Ontario Financing Authority

Annual Report 2006

Ontario

Mandate

The *Capital Investment Plan Act, 1993* (CIPA) established the Ontario Financing Authority (OFA) and sets out objects and powers of the OFA. In this regard, the OFA:

- Conducts borrowing, investment and financial risk management for the Province of Ontario;
- Manages the Provincial debt;
- Provides financial and centralized cash management services for the Province;
- Advises ministries, Crown agencies and other public bodies on financial policies and projects;
- Assists Crown agencies and other public bodies to borrow and invest money;
- Acts at the direction of the Province in lending to certain public bodies; and
- Invests on behalf of some public bodies.

The OFA also provides a broad range of financial services to the Ontario Electricity Financial Corporation (OEFC) and co-ordinates and arranges the borrowing, investing and other financial activities of Infrastructure Ontario.

The *Financial Administration Act* (FAA) sets out certain financial powers that the OFA exercises on behalf of the Province to execute the Province's borrowing program, manage the Provincial debt, and invest the liquid reserves.

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Statement from the Chair and the Chief Executive Officer

Fiscal 2005–06 was a very successful year for the Ontario Financing Authority.

The OFA fulfilled its primary goal of raising $23.8 billion on behalf of the Province and the Ontario Electricity Financial Corporation at competitive terms and conditions in the long-term public markets. The interim result of $23.8 billion was down $3.4 billion from the $27.2 billion estimated in the 2005 Ontario Budget.

Total savings relative to the performance benchmarks for borrowing, money market and debt management activities were $109 million. Interim Interest on Debt (IOD) costs were $706 million below the 2005 Ontario Budget projection due to lower-than-forecast long-term interest rates and cost-effective debt management practices.

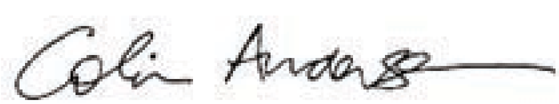
The OFA supported a number of the government's priorities by providing financial advice to public-sector organizations. These included the new Infrastructure Ontario and the proposed Greater Toronto Transportation Authority (GTTA), an agency announced in the 2006 Ontario Budget to improve the planning and coordination of public transportation in the Greater Toronto Area.

The OFA advised on options for optimizing the Province's economic interests on the Initial Public Offering (IPO) of Teranet, a private company that maintains and operates the electronic land registration system in Ontario.

Financial advice was also provided on electricity policies and initiatives including the provision of a credit facility to the Ontario Power Authority (OPA) and management of the non-utility generator (NUG) contracts.

Looking ahead to 2006–07, the OFA will continue to meet financial needs in a cost-effective manner. The long-term public borrowing requirement is forecast at $20.8 billion, primarily due to debt maturities and redemptions totalling $15.8 billion. Debt maturities will continue to remain relatively high in the medium-term.

The OFA will also be engaged in a number of public-sector financing initiatives such as completing the Teranet transaction, continuing to assist Infrastructure Ontario and providing financing options and advice in support of infrastructure projects, as well as advising the government on financial aspects of the electricity sector.



Colin Andersen
Chair

Gadi Mayman
Chief Executive Officer and Vice-Chair

Management's Discussion and Analysis

Management's Discussion and Analysis

This section details management's discussion and analysis of the OFA's results in 2005–06 and its 2006–07 objectives, beginning with a review of the economy and financial markets in 2005 and the outlook for 2006.

Economy

The global economy recorded strong growth in 2005, with real output rising an estimated 3.4 per cent, according to the June *Consensus Forecasts* report, after a 3.8 per cent gain in 2004. Global activity is projected to remain strong, rising by 3.6 per cent in 2006.

The U.S. accounts for almost 90 per cent of the Province's international merchandise exports, making it the Province's largest trading partner. The U.S. economy grew by 3.5 per cent in 2005, easing from a gain of 4.2 per cent in 2004. Economists expect growth to moderate but remain healthy. The June 2006 *Blue Chip Economic Indicators* survey calls for U.S. real GDP growth of 3.4 per cent in 2006 and an average of 3.0 per cent a year during the 2007 to 2008 period.

