



2007 Annual Report

Independent Electricity System Operator

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Letter to the Minister of Energy

I am pleased to submit the 2007 Annual Report of the Independent Electricity System Operator (IESO).

This report outlines the IESO's achievements in enhancing the reliability of Ontario's power system, administering the wholesale electricity market and serving the needs of our participants and stakeholders – all in a cost-effective and prudent manner.

For the fourth consecutive year, the IESO has reduced its overall costs while meeting higher provincial demand. These reductions have allowed the IESO to again lower its usage fees, which now stand at \$0.799 per megawatt hour (MWh), a 17 per cent decrease since market opening.

In 2007, while efficiently meeting its system and market responsibilities, the IESO took on new challenges, acting as the Smart Metering Entity, responsible for the establishment and implementation of Ontario's central meter data repository. The IESO was also an active participant in facilitating the changes taking place within the industry to create a more diverse, reliable and sustainable electricity infrastructure.

Efforts to enhance the IESO's customer relationships are also bearing fruit. We have taken steps to lighten the administrative burden on market participants, generating positive feedback and contributing to a more effective market.

Over the coming year, the IESO will continue to focus on promoting its vision of a vibrant Ontario economy supported by a reliable and competitive electricity market.

A handwritten signature in black ink, appearing to read 'Paul Murphy', with a stylized flourish at the end.

Paul Murphy
President and Chief Executive Officer

2007 Highlights

The Year in Review

The reliable supply of electricity in 2007 was supported by the continued strong performance from Ontario generation and transmission facilities, along with increased demand management and more moderate weather. Short-term reliability concerns did, however, present themselves.

In June, the IESO initiated a voltage reduction throughout most of the province. This was in response to a sudden outage to a major transmission line that reduced the availability of a significant amount of generation. Two public appeals were also issued over the summer: a targeted appeal in June to reduce consumption in the Greater Toronto Area; and a province-wide appeal in early August.

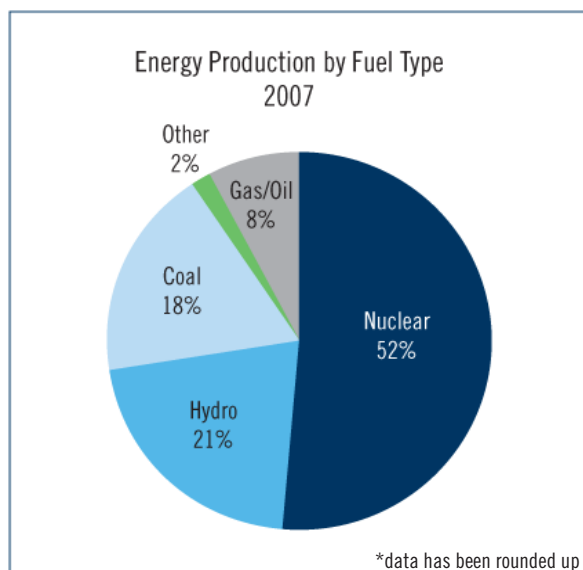
The year's highest peak demand took place on June 26, reaching 25,737 MW, roughly 1,300 MW less than the all-time record of 27,005 MW set in 2006. Total energy use in the province, however, saw a slight increase from 151 terawatt hours (TWh) to 152 TWh.

The impact of wind-powered generation on the supply mix continued to increase as several new wind generators connected to the grid. Total wind generation capacity increased to 470 MW by year-end, and total output for the year doubled to 1.04 TWh.

Nuclear generation continued to supply the largest amount of electricity in Ontario. While its overall contribution was slightly lower than the year before, the total output of 80.9 TWh represented just over 52 per cent of the electricity produced in 2007. Compared to 2006, hydroelectric generation fell slightly in 2007 to 33.4 TWh, while coal-fired generation increased from 25 TWh to 28.2 TWh.

As in 2006, Ontario was once again a net exporter of electricity, with total exports of 12.3 TWh compared to imports of 7.2 TWh.

The average weighted wholesale electricity price in 2007 was 5.05 cents per kilowatt hour (kWh) as compared to 4.88 cents per kWh the year before and to the average five-year price of 5.63 ¢/kWh.



IESO Accomplishments

Throughout 2007, the IESO continued to build on its core strengths of system and market operation and broaden its range of related services.

Reliable Service: Effectively Managing the Power System

The IESO's enduring achievement continues to be the reliable operation of Ontario's integrated power system. Although the supply picture within the province continued to improve over the last year, the IESO routinely manages system events that challenge system reliability.

The Northeast Power Coordinating Council (NPCC) co-ordinated a peer review of the IESO's reliability activities for 2007. The peer group praised the IESO's proactive approach to managing reliability risks, citing the summer 2007 preparations as a noteworthy example. The report also recognized the "continuing commitment of the IESO to the reliable operation of the Ontario power grid and the position of the IESO as an industry leader."

In its reliability readiness audit released last February, the North American Electric Reliability Corporation (NERC) underscored the IESO's reputation as a model organization in its approach to ensuring reliable system operations. NERC cited a number of areas where the IESO sets "examples of excellence," including:

- Its extensive co-op student program which assists in the development and recruitment of skilled employees at a time when many existing staff are nearing retirement. Since 2000, the IESO has hired 40 co-op students into regular positions.
- The IESO gas-electric interdependency assessment, created to better understand dependencies and mitigate risks between the electricity system and Ontario's gas infrastructure.
- The Ontario Reliability Outlook and 18-Month Outlook which the NERC auditors called "model documents for presenting reliability assessments."

The IESO enhanced its capabilities in 2007 through the successful implementation of an updated Energy Management System and a new Back-up Operating Centre. Work has also begun to implement the latest reliability standards for cyber-security.

With its well-developed procedures and processes, Ontario's compliance enforcement program continues to successfully promote effective compliance with the market rules. Of the 257 cases dealt with in 2007, more than 83 per cent were closed by means of Alternative Case Resolution without resorting to a formal investigation. It was also an active year for the IESO in terms of establishing enforcement policies and providing market participants with certainty on the application of penalties and enforcement strategies.

Reliability across North America was also enhanced in 2007 as a result of the adoption of mandatory reliability standards by U.S. jurisdictions. Ontario is a recognized leader in this area as mandatory standards have been a feature of the IESO market rules since market opening in 2002. The broader application of mandatory standards across the continent follows the recommendations that emerged from the 2003 blackout report.

