date. Income from participating mortgages is accrued at the rate stated in the instrument, and any participation income is recorded when realized. Net investment income also includes realized gains and losses from the sale of investments and unrealized gains and losses determined from the change in the difference between cost and fair value at year-end, including appraisal adjustments on real estate valuations and fair value adjustments on real estate debt.

In accordance with "EIC-168: Accounting by Pension Plans for Transaction Costs" issued by the Canadian Institute of Chartered Accountants ("CICA"), OPB changed its accounting policy for investment transaction costs, whereby beginning in 2007 investment transaction costs are expensed as incurred. Prior to 2007, transaction costs were included in investment cost on purchases, and netted against realized gains and losses on sales. The impact of the change is a decrease in cost of equities and real estate, as noted in Notes 4(d) and 4(e), and an increase in investment expenses, realized gains and unrealized gains, as set out in Notes 9(c) and 9(d). The change in accounting policy has been applied retrospectively, without restatement of prior periods.

**d) Actuarial Asset Value Adjustment**

The actuarial asset value adjustment reflects the amount required to adjust the Special Debentures to an actuarial value. The amount is the difference between the recorded value of the Special Debentures, at cost, and an actuarial value determined by discounting cash flows at the same investment return rate assumed in the Plan's accounting basis valuation. OPB does not use asset smoothing.

**e) Accrued Pension Benefits**

The value of accrued pension benefits is based on an actuarial valuation prepared by an independent firm of actuaries. This valuation uses the projected benefit method pro-rated on services and management's best estimate of various economic and non-economic assumptions.

**f) Contributions**

Contributions due to the PSPP at year-end are recorded as receivable. Transfers and purchases of prior service are recorded after cash is received and the case is processed.

**g) Pension Payments**

Payments of pensions, refunds and transfers are recorded in the year in which they are made.

**h) Capital Assets**

Capital assets are carried at cost less accumulated depreciation. Depreciation is provided on a straight-line basis over the estimated useful lives of the capital assets as follows:

Computer equipment	3 years
Leasehold improvements	Remaining term of lease
Furniture and fixtures	10 years

**i) Foreign Currency Translation**

Foreign currency transactions are translated into Canadian dollars at the rates of exchange prevailing at the dates of the transactions. The fair values of investments and cash balances denominated in foreign currencies are translated at the rates in effect at year-end.

**j) Future Accounting and Reporting Changes**

The CICA has issued new accounting standards in 2007: "Section 3862: Financial Instruments - Disclosure" and "Section 3863: Financial Instruments - Presentation". These standards require expanded disclosures related to OPB's risk management practices related to financial instruments. The new standards apply to annual financial statements relating to fiscal years beginning on or after October 1, 2007. OPB intends to adopt these standards effective January 1, 2008.

**Note 4 INVESTMENTS**

As at December 31	<b>2007</b>		<b>2006</b>	
<i>(in thousands of dollars)</i>	<b>Fair Value</b>	<b>Cost</b>	<b>Fair Value</b>	<b>Cost</b>
<b>Cash and short-term investments</b>				
Canada	\$ 930,843	\$ 930,862	\$ 803,403	\$ 802,758
United States and other international	35,088	34,947	299,175	297,929
	<b>965,931</b>	<b>965,809</b>	1,102,578	1,100,687
<b>Fixed income</b>				
Special Province of Ontario Debentures	2,466,519	2,466,519	2,713,358	2,713,358
<b>Bonds</b>				
Canada	2,870,522	2,869,678	2,726,915	2,689,671
United States and other international	785,290	802,736	517,545	489,528
	<b>6,122,331</b>	<b>6,138,933</b>	5,957,818	5,892,557
<b>Equities</b>				
Canada	2,153,459	1,372,607	2,308,650	1,369,074
United States	2,407,898	2,479,347	2,502,621	2,188,605
Other international	1,948,138	1,833,275	1,979,987	1,546,920
	<b>6,509,495</b>	<b>5,685,229</b>	6,791,258	5,104,599
<b>Real estate</b>	<b>2,350,035</b>	<b>1,797,173</b>	2,253,108	1,771,809
<b>Participating mortgages</b>	<b>26,574</b>	<b>26,574</b>	43,589	43,589
<b>Total investments</b>	<b>15,974,366</b>	<b>14,613,718</b>	16,148,351	13,913,241
<b>Investment-related receivables</b>				
Pending trades	8,244	8,244	60,662	60,662
Forward exchange contracts, net	25,916	-	-	-
	<b>34,160</b>	<b>8,244</b>	60,662	60,662
<b>Investment-related liabilities</b>				
Real estate debt	127,294	124,505	133,082	129,404
Pending trades	8,999	8,999	308,087	308,087
Forward exchange contracts, net	-	-	34,701	-
	<b>136,293</b>	<b>133,504</b>	475,870	437,491
<b>Net investments</b>	<b>\$ 15,872,233</b>	<b>\$ 14,488,458</b>	\$ 15,733,143	\$ 13,536,412

**a) Asset Mix**

On December 4, 2007, OPB's long-term asset mix policy was amended. Investments are allocated to and maintained in major asset classes within acceptable ranges, with target allocation as follows:

	Effective December 4, 2007		Prior to December 4, 2007	
	Range	Target	Range	Target
Cash and short-term	0-10%	2%	0-10%	5%
Bonds	33-43%	38%	35-65%	45%
Total interest-bearing instruments	n/a	40%	35-65%	50%
Equity				
Canadian	6-15%	11%	10-20%	15%
International	15-50%	36%	20-30%	25%
Total equity	30-50%	47%	n/a	n/a
Canadian real estate	10-17%	13%	5-15%	10%
Total equity and real estate	n/a	60%	35-65%	50%

Investments in certain other asset classes are allowable, subject to Board approval.

**b) Investment Risk**

The Plan is subject to risks that could impact its cash flows, income, and assets available to meet benefit obligations. Investment risk management is the process of understanding the risks associated with the Plan and its operating environment, and the strategies for dealing with those risks.

OPB has adopted a Statement of Investment Policies and Procedures, which prescribes the asset mix policy, diversification requirements, performance expectations, limits on individual investments, valuation standards, and guidelines for the management of the Plan.

**(i) Interest Rate Risk** – Interest rate risk refers to the effect on the fair value of the Plan's assets and liabilities due to fluctuations in market interest rates. The value of the Plan's investments is affected by short-term changes in nominal and real interest rates. Pension liabilities are exposed to fluctuations in long-term interest rates and inflation. The Plan has established an asset mix policy that balances interest-sensitive investments with other investments and addresses the impact on benefit obligations. Duration and weighting for the fixed income portfolio are actively managed. See the schedule of Fixed Income Maturities for further information.

**(ii) Credit Risk** – The Plan is exposed to the risk of loss arising from a default or insolvency of a securities issuer. As at December 31, 2007, the Plan's greatest credit exposure is with the Province of Ontario, with Special Debentures valued at \$2.467 billion (2006 - \$2.713 billion) and bonds and short-term investments valued at \$408 million (2006 - \$361 million). At December 31, 2007, 98% (2006 - 98%) of bonds held had at least an "A" rating.

**(iii) Foreign Currency Risk** - Foreign currency exposure arises from the Plan holding foreign exchange denominated investments and entering into contracts that provide exposure to currencies other than the Canadian dollar. Fluctuations in the value of the Canadian dollar against these foreign currencies can have an impact on the fair value of investments. The Plan hedges a portion of its foreign currency exposure through the use of foreign exchange forward contracts, which are accounted for at fair value. Total currency exposure, impact of foreign exchange forward contracts and the net currency exposure are as follows:

As at December 31	2007		2006
(in thousands of dollars)	Total Exposure	Net Hedge	Net Exposure
Canadian dollar	\$ 10,825,217	\$ 1,223,181	\$ 12,048,398
United States dollar	2,586,109	(1,439)	2,584,670
Euro	1,375,634	(798,457)	577,177
Japanese yen	242,163	-	242,163
British pound sterling	557,215	(338,005)	219,210
Swiss franc	140,803	(34,747)	106,056
Other	119,176	(24,617)	94,559
	\$ 15,846,317	\$ 25,916	\$ 15,872,233
			\$ 15,733,143

The total fair value of contracts payable is \$1.697 billion (2006 - \$1.676 billion) and the total fair value of contracts receivable is \$1.723 billion (2006 - \$1.641 billion).

(iv) **Liquidity Risk** – Liquidity risk is the risk that the Plan has insufficient cash flows to meet its pension obligations and operating expenses as they become due. Cash sources include investment income, proceeds of sales of investments, and member and employer contributions. The largest sources of cash were the interest and principal payments from the Special Province of Ontario Debentures, which provided \$536 million (2006 - \$529 million) to the Plan.

#### c) Cash and Short-Term Investments

As at December 31 (in thousands of dollars)	Fair Value	2007 Cost	Fair Value	2006 Cost
Canada				
Cash	\$ 4,554	\$ 4,554	\$ 90,207	\$ 90,207
Short-term notes and treasury funds	907,547	907,566	666,275	665,666
Term deposits	14,435	14,435	44,186	44,150
Accrued interest	4,307	4,307	2,735	2,735
	<b>\$ 930,843</b>	<b>\$ 930,862</b>	<b>\$ 803,403</b>	<b>\$ 802,758</b>
United States and other international				
Cash	\$ 5,791	\$ 5,791	\$ 46,537	\$ 46,537
Short-term notes and treasury funds	16,100	16,025	32,049	31,872
Term deposits	13,131	13,065	60,153	60,153
Pooled funds	-	-	160,334	159,265
Accrued interest	66	66	102	102
	<b>\$ 35,088</b>	<b>\$ 34,947</b>	<b>\$ 299,175</b>	<b>\$ 297,929</b>

#### d) Fixed Income and Equities

The Special Debentures are recorded at their aggregate cost of \$2.467 billion (2006 - \$2.713 billion). By discounting cash flows based on year-end market yields of comparable bonds, a value of \$3.010 billion (2006 - \$3.420 billion) could be determined. There are currently seven Special Debentures maturing over the next seven years with a weighted average interest rate of 11.70% (2006 – 11.96%).

In 2007, the cost of equities was reduced by transaction costs, in accordance with the change in accounting policy described in Note 3(c). The impact on the cost of equities as at December 31, 2007 was a decrease equal to the unrealized gain set out in Note 9(d).

Included in the fixed income and equities totals are the following amounts related to pooled funds:

As at December 31 (in thousands of dollars)	Fair Value	2007 Cost	Fair Value	2006 Cost
Bonds - Canada	\$ 352,572	\$ 365,424	\$ 252,759	\$ 255,222
Equities - Canada	121,018	62,979	117,139	62,288
Equities - United States	2,756	2,841	-	-
Equities - Other International	75,487	94,826	-	-

See the schedules of Fixed Income Maturities and Investments over \$20 Million for further information.

#### e) Real Estate

As at December 31 (in thousands of dollars)	Fair Value	2007 Cost	Fair Value	2006 Cost
Real estate properties	\$ 2,302,364	\$ 1,749,502	\$ 2,215,108	\$ 1,733,809
Other assets, net	47,671	47,671	38,000	38,000
Total assets	<b>2,350,035</b>	<b>1,797,173</b>	<b>2,253,108</b>	<b>1,771,809</b>
Debt on real estate properties	(127,294)	(124,505)	(133,082)	(129,404)
<b>Net investment in real estate</b>	<b>\$ 2,222,741</b>	<b>\$ 1,672,668</b>	<b>\$ 2,120,026</b>	<b>\$ 1,642,405</b>

In 2007, the cost of real estate was reduced by transaction costs, in accordance with the change in accounting policy described in Note 3(c). The impact on the cost of real estate as at December 31, 2007 was a decrease equal to the unrealized gain set out in Note 9(d).

Debt includes mortgages and other secured debt with various terms to maturity up to 2018 and a weighted average interest rate of 6.56% (2006 - 6.56%). A specific asset secures each debt instrument.

The following schedule shows the total principal payments related to this debt:

For the Year Ended December 31

(in thousands of dollars)

2008	\$ 11,174
2009	33,735
2010	7,646
2011	16,843
2012	2,551
2013 and thereafter	52,556

#### f) Securities Lending

At year-end, \$1.536 billion (2006 - \$1.476 billion) of OPB's securities were on loan to third parties. Pursuant to a securities lending agreement, OPB's custodian arranges the loans and OPB earns a fee. The custodian follows strict lending criteria and over-collateralizes the loans with comparable securities.

#### Note 5 CONTRIBUTIONS RECEIVABLE

As at December 31

(in thousands of dollars)

	2007	2006
Members	\$ 16,110	\$ 15,181
Employers	24,454	22,329
<b>Total contributions receivable</b>	<b>\$ 40,564</b>	<b>\$ 37,510</b>

#### Note 6 CAPITAL ASSETS

As at December 31

(in thousands of dollars)

	Cost	Accumulated Depreciation	2007 Net Book Value	2006 Net Book Value
Computer equipment	\$ 3,084	\$ 2,414	\$ 670	\$ 490
Leasehold improvements	2,136	1,992	144	329
Furniture and fixtures	1,168	771	397	446
<b>Total capital assets</b>	<b>\$ 6,388</b>	<b>\$ 5,177</b>	<b>\$ 1,211</b>	<b>\$ 1,265</b>

#### Note 7 ACCRUED PENSION BENEFITS

##### a) Accounting Basis

The value of accrued pension benefits of \$16.315 billion (2006 - \$15.318 billion) is an estimate of pension benefit obligations accrued to date for members and pensioners. The accounting valuation uses the projected benefit method (pro-rated on service), which is required under Canadian generally accepted accounting principles. Under this method, the accrued pension benefits are based on service earned up to the reporting date. The accrued pension benefits as at December 31, 2007 are computed by extrapolating data used for the December 31, 2006 funding valuation.



(i) **Actuarial Assumptions** - The actuarial assumptions used in determining the value of accrued pension benefits reflect management's best estimate of future economic and non-economic events. The primary economic assumptions, as at December 31, are:

	2007	2006
Investment return	6.15%	6.15%
Inflation	2.50%	2.50%
Real rate of return	3.65%	3.65%
Salary increases	3.50%	3.50%
	+promotional scale	+promotional scale

The non-economic assumptions include mortality, withdrawal and retirement rates. In 2007, the change in actuarial assumptions, made based on an experience study, includes a change in the termination rates (the rates were lowered) and a change in mortality rates (the rates for males were lowered across all ages and the rates for females were increased for certain ages).

(ii) **Actuarial Asset Value Adjustment** - The Special Debentures discounted at the assumed investment return rate are valued at \$2.846 billion (2006- \$3.201 billion), resulting in an actuarial asset value adjustment of \$379 million (2006 - \$487 million).

#### b) Funding Basis

The funding valuation of the PSPP is based on methods required under the *PSPAct*. The *Pension Benefits Act (Ontario)* and the *Income Tax Act* require that an actuarial funding valuation of the PSPP be completed, and filed with the regulatory authorities, at least every three years. The most recent filing was a funding valuation as at December 31, 2005, which disclosed a funding shortfall of \$587 million.

The funding valuation is used as a basis for funding and plan design decisions.

A funding valuation was prepared for management purposes as at December 31, 2006. That valuation disclosed a funding shortfall of \$300 million.

#### Note 8 EXCESS (DEFICIT)

The primary difference between the accounting and funding valuations is the cost allocation method that is prescribed for each. The accounting valuation reflects only the accrued pension benefits on service earned, as well as assets accumulated, up to the reporting date. By contrast, the funding valuation also considers future service. The funding valuation includes the amount by which the present value of liabilities for future service accruals exceeds the present value of future contributions, whereas the accounting valuation does not reflect this additional funding obligation of the Plan.

In these financial statements, the amount by which the actuarial value of net assets available for benefits is less than the accrued pension benefits based on accounting valuation is represented by the deficit, which as at December 31, 2007 was \$67 million (2006 - \$915 million excess).

**Note 9 NET INVESTMENT INCOME**

For the Year Ended December 31				2007				2006
<i>(in thousands of dollars)</i>	Investment Income <sup>1</sup>	Realized Gain (Loss)	Unrealized Gain (Loss)	Total	Investment Income <sup>1</sup>	Realized Gain (Loss)	Unrealized Gain (Loss)	Total
<b>Cash and short-term investments</b>								
Canada	\$ 33,818	\$ (3,698)	\$ ( 663)	\$ 29,457	\$ 30,993	\$ (1,532)	\$ 323	\$ 29,784
United States and other international	4,967	27,972	59,512	92,451	5,469	(44,713)	(39,171)	(78,415)
	38,785	24,274	58,849	121,908	36,462	(46,245)	(38,848)	(48,631)
<b>Fixed income</b>								
Special Province of Ontario Debentures	288,749	-	-	288,749	320,089	-	-	320,089
<b>Bonds</b>								
Canada	139,861	(12,260)	(36,400)	91,201	130,789	2,663	(25,758)	107,694
United States and other international	27,820	2,775	(45,463)	(14,868)	20,410	(5,670)	41,121	55,861
	456,430	(9,485)	(81,863)	365,082	471,288	(3,007)	15,363	483,644
<b>Equities</b>								
Canada	44,769	323,062	(158,724)	209,107	44,136	301,982	44,895	391,013
United States	57,164	4,037	(385,465)	(324,264)	40,962	51,861	262,751	355,574
Other international	61,298	173,406	(318,205)	(83,501)	43,938	156,981	231,125	432,044
	163,231	500,505	(862,394)	(198,658)	129,036	510,824	538,771	1,178,631
<b>Real estate</b>	137,135	4,529	72,452	214,116	133,014	-	157,915	290,929
<b>Participating mortgages</b>	2,685	-	-	2,685	1,817	-	-	1,817
<b>Total investment income</b>	\$ 798,266	\$ 519,823	\$ (812,956)	505,133	\$ 771,617	\$ 461,572	\$ 673,201	\$ 1,906,390
Investment fees				(32,147)				(19,375)
<b>Net investment income</b>				\$ 472,986				\$ 1,887,015

<sup>1</sup> Investment income includes interest on cash and short-term investments, fixed income and participating mortgages, dividend income on equities, and real estate operating income.

**a) Interest Income**

For the Year Ended December 31		2007	2006
<i>(in thousands of dollars)</i>			
<b>Cash and short-term investments</b>			
Canada			
Cash		\$ 1,924	\$ 1,577
Short-term notes and treasury funds		30,867	28,123
Term deposits		1,027	1,293
		\$ 33,818	\$ 30,993

United States and other international		
Cash	\$ 185	\$ 163
Short-term notes and treasury funds	1,830	3,527
Term deposits	2,952	1,779
	<b>\$ 4,967</b>	<b>\$ 5,469</b>

Earnings from pooled short-term investment funds are included with short-term notes and treasury funds.