There are a number of risks to the U.S. economic outlook, including high energy prices, rising interest rates and high personal debt. Taken together these risks could begin to dampen household spending. In late 2005 signs of a weakening housing market emerged; potential softening in house prices would lower household wealth and reduce funds available for consumer spending through mortgage equity withdrawal. As well, the record size of the U.S. current account deficit combined with the large fiscal deficit could leave the economy exposed to a potential cutback in foreign capital flows.

Oil prices soared to record levels in 2005, climbing 36 per cent to an average of U.S. $56.50 per barrel. Other key commodity prices have increased sharply as well. This raises costs for Ontario's businesses and consumers. According to the average private-sector forecast, oil prices are expected to average U.S. $66.00 per barrel in 2006. As additional production capacity comes online over the medium-term, private-sector forecasters expect oil prices will decline to U.S. $54.40 per barrel by 2008.

The rapid increase in the Canadian dollar is a challenge for Ontario manufacturers that sell their goods in an increasingly competitive global marketplace. However, the higher dollar lowers the cost of machinery and equipment imports that help to increase productivity. On average, forecasters expect the Canadian dollar to average 88.2 cents U.S. in 2006, 88.9 cents U.S. in 2007 and 87.6 cents U.S. in 2008. However, there are considerable differences of opinion about the future path of the dollar, with forecasts ranging from 86.0 to 90.4 cents U.S. in 2006 and from 84.0 to 91.0 cents U.S. in 2008.

Ontario's economy has demonstrated considerable resilience in the face of higher oil prices and the strong Canadian dollar. Ontario real GDP increased 2.8 per cent in 2005, slightly ahead of the 2.7 per cent pace of growth recorded in 2004. The average private-sector forecast expects Ontario growth of 2.5 per cent in 2006 and 2.5 per cent in 2007, followed by growth of 2.9 per cent in 2008.

Financial Markets

Since September 2005, the Bank of Canada has increased its benchmark target for the overnight interest rate by a total of 175 basis points to 4.25 per cent. In its latest announcement, the Bank of Canada stated "…the target for the overnight rate is now at a level that is expected to keep the Canadian economy on the base-case path." This suggests there will probably be a pause in interest rate changes in coming months. The core rate of inflation in Canada was 1.6 per cent in 2005. It reached two per cent in May this year, after remaining under two per cent for 28 consecutive months.

Private-sector forecasts expect three-month treasury bill yields to increase from an average of 2.7 per cent in 2005 to 4.0 per cent in 2006, 4.1 per cent in 2007 and 4.5 per cent in 2008. The yield on 10-year Government of Canada bonds is expected to rise from an average of 4.1 per cent in 2005 to 4.4 per cent in 2006, 4.7 per cent in 2007 and 5.2 per cent in 2008.

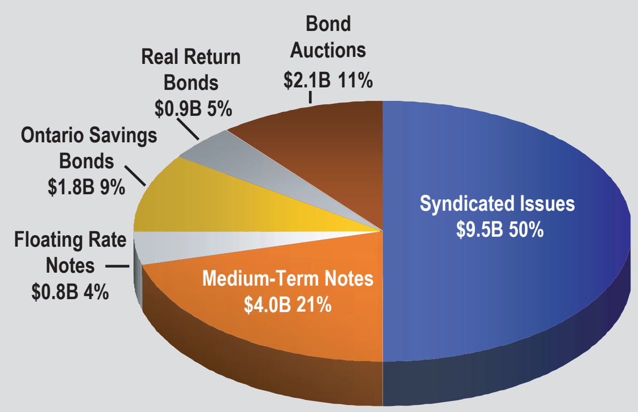
The U.S. Federal Reserve has also tightened monetary conditions considerably to combat increased inflation pressures, increasing its benchmark rate 425 basis points since June 2004. According to the June Blue Chip report, forecasters expect U.S. three-month treasury bill rates to average 4.8 per cent a year during the 2006 through 2008 period. The yield on 10-year U.S. Treasury bonds is expected to rise from 5.0 per cent in 2006 to 5.2 per cent in 2007 and 5.4 per cent in 2008.