Enabling Change within the Energy Sector

The release of the Integrated Power System Plan (IPSP) by the Ontario Power Authority (OPA) in August of 2007 represented a significant milestone for the province's electricity sector. The 20-year plan, currently before the Ontario Energy Board, calls for a sweeping transformation of the province's electricity infrastructure. For example, the IPSP recommends that by 2025, 45 per cent of the province's electricity supply will be provided by conservation and renewable resources, 8 per cent from natural gas and 47 per cent from nuclear power.

Integrating these changes into the current electricity system will result in different operating characteristics from what exists now. To ensure future real-time needs are met, the IESO will be providing the OPA with analyses and recommendations regarding the operability requirements for the proposed supply mix.

The province's Smart Metering Initiative will increase the role residential and small business consumers play in contributing to the reliability of the system and lessening their impact on the environment. As the Smart Metering Entity, the IESO developed and deployed the smart meter data management and repository system (MDM/R) in 2007. Newmarket-Tay Hydro Power Distribution Ltd. will become the first local distribution company (LDC) to enter into production operations with the MDM/R – sending residential meter data to the repository and receiving it back as time-of-use billing quantity data.

With more timely and robust data about their electricity use, homeowners and small businesses will have the opportunity to better manage their electricity use, with the potential of becoming providers of demand response. The IESO launched a pilot communications program in partnership with the Ontario government to support the initial LDCs making the transition to time-of-use rates.

Enhancing Our Relationships

The IESO's management of its relationships is essential to the effective performance of all its roles. In the IESO's most recent customer survey, market participants evaluated their relationship with the IESO on all levels – from account managers to the IESO Board of Directors. This year, more than three-quarters rated their relationship with the IESO as excellent (between 8 to 10 out of 10), a significant increase from 2006.

These improvements reflect the increased efforts by the IESO to directly respond to market participant concerns by simplifying and reducing the cost of participating in the market. These efforts included:

- The reduction of prudential support (collateral posting) requirements of market participants.
- A consolidated weekly communications bulletin to reduce the number of e-mails flowing from the IESO to market participants and other interested parties.
- A significant reduction in the number of market participants required to obtain and maintain digital certificates.

The IESO has also moved to provide more value-added information to market participants and others about key industry issues. The Market Evolution Analysis and Research Group was created to support market evolution proposals through the provision of in-depth and neutral research and analysis. One of the first products developed as a result of its creation was the Ontario Market Outlook which provided a broad assessment of market performance and identified future market opportunities.

Throughout 2007, the IESO expanded its efforts to provide those customers who pay the market price for electricity with greater educational support. As increasing numbers of municipalities made the shift to hourly prices, the IESO responded by tailoring its existing customer education program to meet the needs of municipalities and other public sector institutions.

Organizational Change

The IESO announced a number of organizational changes during 2007.

James D. Hinds was elected Chair of the IESO Board of Directors. Mr. Hinds has served as the Chair of the IESO Audit Committee since he was first appointed to the IESO Board in May, 2005. He brings a breadth of experience from his career in investment banking and as the Chairman of Irish Line Capital Inc., a private investment company.

A number of additions to the Board brought new expertise and experience to the IESO. These appointments included: David Cassivi, former Chair of Enwin Utilities; Angela Ferrante, former Chief Operating Officer of the Ontario Energy Board; and former director of Hydro Ottawa Robert Chiarelli, who has also served as Mayor of Ottawa.

Changes to the IESO management team were also announced in late 2007. Ken Kozlik was appointed as the organization's Chief Operating Officer and Vice President of Market and System Operations, replacing Derek Cowbourne who will be retiring in spring 2008. Current Vice President of Information Technology Bill Limbrick took on expanded responsibilities as Chief Information Officer. External Relations Director Terry Young became part of the Senior Management Team reflecting the IESO's increased focus on strengthening its relationships with all stakeholders. These changes took effect in early 2008.

Demonstrating Fiscal Responsibility

Ontario's wholesale electricity market represents more than \$10 billion in transactions each year. The IESO has continued to provide its services to all participants in the market in a prudent manner, providing value for money without compromising the core values of system reliability and superior customer service.

For the third year in a row, the IESO moved to reduce the fees it charges to Ontario consumers. The new rate, which took effect on January 1, 2008, pending Ontario Energy Board approval, brings the fee down to \$0.799/MWh, down 17 per cent from \$0.959/MWh at market opening. Fee reductions are expected to save market participants \$21 million over the next three years, on top of the \$49 million in savings they have enjoyed over the last two years.

Market Year in Review - Price



Management Report

Management's Responsibility for Financial Reporting

The accompanying financial statements of the Independent Electricity System Operator are the responsibility of management and have been prepared in accordance with accounting principles generally accepted in Canada. The significant accounting policies followed by the Independent Electricity System Operator are described in the Summary of Significant Accounting Policies contained in Note 2 in the financial statements. The preparation of financial statements necessarily involves the use of estimates based on management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been prepared within reasonable limits of materiality and in light of information available up to February 15, 2008.

Management maintained a system of internal controls designed to provide reasonable assurance that the assets were safeguarded and that reliable information was available on a timely basis. The system included formal policies and procedures and an organizational structure that provided for the appropriate delegation of authority and segregation of responsibilities.

These financial statements have been examined by PricewaterhouseCoopers LLP, a firm of independent external auditors appointed by the Board of Directors. The external auditors' responsibility is to express their opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles in Canada. The Auditors' Report, which follows, outlines the scope of their examination and their opinion.

INDEPENDENT ELECTRICITY SYSTEM OPERATOR

On behalf of management,



Paul Murphy
President and Chief Executive Officer
Toronto, Canada
February 15, 2008



Gary Sherkey
Vice President – Corporate Services
Chief Financial Officer and Treasurer
Toronto, Canada
February 15, 2008

Auditors' Report

February 15, 2008

To the Board of Directors of the Independent Electricity System Operator (IESO):

We have audited the statement of financial position of the IESO as of December 31, 2007 and the statements of operations, other comprehensive income (loss) and accumulated surplus and cash flows for the year then ended. These financial statements are the responsibility of the IESO'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 principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the IESO 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.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants
Toronto, Ontario

Statement of Operations, Other Comprehensive Income/(Loss) and Accumulated Surplus

