2006 Financial Statements

Independent Electricity System Operator

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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 6, 2007.

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 6, 2007

Gary Sherkey
Vice President – Corporate Services
Chief Financial Officer and Treasurer
Toronto, Canada
February 6, 2007

Auditors' Report

February 6, 2007

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, 2006 and the statements of operations 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, 2006 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

Statement of Operations and Accumulated Surplus

(in thousands of Canadian dollars)	For the Year Ended December 31, 2006	For the Year Ended December 31, 2005
	$	$
REVENUES		
System fees (Note 6)	132,015	143,273
Other revenue	7,622	4,969
TOTAL REVENUES	**139,637**	**148,242**
EXPENSES		
Labour	76,096	65,098
Computer services, support & equipment	9,728	10,413
Contract services & consultants	7,018	8,058
Telecommunications	2,706	2,761
Other costs	5,047	5,656
Amortization	32,353	47,392
TOTAL EXPENSES	**132,948**	**139,378**
Income Before Interest and Investment Income	**6,689**	**8,864**
Interest and investment income	1,731	1,659
Interest expense & financing charges	(7,959)	(9,330)
NET INCOME FOR THE YEAR	**461**	**1,193**
ACCUMULATED SURPLUS - BEGINNING OF YEAR	**7,500**	**21,307**
Transfer to Ontario Power Authority (Note 9)	-	(15,000)
ACCUMULATED SURPLUS - END OF YEAR (Note 6)	**7,961**	**7,500**

See accompanying notes to Financial Statements.

Statement of Financial Position

(in thousands of Canadian dollars)	As at December 31, 2006	As at December 31, 2005
	$	$
ASSETS		
Current assets		
Cash & cash equivalents	3,565	9,631
Temporary investments	-	5,980
Prepaid expenses & receivables	24,639	22,621
	28,204	**38,232**
Property & Equipment (Note 3)		
In service	113,051	127,886
Construction-in-progress	4,787	4,027
	117,838	**131,913**
Other Assets		
Long-term investments (Note 4)	12,585	9,912
Prepaid pension cost (Note 8)	12,471	21,856
Deferred costs - smart metering initiative	1,636	-
	26,692	**31,768**
TOTAL ASSETS	**172,734**	**201,913**
LIABILITIES		
Current Liabilities		
Accounts payable & accrued liabilities (Note 5)	21,073	19,894
Accrued interest on long-term debt	1,030	1,030
Short-term debt (Note 7)	15,000	-
Rebates to market participants (Note 6)	12,699	13,560
	49,802	34,484
Long-term Debt (Note 7)	78,200	128,200
Accrual for Employee Future Benefits Other than Pensions (Note 8)	36,771	31,729
TOTAL LIABILITIES	**164,773**	**194,413**
ACCUMULATED SURPLUS (Note 6)	**7,961**	**7,500**
TOTAL LIABILITIES & ACCUMULATED SURPLUS	**172,734**	**201,913**

See accompanying notes to Financial Statements.

On behalf of the Board:

Glenna Carr
Chair
Toronto, Canada
February 6, 2007

James Hinds
Chair, Audit Committee
Toronto, Canada
February 6, 2007

Statement of Cash Flows

(in thousands of Canadian dollars)	For the Year Ended December 31, 2006	For the Year Ended December 31, 2005
	$	$
OPERATING ACTIVITIES		
Net income for the year	461	1,193
Adjustments for non-cash items:		
Amortization	32,353	47,392
Prepaid pension cost	17,746	8,406
Other employee future benefits cost	6,426	4,470
	56,986	61,461
Changes in non-cash balances related to operations:		
Increase in accounts payable and accrued liabilities	663	337
Increase/(decrease) in rebates to market participants	(861)	13,560
Increase in prepaid expenses and receivables	(2,018)	(2,433)
	(2,216)	11,464
Other:		
Contribution to pension fund	(8,361)	(8,165)
Payment of employee future benefits	(1,384)	(1,312)
	(9,745)	(9,477)
Cash provided from operating activities	**45,025**	**63,448**
INVESTING ACTIVITIES		
Net sale of temporary investments	5,980	39,861
Purchase of long-term investments	(2,673)	(1,896)
Investment in deferred costs- smart metering initiative	(1,636)	-
Investment in property & equipment	(17,762)	(9,084)
Cash provided from/(used in) investing activities	**(16,091)**	**28,881**
FINANCING ACTIVITIES		
Net retirement of debt (Note 7)	(35,000)	(75,000)
Transfer to Ontario Power Authority (Note 9)	-	(15,000)
Cash used in financing activities	**(35,000)**	**(90,000)**
NET CHANGE IN CASH & CASH EQUIVALENTS	(6,066)	2,329
CASH & CASH EQUIVALENTS - BEGINNING OF YEAR	9,631	7,302
CASH & CASH EQUIVALENTS - END OF YEAR	**3,565**	**9,631**

See accompanying notes to Financial Statements.

Supplementary Information:

(in thousands of Canadian dollars)

Interest Paid	**7,781**	**9,698**

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 licence 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* 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*.

The objects were amended by Ontario Regulation 452/06 under the *Electricity Act* made on August 24, 2006. The regulation came into force on September 22, 2006. The additional objects are as follows:

- 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 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 February 14, 2006 the OEB approved the IESO's requested expenditures, revenue requirements and fees for fiscal 2006.

For its 2007 application, the IESO obtained permission of the Minister to submit its proposed 2007 expenditures, revenue requirements, and fees to the OEB on October 17, 2006. The IESO filed its submission for review with the OEB on October 30, 2006. The OEB approved the IESO's proposed usage fee for 2007 of $0.815/MWh on an interim basis, effective January 1, 2007, pending completion of its review of the IESO's requested 2007 expenditures, revenue requirements and fees.

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.

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) Temporary investments

Short-term money market investments with original maturities of 90 days or longer are classified as temporary investments and valued at amortized cost. Premiums and discounts are amortized to income using the constant yield method over the period to maturity.

e) 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.

f) 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.

g) 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:

Class	Estimated Average Service Life
Facilities	40
Market Systems and Applications	4 to 8
Infrastructure and Other Assets	4 to 8

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 2006.

h) Long term investments

Portfolio investments are carried at cost less any provision for other than temporary losses.

i) 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 (2005: 11 years).

j) Fair value of financial instruments

The carrying amounts reported in the balance sheet for financial instruments, comprising current assets and current liabilities, approximate to their fair values. The fair value of long term investments is disclosed in Note 4. The fair value of the long-term debt is not readily available.

k) Derivative Financial Instruments

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.

Where such forward contracts meet the criteria for hedge accounting, changes in their values resulting from exchange rate movements are not reflected in the financial statements. Where such contracts do not meet the criteria for hedge accounting, they are recorded at their fair value at the balance sheet date, with changes in their value recognized in the statement of operations.

l) 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.

m) 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.

3. PROPERTY AND EQUIPMENT

	As at December 31, 2006			As at December 31, 2005
(in thousands of Canadian dollars)	Cost	Accumulated Amortization	Net Book Value	Net Book Value*
	$	$	$	$
Property and equipment in service				
Facilities	49,540	9,342	40,198	40,818
Market Systems and Applications	218,884	159,581	59,303	78,396
Infrastructure and Other Assets	83,773	70,223	13,550	8,672
	352,197	239,146	113,051	127,886
Construction-in-progress	4,787	-	4,787	4,027
	356,984	239,146	117,838	131,913

* Certain 2005 comparative figures above have been reclassified to conform to 2006 presentation.

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. In 2005 no adjustments were made to management's estimates of remaining asset service lives.

Interest capitalized to construction-in-progress during 2006 was $24,757 (2005 - $nil).

4. LONG TERM INVESTMENTS

Long term investments represent a balanced portfolio of pooled funds. The market value of these investments was $14,450,453 as at December 31, 2006 (2005 - $11,365,515).