Capital Markets Activities

In 2005–06, $19.1 billion or approximately 80 per cent of the Province's borrowing program was completed in the domestic market through a number of instruments and methods, including:

- Syndicated issues;
- Medium-term notes;
- Bond auctions;
- Ontario Savings Bonds (OSB);
- Real Return Bonds; and
- Floating rate notes.

C$19.1 billion issued – Domestic Market

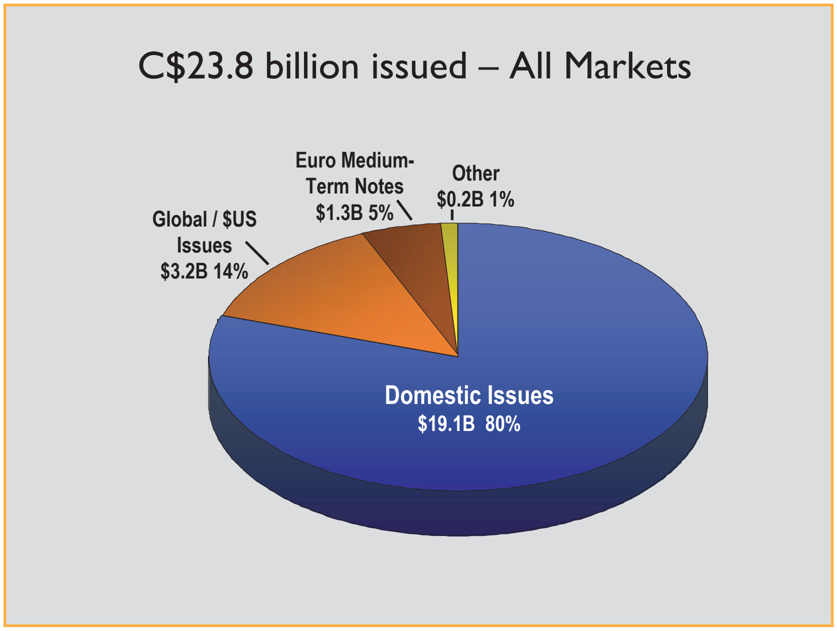


On September 28, 2005, the OFA issued Ontario's first Real Return Bond (RRB). RRBs pay investors a rate of return that is adjusted for inflation using the Canadian Consumer Price Index (CPI). The Province issued the RRB at a real rate below two per cent, compared to an average over the past five years of 2.8 per cent and a high of 3.8 per cent for Government of Canada RRBs. Due to strong demand from institutional investors, the issue amount was increased from $250 million to $700 million.

The RRB was issued on behalf of the OEFC to replace an existing liability that pays 3.25 per cent over the Ontario CPI. This will save the OEFC over $9 million annually.

2005 Ontario Savings Bonds

The eleventh savings bond campaign raised $1.8 billion at cost-effective rates relative to regular funding sources.



Following the success of the first issue, the OFA issued a second RRB for $300 million in March 2006, using derivatives to cost-effectively convert the issue into fixed-rate debt.

The Province also issued successfully in the international capital markets, including:

- Bonds denominated in U.S. and New Zealand dollars;
- European Medium-Term Notes (EMTNs) in Canadian and Australian dollars as well as Swiss francs; and
- South African rand EMTNs. Ontario was the first Canadian province to issue in rand.

The European Union Prospectus Directive (effective July 1, 2005) imposed various regulatory and operational obligations on non-European issuers that sell securities into the European Economic Region. By updating the Province's EMTN program and ensuring Ontario complied with the Directive, the OFA was able to access that market through five debt issues, achieving costs below those available in the Canadian domestic market. The OFA also established an Australian Medium-Term Note program in October 2005, which will permit Ontario to issue debt in the Australian domestic market.