(in thousands of Canadian dollars)	For the Year Ended December 31, 2007	For the Year Ended December 31, 2006
	\$	\$
REVENUES		
System fees (Note 9)	131,538	132,015
Other revenue (Note 3)	2,143	7,622
TOTAL REVENUES	133,681	139,637
EXPENSES		
Labour	77,514	76,096
Computer services, support & equipment	8,980	9,728
Contract services & consultants	8,213	7,018
Telecommunications	3,329	2,706
Other costs	6,494	5,047
Amortization	29,184	32,353
TOTAL EXPENSES	133,714	132,948
Income Before Interest and Investment Income	(33)	6,689
Interest and investment income	97	1,731
Interest expense & financing charges	(6,848)	(7,959)
NET INCOME/(LOSS) FOR THE YEAR	(6,784)	461
OTHER COMPREHENSIVE INCOME/(LOSS)	(29)	-
COMPREHENSIVE INCOME/(LOSS)	(6,813)	461
ACCUMULATED SURPLUS - BEGINNING OF YEAR	7,961	7,500
Change in accounting policy (Note 2)	1,866	-
ACCUMULATED SURPLUS - END OF YEAR (Note 9)	3,014	7,961

See accompanying notes to Financial Statements.

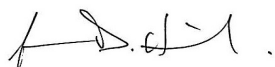
Statement of Financial Position

(in thousands of Canadian dollars)

	As at December 31, 2007	As at December 31, 2006
	\$	\$
ASSETS		
Current assets		
Cash & cash equivalents	1,229	3,565
Prepaid expenses & receivables	16,957	24,429
	18,186	27,994
Property & Equipment (Note 4)		
In service	96,048	113,051
Construction-in-progress	14,898	4,827
	110,946	117,878
Other Assets		
Long-term investments (Note 5)	16,718	12,585
Prepaid pension cost (Note 6)	2,971	12,471
Deferred costs	1,596	1,596
	21,285	26,652
TOTAL ASSETS	150,417	172,524
LIABILITIES		
Current Liabilities		
Accounts payable & accrued liabilities (Note 7)	26,236	20,863
Accrued interest on long-term debt	1,030	1,030
Short-term debt (Note 8)	-	15,000
Rebates to market participants (Note 9)	-	12,699
	27,266	49,592
Long-term Debt (Note 8)	78,200	78,200
Accrual for Employee Future Benefits Other than Pensions (Note 6)	41,937	36,771
TOTAL LIABILITIES	147,403	164,563
ACCUMULATED SURPLUS (Note 9)	3,014	7,961
TOTAL LIABILITIES & ACCUMULATED SURPLUS	150,417	172,524

See accompanying notes to Financial Statements.

On behalf of the Board:



James Hinds
Chair
Toronto, Canada



William Museler
Director
Toronto, Canada

Statement of Cash Flows

(in thousands of Canadian dollars)	For the Year Ended December 31, 2007	For the Year Ended December 31, 2006
	\$	\$
OPERATING ACTIVITIES		
Net income/(loss) for the year	(6,784)	461
Adjustments for non-cash items:		
Amortization	29,184	32,353
Prepaid pension cost	17,349	17,746
Other employee future benefits cost	6,592	6,426
Change in fair value of long-term investment held for trading	(417)	-
Provision for other than temporary losses on long-term investment	666	-
	46,590	56,986
Changes in non-cash balances related to operations:		
Increase in accounts payable and accrued liabilities	1,182	663
Decrease in rebates to market participants	(12,699)	(861)
Change in prepaid expenses and receivables	7,472	(2,018)
	(4,045)	(2,216)
Other:		
Contribution to pension fund	(7,849)	(8,361)
Payment of employee future benefits	(1,426)	(1,384)
	(9,275)	(9,745)
Cash provided from operating activities	33,270	45,025
INVESTING ACTIVITIES		
Net sale of temporary investments	-	5,980
Net purchase of long-term investments	(2,516)	(2,673)
Investment in deferred costs	-	(1,596)
Investment in property & equipment	(18,090)	(17,802)
Cash used in investing activities	(20,606)	(16,091)
FINANCING ACTIVITIES		
Retirement of debt	(15,000)	(35,000)
Cash used in financing activities	(15,000)	(35,000)
NET CHANGE IN CASH & CASH EQUIVALENTS	(2,336)	(6,066)
CASH & CASH EQUIVALENTS - BEGINNING OF YEAR	3,565	9,631
CASH & CASH EQUIVALENTS - END OF YEAR	1,229	3,565

See accompanying notes to Financial Statements.

Supplementary Information:

(in thousands of Canadian dollars)

Interest Paid	6,765	7,781
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Notes to Financial Statements

1. NATURE OF OPERATIONS

Independent Electricity System Operator (IESO) is a not-for-profit, non-taxable corporation, created by statute effective on April 1, 1999 pursuant to Part II of the *Electricity Act, 1998*. As set out in the *Electricity Act*, the IESO operates pursuant to a license granted by the Ontario Energy Board (OEB). The objects of the IESO as contained in the *Electricity Act*, and amended in the *Electricity Restructuring Act, 2004* and Ontario Regulation 452/06 are as follows:

- to exercise the powers and perform the duties assigned to the IESO under the *Electricity Restructuring Act, 2004*, the market rules and its license;
- to enter into agreements with transmitters giving the IESO the authority to direct the operation of their transmission systems;
- to direct the operation and maintain the reliability of the IESO-controlled grid to promote the purposes of the *Electricity Restructuring Act, 2004*;
- to participate in the development, by any standards authority, of standards and criteria relating to the reliability of the transmission systems;
- to work with the responsible authorities outside Ontario to co-ordinate the IESO's activities with their activities;
- to collect and provide information to the Ontario Power Authority (OPA) and the public relating to the current and short-term electricity needs of Ontario and the adequacy and reliability of the integrated power system to meet those needs; and
- to operate the IESO-administered markets to promote the purposes of the *Electricity Restructuring Act, 2004*.
- to plan, manage and implement the smart metering initiative or any aspect of the initiative;
- to oversee, administer and deliver the smart metering initiative or any aspect of the initiative; and
- to establish and enforce standards and criteria relating to the reliability of transmission systems.

The IESO was designated the Smart Metering Entity by Ontario Regulation 393/07 under the *Electricity Act* made on March 28, 2007. The regulation came into effect on July 26, 2007.