Canadian bond interest includes \$15.473 million (2006 - \$11.295 million) from pooled bond funds.

#### b) Dividend Income

Canadian dividend income includes \$2.473 million (2006 - \$1.853 million) from pooled equity funds. United States dividend income includes \$26 thousand (2006 - \$118 thousand) from pooled equity funds. Other international dividend income includes \$8.786 million (2006 - nil) from pooled equity funds.

#### c) Real Estate

The following is selected information from the operations of the subsidiary OPB Realty Inc.:

For the Year Ended December 31 (in thousands of dollars)	2007	2006
<b>Revenue</b>		
Rental	\$ 253,042	\$ 246,317
Other income	5,975	5,534
	<b>259,017</b>	<b>251,851</b>
<b>Expenses</b>		
Operating expenses	95,807	93,481
General, administrative and other	19,331	18,286
	<b>115,138</b>	<b>111,767</b>
<b>Operating income, before interest</b>	<b>143,879</b>	<b>140,084</b>
Interest expense	8,232	9,148
<b>Net operating income</b>	<b>135,647</b>	<b>130,936</b>
Unrealized Gain		
Appraisal adjustment	72,295	151,196
Fair value adjustment on debt	889	6,719
	<b>73,184</b>	<b>157,915</b>
Realized gain	2,233	-
Transaction costs (Note 9(d))	(412)	-
<b>Net income of OPB Realty Inc.</b>	<b>\$ 210,652</b>	<b>\$ 288,851</b>

#### d) Investment Fees

For the Year Ended December 31 (in thousands of dollars)	2007	2006
Portfolio fund management	\$ 18,606	\$ 15,836
Transaction costs	8,800	-
Custody	2,181	1,872
Real estate	1,880	1,354
Consulting	680	313
	<b>\$ 32,147</b>	<b>\$ 19,375</b>

Transaction costs include commissions and fees on trades but exclude costs incurred on real estate transactions. As noted in Note 3(c), beginning in 2007 investment transaction costs are expensed as incurred. Prior to 2007, transaction costs were included in investment cost on purchases, and netted against realized gains and losses on sales. The change in accounting policy has been applied retrospectively, without restatement of prior periods. As a result, there is no comparative restatement of 2006 transaction costs. The effect of the new accounting treatment for the year ended December 31, 2007 was to increase income from equities as follows:

<i>(in thousands of dollars)</i>	Realized gain	Unrealized gain	2007 Total
Equities – Canada	\$ 870	\$ 693	\$ 1,563
Equities – United States	674	803	1,477
Equities – Other International	1,940	3,820	5,760
	<u>\$ 3,484</u>	<u>\$ 5,316</u>	<u>\$ 8,800</u>

Real estate transaction costs are included in real estate fees, as follows:

<i>(in thousands of dollars)</i>	Realized gain	Unrealized gain	2007 Total
OPB Realty Inc.	\$ 180	\$ 232	\$ 412
Other	159	-	159
	<u>\$ 339</u>	<u>\$ 232</u>	<u>\$ 571</u>

Total transaction costs in 2006 were \$6.68 million for equities, and \$59 thousand for real estate.

#### Note 10 CONTRIBUTIONS

For the Year Ended December 31

<i>(in thousands of dollars)</i>	2007	2006
<b>Members</b>		
Current service	\$ 191,376	\$ 178,521
Prior service	8,825	7,082
	<u>200,201</u>	<u>185,603</u>
<b>Employers</b>		
Current service		
Regular contributions	191,953	180,943
PSSBA transfer	(10,177)	(10,010)
Long Term Income Protection	6,020	4,740
	<u>187,796</u>	<u>175,673</u>
Prior service	4,471	3,117
Special Payments	59,390	60,516
	<u>251,657</u>	<u>239,306</u>
<b>Total contributions</b>	<u>\$ 451,858</u>	<u>\$ 424,909</u>

The contribution requirements are set out in the *PSPAct* and summarized in Note 2(b).

Members who are receiving benefits on Long Term Income Protection ("LTIP") have their contributions to the PSPP paid by their employers.

The Province contributes Special Payments towards the funding shortfall identified in the filed funding valuation as at December 31, 2005.

**Note 11 OPERATING EXPENSES**

For the Year Ended December 31

*(in thousands of dollars)*

	2007	2006
Staffing	\$ 13,327	\$ 11,297
Information technology and project management	5,448	3,891
Office premises and operations	3,470	3,293
Professional services	2,106	1,294
Staff development and support	964	891
Communication	626	649
Depreciation	568	508
Audit	338	213
Board remuneration	169	154
<b>Total operating expenses</b>	<b>\$ 27,016</b>	<b>\$ 22,190</b>

Fees for services provided by the firm of Ernst &amp; Young LLP include:

For the Year Ended December 31

	2007	2006
<i>(in thousands of dollars)</i>		
Audit and related services provided to Ontario Pension Board	\$ 82	\$ 175
Audit and related services provided to OPB Realty Inc.	123	149
<b>Total fees</b>	<b>\$ 205</b>	<b>\$ 324</b>

**Note 12 COMPENSATION**

Compensation to the senior management team includes base salary, incentives, insured benefits and supplementary retirement incentives. Compensation totals, excluding retirement benefits, for the President & CEO and all positions reporting directly to the President & CEO:

	Year	Base Salary	Incentives <sup>1</sup>	Taxable Benefits & Allowances <sup>2</sup>	Total
For the Year Ended December 31					
Donald D. Weiss, President & CEO	2007	\$ 358,672	128,250	\$ 16,188	\$503,110
	2006	333,742	125,625	15,915	475,282
Mark J. Fuller, Executive Vice-President & COO	2007	332,648	117,992	11,304	461,944
	2006	299,032	112,551	13,561	425,144
Anne-Marie Thomas, Senior Vice-President, Investments	2007	297,470	97,960	11,357	406,807
	2006 <sup>3</sup>	82,213	36,231	2,833	121,277
Linda J. Bowden, Senior Vice-President, Corporate Services	2007	258,617	85,180	10,009	353,806
	2006	232,976	87,715	9,965	330,656

<sup>1</sup>Incentives earned in 2006 were paid during 2006. Incentives earned in 2007 are to be paid in March 2008.<sup>2</sup>Includes life insurance, car allowance and parking.<sup>3</sup>Start date of September 18, 2006.

Compensation for the President & CEO is approved by the Board. Compensation for the Executive and Senior Vice-Presidents is approved by the Human Resources Committee of the Board. Incentives are performance-based.

The above-noted individuals are entitled to benefits from both the PSPP and the PSSBA.

The President & CEO, the Executive Vice-President & COO, the Senior Vice-President, Corporate Services and the Senior Vice-President, Investments also participate in a Supplemental Executive Retirement Plan ("SERP") that provides additional retirement benefits equal to 1.5% of the best five-year average annual base salary for each year of service with the Ontario Pension Board. All the other provisions of the SERP mirror the provisions of the PSPP, including the exclusion of incentives from the pension entitlement calculation. The SERP is an unregistered arrangement that is non-contributory and not funded.

**Note 13 COMPARATIVE FIGURES**

Certain comparative figures have been restated to conform with the financial statement presentation adopted in 2007.

**Fixed Income Maturities**

As at December 31

<i>(in thousands of dollars)</i>	<b>Fair Value</b>	<b>2007 Effective Yield %</b>	<b>Fair Value</b>	<b>2006 Effective Yield %</b>
<b>Special Province of Ontario Debentures</b>				
0 – 1 year	\$ 198,385	12.89	\$ 163,772	15.38
1 – 5 years	1,267,373	10.38-13.33	1,157,406	11.55 – 13.33
5 – 10 years	860,616	11.10-11.19	1,235,096	10.38 – 11.19
Accrued interest	140,145		157,084	
	<b>2,466,519</b>		<b>2,713,358</b>	
<b>Bonds</b>				
Canada				
0 – 1 year	92,770	3.55-5.71	34,774	3.01 – 6.74
1 – 5 years	830,292	3.60-8.27	682,711	3.58 – 8.22
5 – 10 years	730,911	3.89-7.53	959,483	3.93 – 7.41
> 10 years	842,535	4.31-6.89	771,704	4.04 – 6.32
PH&N Bond Fund: 1-29 years	352,572	5.53	252,759	4.62
Accrued interest	21,442		25,484	
	<b>2,870,522</b>		<b>2,726,915</b>	
United States and other international				
0 – 1 year	-		84,575	2.64 – 7.12
1 – 5 years	351,220	2.87-5.94	163,281	3.08 – 6.00
5 – 10 years	261,527	3.68-6.82	211,082	2.81 – 6.80
> 10 years	158,577	4.33-6.70	49,589	4.30 – 5.28
Accrued interest	13,966		9,018	
	<b>785,290</b>		<b>517,545</b>	
	<b>\$ 6,122,331</b>		<b>\$ 5,957,818</b>	

## Investments over \$20 Million

As at December 31, 2007

<i>(in thousands of dollars)</i>	Maturities	Coupon %	Fair Value <sup>1</sup>
<b>Cash and short-term investments</b>			
Canada			
Government of Canada			\$ 569,561
Province of Ontario			63,162
Toronto-Dominion Bank			37,578
Bon TRQC			36,663
Province of British Columbia			32,219
Alberta Treasury			31,078
Bank of Nova Scotia			27,133
Financement			23,589
<b>Fixed income</b>			
Special Province of Ontario Debentures <sup>2</sup>	2008-2014	10.38 - 13.38	\$ 2,326,373
<b>Bonds</b>			
Canada			
Government of Canada	2008-2037	3.55 - 10.35	884,095
Phillips, Hager & North High Grade Corporate Bond Fund	2009-2036	3.75 - 7.78	352,572
Province of Ontario	2009-2037	4.30 - 9.50	349,141
Province of Quebec	2010-2036	4.50 - 6.25	103,608
Royal Bank of Canada	2010-2053	4.45 - 7.10	86,384
Toronto-Dominion Bank	2009-2106	4.25 - 7.60	65,659
Bank of Nova Scotia	2008-2017	3.99 - 6.63	51,678
Canadian Imperial Bank of Commerce	2009-2016	3.75 - 5.89	47,066
Sun Life Financial Inc.	2015-2036	4.80 - 6.65	42,351
Power Corporation	2011-2067	5.69 - 6.75	41,574
Manulife Financial Corporation	2012-2041	4.67 - 6.70	40,831
Province of British Columbia	2012-2037	4.70 - 8.75	40,688
Merrill Lynch	2009-2037	4.17 - 6.79	37,073
Bank of Montreal	2009-2021	4.30 - 6.90	31,867
GE Capital	2009-2037	4.38 - 6.25	31,038
Woodbine Entertainment Group	2011	8.58	29,629
Wells Fargo Financial	2009-2015	3.60 - 6.05	28,622
Enbridge Inc.	2010-2036	5.00 - 6.90	27,863
Ontario Hydro	2014-2025	8.50 - 10.00	23,952
Province of New Brunswick	2010-2039	4.50 - 6.75	23,925
Greater Toronto Airports Authority	2011-2017	4.40 - 6.25	23,477
Loblaw Companies Limited	2010-2036	5.90 - 7.10	22,980
Province of Manitoba	2008-2038	4.60 - 6.50	22,452
United States and other international			
Government of France	2009-2025	3.00 - 6.00	318,086
U.K. Treasury	2009-2014	5.00 - 8.00	179,780
Federal Republic of Germany	2009-2034	4.50 - 5.63	101,179
Kingdom of Belgium	2015	8.00	54,730
Santander International Debt	2011	4.89	20,116

**Investments over \$20 Million** *(continued)*

As at December 31, 2007

<i>(in thousands of dollars)</i>	Maturities	Coupon %	Fair Value <sup>1</sup>
<b>Real estate</b>			
OPB Realty Inc. (holding company, 100% owned)			\$ 2,302,364
<b>Participating mortgages</b>	2019	5.00	20,855

<i>in thousands)</i>	Shares/Units <sup>3</sup>	Fair Value <sup>3</sup>
<b>Equities</b>		
Canada		
Royal Bank of Canada	2,421	\$ 122,845
Manulife Financial Corporation	2,772	112,447
EnCana Corporation	1,558	105,182
Potash Corporation of Saskatchewan, Inc	723	103,708
Toronto-Dominion Bank	1,442	100,214
Bank of Nova Scotia	1,991	100,124
Sceptre Small Cap Fund	718	96,882
Suncor Energy Inc.	742	80,104
Rogers Communications Inc.	1,737	78,139
Petro-Canada	1,009	53,708
Canadian Imperial Bank of Commerce	741	52,292
Power Corporation of Canada	1,236	50,178
Nexen Inc.	1,532	49,189
Canadian National Railway Company	1,031	48,109
TransCanada Corp.	1,104	44,775
TELUS Corporation	823	40,041
Bank of Montreal	599	33,718
Talisman Energy Inc.	1,821	33,485
Agrium Inc.	461	33,008
Canadian Natural Resources Limited	446	32,350
Great-West Lifeco Inc.	871	30,993
Shaw Communications Inc.	1,295	30,605
Cameco Corporation	761	30,125
BCE Inc.	728	28,852
Canadian Pacific Railway Ltd.	428	27,487
Shoppers Drug Mart Corporation	514	27,381
Goldcorp Inc.	804	27,172
Husky Energy Inc.	588	26,197
Thomson Corporation	614	24,739
Brookfield Asset Management Inc.	676	23,975
Teck Cominco Limited	612	21,677
Research In Motion Limited	189	21,313
Jarislowsky Fraser Special Equity Fund	907	21,201
SNC-Lavalin Group Inc.	423	20,341



**Investments over \$20 Million** *(continued)*

As at December 31, 2007

<i>(in thousands)</i>	Shares/Units <sup>3</sup>	Fair Value <sup>3</sup>
United States		
General Electric Co .	1,958	\$71,634
Johnson & Johnson	976	64,269
Pfizer Inc.	2,843	63,774
ConocoPhillips Pfizer Inc.	713	62,171
Exxon Mobil Corp.	672	62,115
Chevron Corporation	604	55,680
Procter & Gamble Co.	612	44,334
Microsoft Corp.	1,149	40,388
Wal-Mart Stores Inc.	857	40,220
Cisco Systems, Inc	1,466	39,155
CVS Corp.	958	37,572
AT&T Inc.	898	36,835
Alcoa Inc.	1,003	36,163
Berkshire Hathaway Inc.	8	36,155
Illinois Tool Works Inc.	683	36,075
American International Group, Inc.	621	35,744
Emerson Electric Co.	593	33,149
The Allstate Corporation	635	32,744
Intel Corp.	1,218	32,048
Altria Group, Inc.	390	29,095
PepsiCo, Inc.	381	28,534
Wells Fargo & Co.	941	28,050
Colgate-Palmolive Company	337	25,937
Bank of America	608	24,767
JPMorgan Chase & Co.	573	24,698
The Hartford Financial Services Group, Inc.	264	22,741
Wachovia Corp	603	22,650
Kimberly-Clark Corporation	330	22,577
Comcast Corporation	1,256	22,545
Anheuser-Busch Cos., Inc.	425	21,949
McDonald's Corporation	373	21,700
Tim Hortons Inc.	556	20,368
Abbott	366	20,277
Valero Energy Corporation	290	20,018

**Investments over \$20 Million (continued)**

As at December 31, 2007

<i>(in thousands)</i>	Shares/Units <sup>3</sup>	Fair Value <sup>3</sup>
Other international		
Leith Wheeler International Pool Fund	4,658	\$ 75,487
Total S.A.	588	48,252
Vodafone Group	11,712	43,213
Roche Holdings	227	38,720
E.ON AG	184	38,613
BNP Paribas	318	34,095
Siemens	215	33,790
Nokia	881	33,706
Nestlé	73	33,144
Bayer	347	31,319
Royal Bank of Scotland	3,122	27,233
sanofi-aventis	288	26,168
Mitsubishi UFJ Financial Group	2,781	25,724
Royal Dutch Shell	611	25,360
HBOS	1,392	20,103
BASF SE	137	20,062

<sup>1</sup> Excludes accrued income; includes guaranteed instruments issued by subsidiaries/agencies<sup>2</sup> At cost<sup>3</sup> Includes all share classes and American Depositary Receipts

## Real Estate Properties

All properties are 100% owned by Ontario Pension Board through its subsidiary OPB Realty Inc.

As At December 31, 2007  
(in thousands of square feet)

	Location	Area
<b>Retail</b>		
Hillside Centre	Victoria	425
Brentwood Town Centre	Burnaby	516
Lougheed Town Centre	Burnaby	657
Aberdeen Village Centre	Kamloops	104
Christy's Corner	Edmonton	111
Marlborough Mall	Calgary	510
Portland Place	Calgary	149
Gaetz Avenue Crossing	Red Deer	177
St. Vital Centre	Winnipeg	926
Pen Centre	St. Catharines	1,007
Pickering Town Centre	Pickering	890
Carlingwood Shopping Centre	Ottawa	511
Halifax Shopping Centre	Halifax	526
Halifax Shopping Centre Annex	Halifax	419
2003 Gottingen Street	Halifax	25
215 Chain Lake Drive	Halifax	65
		7,018
<b>Office</b>		
Marlborough Professional Bldg.	Calgary	51
One Queen Street East / 20 Richmond Street East	Toronto	502
Halifax Office Complex	Halifax	114
		667
<b>Industrial</b>		
Mississauga Industrial	Mississauga	2,885
Burnside Industrial Park	Halifax	498
Wright Place	Halifax	107
		3,490
<b>Total properties</b>		<b>11,175</b>

**Financial Services  
Commission  
of Ontario**Deputy Superintendent  
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services financiers  
de l'Ontario**Surintendant adjoint  
Division des régimes de retraite5160, rue Yonge  
boîte 85 8<sup>e</sup> étage  
Toronto ON M2N 6L9Téléphone: (416) 226-7795  
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May 30, 2008

**Pension Benefit Guarantee Fund  
Management's Responsibility for Financial Information**

The Superintendent of the Financial Services Commission of Ontario ("FSCO") pursuant to the *Financial Services Commission of Ontario Act, 1997* is responsible for the administration of the Pension Benefit Guarantee Fund.

Under the direction of the Superintendent, Management of FSCO is responsible for the integrity and fair presentation of all information in the financial statements and notes. The financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles. The preparation of financial statements involves the use of management's judgement and best estimates particularly when transactions affecting the current period cannot be determined with certainty until future periods.