Investor relations initiatives related to fiscal 2005–06 include the first web cast featuring the Minister of Finance, following the release of the 2005 Budget. The Minister also traveled to New York in May 2005 and to Asia (Hong Kong, Beijing and Tokyo) in September 2005 to meet with representatives of those financial communities. The Asia initiative was the Province's first to the region since 2001.

Objectives for 2006-07

Long-term public borrowing requirements for 2006–07 are forecast at $20.8 billion, a $3.0 billion decrease from 2005–06. This amount includes $15.8 billion of debt maturities and redemptions, and $2.4 billion from the deficit.

The Canadian dollar domestic market will again be the main source of funding for the Province. The OFA will continue to diversify its domestic borrowing program by using a combination of syndicated issues, bond auctions, floating rate notes and medium-term notes. The 2006–07 borrowing program will include the twelfth OSB campaign. The size of the campaign will depend on market conditions.

International markets will remain a significant component of the Province's borrowing program. It is expected that in excess of 25 per cent of the borrowing requirements will be executed in international markets, depending on market conditions. While the U.S. dollar market is expected to be the most important international market, the OFA also will look at opportunities to expand its presence in the Euro Canadian dollar, Swiss francs, pound Sterling, Euro, yen, Australian dollar, New Zealand dollar and South African rand markets. New possibilities for 2006–07 include the Icelandic krona, the Turkish lira and Mexican peso markets.

Investor relations initiatives related to fiscal 2006–07 include a web cast featuring the Minister of Finance following the 2006 Budget. The Minister also led initiatives in Boston and New York as well as to Europe (Dublin, Zurich and London). This was the first European investor relations initiative led by a Minister of Finance since 1999 and the first visit by the Province to Dublin as part of an effort to expand the Province's investor base.

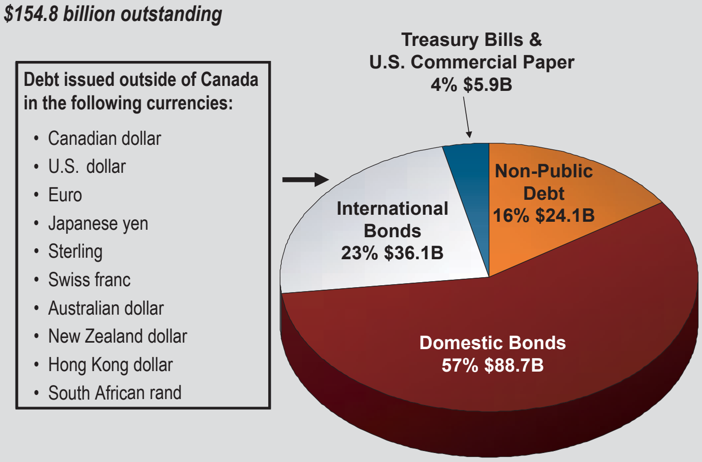
Debt Management, Investments and Financial Risk

The OFA manages $154.8 billion of debt (interim as at March 31, 2006) for the Province and the OEFC. It also manages the Province's short-term liquid reserves to optimize investment returns and to ensure that sufficient funds are available to meet cash requirements. As at March 31, 2006, liquid reserves totaled $6.0 billion.

The OFA employs prudent risk management policies and practices to mitigate the financial risks inherent in managing large debt and liquid reserve portfolios. A variety of financial instruments, such as swaps and options, are utilized to manage the Province's exposure to fluctuations in interest rates and foreign currency exchange rates. Risk exposures are monitored daily and audited annually. Risk management policies are reviewed annually and amendments are approved by the OFA Board of Directors.

Total Debt Composition

$154.8 billion outstanding



Ontario's total debt of $154.8 billion (interim as at March 31, 2006) is composed of bonds and debentures issued in both the short-and long-term public capital markets and of non-public debt held by certain federal and provincial public-sector pension plans and government agencies.

Public debt totals $130.7 billion, primarily consisting of bonds issued in the domestic and international long-term public markets in 10 currencies. Ontario also had $24.1 billion outstanding in non-public debt issued in Canadian dollars.