The objects of the Smart Metering Entity as contained in the *Electricity Act* are as follows:

- to plan and implement and, on an ongoing basis, oversee, administer and deliver any part of the smart metering initiative as required by regulation under this or any Act or directive made pursuant to sections 28.3 or 28.4 of the *Ontario Energy Board Act, 1998*, and, if so authorized, to have the exclusive authority to conduct these activities;
- to collect and manage and to facilitate the collection and management of information and data and to store the information and data related to the metering of consumers' consumption or use of electricity in Ontario, including data collected from distributors and, if so authorized, to have the exclusive authority to collect, manage and store the data;
- to establish, to own or lease and to operate one or more databases to facilitate collecting, managing, storing and retrieving smart metering data;
- to provide and promote non-discriminatory access, on appropriate terms and subject to any conditions in its licence relating to the protection of privacy, by distributors, retailers, the OPA and other persons,

- i. to the information and data referred to above, and
 - ii. to the telecommunication system that permits the Smart Metering Entity to transfer data about the consumption or use of electricity to and from its databases, including access to its telecommunication equipment, systems and technology and associated equipment, systems and technologies
- to own or to lease and to operate equipment, systems and technology, including telecommunication equipment, systems and technology that permit the Smart Metering Entity to transfer data about the consumption or use of electricity to and from its databases, including owning, leasing or operating such equipment, systems and technology and associated equipment, systems and technologies, directly or indirectly, including through one or more subsidiaries, if the Smart Metering Entity is a corporation;
 - to engage in such competitive procurement activities as are necessary to fulfil its objects or business activities;
 - to procure, as and when necessary, meters, metering equipment, systems and technology and any associated equipment, systems and technologies on behalf of distributors, as an agent or otherwise, directly or indirectly, including through one or more subsidiaries, if the Smart Metering Entity is a corporation;
 - to recover, through just and reasonable rates, the costs and an appropriate return approved by the Board associated with the conduct of its activities; and
 - to undertake any other objects that are prescribed by associated regulation.

The IESO is required to submit its proposed expenditures, revenue requirements, and fees for the coming year to the OEB for review. The submission may be made only with the approval of the Minister of Energy (Minister).

On March 21, 2007 the OEB approved the IESO's requested expenditures, revenue requirements and fees for fiscal 2007.

The IESO filed proposed 2008 expenditures, revenue requirements, and fees for review on November 2, 2007. The OEB approved the IESO's proposed usage fee for 2008 of \$0.799/MWh on an interim basis, effective January 1, 2008, pending completion of its review of the IESO's requested 2008 expenditures, revenue requirements and fees.

The IESO's smart meter service fees have not yet been established for 2008.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Basis of financial statement preparation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in Canada. The IESO adopted new Canadian Institute of Chartered Accountants Handbook: section 1530, comprehensive income; section 3855, financial instruments - recognition and measurement; section 3861, financial instruments - disclosure and presentation; and section 3865, hedges, effective January 1, 2007. Prior to adoption of these new standards, financial assets comprising cash, accounts receivable and investments were recorded at cost or amortized cost. On adoption of the new standards, the IESO designated its investment portfolio as being "held for trading" and classified its cash and accounts receivable as "loans and receivables" which are accounted for as follows:

- Held for trading investments are recorded at fair value with gains and losses recorded in the statement of operations. Transactions are recorded based on trade dates. Transaction costs are charged to operations as incurred. The IESO adopted these standards prospectively and accordingly the comparative financial statements have not been restated. The IESO has adjusted opening accumulated surplus by \$1,866,000, reflecting unrealized gains on long-term investments at January 1, 2007 not recognized under the previous accounting policy.
- Loans and receivables are initially recorded at fair value and subsequently measured at amortized cost using the effective interest rate method. There was no material impact of the change in accounting policy on the carrying values of cash and accounts receivable.

Foreign exchange forward contracts are recorded at fair value. Where foreign exchange forward contracts meet the criteria for hedge accounting, changes in their values are reflected in accumulated surplus as other comprehensive income. Where such contracts do not meet the criteria for hedge accounting changes in their value are recognized in the statement of operations. Prior to 2007, where such forward contracts met the criteria for hedge accounting, changes in their values resulting from exchange rate movements were not reflected in the financial statements.

The new accounting standards had no material impact on the carrying value of the IESO's financial liabilities, comprising accounts payable and long-term debt which are carried at amortized cost.

b) Revenue recognition

System fees earned by the IESO are based on approved rates for each megawatt of electricity withdrawn from the IESO-controlled grid, including exports. System fees are recognized as revenue at the same time as the electricity is withdrawn. Rebates are recognized in the year in which the approved regulatory deferral account, before such rebates, exceeds regulated limits.

These financial statements do not include the financial transactions of market participants within the IESO-administered markets.

Other revenue represents amounts that accrue to the IESO relating to services the IESO performs and charges on a recovery basis, interest on funds passing through market settlement accounts, as well as fines and penalties passing through the market adjustment account. Such revenue is recognized as it accrues.

c) Cash and cash equivalents

Cash and cash equivalents comprise cash, term deposits and other short-term investments with original maturity dates of less than 90 days.

d) Construction-in-progress

Construction-in-progress generally relates to the costs of physical facilities, hardware and software, and includes costs paid to vendors, internal and external labour, consultants, an applicable share of overhead, and an allocation of interest related to funds borrowed to finance the project. Costs relating to construction-in-progress are transferred to property and equipment in service when the asset under construction is deemed to be ready for use.

e) Property and equipment in service

Property and equipment are capitalized at cost, which comprises materials, labour, external support, overheads, and interest applicable to capital activities.

f) Amortization

The capital cost of property and equipment in service is amortized on a straight line basis over their estimated service lives.

The estimated service lives in years, from the date the assets were acquired, are:

<u>Class</u>	<u>Estimated Average Service Life</u>
Facilities	39
Market Systems and Applications	4 to 8
Infrastructure and Other Assets	4 to 7

Gains and losses on sales of property and equipment and losses on premature retirements are charged to operations. Removal costs are charged to operations as incurred.

The estimated service lives of property and equipment and the significant assumptions underlying the estimates of removal costs are subject to periodic review. The impacts of changes in the estimated lives of property and equipment are amortized on a prospective basis. The most recent review was completed in fiscal 2007.

g) Long-term investments

Portfolio investments designated as held for trading are recorded at fair value, with gains and losses recorded in the statement of operations. Transactions are recorded based on trade dates. Transaction costs are charged to operations as incurred.

h) Pension and other post-employment benefits

The IESO's post-employment benefit programs include pension, group life insurance, health care, long-term disability and workers compensation benefits.