Management of FSCO, in the administration of the Pension Benefit Guarantee Fund, is dedicated to the highest standards of integrity in provision of its services. Management has developed and maintains financial controls, information systems and practices to provide reasonable assurances on the reliability of financial information and safeguarding of its assets.

The financial statements have been audited by the Office of 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 Canadian generally accepted accounting principles. They have been approved by the Commission's Audit Committee. The Auditor's report follows.

Yours very truly,

A handwritten signature in black ink, appearing to read 'K. David Gordon'.

K. David Gordon  
Deputy Superintendent, Pensions

A handwritten signature in black ink, appearing to read 'D. Pejic'.

Darinka Pejic  
Chief Accountant



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

*Auditor's Report*

To the Financial Services Commission of Ontario  
and to the Minister of Finance

I have audited the balance sheet of the Pension Benefits Guarantee Fund of the Financial Services Commission of Ontario as at March 31, 2008 and the statements of operations and fund deficit and cash flows for the year then ended. These financial statements are the responsibility of the Commission'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 Commission's pension benefits guarantee fund as at March 31, 2008 and the results of its operations and its cash flows for the year then ended, in accordance with Canadian generally accepted accounting principles.

Gary R. Peall, CA  
Deputy Auditor General  
Licensed Public Accountant

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Toronto, Ontario  
May 30, 2008

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**FINANCIAL SERVICES COMMISSION OF ONTARIO****Pension Benefits Guarantee Fund****Balance Sheet****As at March 31, 2008**

	<b>2008</b> <b>(\$ '000)</b>	<b>2007</b> <b>(\$ '000)</b>
<b>ASSETS</b>		
<b>Current</b>		
Cash	100	66
Accounts receivable	46,600	54,151
Investments (Note 4)	128,457	98,026
	<u>175,157</u>	<u>152,243</u>
<b>LIABILITIES AND FUND DEFICIT</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	3,394	5,499
Current portion of loan payable	11,000	11,000
Claims payable	116,452	99,138
	<u>130,846</u>	<u>115,637</u>
<b>Loan payable (Note 5)</b>	<u>146,529</u>	<u>149,447</u>
	277,375	265,084
<b>Fund deficit</b>	<u>-102,218</u>	<u>-112,841</u>
	<u>175,157</u>	<u>152,243</u>

See accompanying notes to financial statements

Approved by:



Chief Executive Officer  
and Superintendent of Financial Services  
Financial Services Commission of Ontario

## FINANCIAL SERVICES COMMISSION OF ONTARIO

**Pension Benefits Guarantee Fund**  
**Statement of Operations and Fund Deficit**  
**For the year ended March 31, 2008**

	<b>2008</b> <b>(\$ '000)</b>	<b>2007</b> <b>(\$ '000)</b>
<b>Revenue</b>		
Premium revenue	31,939	45,571
Investment income (Note 4)	5,411	4,254
Recoveries (Note 6)	37,819	8,125
	<u>75,169</u>	<u>57,950</u>
<b>Expenses</b>		
Claims	55,616	31,995
Pension management fees (Note 6)	430	859
Investment management fees (Note 7)	41	42
Administration fee (Note 7)	375	370
Unrealized loss / (gain) in the market value of investments	3	-160
Amortization of loan discount	8,081	8,221
	<u>64,546</u>	<u>41,327</u>
<b>Excess of revenue over expenses</b>	10,623	16,623
<b>Fund deficit, beginning of year</b>	-112,841	-274,238
Prospective change in accounting policy for loan payable (Note 5)		144,774
<b>Fund deficit, beginning of year as restated</b>		(129,464)
<b>Fund deficit, end of year</b>	<u><u>-102,218</u></u>	<u><u>(112,841)</u></u>

See accompanying notes to financial statements

## FINANCIAL SERVICES COMMISSION OF ONTARIO

## Pension Benefits Guarantee Fund

## Statement of Cash Flows

For the year ended March 31, 2008

	2008 (\$ '000)	2007 (\$ '000)
<b>Net inflow (outflow) of cash related to the following activities</b>		
<b>Cash flows from operating activities</b>		
Excess of revenue over expenses	10,623	16,623
Add items not affecting cash:		
Unrealized loss (gain) on investments	3	-160
Amortization of loan discount	8,081	8,221
	<u>18,707</u>	<u>24,684</u>
Changes in non cash working capital		
Accounts receivable	7,551	9,826
Accounts payable	-2,105	97
Claims payable	17,314	-4,926
	<u>41,467</u>	<u>29,681</u>
<b>Cash flows from investing activities</b>		
Purchases of investments	(2,387,106)	-1,624,425
Proceeds from sale of investments	2,356,673	1,605,652
	<u>-30,433</u>	<u>-18,773</u>
<b>Cash flows from financing activities</b>		
Loan repayment	-11,000	-11,000
	<u>-11,000</u>	<u>-11,000</u>
<b>Change in cash position</b>	34	-92
<b>Cash position, beginning of year</b>	66	158
<b>Cash position, end of year</b>	<u><u>100</u></u>	<u><u>66</u></u>

See accompanying notes to financial statements



**FINANCIAL SERVICES COMMISSION OF ONTARIO****Pension Benefits Guarantee Fund****Notes to the Financial Statements****March 31, 2008**

---

**1. STATUTORY AUTHORITY**

The Pension Benefits Guarantee Fund (the “Fund”) is continued under the *Pension Benefits Act, R.S.O. 1990, c. P.8* (the “Act”).

**2. FUND OPERATIONS**

The purpose of the Fund is to guarantee payment of certain pension benefits of certain defined benefit pension plans wound up under conditions specified in the *Act* and regulations thereto. The regulations also prescribe an assessment payable into the Fund by plan registrants.

The Act provides that if the assets of the Fund are insufficient to meet payments for claims, the Lieutenant Governor in Council may authorize the Minister of Finance of Ontario to make loans on such terms and conditions as the Lieutenant Governor in Council directs. The total liability of the Fund to guarantee pension benefits is limited to the assets of the Fund plus any loans received from the Province.

The Superintendent of the Financial Services Commission of Ontario (“FSCO”) pursuant to the *Financial Services Commission of Ontario Act, 1997* is responsible for the administration and the investment of the assets of the Fund. The Fund reimburses FSCO for the cost of the services provided.

**3. SIGNIFICANT ACCOUNTING POLICIES**

The financial statements of the Fund have been prepared by the management of FSCO in accordance with Canadian generally accepted accounting principles. The significant accounting policies used to prepare these statements are summarized below.

**(a) Financial Instruments**

The Fund follows the accounting standards issued by the Canadian Institute of Chartered Accountants pertaining to financial instruments. Under these standards, all financial instruments, are included on the balance sheet and are measured either at fair market value, or in limited circumstances, at cost or amortized costs. The Fund has classified its financial instruments into the following categories:

- Cash and investments are classified as held for trading and recorded at fair value, with changes in fair value during the period recognized in the statement of operations.

**FINANCIAL SERVICES COMMISSION OF ONTARIO****Pension Benefits Guarantee Fund  
Notes to the Financial Statements  
March 31, 2008**

---

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

- Accounts receivable is classified as loans and receivables and valued at face value which approximates fair value given their short term maturities.
- Accounts payable and accrued liabilities are classified as other financial liabilities and are recorded at face value which approximates fair value given their short term maturities.
- Loan Payable is classified as other financial liabilities, and due to the concessionary nature of the loan is reflected at amortized cost using the effective interest rate method (Note 5).

**(b) Claims payable**

Claims payable are liabilities in respect of those defined benefit pension plans prescribed by the Act that are wound up or in the process of being ordered wound up under conditions specified in the Act, and the amounts can be reasonably estimated. Claims payable are based on information provided by appointed pension plan administrators. These estimates represent the present value of future payments to settle claims for benefits and expenses by pension plans.

Adjustments to the liabilities, if any, between the amounts recognized based on estimates and the actual claims made, will be charged or credited to the provision for claims in the year when the actual amounts are determined.

The actual claims are reviewed and verified by FSCO's Chief Actuary and approved by FSCO's management before any funds are paid out of the PBGF.

**(c) Premium revenue**

An estimate of the premium revenue due from defined benefit pension plans at rates prescribed by the Act is recorded until receipt of the annual assessment certificate nine months after the plan's fiscal year end.

Adjustments to premium revenue, if any, between the estimated amounts recognized and the actual revenues due are charged or credited to revenue in the year when the actual amounts are determined.

## FINANCIAL SERVICES COMMISSION OF ONTARIO

**Pension Benefits Guarantee Fund**  
**Notes to the Financial Statements**  
**March 31, 2008**

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)****(d) Use of Estimates**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires that FSCO's management make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent liabilities as at the date of the financial statements and the reported amounts of revenue and expenses for the period. Estimates and assumptions may change over time as new information is obtained or subsequent developments occur. Actual results could differ from these estimates.

**4. INVESTMENTS**

As administrator of the investment assets of the Fund, FSCO has formed a PBGF Management Committee, developed Investment Policies and Guidelines and appointed the Ontario Financing Authority, a related party, as investment manager. The statement provides operational objectives, investment principles, policies and guidelines for the management of the investments and is reviewed bi-annually.

Investments consist of:

	2008 (\$'000)		2007 (\$'000)	
	Market Value	Cost	Market Value	Cost
Short term deposits	128,457	128,458	89,824	89,824
Government and corporate bonds	-	-	8,202	8,200
	<u>128,457</u>	<u>128,458</u>	<u>98,026</u>	<u>98,024</u>

**FINANCIAL SERVICES COMMISSION OF ONTARIO****Pension Benefits Guarantee Fund  
Notes to the Financial Statements  
March 31, 2008**

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**4. INVESTMENTS (cont'd)**

The Fund's investment portfolio is exposed to various risks, which are mitigated by the type of investment and therefore risk is low. The associated risks with the investments are as follows:

**Interest rate and Liquidity risk:**

Short term deposits have yields in the range of 1.9% to 3.7% (2007 – 4.2% to 4.6%) and there are no government and corporate bonds for the current year (2007 – yields in the range of 4.4% to 4.5%). At March 31, 2008, a 1% move in interest rates could impact the market value by approximately \$300 thousand. Short term deposits represent instruments in highly liquid investments that are readily converted into known amounts of cash.

Investment income includes interest earned from interest bearing securities and realized gains/losses from the sale of securities. The realized gain on the sale of securities amounted to \$180 (2007 – realized gain of \$304 thousand). Unrealized changes in the market value of investments are reflected separately on the statement of operations and fund deficit.

**5. LOAN PAYABLE**

On March 31, 2004, the Fund obtained a \$330 million loan from the Province, a related party. The loan is non-interest bearing and repayable to the Province in thirty equal annual installments of \$11 million. The loan agreement provides for the Minister of Finance to advance any installment payment date depending on the cash position of the Fund. Repayments over the next five years total \$55 million.

Effective April 1, 2006, the Fund adopted the new CICA standard on Financial Instruments. The new standard requires that loans payable be reflected at their fair value. As the loan from the Province confers a benefit to the Fund in that it is interest free, a fair value is determined by discounting future cash flows using the Provincial cost of borrowing (5.04%). The resulting benefit (the difference between the face value of the loan and the net present value) is accounted for as a grant in the year the loan was received and is amortized to loan discount expense over the term of the loan.

## FINANCIAL SERVICES COMMISSION OF ONTARIO

## Pension Benefits Guarantee Fund

## Notes to the Financial Statements

March 31, 2008

## 5. LOAN PAYABLE (cont'd)

As required by the standard, this accounting change was applied prospectively from April 1, 2006. Accordingly, as of April 1, 2006, the carrying value of Loan Payable was decreased by \$144,774 thousand to recognize the amount of the unamortized discount, and the opening balance of the Fund Deficit was decreased by the same amount.

The face value of this non-interest bearing loan has been discounted to reflect its fair value outstanding as of March 31, 2008 as follows:

	2008 (\$'000)	2007 (\$'000)
Face Value	286,000	297,000
Less: Discount	<u>(128,471)</u>	<u>(136,553)</u>
Fair Value	<u>157,529</u>	<u>160,447</u>
Classified as:		
Current Portion	11,000	11,000
Long Term Portion	<u>146,529</u>	<u>149,447</u>
Balance	<u>157,529</u>	<u>160,447</u>

The discount will be amortized to loan discount expense over the term of the loan based on the effective interest rate method. Amortization for the current year and for the subsequent four fiscal years is as follows:

	(\$'000)
2008	8,081
2009	7,934
2010	7,780
2011	7,618
2012	7,447

**FINANCIAL SERVICES COMMISSION OF ONTARIO****Pension Benefits Guarantee Fund  
Notes to the Financial Statements  
March 31, 2008**

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**6. PENSION MANAGEMENT FEES AND RECOVERIES**

The Fund periodically engages the services of experts to represent the Fund's interests with respect to companies which have made claims against the Fund. During fiscal 2008, \$430 thousand was paid to such experts related to negotiations involving one company (2007 - \$859 thousand involving three companies) .

Following distribution of claims and submission of a final wind up report any remaining funds are recovered by the Fund. During fiscal 2008, \$37,819 thousand (2007 - \$8,125 thousand) in recoveries were made by the Fund.

**7. ADMINISTRATION FEE AND RELATED PARTY TRANSACTIONS**

For fiscal 2008, an administration fee of \$375 thousand (2007 - \$370 thousand) was incurred and has been paid to FSCO for management salaries and benefits, accounting, information technology, legal, pension and other services. The Fund and FSCO are related parties.

Investment Management fees of \$36 (2007 - \$36) were paid to the Ontario Financing Authority. The Fund and Ontario Financing Authority are related parties.

The costs of processing of premium revenue transactions are absorbed by FSCO without charge to the Fund.

**8. CONTINGENCIES AND SUBSEQUENT EVENT**

In the ordinary course of the Fund's business, there are a number of companies operating under CCAA protection whose plans could make claims upon the Fund. The outcome and the amount of such potential claims are not determinable at this time.

A substantial recovery of funds for the PBGF is expected in 2009. Neither the amount nor the timing of the recovery can be determined at this point of time with any degree of certainty.





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

## PROVINCIAL JUDGES PENSION PLAN

### *Auditor's Report*

To the Provincial Judges Pension Board  
and to the Minister of Finance

I have audited the statement of changes in fund balance of the Provincial Judges Pension Fund for the year ended March 31, 2008. As described in note 2, this financial statement has been prepared to comply with section 34 of Ontario Regulation 67/92 under the *Courts of Justice Act*. This financial statement is the responsibility of the Fund's management. My responsibility is to express an opinion on this financial statement 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 statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. 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, this financial statement presents fairly, in all material respects, the changes in fund balance for the year ended March 31, 2008 in accordance with the accounting policy described in note 2 to the financial statement.

This financial statement, which has not been, and was not intended to be, prepared in accordance with Canadian generally accepted accounting principles, is solely for the information and use of the Provincial Judges Pension Board and the Minister of Finance for the purpose of fulfilling their fiduciary and custodial responsibilities under Regulation 67/92 of the *Courts of Justice Act*. This financial statement is not intended to be and should not be used by anyone other than the specified users or for any other purpose.

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Toronto, Ontario  
April 25, 2008

Gary R. Peall, CA  
Deputy Auditor General  
Licensed Public Accountant




# Provincial Judges Pension Fund

## Statement of Changes in Fund Balance For the Year Ended March 31, 2008

	2008 (\$ 000)	2007 (\$ 000)
<b>Deposits</b>		
Contributions		
Participants	4,122	3,977
Province of Ontario (Note 4)	23,558	22,652
Interest earned	35,362	33,527
	<u>63,042</u>	<u>60,156</u>
<b>Payments</b>		
Pension payments and survivor allowances (Note 4)	<u>22,581</u>	<u>21,675</u>
<b>Net increase in the Fund</b>	40,461	38,481
<b>Fund Balance on deposit with the Minister of Finance (Note 4)</b>		
Beginning of year	<u>467,465</u>	<u>428,984</u>
End of year	<u>507,926</u>	<u>467,465</u>

See accompanying notes to financial statements.

Approved on behalf of the Board:



Chair

# Provincial Judges Pension Fund

## Notes to Financial Statement

March 31, 2008

---

### 1. Description of the Fund

The Provincial Judges Pension Fund (the Fund), is administered by the Provincial Judges Pension Board as designated by Ontario Regulation 67/92, as amended, of the *Courts of Justice Act*. The following brief description of the Fund is provided for general purposes only. For more complete information, reference should be made to the Regulation.

#### (A) GENERAL

The purpose of the Fund is to provide pension payments to retired Provincial Judges and Masters who are members of the Plan or survivor allowances to the dependents of these Judges and Masters.

#### (B) FUNDING POLICY

Participants are required to contribute 7% of their salary to the earlier occurrence of meeting their basic service requirement or attaining age 70 years.

The contribution required from the Province is determined by an actuarial valuation as described in note 4.

#### (C) PENSION PAYMENTS

A pension payment is available based on the age and the number of years of full-time service for which the participant has credit upon ceasing to hold office and is based on the salary of a full-time judge of the highest judicial rank held by the participant while in office. The participant is entitled to these payments during his/her lifetime.

#### (D) DISABILITY PENSION PAYMENTS

A full pension is available at age 65 for participants with a minimum of five years of full-time service who are unable to serve in office due to injury or chronic illness.

#### (E) SURVIVOR ALLOWANCES

A survivor allowance equal to 60% of the pension payment is paid to the spouse during the spouse's lifetime or to children who meet the age, custody, education or disability criteria defined in section 22 of the Regulation.

#### (F) DEATH REFUNDS

A death refund is payable to the personal representative of a participant where there is no further entitlement to a survivor allowance. The amount of the refund is equal to the participant's contributions in the Fund plus interest, less entitlements already paid out.

#### (G) WITHDRAWAL REFUNDS

Upon ceasing to hold office for a reason other than death, participants not eligible to receive pension payments are entitled to receive a refund of their contributions to the Fund plus interest.

# Provincial Judges Pension Fund

## Notes to Financial Statement

March 31, 2008

---

### 1. Description of the Fund (Continued)

#### (H) INTEREST REVENUE

Interest is credited to the Fund based on a calculation specified by Order-in-Council as follows:

- to the beginning balance based on the weighted averaged interest rates applicable to 25-year securities issued or guaranteed by the Province since the inception of the fund (7.55% on the April 1, 2007 balance);
- on the monthly excess of contributions over payments during the year at the estimated 25-year rate for the year, with adjustments to actual made the following year.

