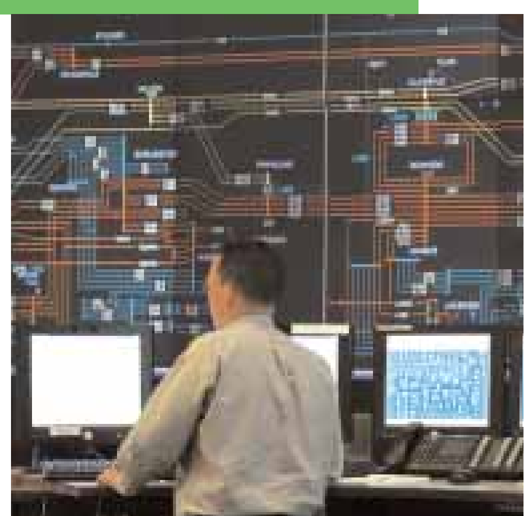
Independent Electricity Market Operator

IMO FINANCIAL STATEMENTS 2003



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Management's Responsibility for Financial Reporting

The accompanying financial statements of the Independent Electricity Market 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 Market 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 12, 2004.

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 MARKET OPERATOR

On behalf of management,

Dave Goulding
President and Chief Executive Officer

Gary Sherkey
Vice President – Finance, CFO and Treasurer

Toronto, Canada
February 12, 2004

AUDITORS’ REPORT

To the Board of Directors of the Independent Electricity Market Operator (“IMO”)

We have audited the statement of financial position of the IMO as at December 31, 2003 and the statements of operations and accumulated surplus and cash flows for the year then ended. These financial statements are the responsibility of the IMO’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 IMO as at December 31, 2003, 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
February 12, 2004

STATEMENT OF OPERATIONS AND ACCUMULATED SURPLUS

(in thousands of Canadian dollars)	FOR THE YEAR ENDED DECEMBER 31, 2003	FOR THE YEAR ENDED DECEMBER 31, 2002
REVENUES		
System fees	$ 148,895	$ 146,650
Other revenue	7,303	2,734
Ancillary services, rural rate assistance and remote subsidies	—	83,436
TOTAL REVENUES	**$ 156,198**	**$ 232,820**
EXPENSES		
Cost of ancillary services, rural rate assistance and remote subsidies	—	83,436
Labour	56,630	52,969
Computer services, support and equipment	10,984	12,548
Consultants, contract and legal services	6,146	4,961
Telecommunications	2,938	7,430
Other costs	5,604	4,661
Amortization	51,160	46,216
TOTAL EXPENSES	**$ 133,462**	**$ 212,221**
Net Income Before Interest and Investment Income	22,736	20,599
Interest and investment income	3,722	2,737
Interest expense and financing charges	(21,535)	(22,225)
NET INCOME FOR THE YEAR	**4,923**	**1,111**
ACCUMULATED SURPLUS — BEGINNING OF YEAR	10,715	9,604
ACCUMULATED SURPLUS — END OF YEAR	**$ 15,638**	**$ 10,715**

See accompanying notes to Financial Statements.

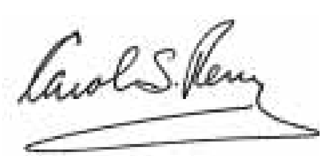
STATEMENT OF FINANCIAL POSITION

(in thousands of Canadian dollars)	FOR THE YEAR ENDED DECEMBER 31, 2003	FOR THE YEAR ENDED DECEMBER 31, 2002
ASSETS		
Current assets		
Cash & cash equivalents	$ 36,939	$ 47,818
Temporary investments	12,442	65,158
Prepaid expenses & receivables	19,344	18,174
	68,725	**131,150**
Property & Equipment (Note 3)		
In service	211,462	237,001
Construction-in-progress	1,664	14,243
	213,126	**251,244**
Other Assets		
Long term investments (Note 4)	6,464	—
Prepaid pension expense (Note 7)	24,566	24,447
	31,030	**24,447**
TOTAL ASSETS	**$ 312,881**	**$ 406,841**
LIABILITIES		
Current Liabilities		
Accounts payable & accrued liabilities (Note 5)	$ 16,431	$ 15,775
Accrued interest	1,952	3,749
Long-term debt payable within one year (Note 6)	—	275,000
	18,383	294,524
Long-term Debt (Note 6)	253,200	78,200
Accrual for Employee Future Benefits Other than Pensions (Note 7)	25,660	23,402
TOTAL LIABILITIES	**297,243**	**396,126**
ACCUMULATED SURPLUS	**15,638**	**10,715**
TOTAL LIABILITIES & ACCUMULATED SURPLUS	**$ 312,881**	**$ 406,841**

See accompanying notes to Financial Statements.