The IESO accrues obligations under pension and other post-employment benefit ("OPEB") plans and the related costs, net of plan assets. Pension and OPEB expenses and obligations are determined annually by independent actuaries using the projected benefit method and management's best estimate of expected return on plan assets, salary escalation, retirement ages of employees, mortality and expected health-care costs. The discount rate used to value liabilities is based on market rates as at the measurement date of September 30.

The expected return on plan assets is based on management's long-term best estimate using a market-related value of plan assets. The market-related value of plan assets is determined using market-related values for equities (whereby fund assets are calculated using the smoothed value of assets over five years) and market values for fixed income securities, as at the measurement date of September 30.

Pension and OPEB expenses are recorded during the year in which employees render services. Pension and OPEB expenses consist of current service costs, interest expense on liabilities, expected return on plan assets and the amortization of plan amendments on a straight-line basis over the expected average remaining service life of the employees covered by the plan. Actuarial gains (losses) arise from, amongst other things, the difference between the actual rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligations. The excess, if any, of the cumulative unamortized net actuarial gain or loss over 10% of the greater of the projected benefit obligation and the market-related value of plan assets is also amortized over the expected average remaining service life of the employees covered by the plan.

The expected average remaining service life of employees covered by the pension and OPEB plans is 11 years (2006: 11 years).

i) Deferred costs

Deferred costs represent start-up costs incurred by the IESO during 2006 for the smart metering initiative (\$1,595,605). These costs will be recognized in operating results over a six year period commencing in 2008. These costs will be recognized in a manner consistent with estimated IESO smart meter service fee revenues over that period.

j) Foreign exchange

Transactions denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated in Canadian dollars at the rate prevailing at that date. Exchange gains and losses arising on settlement of foreign exchange transactions are reported in the statement of operations at the date at which the transactions are settled.

k) Use of 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 revenues, expenses, assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the financial statements. Actual results could differ from those estimates.

l) Comparative figures

Certain 2006 comparative figures have been reclassified to conform to the 2007 presentation.

3. OTHER REVENUE

In its administration of the IESO-administered markets, the IESO directs the investment of market funds in highly-rated short-term investments, including asset-backed commercial paper ("ABCP"), throughout the settlement cycle. The IESO is ordinarily entitled to receive the investment income earned on funds passing through the real-time market settlement accounts.

As a result of developments with respect to the Canadian market for ABCP in August 2007 some of the investments made for the real-time energy market are not liquid. As at December 31, 2007, investments with a principal amount of \$23.1 million in non-bank sponsored ABCP notes remain illiquid and neither the associated principal repayments nor the interest payments on these notes were paid at their maturity dates, all of which were prior to December 31, 2007. Under the Pan-Canadian Investors Committee for Third-Party Structured Asset Backed Commercial Paper ("Montreal Accord") there is a broad based industry initiative to restructure the ABCP notes to secure investor value and restore liquidity. Pursuant to this initiative the trusts which issued the ABCP have adopted a standstill period to February 22, 2008.

The IESO is not obligated to reimburse the market accounts in respect of the credit losses incurred on the ABCP investments. However, the IESO has not recognized as other revenue any investment income earned in the market settlement accounts during the year.

In addition, as a result of the illiquid ABCP in the market accounts, the IESO has, from time to time in 2007, provided short-term financing to the market to fund the settlement process. The IESO financed these loans through short-term drawings on its credit facility. The maximum amount borrowed by the IESO and advanced to the market during the year at any one time was \$16,100,000.

4. PROPERTY AND EQUIPMENT

	As at December 31, 2007			As at December 31, 2006		
(in thousands of Canadian dollars)	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
	\$	\$	\$	\$	\$	\$
Property and equipment in service						
Facilities	49,619	10,761	38,858	49,540	9,342	40,198
Market Systems and Applications	224,497	181,952	42,545	218,884	159,581	59,303
Infrastructure and Other Assets	89,662	75,017	14,645	83,773	70,223	13,550
	363,778	267,730	96,048	352,197	239,146	113,051
Construction-in-progress	14,898	-	14,898	4,827	-	4,827
	378,676	267,730	110,946	357,024	239,146	117,878

In 2007 the impact of adjustments to management's estimates of remaining asset service lives was a decrease in amortization expense of \$3,356,468. In 2006 the impact of adjustments to management's estimates of remaining asset service lives was a decrease in amortization expense of \$4,933,698.

Interest capitalized to construction-in-progress during 2007 was \$617,232 (2006 - \$24,757).

5. LONG-TERM INVESTMENTS

Long-term investments in a balanced portfolio of pooled funds are valued based on published price quotations in an active market and amount to \$16,051,815 (2006 – 14,450,453). At December 31, the market value allocation of these long-term investments was 60.8% equity securities, 34.7% debt securities and 4.5% cash equivalents (2006 - 61.7%, 34.4% and 3.9% respectively).

Long-term investments in non-bank sponsored ABCP carried at \$666,260 are valued based on probability-weighted discounted cash flows and reflect a provision for other than temporary losses of \$666,260.

6. POST-EMPLOYMENT BENEFIT PLANS

The IESO provides pension and other employee post-employment benefits, comprising group life insurance, long-term disability and group medical and dental plans, for the benefit of current and retired employees.

Pension plans

The IESO provides a contributory defined benefit, indexed, registered pension plan. In addition to the funded, registered, pension plan, the IESO provides certain non-registered defined benefit pensions through an unfunded, indexed, non-registered plan.

Other employee future benefits

The group life insurance, long-term disability and group medical and dental benefits are provided through unfunded, non-registered defined benefit plans.

Summary of accrued benefit obligations and plan assets

(in thousands of Canadian dollars)	2007 Pension Benefits \$	2006 Pension Benefits \$	2007 Other Benefits \$	2006 Other Benefits \$
Accrued benefit obligation	383,311	388,585	59,047	59,714
Fair value of plan assets	320,468	296,144	-	-
Funded status	(62,843)	(92,441)	(59,047)	(59,714)
Employer contribution after measurement date	1,956	2,055	352	357
Unamortized past service costs	3,720	4,417	41	428
Unamortized net actuarial loss	60,138	98,440	16,717	22,158
Prepaid (accrued) benefit cost recognized in the statements of financial position	2,971	12,471	(41,937)	(36,771)

Prepaid benefit cost is shown net of valuation allowance of \$nil (2006: \$nil).