#### (I) FUND STATUS

The Fund is not subject to the reporting requirements under the *Pension Benefits Act* and Regulations.

#### (J) ESCALATION OF ENTITLEMENTS

Entitlements are adjusted annually based on changes in the weekly wages and salaries of the Industrial Aggregate in Canada as published by Statistics Canada, subject to a maximum of 7% in any one year.

#### (K) FUNDING OF SUPPLEMENTARY BENEFITS

The *Income Tax Act (Canada) (ITA)* limits the pension benefit payable from the Fund for post 1991 service. Cabinet has approved that benefits above the ITA limit will be provided through a separate supplementary account in the Consolidated Revenue Fund.

The terms of the Fund are being revised to comply with the requirements under the ITA, and an Order-in-Council will be required to establish the supplementary account. The Canada Revenue Agency is aware of the status of the supplementary account. Once the account is established, there will be a settlement between the account and the Fund, both of which are to be held within the Consolidated Revenue Fund of the Province of Ontario.

### 2. Significant Accounting Policies

The financial statement has been prepared on a basis of accounting consistent with section 34 of Ontario Regulation 67/92 under the *Courts of Justice Act* which states that the Fund shall consist of contributions and money paid, transferred or credited to the Fund, less money paid out.

### 3. Administrative Expenses

Administrative expenses are paid by the Province of Ontario.

# Provincial Judges Pension Fund

## Notes to Financial Statement

March 31, 2008

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### 4. Liability for Future Benefits

The Provincial Judges Remuneration Commission was established under Ontario Regulation 407/93 under the *Courts of Justice Act*, to conduct an independent process to determine the salary, benefits and pensions for all provincial judges. The Commission's salary and benefits recommendations are binding; pensions recommendations are non-binding. The Plan provides that pensioners receive increases in their pensions based on the same percentage increase in active judges' salaries. The combined report of the Sixth and Seventh Triennial Provincial Judges Remuneration Commission regarding the salaries, benefits and pensions of judges for the six-year period from April 1, 2004 to March 31, 2010 was tabled on April 25, 2008. The Commission endorsed the recommendations of a joint submission from both the Province and the Ontario Conference of Judges.

Over and above the Industrial Aggregate Index increases in judges' salaries for the three-year period from April 1, 2004 to March 31, 2007, the Commission recommended an increase in the salaries that amounted to approximately 3%; and changes to the Plan provisions effective June 1, 2007. Under the new Plan provisions, all judges appointed on or after June 1, 2007 will have their pensions determined under the new Plan provisions, and all judges not retired as at June 1, 2007 can file an election by October 27, 2008, to have their pensions determined in accordance with the new Plan provisions retroactive to June 1, 2007. The amount of the base pension under the new provisions is approximately 24% higher than under the old provisions, but under the new provisions the annual increase is limited to the Consumer Price Index instead of the same percentage increase in active judges' salaries.

The Lieutenant Governor in Council approved Ontario Regulation 508/07, filed August 27, 2007, which implemented the new plan provisions, and automatically came into force on April 25, 2008, the date the Commission report was tabled and the pensions recommendations of the joint submission became effective.

The Province is responsible for the unfunded liabilities of the Provincial Judges Pension Plan and funds these liabilities in amounts recommended by periodic actuarial valuations of the Plan.

The most recent actuarial valuation of the Plan for funding purposes was completed on data as at March 31, 2006, prior to the report of the Commission and any Plan revisions, and determined that the expected present value of future government contributions was \$236,207,000, and recommended that the Province contribute 36.6% of the payroll of sitting judges until the next valuation. The valuation estimated the Province's contribution for the fiscal year ended March 31, 2008 to be \$23,558,000.

The Province will complete another actuarial valuation of the Plan on data as at March 31, 2008, after October 27, 2008 when the period for judges to file an election expires, which will consider the impact of Regulation 508/07. Once the valuation is completed, the Province will make a catch-up adjustment to its contribution for prior years.

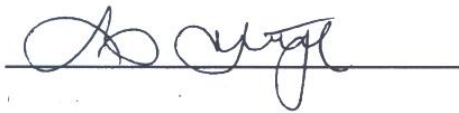


**OFFICE OF THE PUBLIC GUARDIAN AND TRUSTEE****Management's Responsibility for Financial Information**

Management is responsible for the financial statements and all other information presented in the financial statements. The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles, and, where appropriate, include amounts based on Management's best estimates and judgments.

The Office of the Public Guardian and Trustee is dedicated to the highest standards of integrity in provision of its services. Management has developed and maintains financial controls, information systems and practices to provide reasonable assurances on the reliability of financial information and that the assets were safeguarded. Internal audits are conducted to assess management systems and practices and reports are issued to the Public Guardian and Trustee and her management committee.

The financial statements have been examined by the Office of the Auditor General. The Auditor General's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with Canadian generally accepted accounting principles. The Auditor's Report outlines the scope of the auditor's examination and opinion.



Louise Stratford  
Public Guardian and Trustee



Sharon Yetter  
Chief Financial Officer

May 23, 2008



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

***Auditor's Report***

To the Public Guardian and Trustee for the Province of Ontario  
and to the Attorney General

I have audited the balance sheet of The Public Guardian and Trustee for the Province of Ontario as at March 31, 2008 and the statements of revenue and expenses, changes in fund balances and cash flows for the estates and trusts and the administration fund for the year then ended. These financial statements are the responsibility of The Public Guardian and Trustee'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 Public Guardian and Trustee for the Province of Ontario as at March 31, 2008, the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Gary R. Peall, CA  
Deputy Auditor General  
Licensed Public Accountant

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Toronto, Ontario  
May 23, 2008

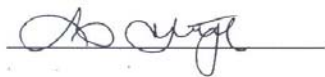
**The Public Guardian and Trustee  
for the Province of Ontario**  
**Balance Sheet**  
**(in thousands of dollars)**

March 31, 2008

	<b>Estates and Trusts</b>		<b>Administration Fund</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Assets</b>				
Cash and cash equivalents	\$ 11,690	\$ 2,443	\$ 122	\$ 47
Accounts receivable	6,104	3,707	1,934	1,882
Bonds and other debt issues	33,021	29,888	-	-
Fixed income funds (Schedule A)	966,377	953,585	15,638	11,227
Diversified fund (Schedule B)	55,423	60,186	55,317	55,793
Canadian income and dividend fund (Schedule C)	37,447	19,586	15,775	15,864
Stocks and other securities	48,386	49,821	-	-
Real estate	76,577	68,271	-	-
Other assets	14,495	13,453	-	-
	<b>1,249,520</b>	<b>1,200,940</b>	<b>88,786</b>	<b>84,813</b>
Deferred special project charges	-	-	8,545	6,703
	<b>\$ 1,249,520</b>	<b>\$ 1,200,940</b>	<b>\$ 97,331</b>	<b>\$ 91,516</b>
<b>Liabilities and Fund Balances</b>				
Accounts payable and accrued liabilities	24,604	22,290	7,000	2,415
Fund balances	1,224,916	1,178,650	90,331	89,101
	<b>\$ 1,249,520</b>	<b>\$ 1,200,940</b>	<b>\$ 97,331</b>	<b>\$ 91,516</b>

**Contingencies (Note 6)**

On behalf of The Public Guardian and Trustee for the Province of Ontario



Public Guardian and Trustee



Chief Financial Officer



**The Public Guardian and Trustee  
for the Province of Ontario**  
**Statement of Revenue and Expenses - Estates and Trusts**  
**(in thousands of dollars)**

For the year ended March 31	2008	2007
<b>Revenue</b>		
Pension	\$ 66,932	\$ 64,232
Social benefits	61,120	56,429
Investment (Schedule E)	48,182	42,393
Other	22,713	25,862
Realized investment appreciation	1,729	6,317
Net unrealized investment (depreciation)/appreciation	(5,155)	4,871
	195,521	200,104
<b>Expenses</b>		
Accommodation	83,716	77,167
Allowances	26,053	23,882
Public Guardian and Trustee fees (Schedule D)	20,815	21,774
Living	9,871	8,840
Taxes	9,666	7,248
Other	8,136	9,532
Real estate	4,733	5,132
Funeral	4,653	4,420
Medical	4,243	3,946
Utilities	2,683	2,374
Insurance	760	785
	175,329	165,100
<b>Excess of revenue over expenses</b>	\$ 20,192	\$ 35,004

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

**The Public Guardian and Trustee  
for the Province of Ontario**  
**Statement of Revenue and Expenses - Administration Fund**  
**(in thousands of dollars)**

<b>For the year ended March 31</b>	<b>2008</b>	<b>2007</b>
<b>Revenue</b>		
Investments - fixed income funds (Schedule A)	\$ (128)	\$ 1,734
Investments - diversified fund (Schedule B)	(924)	2,460
Investments - Canadian income and dividend fund (Schedule C)	(260)	772
Net realized investment appreciation	-	1,898
	(1,312)	6,864
Fees collected (net) (Schedule D)	19,628	20,644
	18,316	27,508
<b>Expenses</b>		
Salaries and wages	23,857	22,124
Employee benefits (Note 4)	2,993	2,740
Services (Note 4)	3,784	2,913
Transportation and communication	1,237	1,257
Supplies and equipment	1,408	696
	33,279	29,730
Amount recovered from the Ministry of the Attorney General (Note 4)	(17,540)	(13,193)
	15,739	16,537
Claims	1,347	398
	17,086	16,935
<b>Excess of revenue over expenses</b>	<b>\$ 1,230</b>	<b>\$ 10,573</b>

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

**The Public Guardian and Trustee  
for the Province of Ontario**

**Statement of Changes in Fund Balances - Estates and Trusts  
(in thousands of dollars)**

**For the year ended March 31, 2008**

	Client Trusts	Minors	Litigants	Deceased Estates (note 2)	Cemetery Trusts	Forfeited Corporate Assets	Corporate Trusts	Land Titles	Total 2008	Total 2007
Balance, beginning of year	\$ 438,587	379,395	215,578	111,660	20,552	8,305	3,078	1,495	\$ 1,178,650	\$ 1,127,507
Excess (deficiency) of revenue over expenses	1,722	9,683	7,473	1,230	(327)	333	1	77	20,192	35,004
Net client capital contribution (distribution)	26,731	(11,273)	(4,208)	14,282	92	(332)	(6)	788	26,074	16,139
Balance, end of year	\$ 467,040	377,805	218,843	127,172	20,317	8,306	3,073	2,360	\$ 1,224,916	\$ 1,178,650

**Statement of Changes in Fund Balances - Administration Fund  
(in thousands of dollars)**

**For the year ended March 31, 2008**

	Special Projects Fund	Assurance Fund	Litigation Reserve Fund	Allowance for Doubtful Accounts Fund	Capacity Assessment Fund	Unappro- priated Fund	Total 2008	Total 2007
Balance, beginning of year	\$ 25,059	\$ 11,000	\$ 3,000	\$ 100	\$ 100	\$ 49,842	\$ 89,101	\$ 78,528
Excess (deficiency) of revenue over expenses	(924)	(1,230)	(103)	-	(14)	3,501	1,230	10,573
Interfund transfers	-	4,530	103	-	14	(4,647)	-	-
Balance, end of year	\$ 24,135	\$ 14,300	\$ 3,000	\$ 100	\$ 100	\$ 48,696	\$ 90,331	\$ 89,101

**The Public Guardian and Trustee  
for the Province of Ontario**  
**Statement of Cash Flows**  
**(in thousands of dollars)**

	<b>Estates and Trusts</b>		<b>Administration Fund</b>	
<b>For the year ended March 31</b>	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Cash was provided by (used in)</b>				
<b>Operating activities</b>				
Excess of revenue over expenses	\$ 20,192	\$ 38,018	\$ 1,230	\$ 10,573
Adjustments to reconcile excess of revenue over expenses to net cash provided by operating activities				
Unrealized depreciation/(appreciation) of investments	5,155	(4,871)	3,126	(1,726)
Accounts receivable	(2,397)	(447)	(52)	1,590
Other assets	(1,042)	(505)	-	-
Accounts payable	2,314	258	4,584	1,994
	<b>24,222</b>	<b>32,453</b>	<b>8,889</b>	<b>12,431</b>
<b>Investing activities</b>				
Net acquisition/redemption of				
Bond and other debt issues	(3,133)	(5,381)	-	-
Fixed income fund investments	(12,792)	(34,347)	(4,411)	(7,285)
Stocks and other securities	530	7,139	-	-
Diversified fund investments	2,278	2,884	(1,891)	11,266
Canadian income and dividend fund	(19,626)	(19,188)	(670)	(15,260)
Real estate	(8,306)	141	-	-
Deferred special project charges	-	-	(1,842)	(1,240)
Net client capital contribution	26,074	13,125	-	-
	<b>(14,975)</b>	<b>(35,627)</b>	<b>(8,814)</b>	<b>(12,519)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>9,247</b>	<b>(3,174)</b>	<b>75</b>	<b>(88)</b>
<b>Cash and cash equivalents, beginning of the year</b>	<b>2,443</b>	<b>5,617</b>	<b>47</b>	<b>135</b>
<b>Cash and cash equivalents, end of the year</b>	<b>\$ 11,690</b>	<b>\$ 2,443</b>	<b>\$ 122</b>	<b>\$ 47</b>

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

## The Public Guardian and Trustee for the Province of Ontario

### Summary of Significant Accounting Policies

March 31, 2008

**Nature of Operations** The Public Guardian and Trustee for the Province of Ontario ("The Public Guardian and Trustee") performs duties under a number of statutes with the following main responsibilities:

- ♦ the management of estates of incapable adults
- ♦ the administration of estates of persons who have died in Ontario intestate and without next-of-kin
- ♦ the gathering of assets reverting to the Crown under the Escheats Act
- ♦ the management of funds, mortgages and securities paid into or lodged with the Accountant of the Superior Court of Justice on behalf of minors and litigants
- ♦ a general supervisory role over charitable property

The Public Guardian and Trustee is exempted from federal and provincial income taxes under the Income Tax Act (Canada).

**Basis of Accounting** The Public Guardian and Trustee prepares its financial statements on an accrual basis and follows Canadian generally accepted accounting principles.

**Estates and Trusts** Estates and Trusts represent accounts over which The Public Guardian and Trustee acts as guardian or trustee under the *Substitute Decisions Act*, the *Public Guardian and Trustee Act*, the *Crown Administration of Estates Act*, the *Estates Act* and various other statutes.

**Administration Fund** The Administration Fund is the operating account of The Public Guardian and Trustee. It is used to accumulate fees charged to each estate and trust for services, as prescribed by the Fee Schedule created pursuant to *The Public Guardian and Trustee Act* and to pay operating expenses.

Cash balances in the Administration Fund which are not required for operating purposes are invested along with the cash funds of Estates and Trusts. The Fund receives the net interest income of these investment activities, after interest is distributed on the funds of Estates and Trusts in accordance with the interest rates prescribed by *The Public Guardian and Trustee Act*.

Funds appropriated for specific purposes are identified below.

#### **Special Projects Fund**

The Special Projects Fund was established to provide funding for significant special projects of The Public Guardian and Trustee. A portion of the income earned from the Unappropriated Fund, invested in the Diversified Fund, Canadian Income and Dividend Fund, and Fixed Income Funds, is included in revenue for the Special Projects Fund. To date, about \$12 million of the funding has been allocated for the development and implementation of a new trust management technology system.

#### **Assurance Fund**

The *Public Guardian and Trustee Act* and the regulations under the Act provide that an Assurance Fund shall be established to meet losses for which The Public Guardian and Trustee might become liable.

During the year the Fund was reimbursed \$1,230,000 (2007 - \$258,058) and increased by transfer of an additional \$3,300,000 (2007 - \$6,000,000) from the Unappropriated Fund.

#### **Litigation Reserve Fund**

The Litigation Reserve Fund is used to cover expenses and costs of legal proceedings paid by The Public Guardian and Trustee on behalf of its litigation clients.

## The Public Guardian and Trustee for the Province of Ontario Summary of Significant Accounting Policies

March 31, 2008

During the year, legal costs incurred on behalf of clients of \$103,241 (2007 –\$115,721) were reimbursed from the Unappropriated Fund.

### **Allowance for Doubtful Accounts Fund**

The intent of the Allowance for Doubtful Accounts Fund is to provide for all clients' accounts whereby The Public Guardian and Trustee has advanced funds on a client's behalf and has a statutory lien pursuant to section 8.1 of the *Public Guardian and Trustee Act* but may not be able to recover the amount from the client.

### **Capacity Assessment Fund**

The Capacity Assessment Fund was set up to cover fees of capacity assessors when a client is unable to pay for the costs of an assessment or re-assessment.

During the year the Fund was reimbursed \$14,058 (2007 - \$24,309) from the Unappropriated Fund.

### **Cash and Cash Equivalents**

Cash and Cash Equivalents includes cash on hand, current bank accounts and short term deposits, if any, with terms to maturity of less than 90 days.

### **Valuation of Financial Instruments**

The Public Guardian and Trustee considers Bonds and Other Debt Issues, the Diversified and Canadian Income and Dividend Funds, and Stocks and Other Securities as financial instruments held for trade. The fair values of these instruments have been determined according to published prices in the active market, where applicable. In determining fair values, adjustments have not been made for transaction costs, as they are not considered to be significant. The change in the difference between the fair value and cost of investments at the beginning and end of each year is reflected in the statements of revenue and expenses.

The Public Guardian and Trustee considers Fixed Income funds which are funds invested in money market instruments and in bonds under a laddered buy-and-hold strategy as financial instruments held to maturity. These financial instruments are reflected in these statements at cost adjusted for the amortization of premiums or discounts on purchase over the period to maturity.

Purchases and sales of these financial instruments are recognized at the settlement date.

The Public Guardian and Trustee is exposed to financial risk as follows:

- Investments are subject to the risk that values will fluctuate due to changes in market interest rates and in foreign exchange rates.
- These risks are mitigated by investing in a diversified portfolio.

**The Public Guardian and Trustee  
for the Province of Ontario  
Summary of Significant Accounting Policies**

March 31, 2008

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**Bonds and other debt issues  
and Stocks and other securities**

Bonds and other debt issues and Stocks and other securities of Estates and Trusts, which are owned by individual clients rather than part of the Public Guardian and Trustee's investment funds, are recorded at year-end quoted market prices where available or the most recently available values received from third parties.

**Other Assets**

Other Assets of Estates and Trusts are recorded at appraised value at the time of taking over the Estates and Trusts.