On behalf of the Board:

James C. Baillie



Carol S. Perry

STATEMENT OF CASH FLOWS

(in thousands of Canadian dollars)	FOR THE YEAR ENDED DECEMBER 31, 2003	FOR THE YEAR ENDED DECEMBER 31, 2002
OPERATING ACTIVITIES		
Net income for the year	$ 4,923	$ 1,111
Adjustments for non-cash items:		
Amortization	51,160	46,216
Decrease/(Increase) in prepaid pension expense	4,276	(209)
Increase in accrual for employee future benefits other than pensions	2,258	1,713
	62,617	48,831
Changes in non-cash balances related to operations:		
Contribution to pension fund	(4,395)	(135)
Decrease in accounts payable and accrued liabilities	(1,832)	(3,406)
Increase in prepaid expenses and receivables	(1,170)	(11,999)
Decrease in amounts due under Transitional Revenue Allocation Agreement	—	12,626
	(7,397)	**(2,914)**
Cash provided from operating activities	**$ 55,220**	**$ 45,917**
INVESTING ACTIVITIES		
Net sale/(purchase) of temporary investments	52,716	(65,158)
Purchase of long term investments	(6,464)	—
Investment in property & equipment	(12,351)	(49,050)
Cash provided from/(used in) investing activities	**$ 33,901**	**$ (114,208)**
FINANCING ACTIVITIES		
Retirement of long-term debt	(100,000)	—
Cash used in financing activities	(100,000)	—
NET CHANGE IN CASH & CASH EQUIVALENTS	(10,879)	(68,291)
CASH & CASH EQUIVALENTS — BEGINNING OF YEAR	47,818	116,109
CASH & CASH EQUIVALENTS — END OF YEAR	**$ 36,939**	**$ 47,818**

See accompanying notes to Financial Statements.

Supplementary Information: *(in thousands of Canadian dollars)*

Interest Paid	**$ 23,291**	**$ 23,291**

1. NATURE OF OPERATIONS

Independent Electricity Market Operator (IMO) 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 IMO operates pursuant to a license granted by the Ontario Energy Board. The objects of the IMO as contained in *The Electricity Act*, are as follows:

- to exercise and perform the powers and duties assigned to the IMO under *The Electricity Act*, 1998, the market rules and license;
- to enter into agreements with transmitters giving the IMO the authority to direct the operations of their transmission systems;
- to direct the operations and maintain the reliability of the IMO-controlled grid to promote the purposes of *The Electricity Act*, 1998;
- to establish and operate the IMO-administered markets to promote the purposes of *The Electricity Act*, 1998;
- to collect and provide to the public information relating to the current and future electricity needs of Ontario and the capacity of the integrated power system to meet those needs;
- 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 IMO's activities with their activities.

The North American electrical utility industry has undertaken initiatives to move away from traditional monopolies toward introducing competition into power generation. On October 30, 1998 the Government of Ontario enacted the Energy Competition Act, 1998 to restructure the business carried on by Ontario Hydro and introduce competition. On May 1, 2002 the Government of Ontario opened the competitive electricity market.

On December 9, 2002 the Government passed Bill 210, *Electricity Pricing, Conservation and Supply Act, 2002*. Bill 210, among other things, froze the commodity cost of electricity for a portion of the competitive market, specifically low-volume and designated customers, until May 1, 2006 at 4.3 cents per kilowatt hour. On December 15, 2003, the newly elected Government of Ontario passed Bill 4, Ontario Energy Board and Amendment Act, 2003. Under Bill 4, beginning April 1, 2004 low-volume and designated consumers will pay 4.7 cents per kilowatt hour for their first 750 kilowatt hours of consumption and 5.5 cents per kilowatt hour for their remaining monthly consumption. This interim pricing scheme will remain in place until the Ontario Energy Board (OEB) develops an alternative mechanism for setting prices in the future, and no later than May 1, 2005.

The price signals for the wholesale price of energy continue to be set in the market, utilizing methodologies and systems unchanged from those utilized prior to either Bill 210 or Bill 4. In addition, customers that are neither low-volume or designated customers continue to pay market prices, unchanged from prior to the passage of either Bill 210 or Bill 4.