Registered pension plan assets

As at the measurement date of September 30, registered pension plan assets were split by market value between the following categories:

	2007	2006
Equity securities	59.7%	59.0%
Debt securities	39.9%	40.8%
Cash equivalents	0.4%	0.2%
	100.0%	100.0%

Summary of principal assumptions used to calculate benefit obligations

	2007 Pension Benefits	2006 Pension Benefits	2007 Other Benefits	2006 Other Benefits
Discount rate at end of the period	5.4%	5.0%	5.4%	5.0%
Rate of compensation increase	3.5%	3.5%	3.5%	3.5%

The assumed hospital and drug cost increase is 9.0% per annum initially. The rate is assumed to begin decreasing gradually commencing October 1, 2008 to a rate of 5.0% in the year 2014 and remain at that level thereafter. Dental costs are assumed to increase by 6.0% per annum initially and to begin decreasing commencing October 1, 2008 to a rate of 4.5% in the year 2009 and remain at that level thereafter.

Summary of benefit costs and plan contributions

(in thousands of Canadian dollars)	2007 Pension Benefits \$	2006 Pension Benefits \$	2007 Other Benefits \$	2006 Other Benefits \$
Benefit cost	17,349	17,746	6,592	6,426
Employer contributions	7,948	6,329	1,432	1,331
Plan participants' contributions	2,385	2,014	-	-
Benefits paid	13,928	11,450	1,432	1,331

The most recent actuarial valuation of the registered pension plan for funding purposes was at January 1, 2005, and the date of the next required valuation is January 1, 2008.

Summary of principal assumptions used to calculate benefit costs

	2007 Pension Benefits	2006 Pension Benefits	2007 Other Benefits	2006 Other Benefits
Discount rate at the beginning of the period	5.0%	5.1%	5.0%	5.1%
Expected return on plan assets	7.0%	7.0%	-	-
Rate of compensation increase	3.5%	3.5%	3.5%	3.5%
Rate of indexing of pension benefits	2.5%	2.5%	-	-

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	As at December 31, 2007	As at December 31, 2006
(in thousands of Canadian dollars)	\$	\$
Relating to property and equipment	7,938	3,775
Relating to operations	18,298	17,088
	26,236	20,863

8. DEBT

	As at December 31, 2007	As at December 31, 2006
(in thousands of Canadian dollars)	\$	\$
Note payable to Ontario Electricity Financial Corporation (OEFC)	78,200	78,200
	78,200	78,200
Short-term debt (credit facility)	-	15,000
	78,200	93,200

Note payable to OEFC

The long-term note payable to Ontario Electricity Financial Corporation (OEFC) is unsecured, bears interest at 7.9% per annum and is repayable in full on May 1, 2009. Interest accrues daily and is payable in arrears, in equal semi-annual payments on May 1 and November 1 of each year. The fair value of the long-term note payable is estimated at \$81,722,627.

Credit facility

IESO has an unsecured, committed, and extendible 364-day revolving credit facility agreement with a Canadian chartered bank, under which the bank will make available to the IESO an amount up to \$60.0 million. Advances under this facility are available in Canadian dollars by way of a prime rate loan or the issuance of Bankers' Acceptances at market rates plus a stamping fee of 30 basis points per annum. Unused portions of this credit facility are subject to a commitment fee of 10 basis points per annum. As at December 31, 2007, there were no funds drawn on the credit facility.

9. ACCUMULATED SURPLUS AND REBATES TO MARKET PARTICIPANTS

In 2007 the IESO recognized \$nil rebates to market participants of system fees (2006 – \$12,699,435), due to net operating losses in the year, reducing the IESO's approved regulatory deferral account below \$5 million. As at December 31 the components of the IESO's Accumulated Surplus were as follows:

(in thousands of Canadian dollars)	As at December 31, 2007 \$	As at December 31, 2006 \$
Approved regulatory deferral account	691	5,000
Accumulated market penalties and fines	2,476	2,961
Accumulated deficit - Smart Metering Entity	(124)	-
Accumulated other comprehensive deficit	(29)	-
	3,014	7,961

10. FINANCIAL RISK MANAGEMENT

The IESO enters into foreign exchange forward contracts for risk management purposes. Foreign exchange forward contracts are commitments to purchase foreign currencies for delivery at a specified date in the future at a fixed rate. The IESO enters into such contracts only for known or anticipated transactions that will require settlement in foreign currency, and does not use any other derivative instruments.

The IESO is exposed to changes in the value of such contracts prior to their settlement as a result of movements in the underlying foreign exchange rates. Senior management responsible for cash management manages this risk.

The IESO holds long-term investments in a balanced portfolio of pooled funds earmarked for the IESO's non-registered, defined benefit pension obligations which are unfunded.

11. SEGMENTED INFORMATION

IESO consists of a single business engaged in the operation of the wholesale electricity markets, maintenance of the reliability of the IESO-controlled grid and implementation and administration of the smart metering initiative in Ontario.

12. COMMITMENTS

Operating commitments

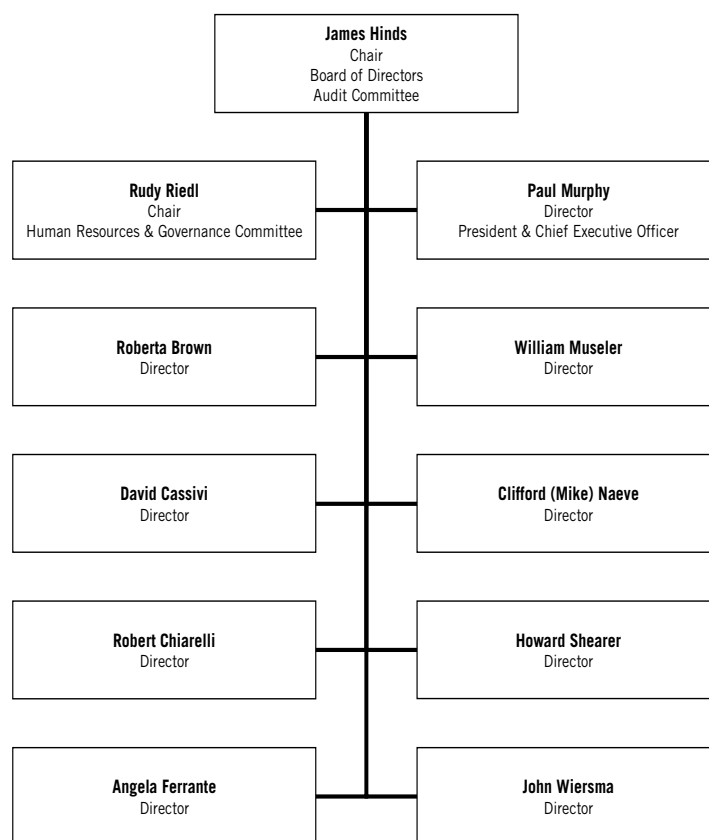
The obligations of the IESO with respect to non-cancellable operating leases over the next five years are as follows:

(in thousands of Canadian dollars)		\$
2008		1,927
2009		1,818
2010		1,732
2011		1,249
2012		-

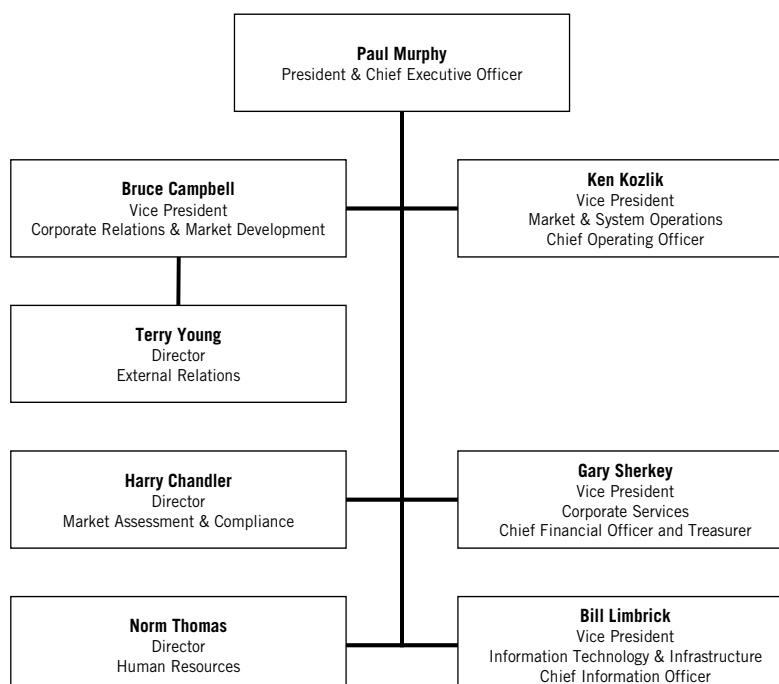
Appendix A - IESO Organizational Charts

(as at January 1, 2008)

Board of Directors



Senior Management Team



Appendix B - Executive Compensation

Program Objectives

The IESO compensation program is an integrated program for all management group staff, designed to attract, retain and motivate the calibre of executives required to support the achievement of our statutory mandate, business objectives and corporate vision. Accordingly, the compensation philosophy and programs have been built on the following objectives:

- To focus executives on meeting the IESO's business objectives
- To attract qualified and talented staff needed to carry out the IESO's mandate
- To be able to retain valued staff
- To have the flexibility to reward results and demonstrated competencies
- To have compensation levels which are responsible and defensible to stakeholders and customers

The philosophy underlying these objectives is that total compensation for senior management should be sufficient, but not overly sufficient, to attract and retain the skills and competencies necessary to carry out the IESO's mandate.

Program Governance

The IESO Board of Directors (the Board) establishes the compensation objectives for these programs. They delegate to the Human Resources and Governance Committee of the Board (HRGC) the responsibility to thoroughly review the compensation objectives, policies and programs and to make recommendations concerning such to the full Board for approval. The Board is composed of ten independent, external Directors, appointed by the Minister of Energy, with broad experience in both industry and public sector organizations, plus the Chief Executive Officer. In carrying out their mandate the Board members have access to Management's perspectives as well as those of expert consultants in the compensation field (including experts at various times from Towers Perrin, Mercer and Hay). These programs are reviewed at least annually including business needs, program objectives and design, industry compensation trends, internal compensation relativities, and external market relativities.

In addition to the formal governance and oversight structure in place for compensation matters, the IESO annually discloses compensation levels for staff earning above \$100,000 as part of the public sector salary disclosure. For the IESO, a further level of public review and assurance is provided through a statutorily required annual fee review. Compensation matters, including management compensation and market relativities, are addressed during the Ontario Energy Board review. A broad range of small and large consumers, assisted by their legal and professional advisors, are represented in these public proceedings. The IESO is also responsive to various requests by the Ministry of Energy in relation to compensation enquiries including the Agency Review Panel (ARP) in 2007 which conducted an exhaustive review of senior management compensation for the various agencies in the Ontario electricity sector.

Market Comparisons

The IESO benchmarks compensation to similar positions in Canadian industry when establishing the compensation program for the following year. The comparator employers include a set of sixteen mid-size to smaller energy sector companies – eight government and eight non-government. Some examples of government companies used in these comparisons are Alberta Electric System Operator, Ontario Power Authority and New Brunswick Power Corporation and some examples of non-government companies are Emera, FortisAlberta and Spectra Energy.

These comparator organizations are segmented into government and non-government categories. Market compensation data is gathered for each segment. A 50/50 weighting is then applied to each of the government and non-government market results to reflect an overall comparator market for executive compensation at the IESO. When comparing the compensation of the IESO executives to this overall market, care is taken to assess positions of similar size, scope and complexity.

While market data is gathered for various components of compensation, emphasis is placed on total rewards including the sum of fixed and variable compensation, benefits and pension. Thus, total rewards for IESO executives are benchmarked to the 50th percentile or midpoint of total rewards reported in the market data.

This approach to gathering market data on executive compensation, while similar to approaches used previously, segments and weights government and non-government market data more explicitly, and focuses more strongly on comparisons at the total rewards level, as recommended by the ARP. In addition to the comparisons outlined above, the IESO Board also reviews available compensation data for other North American Independent System Operators to determine if broader North American trends should be considered.

Program Description

The IESO's program includes fixed and variable compensation, core and flex benefit plans, and pension provisions.

For the fixed compensation plan the Board establishes broad salary ranges for each level of executive taking into account comparable market relativities. Within these bands individuals are assessed as developmental, mature or expert in their position relative to an established competency model. This model consists of behavioural competencies, such as customer focus, drive for results, teamwork, leadership, and strategic business sense. The assessment is based upon demonstrated competency. Each individual is then awarded a fixed compensation level within the band.