**Real Estate**

Real Estate of Estates and Trusts is recorded at appraised value at the time of taking over the Estates and Trusts.

**Deferred Special Project Charges**

Costs of a special project for the development and implementation of a new trust management technology system incurred from 2002 to 2008 have been deferred. These charges will be amortized over management's best estimate of the useful life of the system. Amortization will commence in the period in which the system becomes operational.

**Foreign Currency Translation**

Foreign currency amounts are translated to Canadian dollars as follows: Each asset, liability, revenue or expense is translated into Canadian dollars at the transaction date, by the use of the exchange rate in effect at that date.

At the year-end date, US dollar monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at that date and the resulting foreign exchange gains and losses are included in income in the current period. As of March 31, 2008 The Public Guardian and Trustee held only US dollars in foreign currency.

**Revenue Recognition**

Revenues of Estates and Trusts from Pension, Social Benefits, Investment, Other and Realized Investment Appreciation/(Depreciation) are recognized when received or receivable. Net Unrealized Investment Appreciation/(Depreciation) represents net unrealized gains/(losses) from changes in the market value of Bonds and Other Debt Issues, Diversified Fund, Canadian Income and Dividend Fund, and Stocks and Other Securities.

**Use of Estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Actual results could differ from management's best estimates, as additional information becomes available in the future.

## The Public Guardian and Trustee for the Province of Ontario Notes to Financial Statements

March 31, 2008

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### 1. New Accounting Pronouncements

The Canadian Institute of Chartered Accountants has issued several new accounting standards related to financial instruments: Section 3862, Financial Instruments – Disclosures, Section 3863, Financial Instruments – Presentation, Section 3865, Hedges.

The Public Guardian and Trustee is assessing the implications of these new standards, which are effective for fiscal periods beginning on or after April 1, 2008 and intends to adopt them in its next fiscal period.

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### 2. Deceased Estates and Funds Escheated to the Crown

Deceased Estates include estates administered under the *Crown Administration of Estates Act* and the *Estates Act*.

The Public Guardian and Trustee is authorized by the *Escheats Act* to take possession of property reverting to the Crown under the *Succession Law Reform Act*. After a period of ten years, any property so received by The Public Guardian and Trustee, which remains unclaimed, is required to be transferred to the Consolidated Revenue Fund of the Province. Such property transfers to the Consolidated Revenue Fund are included in client capital distributions in arriving at the amount shown as the net client capital contribution (distribution) for Deceased Estates in the Statement of Changes in Fund Balances – Estates and Trusts.

During the year \$882,590 (2007 - \$1,571,914) was transferred to the Consolidated Revenue Fund.

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### 3. Transfers to Consolidated Revenue Fund

Pursuant to Section 9(5) of *The Public Guardian and Trustee Act*, the Lieutenant Governor in Council may from time to time direct the payment into the Consolidated Revenue Fund of the Province of any balance at the credit of the Administration Fund.

No such transfers were made during the year to the Consolidated Revenue Fund of the Province.

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### 4. Related Party Transactions

The Public Guardian and Trustee considers the Government of the Province of Ontario, its Agencies and its Crown Corporations to be related parties. In the normal course of business, the following transactions were entered into with these related parties at no charge to The Public Guardian and Trustee and therefore are not reflected in the financial statements:

- The Public Guardian and Trustee provides pension benefits for its employees through participation in the Public Service Pension Fund and the Ontario Public Service Employees' Union Pension Fund. The Ministry of Government and Consumer Services (MGCS) funds the employer's contribution to the Pension Funds.
- The cost of post-retirement, non-pension employee benefits are paid by MGCS.
- The Public Guardian and Trustee occupies leased premises paid for by the Ministry of the Attorney General.
- MGCS provides payroll and payment processing for The Public Guardian and Trustee.

The Ministry of the Attorney General provides partial funding for the operations of The Public Guardian and Trustee, which is reflected in the financial statements.

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**The Public Guardian and Trustee  
for the Province of Ontario  
Notes to Financial Statements**

**March 31, 2008**

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**5. Mortgages and Securities Held in Trust**

The Public Guardian and Trustee in its capacity as Accountant of the Superior Court of Justice also acts as custodian of mortgages in the amount of \$728,104 (2007 - \$690,000) and miscellaneous securities and documents having a face value of \$3,844,506 (2007 - \$3,706,946). These amounts are not reflected in the financial statements as The Public Guardian and Trustee does not act as trustee of these funds but simply as custodian of the instruments on behalf of the client. The Public Guardian and Trustee as custodian also holds letters of credit, lien bonds, guardianship bonds and performance guarantee bonds for litigants.

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**6. Contingencies**

The Public Guardian and Trustee is involved in various legal actions arising in the normal course of business operations, the outcome and ultimate disposition of which are not determinable at this time. Settlements, if any, are accounted for in the period in which the settlements occur.

In June 2007, the Public Guardian and Trustee became aware of some account irregularities of some clients of a former employee. Investigation of these irregularities continues. An estimate of the amount of losses incurred by clients, who will be fully reimbursed by the Public Guardian and Trustee, has been accrued in the financial statements.

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**7. Comparative Figures**

Certain prior year amounts have been reclassified to conform to current year presentation.

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# The Public Guardian and Trustee for the Province of Ontario

## Schedule A - Fixed Income Funds (in thousands of dollars)

March 31	2008	2007
<b>INVESTMENTS</b>		
Cash	\$ 3,522	\$ 787
Accrued interest	13,117	11,362
Short term investments	389,367	539,604
	<u>406,006</u>	<u>551,753</u>
Mid term investments		
Corporate Bonds (i)	84,673	18,150
Federal Government (ii)	8,110	37,209
Provincial Governments (iii)	101,046	169,238
Financial Institutions (iv)	382,180	188,462
	<u>576,009</u>	<u>413,059</u>
	\$ 982,015	\$ 964,812
Allocated as follows		
Estates and Trusts	\$ 966,377	\$ 953,585
Administration	15,638	11,227
	<u>\$ 982,015</u>	<u>\$ 964,812</u>
<b>INCOME</b>		
Allocated as follows		
Estates and Trusts	\$ 40,322	\$ 34,431
Administration	(128)	1,734
	<u>\$ 40,194</u>	<u>\$ 36,165</u>

Short term investments at March 31, 2008 bear interest at annual rates ranging from 3.50% to 10.85% (2007 - from 2.60% to 7.25%), with maturity dates ranging from 1 day to 264 days (2007 - from 2 days to 303 days)

Mid term investments at March 31, 2008		Interest Rates	Carrying Value	Fair Value
(i)	Corporate Bonds			
	1 - 3 years	5.25 - 7.15%	\$ 43,520	\$ 44,433
	3 years +	5.77 - 6.40%	41,153	42,005
			<u>84,673</u>	<u>86,439</u>
(ii)	Federal Government			
	1 - 3 years	5.50%	8,110	8,263
			<u>8,110</u>	<u>8,263</u>
(iii)	Provincial Governments			
	1 - 3 years	4.00 - 6.50%	90,360	91,829
	3 years +	4.50%	10,686	10,809
			<u>101,046</u>	<u>102,638</u>
(iv)	Financial Institutions			
	1 - 3 years	3.65 - 6.19%	123,916	125,462
	3 years +	3.70 - 6.87%	258,264	261,365
			<u>382,180</u>	<u>386,826</u>
			<u>\$ 576,009</u>	<u>\$ 584,166</u>

### Fixed Income Funds

Funds are invested in high quality fixed income instruments subject to the investment guidelines of the *Trustee Act* and the guidelines and limitations as set by The Public Guardian and Trustee with emphasis on preservation of capital and maximizing return. This includes US dollar trust funds where the Accountant of the Superior Court of Justice is ordered by the courts to hold these funds in US dollars.

Interest income is distributed to participants by a prescribed interest rate approved by The Public Guardian and Trustee's Investment Advisory Committee. During the year, the prescribed rate for the Canadian Funds ranged from 4.00% to 4.25% (2007 ranged from 3.50 to 4.00%), and for the U.S. Funds was 4.75% (2007 ranged from 3.75% to 4.75%).

## The Public Guardian and Trustee for the Province of Ontario

### Schedule B - Diversified Fund (in thousands of dollars)

March 31	2008	2007
<b>INVESTMENTS</b>		
Cash	\$ 199	\$ 49
Net other liabilities	(148)	(172)
Short term notes	2,296	1,916
	2,347	1,793
Bonds	46,226	43,946
Canadian equity	39,944	45,094
Foreign equity	22,223	25,146
	\$ 110,740	\$ 115,979
<b>Allocated as follows</b>		
Estates and Trusts	\$ 55,423	\$ 60,186
Administration Fund	55,317	55,793
	\$ 110,740	\$ 115,979
<b>INCOME</b>		
Estates and Trusts		
Investment earnings	\$ 1,980	\$ 1,884
Unrealized (depreciation)/appreciation	(1,724)	2,736
Net unrealized foreign exchange (depreciation)/appreciation	(761)	788
Net unrealized (depreciation)/appreciation	(2,485)	3,524
Realized investment appreciation	2,076	7,244
Net realized foreign exchange depreciation	(347)	(927)
Net realized investment appreciation	1,729	6,317
	\$ 1,224	\$ 11,725
Administration		
Investment earnings	\$ 1,443	\$ 1,339
Unrealized (depreciation)/appreciation	(1,608)	314
Net unrealized foreign exchange (depreciation)/appreciation	(759)	807
Net unrealized (depreciation)/appreciation	(2,367)	1,121
Realized investment appreciation	-	2,848
Net realized foreign exchange depreciation	-	(950)
Net realized investment appreciation	-	1,898
	\$ (924)	\$ 4,358

The Short term Notes and Bonds at March 31, 2008 bear interest at annual rates ranging from 3.60% to 12.20% (2007 - from 3.75% to 12.20%), with maturity dates ranging from 3 days to 41 years (2007 - from 11 days to 99 years).

#### Diversified Fund

The Public Guardian and Trustee has a Diversified Fund that includes high quality equity and fixed income securities. This fund was established in order to provide an alternative for those clients whose unique investment objectives require a broader, longer range investment strategy. The fund is subject to the investment guidelines of the *Trustee Act* and the guidelines and limitations as set by The Public Guardian and Trustee with emphasis on the need to preserve and enhance the purchasing power of capital over the longer term. The Administration Fund also participates in the Diversified Fund.

The investment returns on this fund accrue directly to the participants and the investments are carried at fair value.

**The Public Guardian and Trustee  
for the Province of Ontario**  
**Schedule C - Canadian Income and Dividend Fund**  
(in thousands of dollars)

March 31	2008	2007
<b>INVESTMENTS</b>		
Cash	\$ 23	\$ 11
Net other assets	1,561	532
Short term notes	679	945
	<u>2,263</u>	<u>1,488</u>
Bonds	27,033	16,049
Canadian equity	23,926	17,913
	<u>\$ 53,222</u>	<u>\$ 35,450</u>
<b>Allocated as follows</b>		
Estates and Trusts	\$ 37,447	\$ 19,586
Administration Fund	15,775	15,864
	<u>\$ 53,222</u>	<u>\$ 35,450</u>
<b>INCOME</b>		
Estates and Trusts		
Investment earnings	\$ 1,243	\$ 209
Unrealized (depreciation)/appreciation	(1,765)	399
	<u>\$ (522)</u>	<u>\$ 608</u>
Administration		
Investment earnings	\$ 499	\$ 167
Unrealized (depreciation)/appreciation	(759)	605
	<u>\$ (260)</u>	<u>\$ 772</u>

The Short term Notes and Bonds at March 31, 2008 bear interest at annual rates ranging from 3.60% to 11.00% (2007 - from 3.70% to 7.60%), with maturity dates ranging from 14 days to 29 years (2007 - from 47 days to 29 years)

**Canadian Income and Dividend Fund**

The Public Guardian and Trustee has a Canadian Income and Dividend Fund that consists of a balanced portfolio of high quality income-producing Canadian securities. This fund includes dividend-paying common and preferred equities and fixed-income securities designed to generate a consistent stream of income and long-term capital appreciation. The fund is subject to the investment guidelines of the *Trustee Act* and the guidelines and limitations as set by The Public Guardian and Trustee. The Administration Fund also participates in the Canadian Income and Dividend Fund.

Income earned in this fund may be distributed to the participants monthly or reinvested in this fund.

**The Public Guardian and Trustee  
for the Province of Ontario**  
**Schedule D - Public Guardian and Trustee Fees**  
(in thousands of dollars)

<b>For the year ended March 31</b>	<b>2008</b>	<b>2007</b>
Client trusts	\$ 13,383	\$ 14,057
Minors	2,817	2,911
Deceased estates	2,877	3,164
Litigants	1,266	1,166
Court-appointed litigation guardian legal services	77	116
Cemetery trusts	176	166
Charity trusts	166	147
Forfeited corporate assets/corporate trusts	53	47
Public Guardian and Trustee Fees - Estates and Trusts	20,815	21,774
less: Costs of fee services	(1,187)	(1,130)
Fees collected (net) - Administration Fund	\$ 19,628	\$ 20,644

**Schedule E - Estates and Trusts Investment Income**  
(in thousands of dollars)

<b>For the year ended March 31</b>	<b>2008</b>	<b>2007</b>
Fixed income funds (Schedule A)	\$ 40,322	\$ 34,431
Diversified fund (Schedule B)	1,980	1,884
Canadian income and dividend fund (Schedule C)	1,243	209
Income from other investments held for clients	4,637	5,869
	\$ 48,182	\$ 42,393

**THE WORKPLACE SAFETY AND INSURANCE BOARD****Responsibility for financial reporting**

The accompanying financial statements were prepared by management in accordance with Canadian generally accepted accounting principles, consistently applied, and include amounts based upon management's best estimates and judgments. Any financial information contained elsewhere in the Annual Report is consistent with these financial statements.

Management is responsible for the integrity of the financial statements and has established systems of internal control to provide reasonable assurance that assets are properly accounted for and safeguarded from loss. The Board of Directors has established an Audit and Finance Committee to ensure that management fulfils these responsibilities. The Audit and Finance Committee meets periodically with management, internal auditors and external auditors to ensure that their responsibilities are properly discharged with respect to financial statement presentation, disclosure and recommendations on internal control.

The Internal Audit Division performs audits designed to test the adequacy and consistency of the WSIB's internal controls, practices and procedures.

**Role of the actuary**

With respect to the preparation of these financial statements, the actuary prepares a valuation, including the selection of appropriate assumptions, of the WSIB's benefit liabilities at the balance sheet date. With respect to the preparation of these financial statements, the actuary determines the valuation of the benefit liabilities and provides an opinion to the Board of Directors regarding the appropriateness of the benefit liabilities recorded by management of the WSIB at the balance sheet date. The work to form that opinion includes an examination of the sufficiency and reliability of data, and review of the valuation processes. The actuary is responsible for assessing whether the assumptions and methods used for the valuation of the benefit liabilities are in accordance with accepted actuarial practice, applicable legislation, and associated regulations and directives. In performing the valuation of these liabilities, which are by their very nature inherently variable, the actuary makes assumptions as to future interest and mortality rates, expenses, related trends and other contingencies, taking into consideration the circumstances of the WSIB. It is certain that the benefit liabilities will not develop exactly as projected and may, in fact, vary significantly from the projections. Further, the projections make no provision for future claim categories not sufficiently recognized in the claims experience and inventories. The actuary's report outlines the scope of the valuation and his opinion.

**Role of the external auditors**

The external auditors, KPMG LLP, working under the direction of the Auditor General of Ontario, have performed an independent and objective audit of the financial statements of the WSIB in accordance with Canadian generally accepted auditing standards. In carrying out their audit, the external auditors make use of the work of the actuary and his report on the benefit liabilities of the WSIB. The

external auditors have full and unrestricted access to the Board of Directors and the Audit and Finance Committee to discuss audit, financial reporting and related findings. The external auditors' report outlines the scope of their audit and their opinion on the financial statements of the WSIB.



Jill Hutcheon,  
President & CEO

March 20, 2008



Malen Ng,  
Chief Financial Officer

## Auditors' report



**To the Workplace Safety and Insurance Board,  
the Minister of Labour, and the Auditor General of Ontario**

Pursuant to the *Workplace Safety and Insurance Act*, which provides that the accounts of the Workplace Safety and Insurance Board ("WSIB") shall be audited by the Auditor General of Ontario or under his direction by an auditor appointed by the Lieutenant Governor in Council for that purpose, we have audited the consolidated balance sheet of the WSIB as at December 31, 2007 and the consolidated statements of operations, changes in unfunded liability, comprehensive income (loss) and cash flows for the year then ended. These financial statements are the responsibility of WSIB's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we 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 our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the WSIB as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads 'KPMG LLP' with a horizontal line underneath.

Chartered Accountants, Licensed Public Accountants  
Toronto, Canada

March 20, 2008



## Actuarial opinion

I have valued the benefit liabilities of the Workplace Safety and Insurance Board of Ontario for its consolidated balance sheet as at December 31, 2007 and its change in the consolidated statement of operations for the year then ended in accordance with actuarial practice generally accepted in Canada, including selection of appropriate assumptions and methods.

In my opinion, the amount of benefit liabilities makes appropriate provision for all Schedule 1 Insurance Fund obligations and the consolidated financial statements fairly present the results of the valuation.



W. Robert Hinrichs  
Fellow, Canadian Institute of Actuaries

March 20, 2008

**CONSOLIDATED BALANCE SHEET**

as of December 31

(\$ millions)	2007	2006
<b>Assets</b>		
Cash and cash equivalents	\$177	\$161
Receivables	888	905
Investments (note 3)	13,754	14,311
Loss of Retirement Income Fund (note 4)	974	919
Property, equipment and other assets (note 5)	179	159
	<b>\$15,972</b>	<b>\$16,455</b>
<b>Liabilities</b>		
Payables and accruals	\$742	\$689
Long-term debt (note 6)	98	92
Loss of Retirement Income Fund (note 4)	974	919
Employee benefit plans (note 7)	492	452
Benefit liabilities (note 8)	21,760	20,300
	<b>24,066</b>	<b>22,452</b>
<b>Unfunded Liability (note 9)</b>		
Accumulated excess of expenses over revenues	(9,501)	(8,371)
Accumulated other comprehensive income	1,407	2,374
	<b>(8,094)</b>	<b>(5,997)</b>
	<b>\$15,972</b>	<b>\$16,455</b>

Commitments and Contingencies (note 12)

On behalf of the Board of Directors:



Jill Hutcheon  
President and CEO  
Director



Patrick Dillon  
Director

The accompanying notes form an integral part of the consolidated financial statements.