The Electricity Act, specifically Section 19, requires on an annual basis, that the IMO submit its proposed expenditures, revenue requirements, and fees it proposes to charge during the coming year to the OEB for review. Bill 210 amended Section 19 to provide that the submission may be made only with the approval of the Minister of Energy, a requirement that remains unchanged under Bill 4. The IMO obtained permission of the Minister of Energy to submit its proposed expenditures, revenue requirements, and fees to the OEB in October 2003. In December 2003, the OEB approved the IMO's requested 2004 expenditures, revenue requirements, and fees. As specified in *The Electricity Act*, any surplus generated shall be used by the IMO for the purposes of carrying out its objects under *The Electricity Act*. The IMO expects to recover any deficit in future system fees, subject to approval by the Ontario Energy Board.

On January 14, 2004, the Energy Conservation and Supply Task Force released its report to the Minister of Energy entitled "Tough Choices: Addressing Ontario's Power Needs". The task force was established in June 2003 to develop an action plan for attracting new generation, promoting conservation, and enhancing the reliability of the transmission grid. Should the Government of Ontario implement the recommendations of the Energy Conservation and Supply Task Force, there will be significant changes to many aspects of Ontario's electricity industry, including the IMO's roles and responsibilities.

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

In accordance with an agreement between the IMO and the other successor entities of Ontario Hydro, the IMO received system fees and ancillary service fees during the period up to market opening on May 1, 2002. Such fees were approved by the Ontario Energy Board (OEB) and were recognized as earned in accordance with the terms of the agreement.

Since the opening of the IMO-administered markets on May 1, 2002, system fees earned by the IMO are based on approved rates for each megawatt of electricity withdrawn from the IMO-controlled grid. System fees are recognized as revenue at the same time as the electricity is withdrawn.

Since market opening, ancillary service transactions became those of the market participants rather than the IMO. These financial statements do not include the financial transactions of market participants within the IMO-administered markets.

Other revenue represents amounts that accrue to the IMO relating to 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 transferred from Ontario Hydro or subsequently acquired, are:

Class	Estimated Average Service Life
Facilities	41
Market Systems and Applications	4 to 7
Infrastructure and Other Assets	3 to 10

Gains and losses on sales of property and equipment and losses on premature retirements are charged to operations as adjustments to amortization expense. Removal costs are charged to amortization expense 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 2003.

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

The IMO accrues obligations under pension and other post-employment benefit ("OPEB") plans and the related costs, net of plan assets. Pension fund assets are valued using market related values for equities, whereby fund assets are calculated using a five-year moving average of year-end market values, and market values for fixed income securities. Pension and OPEB expenses and obligations are determined annually by independent actuaries using the projected benefit method and management's best estimates using a measurement date of September 30.

Pension and OPEB expenses consist of current service costs, interest and adjustments arising from plan amendments, changes in assumptions, and experience gains or losses, which are amortized on a straight line basis over the expected average remaining service life of the employees covered by the plan. Pension and OPEB expenses are recorded during the year in which employees render services.

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) 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.

l) 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, 2003			As at December 31, 2002
(in thousands of Canadian dollars)	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Property and equipment in service				
Facilities	$ 48,081	$ 5,312	$ 42,769	$ 44,156
Market Systems and Applications	205,070	67,593	137,477	145,423
Infrastructure and Other Assets	66,581	35,365	31,216	47,422
	319,732	108,270	211,462	237,001
Construction-in-progress	1,664	—	1,664	14,243
	$ 321,396	**$ 108,270**	**$ 213,126**	**$ 251,244**

In 2003, adjustments were made to reflect management's estimates of remaining asset service lives. The impact of these changes in estimates was an increase in amortization expense of $7,361,243 in the year.

Removal costs of $1,920,219 related to the Data Acquisition and Computer Systems were incurred in 2003. These costs were charged to amortization in the year.

Interest capitalized to construction-in-progress during 2003 was $356,110 (2002 - $960,331).

4. LONG TERM INVESTMENTS

Long term investments represent an investment in a balanced pooled fund. The market value of these investments was $6,938,338 as at December 31, 2003.

5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

(in thousands of Canadian dollars)	As at December 31, 2003	As at December 31, 2002
Relating to property and equipment	$ 2,869	$ 2,178
Relating to operations	13,562	13,597
	$ 16,431	**$ 15,775**

6. LONG-TERM DEBT

(in thousands of Canadian dollars)	As at December 31, 2003	As at December 31, 2002
Notes payable	$ 253,200	$ 353,200
Less payable within one year	—	(275,000)
	$ 253,200	**$ 78,200**

(in thousands of Canadian dollars)	As at December 31, 2003	As at December 31, 2002
Notes payable to		
Ontario Electricity Financial Corporation (OEFC)	$ 78,200	$ 78,200
The Province of Ontario	175,000	275,000
	$ 253,200	**$ 353,200**

Note payable to OEFC

The long-term note payable to Ontario Electricity Finance 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

The long-term note payable to the Province of Ontario is unsecured.