Performance

The OFA measures and monitors the performance of the borrowing, debt management and liquid reserve investment programs. Total savings relative to the performance benchmarks for borrowing, money market and debt management activities were $109 million.

The OFA monitors the Province's IOD to ensure that it is managed in a sound and efficient manner. Interim IOD costs were $706 million below the 2005 Ontario Budget projection due to lower-than-forecast long-term interest rates and cost-effective debt management practices.

The performance of the borrowing program is measured through the difference between the all-in cost of the actual borrowing program against the all-in cost of hypothetical domestic borrowing of the same term and size implemented evenly over the fiscal year (even-pace benchmark). The cost difference is then compared with the performance of fixed income fund managers relative to a commonly used bond market index. During 2005–06, the cost of the borrowing program was $87 million lower than the even-pace benchmark, on a present-value basis. This corresponds to first quartile performance relative to the peer group of fixed income fund managers.

The performance of the debt management program is evaluated based on a comparison of program savings with a risk budget. In 2005–06, the debt management program saved $10 million. This compares to a first quartile performance relative to the risk budget.

Investments

Through its centralized pooled fund initiative, the OFA assists public bodies to increase returns by improving investment processes and reducing investment costs. In 2005–06, the OFA provided investment services to nine agencies, boards and commissions, including the Ontario Strategic Infrastructure Financing Authority (OSIFA), Northern Ontario Heritage Fund Corporation, Ontario Immigration Investor Corporation, Ontario Trillium Foundation, Ontario Realty Corporation, Ontario Securities Commission, Algonquin Forestry Authority, Pension Benefits Guarantee Fund and the Deposit Insurance Corporation of Ontario. Total funds managed for these organizations were $2.3 billion.

In conjunction with Ontario Power Generation Inc. (OPG), the OFA manages the investment activities of the Used Fuel and Decommissioning Funds, established under the Ontario Nuclear Funds Agreement (ONFA). These activities include the development and implementation of the associated investment management policies. The OFA also monitors the operations and reporting of the ONFA funds through liaison with OPG, the fund custodian and auditors.

The ONFA funds were established to pay for the future costs related to the decommissioning of nuclear stations and storage and disposal of nuclear waste, including used nuclear fuel. As at March 31, 2006, the fair market value of the ONFA funds was $8.0 billion, compared to a market value of $4.9 billion when the ONFA funds were formally established. In 2005–06, 17 external investment managers had been retained to invest the nuclear funds in a combination of bonds and equities. The actual combined return of funds was 14.1 per cent, 8.7 per cent higher than the long-term target of 3.25 per cent real rate of return (3.25 per cent plus Ontario CPI).

As part of the implementation of ONFA, the OFA provides advice to the Minister of Finance on the related multi–billion dollar net present value of OPG's nuclear liabilities and the Province's rights and obligations under ONFA, including the approval of reference plans and annual budgets. The OFA provides advice to the Minister on the Province's financial guarantee to the Canadian Nuclear Safety Commission, currently at $1.5 billion. This guarantee, and the Province's obligations, depends on the estimated liability and OPG's contributions to the funds.

The OFA also is responsible for the management of the Province's liquid reserve portfolio. The performance of short-term liquid reserve investments is measured relative to the returns of a custom benchmark with a term of 45 days. The performance difference is then compared with the performance of a peer group of money market managers relative to a commonly used money market index. In 2005–06, the returns of the money market program were $12 million over the 45-day benchmark, which compares to second quartile performance.

Market Risk

Market risk is the risk of loss due to changes in interest rates and foreign exchange. The OFA aims for a balanced debt maturity profile to mitigate the interest rate risk inherent in refinancing maturing debt and the interest rates on floating-rate debt.

Interest rate exposure from maturing debt and floating-rate debt was 14.1 per cent of outstanding debt as at March 31, 2006. During the fiscal year, interest rate resetting exposure was within the Province's approved limit of 25 per cent of outstanding debt. In 2005–06, maturities amounted to $19.8 billion.

Net foreign exchange exposure was 0.8 per cent of outstanding debt as at March 31, 2006. During the fiscal year, foreign exchange exposure was consistently within the Province's approved limit of five per cent of outstanding debt.