**CONSOLIDATED STATEMENT OF OPERATIONS**

For the years ended December 31

(\$ millions)	2007	2006
<b>Gross Revenue</b>	<b>\$4,337</b>	<b>\$4,686</b>
<b>Current Operations</b>		
<b>Revenues</b>		
Premiums for the year	\$2,499	\$2,385
Investments (note 3)	812	1,298
Other income	2	3
	<b>3,313</b>	<b>3,686</b>
<b>Expenses</b>		
Benefit costs (note 8)	4,936	4,335
Loss of Retirement Income Fund (note 4)	70	64
Administrative and other expenses (note 10)	243	221
Legislated obligations and commitments (note 11)	218	208
	<b>5,467</b>	<b>4,828</b>
<b>Excess of expenses over revenues from current operations</b>	<b>(2,154)</b>	<b>(1,142)</b>
Premiums for unfunded liability	1,024	1,000
<b>Excess of expenses over revenues</b>	<b>\$(1,130)</b>	<b>\$(142)</b>

**CONSOLIDATED STATEMENT OF CHANGES IN UNFUNDED LIABILITY**

For the years ended December 31

(\$ millions)	2007	2006
<b>Accumulated excess of expenses over revenues</b>		
Balance at beginning of year	\$(8,371)	\$(8,229)
Excess of expenses over revenues	(1,130)	(142)
<b>Balance at end of year</b>	<b>(9,501)</b>	<b>(8,371)</b>
<b>Accumulated other comprehensive income</b>		
Balance at beginning of year	2,374	1,719
Unrealized gain (loss) on investments net of amounts realized	(967)	655
<b>Balance at end of year</b>	<b>1,407</b>	<b>2,374</b>
<b>Unfunded liability at end of year</b>	<b>\$(8,094)</b>	<b>\$(5,997)</b>

The accompanying notes form an integral part of the consolidated financial statements.

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)**

For the years ended December 31

(\$ millions)	2007	2006
<b>Excess of expenses over revenues</b>	\$(1,130)	\$(142)
<b>Other comprehensive income (loss):</b>		
Unrealized net gains (losses) on available-for-sale financial assets arising during the year	(540)	1,569
Realized gains included in income	(427)	(914)
Unrealized gains (losses) on investments, net of amounts realized	(967)	655
<b>Comprehensive income (loss)</b>	<b>\$(2,097)</b>	<b>\$513</b>

**CONSOLIDATED STATEMENT OF CASH FLOWS**

For the years ended December 31

(\$ millions)	2007	2006
<b>Operating cash flows</b>		
Cash received from:		
Premiums for the year	\$2,531	\$2,392
Premiums for unfunded liability	1,041	1,004
Investment income	374	420
	3,946	3,816
Cash paid to:		
Claimants, survivors and care providers	(3,186)	(2,977)
Loss of Retirement Income Fund	(70)	(64)
Employees and suppliers for administrative goods and services	(508)	(532)
Legislated obligations and commitments	(201)	(208)
	(3,965)	(3,781)
<b>Net cash provided (required) by operating activities</b>	<b>(19)</b>	<b>35</b>
<b>Investing cash flows</b>		
Sale of investments	19,613	18,168
Purchase of investments	(19,578)	(18,095)
<b>Net cash provided by investing activities</b>	<b>35</b>	<b>73</b>
<b>Increase in cash and cash equivalents</b>	<b>16</b>	<b>108</b>
Cash and cash equivalents, beginning of year	161	53
Cash and cash equivalents, end of year	\$177	\$161

The accompanying notes form an integral part of the consolidated financial statements.

# Notes to the consolidated financial statements

December 31, 2007

## 1. Nature of operations

The Workplace Safety and Insurance Board (WSIB) is a statutory corporation created by an Act of the Ontario Legislature in 1914. The WSIB is responsible for administering the *Workplace Safety and Insurance Act, 1997*. The WSIB promotes the prevention of injuries and illnesses in Ontario workplaces and provides insurance benefits to workers who sustain injuries in the course of employment or contract occupational diseases. The WSIB also provides insurance benefits in the case of workers who die due to workplace injuries or illnesses to their survivors and assists injured workers in their early and safe return to work.

Employers covered by the *Workplace Safety and Insurance Act, 1997*, are divided into two groups, referred to as “Schedule 1” and “Schedule 2.” Schedule 1 employers are insured under a “collective liability” system and are required to contribute to the WSIB Insurance Fund. Schedule 2 employers are “self-insured” and are individually liable for the full costs of their workers’ claims. The WSIB pays insurance benefits for Schedule 2 workers and is reimbursed by their employers for the costs of the claims, including administrative costs, and for the cost of the WSIB’s prevention activities.

The WSIB also administers the federal *Government Employees Compensation Act*. Under an agreement with Human Resources Development Canada, the federal government is treated like a Schedule 2 employer.

Revenue is raised through premiums, which are collected from all Schedule 1 employers covered under the *Workplace Safety and Insurance Act, 1997*. Revenue is also earned from a diversified investment portfolio held to meet future obligations on existing claims. Schedule 2 reimbursements also contribute to WSIB revenue.

The WSIB receives no government funding or assistance. The financial statements have been prepared on a going concern basis as management has plans to eliminate the unfunded liability over the course of several years and has prepared projections, which indicate that liabilities can be met as they fall due.

## 2. Significant accounting policies

The consolidated financial statements include the Schedule 1 and Schedule 2 accounts of the WSIB and its subsidiaries. These financial statements have been prepared in accordance with generally accepted accounting principles. These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates.

### The significant accounting policies are summarized as follows:

#### *Basis of consolidation*

WSIB’s subsidiaries and joint ventures are consolidated. Investments in entities in which WSIB exercises a significant influence are accounted for using the equity method.

The consolidated financial statements include the assets, liabilities, results of operations and cash flows of all WSIB subsidiaries after the elimination of intercompany transactions and balances.

<i>Cash and cash equivalents</i>	Cash and cash equivalents consist of cash and money market instruments with original maturities up to three months.
<i>Receivables</i>	Receivables consist of premium receivable from stakeholders. The balance is shown net of an allowance for doubtful accounts of \$115 million (2006: \$177 million).
<i>Investments</i>	<p>Investments in short-term securities, bonds, and equities are classified as either held-for-trading or available-for-sale based on management's intention. Investment transactions are recorded on the trade date basis. The WSIB has designated all of its investments as available-for-sale except for derivatives and the assets of the Loss of Retirement Income Fund, which are classified as held-for-trading.</p> <p>Available-for-sale securities include securities that may be sold in response to or in anticipation of changes in interest rates, changes in foreign currency risk, changes in funding sources, or to meet liquidity needs. Available-for-sale securities are carried at estimated fair value. Realized gains and losses are recognized as investment income in the year in which they occur. Unrealized gains and losses on available-for-sale securities are recognized in other comprehensive income until they are realized.</p> <p>Available-for-sale securities are assessed regularly to determine whether an unrealized loss is an other-than-temporary impairment. Write-downs to reflect other-than-temporary impairment are included in investment income and removed from accumulated other comprehensive income.</p> <p>Held-for-trading securities, which are purchased for sale in the near term, are reported at estimated fair value. Realized and unrealized gains and losses are recognized as investment income as they arise.</p> <p>The WSIB is party to forward foreign exchange contracts that are designated as held-for-trading and are carried at fair value. Changes in the fair value of these forward foreign exchange contracts are recognized in income in the period in which they arise.</p>
<i>Real estate investments</i>	<p>Investments in real estate are carried at cost plus move-to-market adjustments recorded to the end of 2003, less accumulated depreciation recorded after 2003.</p> <p>Prior to 2004, the carrying value of real estate investments was amortized towards appraised market value at 10 per cent annually. Beginning in 2004, new investments in real estate and joint ventures are initially recorded at cost and the carrying value of all buildings is amortized over the estimated useful life of 40 years on a straight line basis.</p>
<i>Fair value of financial instruments</i>	<p>The fair values of investments are the year-end quoted prices where available. Where quoted prices are not available, estimated fair values are calculated based upon the yields and values of comparable marketable securities.</p> <p>Cash and cash equivalents denominated in foreign currencies are translated into Canadian dollars at the exchange rate in effect at the balance sheet date.</p> <p>The cost of short-term securities, treasury bills and term deposits maturing within a year, plus accrued interest income, approximates the fair value of these instruments.</p> <p>The fair value of bonds and equities denominated in foreign currencies is translated to Canadian dollars at the exchange rate in effect at the balance sheet date. Pooled fund</p>

investments are valued at the unit values supplied by the pooled fund administrator. These values represent the WSIB's proportionate share of underlying net assets at fair values.

#### *Derivative instruments*

WSIB invests in active currency through forward contracts which are classified as derivative instruments.

Derivative instruments are financial instruments that derive their value from that of other financial instruments, economic or financial indicators including but not limited to derivatives of equity, fixed-income or currency-related investments, futures and /or forward contracts, swaps, option, warrants, depository receipts, rights or other similar instruments. WSIB uses derivative instruments as an additional source of return, for economic hedging strategies to manage investment risk, to improve liquidity or to manage exposure to asset classes or strategies, including but not limited to rebalancing.

#### *Impairment review*

Available-for-sale securities are reviewed annually to identify and evaluate investments that show indications of possible impairment. An investment is considered impaired if its unrealized losses represent impairment that is considered to be other-than-temporary. In determining whether a loss is temporary, factors considered include the extent of the unrealized loss, length of time that the security has been in an unrealized loss position, and the WSIB's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery. If a decline is considered other-than-temporary, a write down is recorded.

#### *Foreign currency translation*

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at exchange rates prevailing on the balance sheet date. Revenues and expenses are translated at exchange rates in effect on the transaction date. Realized exchange gains and losses are included in income. Unrealized exchange gains and losses for available-for-sale securities are included in other comprehensive income. Unrealized exchange gains and losses for held-for-trading securities are included in income.

#### *Fair value of other financial assets and liabilities*

The carrying value of receivables and payables approximates their fair value because of the short-term nature of these instruments.

#### *Loss of Retirement Income Fund*

The Loss of Retirement Income Fund is invested in short-term securities, bonds, equities and pooled funds. These investments are carried at estimated fair value. Changes in fair value are included in investment income of the Loss of Retirement Income Fund in the year in which they occur.

Annuities purchased from third parties to pay Loss of Retirement Income benefits to eligible claimants are accounted for as financial assets and the corresponding liability to the claimants is accounted for as a financial liability. The WSIB remains liable for the annuities in the event of default by the annuity provider. These assets and liabilities are carried at estimated fair value.

#### *Property, equipment, and other assets*

Property, equipment and other assets are recorded at cost. The cost of buildings includes development, financing and other costs capitalized prior to the day they become fully operational. At this time, amortization commences. Capital assets are amortized using the straight-line method, at rates calculated to expense the cost of assets over their estimated useful lives, which are 20 years for buildings, five years for office equipment, three years for computer equipment, and the lesser of the lease term or ten years for leasehold improvements.

*Premiums*

Each year, the Board of Directors approves preliminary and final premium rates. The preliminary rates are re-calibrated annually with current economic and actuarial assumptions and are used to solicit feedback from stakeholders in the development of the final premium rates. Premium rates are established to cover all expected claims and operating costs for the upcoming injury year. To stabilize premium rates, there are rules in place to govern the amount of increase and to moderate any excessive changes from year to year. Premium rates include a component that is applied to reduce the unfunded liability. The WSIB may also levy a special premium when it is considered appropriate. In advance of the year, Schedule 1 employers are notified of their final premium rates to be paid for the upcoming injury year. Premium revenue is determined by applying premium rates to Schedule 1 employers' insurable payrolls.

Schedule 2 employers are individually liable to pay all insurance benefits and administration costs with respect to their workers' claims. Reimbursements for claims paid and the cost of administration are included in their premium assessment.

The Schedule 1 premiums are net of doubtful accounts. An Allowance for Doubtful accounts is recorded in our Consolidated Balance Sheet and is maintained at a level which is adequate to absorb losses on premiums for Schedule 1 employers. The allowance comprises specific allowances and an additional allowance which covers any impairment in the employer premiums that, based on experience, will not be collectable. The allowance is reviewed and a number of factors are considered in determining the appropriate level.

*Benefit liabilities*

Benefit liabilities are determined annually through an actuarial valuation, which estimates the present value of future payments for loss of earnings, labour market re-entry, short and long-term disability, health care, survivor benefits, retirement income benefits and claim administration costs. They represent a provision for future benefit payments and the future cost of administering claims incurred on or before December 31. The provision has been determined by estimating future benefit payments in accordance with the adjudication practices in effect at December 31, and relevant legislation.

The benefit liabilities do not include any provision for payment of Schedule 2 claims. The costs of these claims are not considered WSIB liabilities because they are a liability of Schedule 2 employers.

Benefit liabilities do not include any provision for future claims relating to occupational diseases, or for injuries and illnesses that are not currently considered to be work related.

*Pension and other benefit plans*

The WSIB offers a number of benefit plans, which provide pension and other post retirement benefits to eligible staff. These plans include a statutory pension plan, a supplemental pension plan, and other post retirement benefits plans including health, dental and life insurance.

The WSIB funds its statutory pension and post retirement benefit plans annually based on actuarially determined amounts required to satisfy employee benefit entitlements under current pension regulation and benefit plan policies. These pension plans provide benefits based on years of service and average earnings at retirement.

Actuarial valuations are performed annually to determine the present value of the accrued pension benefits, based on projections of the employees' compensation levels to the time of retirement. Investments held by the pension funds primarily comprise equity



securities, bonds and debentures. Pension fund assets are valued at fair value.

Pension benefit expense, which is included in staff benefit plans within administrative and other expenses (note 10), consists of the cost of employee pension benefits for the current year's service, interest cost on the liability, expected investment return on the market related value of plan assets and the amortization of unrecognized past service costs, unrecognized net actuarial gains or losses and unrecognized transition asset or obligation. Amortization is charged over the expected average remaining service period of active employees covered by the plan.

The cumulative excess of pension fund contributions over the amount recorded as expenses is reported as accrued benefit liability in the balance sheet. The cumulative excess of pension benefit expense over pension fund contributions is reported in the employee benefit plan liabilities. Liabilities for other post retirement benefits are also reported in the employee benefit plans' liabilities.

The full amount of the gain or loss from the change in obligation for workplace accident benefits is recognized in the year the gain or loss occurs and is included in other benefit plans (note 7).

Other defined contribution plan costs are recognized in income for services rendered by employees during the year.

#### **Financial instruments – Disclosure and Presentation**

#### *Future impact of recently issued accounting standards*

Effective January 1, 2008, the WSIB will adopt new CICA Handbook sections: Section 3862 "Financial Instruments – Disclosures", and Section 3863, "Financial Instruments – Presentation". These new disclosures will provide additional information on the nature and extent of risks arising from financial instruments to which the WSIB is exposed and how it manages those risks.

### 3. Investments and investment revenue

Investments by category are as follows:

(\$ millions)	2007				2006	
	Amortized cost	Carrying value adjustments	Unrealized: gains	Unrealized: losses	Carrying value	Carrying value
<b>Held-for-trading:</b>						
Foreign exchange contracts						
Domestic	\$ –	\$(37)	\$ –	\$ –	\$(37)	\$ –
Foreign – U.S.	–	46	–	–	46	–
– Global	–	(19)	–	–	(19)	(2)
Total held-for-trading	–	(10)	–	–	(10)	(2)
<b>Available-for-sale:</b>						
Fixed income securities						
Bonds	4,018	–	121	(23)	4,116	4,069
Equities						
Domestic	1,867	61	765	(36)	2,657	2,649
Foreign – U.S.	3,407	9	278	(125)	3,569	3,848
– Global	2,753	14	479	(52)	3,194	3,571
	8,027	84	1,522	(213)	9,420	10,068
<b>Total available-for-sale</b>	<b>12,045</b>	<b>84</b>	<b>1,643</b>	<b>(236)</b>	<b>13,536</b>	<b>14,137</b>
<b>Real estate</b>	<b>228</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>228</b>	<b>176</b>
<b>Total investments</b>	<b>\$12,273</b>	<b>\$74</b>	<b>\$1,643</b>	<b>\$(236)</b>	<b>\$13,754</b>	<b>\$14,311</b>

Included in the above is accrued income of \$113 million (2006: \$63 million).

#### Foreign currency

The gross notional amounts in foreign exchange contracts are the contractual amounts on which payments are made. The net notional value is the sum of all the long (or the short) positions in the portfolio and it reflects the aggregate positions of the portfolio. These notional amounts have been converted into Canadian dollars at the contractual exchange rates in effect at the inception of the contracts.

At December 31, 2007 the gross notional value of outstanding foreign currency contracts was \$1,946 million (2006: \$405 million). Outstanding contracts in a favorable position had a fair value of \$13 million (2006: \$2 million) and those in an unfavorable position had a fair value of negative \$23 million (2006: negative \$4 million). Unrealized losses on foreign exchange contracts of \$10 million (2006: \$2 million loss) were included in investment income.

The net notional value of foreign exchange contracts as of December 31, 2007 was \$241 million (2006: \$165 million).

The fair value of the investment portfolio includes \$6,763 million (2006: \$7,419 million) of securities denominated in foreign currency. The major holdings are as follows: 53 per cent (2006: 52 per cent) in US dollar, 18 per cent (2006: 17 per cent) in Euros, 11 per cent (2006: 12 per cent) in British Pound Sterling, seven per cent (2006: nine per cent) in Japanese Yen and 11 per cent (2006: 10 per cent) in other currencies.

**Bonds by term to maturity as of December 31:**

(\$ millions)	2007					2006
	Term to contractual maturity (years)					
	Up to 1	1 – 5	5 – 10	Over 10	Total	Total
<b>Government bonds</b>						
Fair value	\$19	\$1,316	\$539	\$1,008	\$2,882	\$2,827
Yield %*	4.0	4.0	4.2	4.4	4.2	4.2
<b>Corporate bonds</b>						
Fair value	\$7	\$500	\$365	\$362	\$1,234	\$1,242
Yield %*	4.4	5.0	5.1	5.6	5.2	4.7
<b>Total</b>						
<b>Fair value</b>	<b>\$26</b>	<b>\$1,816</b>	<b>\$904</b>	<b>\$1,370</b>	<b>\$4,116</b>	<b>\$4,069</b>
<b>Yield %*</b>	<b>4.1</b>	<b>4.3</b>	<b>4.6</b>	<b>4.7</b>	<b>4.5</b>	<b>4.4</b>

\*The average yield reflects the yield to maturity which is the discount rate that makes the present value of future cash flows for each bond equal to its fair value as of December 31.