The loan agreement provided for an extension of the original repayment date of November 3, 2003, if on or before October 27, 2003, the IMO was unable to obtain a credit rating, or obtained a credit rating below a specific level, to the earlier of March 31, 2005 or six months after which a credit rating is either received or revised to a specific level.

The IMO exercised the extension option and at the same time entered into a revised loan agreement with the Province of Ontario, repaying $100 million of the outstanding principal on November 3, 2003. Under the revised agreement interest accrues daily at an interest rate equal to the three month floating Bankers' Acceptance rate plus 50 basis points during this period. At December 31, 2003, the interest rate was 3.26%. The revised loan agreement provides the right for the IMO to make prepayments on the outstanding principal at three month intervals, in multiples of $5 million, co-incident with the payment of interest. On February 3, 2004 the IMO repaid a further $25 million.

Credit facility

IMO 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 IMO an amount up to $20 million. As at December 31, 2003 and 2002 no balance was drawn on the credit facility. Advances under this facility are available in Canadian dollars by way of prime rate loans or relevant Bankers' Acceptances rates. Unused portions of this credit facility are subject to a commitment fee of 10 basis points per annum and a Stamping Fee of 30 basis points per annum upon acceptance of each Bankers' Acceptance.

The IMO also has an unsecured, committed, and extendible 364-day revolving credit facility agreement with a banking syndicate, under which the syndicate will make available to the IMO an amount up to $100 million. As at December 31, 2003 and 2002 no balance was drawn on this credit facility. Advances under this facility are available in Canadian dollars by way of prime rate loans or relevant Bankers' Acceptances rates. Unused portions of this credit facility are subject to a commitment fee of 10 basis points per annum and a Stamping Fee of 30 basis points per annum upon acceptance of each Bankers' Acceptance. This facility will mainly be used to fund shortfalls in amounts owed to the IMO by Market Participants for payment to other Market Participants prior to their recovery under the provisions of the market rules.

7. BENEFIT PLANS

The IMO provides pension and other employee future 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 Independent Electricity Market Operator Pension Plan is a contributory defined benefit, registered pension plan. In addition to the funded, registered, pension plan, the IMO provides certain non-registered defined benefit pensions through an unfunded, 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)	2003 Pension benefits	2002 Pension benefits	2003 Other benefits	2002 Other benefits
Accrued benefit obligation	$ 272,317	$ 234,967	$ 34,694	$ 28,876
Fair value of plan assets	215,412	203,693	—	—
Funded status	$ (56,905)	$ (31,274)	$ (34,694)	$ (28,876)
Prepaid (accrued) benefit cost recognized in the statements of financial position	$ 24,566	$ 24,447	$ (25,660)	$ (23,402)

Summary of principal assumptions used to calculate benefit costs and obligations

	2003 Pension benefits	2002 Pension benefits	2003 Other benefits	2002 Other benefits
Discount rate	6.1%	6.6%	6.1%	6.6%
Expected return on plan assets	7.25%	7.25%	—	—
Rate of compensation increase	3.5%	3.5%	3.5%	3.5%
Rate of benefit increases	3.0%	3.0%	—	—
Expected average remaining service life of employees	12 years	12 years	12 years	12 years

Hospital and drug costs are assumed to increase by 9.0% in 2004, 8.0% in 2005, 7.0% in 2006, 6.0% in 2007 and by 5.0% per annum thereafter. Dental costs are assumed to increase by 5.0% per annum.

Summary of accrued benefit obligations and plan assets

(in thousands of Canadian dollars)	2003 Pension benefits	2002 Pension benefits	2003 Other benefits	2002 Other benefits
Benefit cost (income)	$ 4,276	$ (209)	$ 3,298	$ 2,639
Employer contributions	123	39	1,008	890
Plan participant's contributions	1,803	1,654	—	—
Benefits paid	9,228	7,833	1,008	890

An employer contribution in the amount of $4.366 million was made to the registered pension plan in December 2003.

8. SEGMENTED INFORMATION

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

9. COMMITMENTS

Operating commitments

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

(in thousands of Canadian dollars)

2004	$ 2,123
2005	1,755
2006	1,305
2007	994
2008	994

10. COMPARATIVE FIGURES

Certain of the 2002 comparative figures in the financial statements have been reclassified to conform to the 2003 financial statement presentation.

Independent Electricity Market Operator

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