Credit Risk

Credit risk is the risk of loss due to default of bond issuers or counterparties of derivatives or other financial transactions. The lowest acceptable credit rating of counterparties for Ontario is A–. However, Ontario typically enters into new swap transactions with counterparties rated AA– or higher.

As at March 31, 2006, the Province's total swap portfolio had a notional value of $97.3 billion, which consisted of $28.4 billion in cross-currency swaps and $64.7 billion in interest rate swaps. At year-end, over 80 per cent of the Province's counterparties with swaps outstanding had credit ratings AA– or higher.

Liquidity Risk

Liquidity risk is the risk that liquid reserves and short-term borrowing capacity will not be sufficient to meet the Province's cash requirements. This risk is controlled through the management of operational cash flows, liquid reserves levels and short-term borrowing programs. The average level of liquid reserves was $10.8 billion in 2005–06. The Province's Treasury Bill and U.S. Commercial Paper programs have authorized limits of $12.0 billion ($6.0 billion for the Province and $6.0 billion for OEFC) and $2.5 billion respectively, of which $8.2 billion was available as at March 31, 2006.

Credit Rating Agency Relations

The Province requires ratings from recognized credit rating agencies to issue debt at favourable conditions in public capital markets. The OFA ensures credit rating agencies understand government policies and budget direction as well as economic and fiscal performance, and properly reflect these in their reports and decisions. Through the OFA, the government maintains a one-window contact with the agencies to ensure all information requests pertaining to government policies and or/other information is consistent and coordinated.

Following the release of the 2005 Budget, Standard & Poor's confirmed the Province's AA rating on June 7, 2005, Moody's confirmed its Aa2 rating on June 3, 2005 and the Dominion Bond Rating Service confirmed its AA rating and changed the trend to stable from negative on June 2, 2005.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, systems, or external events. The OFA manages operational risks through divisional procedures and contingency plans as well as appropriate staffing and training, all of which are reviewed on an ongoing basis.

The reliability of information technology and computing systems is crucial to ensuring the OFA carries out its mandate efficiently and effectively. To this end, systems for the OFA, OEFC and OSIFA were maintained at a high level during 2005–06 to ensure availability, integrity and security.

Business Continuity Planning
As part of its risk management strategy, the OFA has a Business Continuity Plan (BCP) based on a decentralized recovery model. The plan ensures that critical operations are completed in a timely manner in the event of a business disruption. BCP advisors and recovery team leaders maintain contact with Ministry of Finance and other related committees to ensure that the BCP is aligned with the other areas of the Ontario government. BCP tests and training sessions are conducted regularly.

Objectives for 2006–07

Cost-effective and prudent debt management strategies will continue to be key objectives in 2006-07. Estimated debt maturities for the next three years are $15.1 billion in 2006–07, $14.9 billion in 2007–08 and $19.3 billion in 2008–09. The OFA will also manage the Province's liquid reserves in a conservative manner, ensuring a rate of return consistent with its investment objectives.

With OPG, the OFA will manage the Used Fuel and Decommissioning Funds' investments, ensuring that the investment management is consistent with ONFA objectives and that the Province's contingent liability in connection with the ONFA is prudently managed. This will require the refinement of investment policies and procedures.

The OFA will provide treasury and administrative services to Crown agencies and manage funds for other public bodies through the centralized and pooled fund initiative to reduce investment costs. The funds will be managed in a manner consistent with industry best practices.

The OFA will comply with risk management policies and portfolio program limits approved by the Boards of Directors of the OFA and OEFC. Risk management policies will be reviewed and revised as required in response to an ever-evolving regulatory and capital markets environment.

Work with the rating agencies will continue. Following the release of the 2006 Budget, Moody's and Dominion Bond Rating Service confirmed their Aa2 and AA ratings on April 10, 2006 and April 21, 2006 respectively. Standard and Poor's confirmed Ontario's AA rating on May 16, 2006.