**Revenue by category of investment is as follows:**

(\$ millions)	2007	2006
<b>Held-for-trading</b>		
Foreign exchange contracts	\$(15)	\$(3)
<b>Available-for-sale</b>		
Bonds	205	214
Amortization	(16)	(18)
Equities	654	1,116
	843	1,312
Real estate	12	16
Short-term securities	6	3
	846	1,328
Investment expenses	(34)	(30)
<b>Net investment revenue</b>	<b>\$812</b>	<b>\$1,298</b>

Revenue from bonds includes \$2 million (2006: \$19 million) of net realized gains. Revenue from equities and real estate includes \$425 million (2006: \$895 million) of net realized gains. Revenue from foreign exchange contracts includes \$3 million (2006: \$0) of net realized losses.

During the year \$408 million (2006: \$37 million) was assessed as an other-than-temporary impairment and recognized as a reduction in investment income. The remaining unrealized losses on available-for-sale securities of \$236 million (2006: \$17 million) are not considered to be other-than-temporarily impaired as at December 31, 2007.

*Securities Lending*

WSIB earns additional income by participating in a securities lending program. Securities it owns are loaned to others for a fee and are secured by high quality collateral. The fair value of the collateral always exceeds the fair value of the securities loaned and the collateral is marked to market daily. The program is managed by a Canadian financial institution.

At December 31, 2007, the fair value of securities on loan was \$1,453 million (2006: \$1,741 million). The collateral held with respect to these securities was \$1,526 million (2006: \$1,876 million).

*Investments Risk Management*

The WSIB is responsible for investing the funds of the Insurance Fund and Loss of Retirement Income Fund (LRI Fund). These responsibilities are carried out through strategic and other investment policies that govern how the Funds are to be invested and how the investment performance and compliance of the Funds is to be monitored and evaluated. A statement of investment policies and procedures (SIPP) is reviewed and presented to the Board of Directors for approval. Review is undertaken of the WSIB's benefit liabilities and capital market assumptions to ascertain that the Policy Asset Mix and other provisions of the SIPP remain relevant to the prevailing and forecasted nature of the Funds' liabilities. The Policy Asset Mix mitigates, but does not eliminate short term risk through diversification across asset strategies and strikes a reasonable compromise between achieving the long-term return objective and enduring short-term variability.

Although, neither the Insurance nor LRI Fund is a registered pension fund, the Act requires the funds available for investment be invested in those investments that are authorized under the Ontario Pension Benefits Act. It further requires that the funds be invested in the same manner as is authorized for those pension funds, namely with the care, diligence and skill that a person of ordinary prudence would exercise in dealing with the property of another person and using all relevant knowledge and skill that the person may possess.

Risk is inherent in the generating of investment returns in excess of the risk-free rate (i.e., three-month Government of Canada treasury bills) and in each element of the investment decision-making process; hence risk measurement and risk management are integral to the asset management program.

The primary risk is that investment returns, taken together with a reasonable and sustainable level of contributions, are insufficient to meet the long-term obligations for which the Fund is established. This risk would be manifest in the failure to achieve a return of at least the actuarial discount rate of seven per cent over a long-term horizon of rolling 15 year periods.

The significant risks related to financial instruments are credit risk, liquidity risk and price risk (currency, interest rate and market). The following sections describe how WSIB manages each of these financial instrument risks:

***Credit risk***

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. WSIB mitigates portfolio credit risk through comprehensive due diligence and diversification. WSIB's fixed income is invested in indexed portfolios and none of the index constituents is more than three per cent of the index. Also, WSIB manages credit risk through exposure limits on underlying

securities. As such, not more than five per cent of the market value of the Insurance Fund is invested in the securities of a single issuer.

WSIB manages counterparty risk through a due diligence process by selecting multiple highly rated counterparties and by setting counterparty exposure limits. In addition, WSIB requires its active currency managers to use a continuous linked settlement service to mitigate settlement risk and an international foreign exchange master agreement to mitigate risk of default at any time. WSIB monitors its exposure daily.

WSIB manages counterparty risk relating to our Security Lending program by establishing a pre-approved qualified borrower list and through exposure limits. Also, our custodian risk management team conducts regular credit review and monitoring for all our borrowers. In addition, WSIB mitigates counterparty risk by requiring daily marking-to-market to maintain full collateralization with additional margin for safety.

***Liquidity risk***

Liquidity risk or funding risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value.

Liquidity risk to WSIB is the risk that it will not be able to fund all cash outflow commitments as they fall due. WSIB mitigates this risk by investing 95 per cent of its insurance assets in readily marketable, publicly traded, equity and fixed income securities. WSIB also has effective cash management strategies.

In addition, WSIB maintains a line of credit with a commercial bank to serve as sources of interim liquidity if needed.

***Price risk***

There are three types of price risk: currency risk, interest rate risk and market risk. Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Interest rate risk is the risk that the value of the financial instrument will fluctuate due to changes in market interest rates. Market risk is the risk that the value of the financial instrument will fluctuate as a result of changes in market prices.

***i) Foreign currency risk***

Foreign currency risk is the risk of loss due to adverse movements in foreign currency rates as compared to the Canadian dollar. WSIB uses foreign exchange contracts as an additional source of return, for economic hedging strategies to manage investment risk, to improve liquidity or to manage exposure to asset classes or strategies. Foreign exchange contracts are agreements to exchange an amount of one currency for another at a future date and at a set price, agreed upon at the contract inception. The fair value of these financial instruments would change in response to changes in the underlying variables affecting the contracts, such as changes in the foreign exchange rates of the currencies involved in the contracts.

There are foreign currency positions inherent in the foreign equity holdings of the Insurance and LRI Funds. The WSIB has a sufficiently long investment time horizon to accept the variability of these currency positions, which can be significant, over shorter periods.

**ii) Interest rate risk**

Interest rate risk is the potential for financial loss arising from changes in interest rates. WSIB reviews interest rate risk through periodic asset liability analyses which assess the impact of different interest rate scenarios on asset and liabilities of the Insurance Fund over a period of time. Interest rate risk is mitigated primarily through asset allocation which aims to cover interest rate risk over the long term.

**iii) Market risk**

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market.

The WSIB mitigates market risk by diversification of its investment portfolios. Also, the SIPP outlines the policy mix requirements to manage the market risk. As well, the Funds are actively managed. A balanced allocation of risk across a broad set of return sources is appropriate to meet the return objectives of the Funds. The assets of the Fund are diversified by combining different sources of return across and within asset classes and investment strategies.

**4. Loss of Retirement Income fund**

**The carrying value of the Loss of Retirement Income (LRI) Fund Investments at December 31 is as follows:**

(\$ millions)	2007	2006
Cash and cash equivalents	\$35	\$31
Bonds	176	170
Equities	248	261
Investment in pooled fund	459	410
<b>Investment fund</b>	<b>918</b>	<b>872</b>
<b>Annuities</b>	<b>56</b>	<b>47</b>
	<b>\$974</b>	<b>\$919</b>

The underlying securities in the pooled fund include fixed income securities valued at \$131 million (2006: \$109 million), equities valued at \$317 million (2006: \$292 million) and money market instruments valued at \$11 million (2006: \$9 million).

The WSIB has purchased annuities from various annuity providers to administer the settlement of LRI benefits to eligible claimants. The related financial asset and corresponding liability are carried at actuarially determined fair values. The WSIB remains liable for the annuities in the event of default by the annuity providers. This risk is mitigated by acquiring annuities from highly rated Canadian financial institutions. At December 31, 2007, none of the annuity providers was in default and no provision for credit risk was required.

**The change in LRI Fund Investment is as follows:**

(\$ millions)	2007	2006
Funds set aside under the <i>Act</i>	\$76	\$69
Investment income	4	96
Benefit costs paid	(34)	(28)
Increase in net assets	46	137
Net assets, beginning of year	872	735
<b>Net assets, end of year</b>	<b>\$918</b>	<b>\$872</b>

For injuries and illnesses that occurred prior to January 1, 1998, the WSIB sets aside funds equal to 10 per cent of every payment made to injured workers.

Effective January 1, 1998, for claims incurred after December 31, 1997, for workers who have received loss of earnings benefits for 12 continuous months, the WSIB sets aside 5 per cent of their loss of earnings benefits for their retirement fund. Injured workers may choose to contribute a further 5 per cent from their loss of earnings benefits. These funds are segregated from the WSIB's investment portfolio and are invested to provide retirement income benefits for injured workers.

**5. Property, equipment and other assets**

(\$ millions)	2007		2006
	Cost	Net Carrying Value	Net Carrying Value
Land, under a capital lease	\$29	\$29	\$29
Buildings and leasehold improvements	196	92	101
Office equipment	112	2	1
Computer equipment	174	55	23
	511	178	154
Other assets	1	1	5
	<b>\$512</b>	<b>\$179</b>	<b>\$159</b>

Amortization expense in 2007 was \$12 million (2006: \$13 million).

The WSIB, through its wholly owned subsidiary, 799549 Ontario Inc., is a 75 per cent participant in a co-ownership agreement for its head office land and building at 200 Front Street West, Toronto.

The land of \$29 million represents WSIB's 75 per cent cost share of the co-ownership share of land on which WSIB's head office building was constructed.

The building and leasehold improvements of \$92 million (2006: \$101 million) represent WSIB's 75 per cent share of the co-ownership.

**6. Long-term debt**

(\$ millions)	2007	2006
Mortgage payable	\$68	\$69
Obligation under capital leases	30	23
	<b>\$98</b>	<b>\$92</b>

*Mortgage payable*

To fund part of the development and construction of the building at 200 Front Street West, Toronto, (note 5) the WSIB entered into a long-term mortgage loan agreement in 1993. The mortgage loan is secured by the building, and matures in the year 2015. The interest rate is fixed at 10.25 per cent per annum, compounded semi-annually.

The fair value of the mortgage payable as of December 31, 2007 was \$70 million (2006: \$74 million) with a book value of \$68 million (2006: \$69 million). The \$7 million mortgage interest expense for the year was included in occupancy costs (note 10) (2006: \$7 million).

*Obligation under capital leases*

**The obligation under capital leases consists of the following:**

(\$ millions)	2007	2006
Simcoe Place land lease	\$23	\$23
Computer equipment leases	7	–
	<b>\$30</b>	<b>\$23</b>

The Simcoe Place land lease represents the balance of the lease obligation for the land at 200 Front Street West on which WSIB's office building is located. WSIB, through its wholly owned subsidiary 799549 Ontario Inc, makes annual lease payments of \$4 million under a capital lease.

During 2006, WSIB negotiated an amendment to this lease to accelerate the lease expiry from 2087 to 2027, and to provide WSIB with an option to purchase a 75 per cent interest in the land at the expiry date of May 31, 2027 for \$1.5 million. This option price is considered by management to be advantageous and it is expected that the option will be exercised.

There are four computer equipment leases with terms between three and four years.

The fair value of the lease obligations at December 31, 2007 was \$44 million (2006: \$39 million). Interest on lease obligation for the year was \$4 million (2006: \$0.7 million). Interest on the Simcoe Place land lease obligation for the year of \$4 million (2006: \$0.7 million) was included in occupancy cost.



**7. Employee benefit plans**

The WSIB has several benefit plans for eligible current and retired employees. The cost of employee benefit plans is recognized in the reporting period in which employees have provided service.

*Pension and other benefit plans*

The WSIB has two pension plans for its employees and employees of Safe Workplace Associations, the WSIB Employees' Pension Plan and the WSIB Employees' Supplementary Pension Plan.

The WSIB Employees' Pension Plan is a defined-benefit pension plan that provides for partially indexed pensions based on years of service and best five consecutive years average earnings in the last ten years. The WSIB Employee's Supplementary Pension Plan ensures that employees of the WSIB and Safe Workplace Associations whose earnings exceed the threshold earnings for the maximum pension benefit permitted under the Federal Income Tax Act will receive pension benefits based on their total earnings.

The investment activities and the administrative and accounting functions of the pension plans are administered by the WSIB. The accrued pension obligations of the plans reflect management's estimates of salary escalation, investment rate of return, mortality of members, terminations, and ages at which members will retire.

Other benefits include medical, dental and life insurance, accrued vacation, short-term salary protection to cover periods of illness and other absences, as well as, the costs of insurance benefits provided to employees who sustain injuries in the course of employment. The measurement date for financial reporting purposes of the plan assets and the benefit obligation is as of December 31, 2007. The most recent and next actuarial valuations for funding purposes are as of December 31, 2007 and 2008, respectively.

Information about the WSIB's defined benefit pension plans and other benefit plans in aggregate, is as follows:

(\$ millions)	Employees' Pension Plan		Employees' Supplementary Pension Plan		Other benefit plans		Total Plans	
	2007	2006	2007	2006	2007	2006	2007	2006
<b>Accrued benefit obligation</b>								
<b>Beginning of year</b>	<b>\$1,781.5</b>	<b>\$1,607.3</b>	<b>\$14.8</b>	<b>\$12.5</b>	<b>\$525.6</b>	<b>\$469.8</b>	<b>\$2,321.9</b>	<b>\$2,089.6</b>
Current service cost	59.0	50.6	0.4	0.2	16.0	14.7	75.4	65.5
Interest cost	94.5	87.4	0.8	0.7	27.0	25.4	122.3	113.5
Benefits paid	(50.1)	(53.9)	(0.5)	(0.4)	(16.1)	(16.1)	(66.7)	(70.4)
Employee past service contributions	1.8	3.3	—	—	—	—	1.8	3.3
Employee current service contributions	17.9	21.6	0.2	0.3	—	—	18.1	21.9
Past service benefit cost	—	—	—	—	—	—	—	—
Actuarial (gain) loss	(241.6)	65.2	(1.2)	1.5	(66.0)	31.8	(308.8)	98.5
<b>End of year</b>	<b>1,663.0</b>	<b>1,781.5</b>	<b>14.5</b>	<b>14.8</b>	<b>486.5</b>	<b>525.6</b>	<b>2,164.0</b>	<b>2,321.9</b>
<b>Plan assets</b>								
<b>Fair value at beginning of year</b>	<b>1,707.9</b>	<b>1,474.5</b>	<b>2.6</b>	<b>2.4</b>	<b>—</b>	<b>—</b>	<b>1,710.5</b>	<b>1,476.9</b>
Actual return on plan assets	(9.4)	234.4	0.1	0.1	—	—	(9.3)	234.5
Employer contributions	34.0	28.0	0.2	0.2	16.1	16.1	50.3	44.3
Employee current service contributions	17.9	21.6	0.2	0.3	—	—	18.1	21.9
Employee past service contributions	1.8	3.3	—	—	—	—	1.8	3.3
Benefits paid	(50.1)	(53.9)	(0.5)	(0.4)	(16.1)	(16.1)	(66.7)	(70.4)
<b>Fair value at end of year</b>	<b>1,702.1</b>	<b>1,707.9</b>	<b>2.6</b>	<b>2.6</b>	<b>—</b>	<b>—</b>	<b>1,704.7</b>	<b>1,710.5</b>
<b>Funded status</b>								
Funded status—plan surplus (deficit)	39.1	(73.6)	(11.9)	(12.2)	(486.5)	(525.6)	(459.3)	(611.4)
Unamortized net actuarial (gain) loss	(33.3)	96.2	1.7	2.8	50.1	121.6	18.5	220.6
Unamortized past service costs	13.9	15.5	(0.1)	(0.1)	5.5	6.1	19.3	21.5
Unamortized transitional obligation	(70.7)	(82.6)	—	—	—	—	(70.7)	(82.6)
<b>Accrued benefit liability</b>	<b>(51.0)</b>	<b>(44.5)</b>	<b>(10.3)</b>	<b>(9.5)</b>	<b>(430.9)</b>	<b>(397.9)</b>	<b>(492.2)</b>	<b>(451.9)</b>
Accrued benefit obligation, end of year	1,663.0	1,781.5	14.5	14.8	486.5	525.6	2,164.0	2,321.9
Fair value of plan assets, end of year	1,702.1	1,707.9	2.6	2.6	—	—	1,704.7	1,710.5
<b>Funded status, plan surplus (deficit)</b>	<b>39.1</b>	<b>(73.6)</b>	<b>(11.9)</b>	<b>(12.2)</b>	<b>(486.5)</b>	<b>(525.6)</b>	<b>(459.3)</b>	<b>(611.4)</b>
<b>Net benefit plan expense</b>								
Current service cost	59.0	50.6	0.4	0.2	16.0	14.7	75.4	65.5
Interest cost	94.5	87.4	0.8	0.7	27.0	25.4	122.3	113.5
Expected return on plan assets	(108.6)	(96.1)	(0.1)	(0.1)	—	—	(108.7)	(96.2)
Amortization of past service costs	1.5	1.5	—	—	0.6	0.6	2.1	2.1
Amortization of transitional obligation	(11.8)	(11.8)	—	—	—	—	(11.8)	(11.8)
Amortization of net loss (gain)	5.9	9.1	0.1	—	5.5	3.8	11.5	12.9
<b>Net benefit plan expense</b>	<b>\$40.5</b>	<b>\$40.7</b>	<b>\$1.2</b>	<b>\$0.8</b>	<b>\$49.1</b>	<b>\$44.5</b>	<b>\$90.8</b>	<b>\$86.0</b>

(\$ millions)	Employees' Pension Plan				Employees' Supplementary Pension Plan	
	2007		2006		2007	2006
	\$	%	\$	%	\$	\$
<b>Plan Assets by Major Category</b>						
Equity Securities	1,127.2	66.2	1,167.1	68.3	—	—
Debt Securities	495.0	29.1	477.1	28.0	—	—
Real Estate	48.8	2.9	44.4	2.6	—	—
Accrued Investment Income	10.7	0.6	6.9	0.4	—	—
Other	20.4	1.2	12.4	0.7	2.6	2.6
<b>Total</b>	<b>1,702.1</b>	<b>100.0</b>	<b>1,707.9</b>	<b>100.0</b>	<b>2.6</b>	<b>2.6</b>

The significant actuarial assumptions adopted as of December 31 to value the Employees' Pension Plan, the Employees' Supplementary Pension Plan and other benefit plans are as follows:

	Employees' Pension Plan		Employees' Supplementary Pension Plan		Other benefit plans	
	2007	2006	2007	2006	2007	2006
Discount rate – plan expenses	5.15%	5.40%	5.15%	5.40%	5.15%	5.40%
Discount rate – accrued benefit obligations	5.75%	5.15%	5.75%	5.15%	5.75%	5.15%
Expected long-term rate of return on plan assets	7.0%	7.0%	3.5%	3.5%	—	—
Dental cost escalation	—	—	—	—	4.0%	4.0%
Average remaining service period (years)	13	13	13	13	13	13

#### Health care cost trend rates at December 31

	2007	2006
<b>Medical Cost</b>		
<b>General inflation rate</b>		
Initial rate	9.0%*	10.0%*
Ultimate rate	4.0%	4.0%
Year ultimate rate reached	2013	2013
Age inflation of 2% per year of age		
<b>Dental costs</b>		
General inflation rate	4.0%	4.0%

\*Grading down by 1% per year.