In order to promote a results orientation in the senior team, the variable pay plan is significant within the total compensation of executives. The CEO's target for variable compensation for 2007 was at 85% of fixed compensation and the target for Vice Presidents was 55% of fixed compensation. The IESO Board recently revised these levels to 65% and 50% respectively for 2008. The IESO Board annually establishes a robust set of performance measures which are evaluated at the end of each year and these results carry a 70% weight within each executive's variable compensation award. The remaining 30% results from the assessment of predetermined measures/targets established for each individual executive. To address

retention, 50% of the earned variable compensation is deferred and paid out over a three year period, with accrued but unpaid amounts forfeited in the event of termination with cause or resignation.

The group benefit plan provides a core level of health and dental benefits, life insurance, disability coverage and vacation which can be adjusted by the executives through the flexible component of the plan. The flexible element provides executives the option of adjusting their benefits to meet their individual/family needs including vacation above core amounts, increased life insurance, increased health coverage and other components.

A defined benefit pension plan provides 2% of earnings per year to a maximum of thirty-five years of service, or a maximum benefit of 70% of earnings. After age 65, this pension is reduced to reflect provisions from the Canada Pension Plan. Retirement income is provided through a registered pension plan and a supplemental employee retirement plan. Both the IESO and plan members contribute to the plan.

Performance Measures & Impact on Compensation

The IESO annually establishes corporate performance measures relating to its business priorities. As outlined above the results achieved each year impact on each executive's variable pay. The following chart highlights each of the business perspectives where measures are established and provides a brief description of the type of measurement which was approved by the IESO Board of Directors for 2007.

Business Perspective	Areas of Measurement
Reliability & Operational Effectiveness	- The maintenance of electricity reliability within the province of Ontario. - How the IESO facilitates the Ontario electricity marketplace, provides metering, settlement and market support services and ensures availability of systems.
Addressing Customers' & Stakeholders' Needs	Recognition by customers and stakeholders that the IESO effectively manages communications and relationships in support of both the electrical system and market operation responsibilities, and the needs of Ontario electricity customers.
Effective Use of Funds	- Measures to compare total spending (OM&A + Interest + Amortization) to the budget amounts approved by the IESO Board. - That the IESO's Usage Fee meets levels approved by the IESO Board. - How capital spending compares to the budget approved by the IESO Board including how timelines and results for capital projects compare to approved requirements.
Market Evolution	- Measures relating to the achievement and effective management of identified evolution of the electricity marketplace within the industry environment. - Effective management of the IESO's role in the implementation of the Ontario's Smart Metering Initiative.

A five-point rating scale ranging from unsatisfactory to outstanding is used to assess the results for both corporate and individual performance objectives and is used to calculate the associated variable pay amount. According to this scale corporate results may be rated from zero to two times the target variable amount while individual results can range from zero to 1.7 times the target amount. A payout factor is then determined and applied to the target variable pay amount for each executive.

Other Considerations

Compensation decisions may at times be impacted by market factors – such as the recruitment of an executive with specialized skills/competencies or possessing unique talents within the industry. To this end individual incumbent arrangements are sometimes established relating to terms of employment and the possibility of future termination. The CEO has an employment agreement which outlines terms and conditions for a five and one-half year period of employment and includes termination provisions of 24 months for severance. The Vice-Presidents also have provisions which provide up to 24 months severance for termination without cause. In addition, two Vice Presidents (Mr. Campbell and Mr. Limbrick) have agreements to provide accelerated pension provisions such that, at age 65, they will each have 25 years of credited service.

Executive Compensation Statement

The table below sets forth the annual compensation for the year ended December 31, 2007 and will eventually report compensation over a rolling three-year period, for the Executive Officers listed. The information provided in the Summary Compensation Table differs from the information published under the Public Sector Salary Disclosure Act (Ontario) for the indicated period due to the timing of payment of variable pay. Disclosures under the Public Sector Salary Disclosure Act (Ontario) are limited to amounts listed on T4 taxation forms for each year whereas information in the Summary Compensation Table is based on the year for which the variable pay was earned. Variable pay is determined early in the year following the year assessed. Under the IESO plan 50% of that amount is then paid early in the year following the assessed year and 50% is deferred for payment in future years.

SUMMARY COMPENSATION TABLE

	Year	Salary	Variable Pay ¹		Other Annual Compensation ²	Total Cash Compensation	Amounts Reported Under Public Sector Salary Disclosure
			Paid	Deferred			
Paul Murphy President and CEO	2007	\$275,300 ³	\$138,350	\$138,350	\$49,237 ³	\$601,237	\$494,198
Gary Sherkey VP Corp. Services CFO and Treasurer	2007	\$234,953	\$72,666	\$72,666	\$18,418	\$398,703	\$392,581
Derek Cowbourne VP Market & System Operations and COO	2007	\$238,455	\$75,721	\$75,721	\$18,984	\$408,881	\$397,998
Bill Limbrick VP IT&I and CIO	2007	\$245,540	\$77,970	\$77,970	\$17,359	\$418,839	\$412,086
Bruce Campbell VP Corp. Relations & Mkt. Development	2007	\$254,082	\$84,830	\$84,830	\$10,876	\$434,618	\$419,184

¹ Reflects variable pay earned in 2007 and then paid out to each executive in early 2008 (50%) with deferred amounts (50%) to be paid over the subsequent 3 years with interest.

² Includes annual executive allowance and a residual payout from flex benefit plan. The executive allowance was a program commitment made to executive staff at the time the IESO was established which has now been fully discharged by the IESO Board and will not be offered for 2008 and beyond.

³ In addition to these amounts Mr. Murphy received \$6,300 retroactive salary and \$5,100 retroactive executive allowance payments in 2007 in compensation for 2006 provisions.

ANNUAL LIFETIME PENSION BENEFITS¹

Highest Average Earnings ²	10 years of Service	15 years of Service	20 years of Service	25 years of Service	30 years of Service	35 years of Service
\$200,000	\$37,194	\$55,791	\$74,388	\$92,984	\$111,581	\$130,178
\$300,000	\$57,194	\$85,791	\$114,388	\$142,984	\$171,581	\$200,178
\$400,000	\$77,194	\$115,791	\$154,388	\$192,984	\$231,581	\$270,178
\$500,000	\$97,194	\$145,791	\$194,388	\$242,984	\$291,581	\$340,178

¹ Assumes a normal retirement age of 65 (including a reduction in benefits to account for receipt of income from Canada Pension Plan provisions).

² Best 36 consecutive months of pensionable earnings (salary plus 50% of variable pay).

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