5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

(in thousands of Canadian dollars)	As at December 31, 2006	As at December 31, 2005
	$	$
Relating to property and equipment	3,786	3,270
Relating to operations	17,287	16,624
	21,073	**19,894**

6. ACCUMULATED SURPLUS AND REBATES TO MARKET PARTICIPANTS

During 2006 the IESO recognized rebates to market participants of system fees of $12,699,435 representing amounts accumulated in the IESO's approved regulatory deferral account in excess of $5.0 million (2005 - $13,560,242). As at December 31 the components of the IESO's Accumulated Surplus were as follows:

(in thousands of Canadian dollars)	As at December 31, 2006	As at December 31, 2005
	$	$
Approved regulatory deferral account	5,000	5,000
Accumulated market penalties and fines	2,961	2,500
	7,961	**7,500**

7. DEBT

(in thousands of Canadian dollars)	As at December 31, 2006	As at December 31, 2005
	$	$
Notes payable to:		
Ontario Electricity Financial Corporation (OEFC)	78,200	78,200
The Province of Ontario	-	50,000
Long-term debt	**78,200**	**128,200**
Short-term debt (credit facility)	15,000	-
	93,200	**128,200**

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.

Note payable to Province of Ontario

On March 31, 2006 the IESO repaid the principal balance outstanding to Province of Ontario of $50.0 million.

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; this amount was increased on March 30, 2006 from $10.0 million. As at December 31, 2006, $15.0 million was drawn on the credit facility by way of issuance of Bankers' Acceptances at an interest rate of 4.65%. 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.

8. 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)	2006 Pension Benefits $	2005 Pension Benefits $	2006 Other Benefits $	2005 Other Benefits $
Accrued benefit obligation	388,585	363,776	59,714	55,342
Fair value of plan assets	296,144	282,313	-	-
Funded status	(92,441)	(81,463)	(59,714)	(55,342)
Employer contribution after measurement date	2,055	23	357	305
Unamortized past service costs	4,417	5,115	428	549
Unamortized net actuarial loss	98,440	98,181	22,158	22,759
Prepaid (accrued) benefit cost recognized in the statements of financial position	12,471	21,856	(36,771)	(31,729)

Prepaid benefit cost is shown net of valuation allowance of $nil (2005: $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:

	2006	2005
Equity securities	59.0%	59.1%
Debt securities	40.8%	38.5%
Cash equivalents	0.2%	2.4%
	100.0%	100.0%

Summary of principal assumptions used to calculate benefit obligations

	2006 Pension Benefits	2005 Pension Benefits	2006 Other Benefits	2005 Other Benefits
Discount rate at end of the period	5.0%	5.1%	5.0%	5.1%
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, 2007 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, 2007 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)	2006 Pension Benefits $	2005 Pension Benefits $	2006 Other Benefits $	2005 Other Benefits $
Benefit cost	17,746	8,406	6,426	4,470
Employer contributions	6,329	8,149	1,331	1,290
Plan participants' contributions	2,014	1,962	-	-
Benefits paid	11,450	9,598	1,331	1,290

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

	2006 Pension Benefits	2005 Pension Benefits	2006 Other Benefits	2005 Other Benefits
Discount rate at the beginning of the period	5.1%	6.25%	5.1%	6.25%
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%	-	-

9. TRANSFER TO ONTARIO POWER AUTHORITY

On February 18, 2005, the Government of Ontario issued Ontario Regulation 47/05 to transfer $15.0 million of the IESO's accumulated surplus to the Ontario Power Authority. Accordingly, in 2005, the IESO transferred $15.0 million to the Ontario Power Authority.

10. SEGMENTED INFORMATION

IESO consists of a single business engaged in the operation of the wholesale electricity system in Ontario.

11. 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)	$
2007	2,144
2008	2,519
2009	1,881
2010	1,624
2011	1,237

Independent Electricity System Operator

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