*Sensitivity of actuarial assumptions*

The key economic assumptions used in measuring the pension benefit liability and related expenses are outlined in the table below. The sensitivity analysis provided in the table is hypothetical and changes in each key assumption may not be linear. The sensitivities in each key assumption have been calculated independently of changes in other key assumptions. Actual experience may result in changes in a number of key assumptions simultaneously. Change in one assumption may result in changes in another, which could amplify or reduce certain sensitivities.

(\$ millions)	Discount rate (%)	Impact of 1% increase (\$)	Impact of 1% decrease (\$)	Rate of compensation increase (%)	Impact of 1% increase (\$)	Impact of 1% decrease (\$)	Expected rate of return on plan assets (%)	Impact of 1% increase (\$)	Impact of 1% decrease (\$)
<b>Employees' Pension Plan</b>									
Benefit Liability*	5.75	(243.0)	311.0	3.50	18.6	(18.1)	7.00	N/A	N/A
Benefit Expense**	5.15	(14.0)	16.5	4.00	3.1	(3.0)	7.00	(15.5)	15.5
<b>Employees' Supplementary Pension Plan</b>									
Benefit Liability	5.75	(1.8)	2.2	3.50	0.4	(0.4)	3.50	N/A	N/A
Benefit Expense	5.15	(0.1)	0.1	4.00	0.1	(0.1)	3.50	—	—
<b>Unfunded Pensions</b>									
Benefit Liability	5.75	(0.3)	0.4	3.50	—	—	—	N/A	N/A
Benefit Expense	5.15	—	—	4.00	—	—	—	—	—
<b>Total Change</b>									
Benefit Liability	<b>5.75</b>	<b>(245.1)</b>	<b>313.6</b>	<b>3.50</b>	<b>19.0</b>	<b>(18.5)</b>	<b>7.00</b>	<b>N/A</b>	<b>N/A</b>
Benefit Expense	<b>5.15</b>	<b>(14.1)</b>	<b>16.6</b>	<b>4.00</b>	<b>3.2</b>	<b>(3.1)</b>	<b>7.00</b>	<b>(15.5)</b>	<b>15.5</b>

\*Accrued benefit obligation as at December 31, 2007

\*\*2007 Pension Expense

## 8. Benefit liabilities and benefit costs

Benefit liabilities represent an actuarially determined provision for future benefit payments relating to incurred claims and the expense of administering those future benefit payments that are discounted to the valuation date at the assumed net discount rates shown below. Estimates of future benefit payments apply to both reported and unreported claims resulting from injuries and illnesses, including occupational diseases, that occurred on or before December 31, 2007 and are based on the level and nature of entitlement, and adjudication practices in effect at that date.

The benefit liabilities were determined using accepted actuarial practices in accordance with the standards established by the Canadian Institute of Actuaries.

The actuarial present value of future benefit payments depends on economic and actuarial assumptions that are based on past experience, modified for current trends. These assumptions may change over time to reflect underlying conditions, and it is possible that such changes could cause a material change in the actuarial present value of future benefit payments. The following key long-term economic assumptions were used in the actuarial valuation of the benefit liabilities:

	2007	2006
<b>Inflation rate</b>	3.0%	3.0%
<b>Discount rate</b>	7.0%	7.0%
<b>Rate of indexation of benefits</b>		
Fully indexed	3.0%	3.0%
Partially indexed	0.5%*	0.5%
<b>Discount rate, net of indexation</b>		
Fully indexed	4.0%	4.0%
Partially indexed	6.5%	6.5%
<b>Wage escalation rate</b>	4.0%	4.0%
<b>Health care costs escalation rate</b>	6.5%	6.5%

\*The 0.5% indexation rate is not applied to the partially indexed benefits for 2008 and 2009 as the 2.5% indexation rate specified by Bill 187 is applicable.

Mortality estimates are based on WSIB injured-worker mortality experience from 1996 to 2000 adjusted for mortality improvements to 2007, and for survivors of deceased workers, the 1995 – 1997 Ontario Life Tables adjusted for mortality improvements to 2007.

Loss of Earnings (LOE) termination rates are based on WSIB injured worker termination experience up to and including 2006.

Provisions have been made for the effect of future increases in the covered earnings ceiling and the minimum and maximum limits affecting income benefits.

Management believes that the valuation methods and assumptions are, in aggregate, appropriate for the valuation. Long-term economic and actuarial assumptions and methods are reviewed annually as of December 31, when an actuarial valuation is performed.

The change in present value of future benefit payments for reported and unreported work-related injuries and illnesses, and the change in future claims administration costs, are recorded as benefit cost. Any adjustments resulting from the continuous review of

entitlements and experience, or from changes in legislation, assumptions or methods, are also included as benefit costs.

The benefit liabilities include a provision of \$881 million (2006: \$855 million) for future costs of administering existing claims. Administrative and other expenses have been adjusted by \$294 million (2006: \$301 million) to reflect the amount that was charged against the provision for benefit liabilities relating to future claim administration costs in the current year.

### *Sensitivity of actuarial assumptions*

The benefits liability is calculated based on actuarial assumptions. Changes in these assumptions can cause significant changes in the benefits liabilities. This sensitivity is illustrated as follows:

- The actuarial assumption most sensitive to change is the assumed discount rate of 7% per annum. A 0.5% decrease in the discount rate would increase benefit liabilities by approximately \$735 million (2006: \$725 million).
- A 0.5% increase in the CPI would increase benefit liabilities by approximately \$450 million (new sensitivity for 2007). This 0.5% increase in CPI is not applicable to the partially indexed benefits for 2008 and 2009 as the 2.5% indexation rate specified by Bill 187 is applicable.
- Calculation of the benefit liabilities was based on WSIB injured worker mortality experience. A flat reduction of 5% in these mortality rates would increase benefit liabilities by approximately \$115 million (2006: \$115 million).
- A 10% increase in the number of lost time injuries in the current year would increase the benefit liabilities by approximately \$165 million (2006: \$150 million).
- Health care benefit liabilities are calculated assuming a future rate of escalation of health care costs of 6.5% per annum. A 0.5% increase in the escalation factors used for future health care costs would increase benefit liabilities by approximately \$130 million (2006: \$130 million).
- Calculation of the benefit liabilities for the loss of earnings benefit uses WSIB injured worker claim termination experience. A flat reduction of 5% in termination rates would increase benefit liabilities by approximately \$245 million (2006: \$235 million).

Benefit liabilities and benefit costs paid in 2007 were as follows:

(\$ millions)	2007							2006	
	Loss of Earnings	Labour market re-entry Income support	External providers	Short- & long-term disability	Health care	Survivor benefits	Claim admin. costs	Total	Total
<b>Benefit liabilities, beginning of year</b>	\$4,892	\$54	\$420	\$9,334	\$2,994	\$1,751	\$855	<b>\$20,300</b>	<b>\$19,250</b>
Benefit costs	1,909	129	171	1,509	650	248	320	<b>4,936</b>	<b>4,335</b>
<b>Benefit costs paid during the year</b>									
Schedule 1	(814)	(125)	(149)	(1,194)	(473)	(148)	(294)	<b>(3,197)</b>	<b>(3,024)</b>
Schedule 2	(92)	(5)	(4)	(103)	(54)	(21)	–	<b>(279)</b>	<b>(261)</b>
	(906)	(130)	(153)	(1,297)	(527)	(169)	(294)	<b>(3,476)</b>	<b>(3,285)</b>
<b>Change in benefit liabilities</b>	1,003	(1)	18	212	123	79	26	<b>1,460</b>	<b>1,050</b>
<b>Benefit liabilities, end of year</b>	\$5,895	\$53	\$438	\$9,546	\$3,117	\$1,830	\$881	<b>\$21,760</b>	<b>\$20,300</b>

## 9. Reconciliation of the change in the unfunded liability

The unfunded liability is affected by a number of factors, including an interest charge on the unfunded liability, premiums applied to reduce the unfunded liability, experience gains and losses, changes in accounting practices, policy or legislation and changes in actuarial assumptions for calculating benefit liabilities.

The interest charge on the unfunded liability recognizes that there are insufficient assets to cover existing liabilities resulting in a shortfall in investment income and assets to pay future claim payments. Premiums that are collected to reduce the unfunded liability include an amount to cover this shortfall.

In addition, the difference between expected and actual experience on items such as indexation, investment returns and claims experience also gives rise to changes in the unfunded liability.

**The actuarial reconciliation of the change in the unfunded liability is as follows:**

(\$ millions)	2007	2006
<b>Unfunded liability, beginning of year</b>	\$5,997	\$6,510
Add (deduct):		
<b>Investment income not earned due to shortfall in invested assets</b>	422	458
<b>Premiums allocated to reduction of unfunded liability</b>	(1,024)	(1,000)
<b>Experience (gains)/losses resulting from:</b>		
Indexation of benefits less than expected	(140)	(113)
Lower (higher) than expected investment returns	1,118	(1,063)
Prior and current years' claims experience	647	433
<b>Changes in assumptions:</b>		
Mortality	14	14
Long-term loss of earnings	86	500
<b>Changes in benefit cost assumptions:</b>		
Health care benefits	101	68
Long-term disability	24	15
External agency rehabilitation payments	21	20
Other changes	(22)	59
<b>Other changes:</b>		
Change in personal income tax rates	100	96
<b>Impact of legislation enacted in 2007:</b>		
Increase in liabilities resulting from Bill 187	720	—
Increase in liabilities resulting from Bill 221	30	—
<b>Unfunded liability, end of year</b>	<b>\$8,094</b>	<b>\$5,997</b>



## 10. Administrative and other expenses

Administrative and other expenses consist of the following:

(\$ millions)	2007	2006
Salaries and fringe benefits	\$299	\$288
Equipment and maintenance	37	36
Occupancy	40	40
Communication	17	15
Supplies and services		7
Travel and vehicle maintenance		4
New systems development and integration		7
Other	18	18
	429	415
Amortization expense	12	13
Staff benefit plans	96	94
	537	522
Claim administration costs (note 8)	(294)	(301)
	<b>\$243</b>	<b>\$221</b>

## 11. Related party transactions

### *Legislated obligations and commitments*

Under the *Workplace Safety and Insurance Act, 1997* and as directed by the Lieutenant Governor through Orders in Council, the WSIB is required to reimburse the Government of Ontario for all administrative costs of the *Occupational Health and Safety Act*. The WSIB is also required to fund the Workplace Safety and Insurance Appeals Tribunal (WSIAT), and the Offices of the Worker and Employer Advisor. These reimbursements and funding amounts are determined and approved by the Minister of Labour. The WSIB is also committed to providing funding for the Institute for Work & Health and Safe Workplace Associations, clinics and training centres.

The total amount of funding provided under these legislated obligations and commitments in 2007 was \$218 million (2006: \$208 million).

### *Investments*

Included in investments are marketable fixed income securities issued by the Ontario provincial government and related corporations valued at \$456 million (2006: \$429 million).

### *Other*

In addition to legislated obligations and workplace health and safety expenses, the financial statements include amounts resulting from transactions conducted in the normal course of operations with various Ontario government-controlled ministries, agencies, and Crown corporations. Such transactions are conducted on terms and conditions similar to those that apply to transactions with unrelated parties. Account balances resulting from these transactions are not significant.

**12. Commitments and contingencies***Contractual obligations*

At December 31, 2007, the WSIB was committed under non-cancelable contractual obligations-consisting of software licenses and equipment and property leases-requiring future minimum payments of approximately \$24 million per year over the next five years, and \$33 million in aggregate thereafter.

*Legal actions*

The WSIB is party to various claims and lawsuits which are being contested. In the opinion of management, the outcome of such claims and lawsuits will not have a material effect on WSIB expenses or financial position.

*Bank Line of Credit*

The WSIB maintains an unsecured \$150 million line of credit with a commercial bank. The credit line was not utilized in 2007 and 2006.

**13. Comparative figures**

Certain of the comparative amounts have been reclassified to conform with the presentation adopted in the current year.



**LOSSES DELETED FROM THE ACCOUNTS**(Under the *Financial Administration Act*)

for the year ended March 31, 2008

<u>Ministry</u>	<u>2007-08</u>
REVENUE - TAX .....	\$ 163,130,592.62
TRAINING, COLLEGES AND UNIVERSITIES.....	9,907,694.21
ATTORNEY GENERAL.....	7,327,916.00
COMMUNITY AND SOCIAL SERVICES.....	5,577,722.38
FINANCE - NONTAX.....	5,055,056.73
HEALTH AND LONG-TERM CARE.....	3,399,023.30
ECONOMIC, DEVELOPMENT AND TRADE.....	2,128,792.20
TRANSPORTATION.....	1,312,679.38
NATURAL RESOURCES.....	640,346.52
MUNICIPAL AFFAIRS AND HOUSING.....	490,526.64
REVENUE - NONTAX .....	198,893.16
GOVERNMENT AND CONSUMER SERVICES.....	160,944.27
PUBLIC INFRASTRUCTURE RENEWAL.....	139,834.62
AGRICULTURE, FOOD AND RURAL AFFAIRS.....	87,000.00
COMMUNITY SAFETY AND CORRECTIONAL SERVICES.....	16,843.13
EDUCATION.....	2,909.64
<b>TOTAL.....</b>	<b>\$ 199,576,774.80</b>



**REVENUE REMISSIONS OF \$1,000 OR MORE**

(Under the *Ministry of Revenue Act*)  
granted for the year -ended March 31, 2008

**Ministry of Finance****Other Remissions – OIC 948/2007**

Remission of Income Tax payable was granted to The Canadian Red Cross Society (CRCS) in respect of income of the Transfusion and HIV Claimants' Trust Fund set up to cover benefits for damages due to HIV-AIDS and other blood related diseases on account of tainted blood or tainted blood products received from CRCS.

The estimated revenue impact is \$980,000.00 for the 2001 through the 2005 taxation years.

**Other Remissions – OIC 1389/2007**

Remission of income tax payable was granted to approximately 38,000 individuals in respect of the amount of the Ontario home electricity payment in excess of the amount to which these individuals were entitled for the 2005 taxation year owing to a reassessment of their income tax returns.

The revenue impact is approximately \$1,800,000.00.

**Other Remissions – #07-01**

Remission of Income Tax payable and accrued interest was granted to the Doina-Florica Calin.

The estimated revenue impact is \$9,783.62 plus accrued interest.



**REVENUE REMISSIONS OF \$1,000 OR MORE**

(Under the *Ministry of Revenue Act*)  
granted for the year -ended March 31, 2008

**Ministry of Revenue****\$**

Dora de Pedery-Hunt Retail Sales Tax	21,050.00 plus accrued interest
Estate of Gordon Morel Pyne Succession Duty	877,169.48 plus accrued interest

**Other Remissions – OIC 1963/2007**

Remission of Retail Sales Tax payable was granted on the purchase of bicycles, bicycle helmets and safety equipment for sales occurring after November 30, 2007 and December 1, 2008.

The revenue impact is approximately \$16,000,000.00.

**Other Remissions – OIC 1810/2007**

Remission of Retail Sales Tax payable was granted on the purchase of nicotine replacement therapies that have been assigned a drug identification number by the federal government, are sold for the sole purpose of assisting the purchaser to stop smoking tobacco and purchased after August 12, 2007 and before August 13, 2008.

The revenue impact is approximately \$5,000,000.00.

**Other Remissions – OIC 1399/2007**

Remission of Retail Sales Tax payable was granted on the purchase of certain energy-efficient products that are, at the time of purchase, qualified as Energy Star by the Office of Energy Efficiency, Natural Resources Canada. The contract of sale should be entered into after July 19, 2007 and before July 20, 2008.

The revenue impact is approximately \$51,000,000.00.



**Ministry of Revenue – Cont'd****Other Remissions – OIC 1388/2007**

Remission of the Debt Retirement Charge payable by LANXESS Inc. was granted in respect of its consumption of electricity generated at the JV Generation Facilities and at the TransAlta Generation Facilities, in the operation of its facilities in the Sarnia area. The remission by Ontario Electricity Corporation is subject to the conditions set out in the OIC.

The revenue impact is estimated to be approximately \$2,100,000.00 per calendar year.

**Other Remissions – OIC 1906/2007**

Remission of Land Transfer Tax payable was granted to certain owners of property in the Town of Richmond Hill, Ontario, located on the Oak Ridges Moraine, in respect of the exchange of Uxbridge Exchange Lands for the Parcels under the Uxbridge Valley Land Exchange Agreement.

The revenue impact is approximately \$242,000.00.

**Other Remissions – OIC 1907/2007**

Remission of Corporation Tax payable was granted to certain owners of property in the Town of Uxbridge, Ontario located on the Oak Ridges Moraine, as a consequence of the disposition of their interest in the Uxbridge Exchange Lands in the course of the Land Exchange, subject to the conditions set out in the OIC.

The revenue impact is approximately \$1,000,000.00.

**Other Remissions – OIC 1663/2006**

Deferral of the payment of Corporation Tax was granted to the owners of the Oak Ridges Moraine Land in respect of the exchange of Oak Ridges Moraine Land for the North Pickering Land under the Land Exchange Agreement.

One of the purposes of the Land Exchange Agreement is to ensure that the Oak Ridges Moraine Land is not subject to residential or commercial development in accordance with the Oak Ridges Moraine Conservation Act, 2001.

The revenue impact is approximately \$13,500,000.00.

**Other Remissions – OIC 1064/2006**

Remission of Land Transfer Tax was granted to the owners of the Oak Ridges Moraine Land in respect of the exchange of Oak Ridges Moraine Land for the North Pickering Land under the Land Exchange Agreement.

One of the purposes of the Land Exchange Agreement is to ensure that the Oak Ridges Moraine Land is not subject to residential or commercial development in accordance with the Oak Ridges Moraine Conservation Act, 2001.

The revenue impact is approximately \$2,100,000.00.

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