Financial, Cash Management and Banking Services

The OFA provides centralized cash management services to maximize the returns from liquid reserves, as well as timely and accurate forecasts that align borrowing with cash requirements, minimizing IOD. The OFA is also responsible for settlements and accounting functions required for the Province's and the OEFC's debt management programs. In addition it ensures that efficient banking services are available to the government.

With the Ministry of Finance, the OFA evaluated issues, provided recommendations and negotiated positions related to the development of the Memorandum of Understanding (MOU) between the Canada Revenue Agency (CRA) and the government for transfer of the corporate tax collection function.

In addition, the OFA worked with the Office of the Provincial Controller (OPC) to develop appropriate cash management performance measures, based on best practices from the private and public sectors. These measures were approved by the Financial Practices Committee, a body composed of representatives from all ministries and central agencies of the Province. The measures, scheduled to be implemented in 2006–07, are aimed at reducing the difference between forecast and actual cash variances, which will impact positively on IOD.

A tender was issued to obtain service providers so that ministries could continue to accept credit and debit cards as payment mechanisms when customers purchase government services. The two bids that responded to the tender were disqualified for not meeting government procurement requirements and the tender was reissued in early 2006.

The Canadian Payments Association (CPA) launched a Canada-wide initiative to standardize cheque specifications to enable digital capture and clearing of cheque images. To guide the implementation of this initiative across the government and to ensure that cheques conform to CPA specifications, a steering committee was created with the OFA and the Integrated Financial Information System (IFIS) as the executive sponsors. The new initiative will improve cheque processing times and will achieve greater efficiency for the Province.

The OFA undertook a preliminary review of the new Canadian Institute of Chartered Accountants (CICA) accounting standards on financial instruments and will continue to work closely with the OPC in providing comments on the implementation of these standards to the Public Sector Accounting Board (PSAB).

Objectives for 2006–07

The OFA will ensure that cash management impacts resulting from the proposed transfer of the Province's corporate tax collection function to the CRA are properly identified so that the government can negotiate an equitable agreement between the Province and CRA.

The OFA will assist the OPC in implementing and monitoring the Province-wide cash management performance measures that have already been developed and approved by the Financial Practices Committee.

Further, the OFA will provide advice on sound cash management principles and practices for the Revenue Management Improvement project being led by the Ministry of Government Services. The project, which began in 2005–06, seeks to centralize processes for non-tax revenues. The OFA will assist in developing a submission to approve implementation of the recommendations arising from a report by external consultants.

Enhancements will be made to the OFA's Integrated Treasury System (ITS) Liability System to improve the monitoring of matured debt levels.

A tender will be issued for the provision of banking services for the Province. This requires reviewing bids and awarding contracts to the successful banks. If the tender results in a change in service providers, the OFA will co-ordinate a smooth and successful transition of the Province's business. The OFA, with other stakeholders in the government and the financial industry, will also ensure that the government is able to meet the CPA requirements for cheque truncation in advance of the June 2007 deadline.

In addition, the OFA will continue to research and monitor accounting developments in Canada and internationally, particularly those related to financial instruments, and will assess any potential impact on IOD.

Financial Advice

The OFA was active in 2005–06 in providing financial advice to the Minister of Finance and providing financial advice and assistance to other ministries, Crown agencies and other public bodies on corporate and electricity finance policies and initiatives.

Transactions

The OFA provided advice to the Minister of Finance on a review of options for optimizing the Province's approval and economic participation rights relating to Teranet, a private company that maintains and operates the electronic land registration system in Ontario. The OFA supported negotiations between the Province and the current owner of Teranet on the terms and conditions under which the Province would consider approving a sale of the company. The government announced its approval to permit Teranet to proceed with an IPO on May 9, 2005.

By providing advice in negotiations with lenders in 2005, the OFA continued to assist the Royal Ontario Museum (ROM) with financing advice for phase two of the Renaissance ROM Project.

The "*Good Places to Learn*" initiative, announced in February 2005 by the Ministry of Education, is a plan to support school boards in undertaking additional projects, including school construction and facility repairs. For the first stage of the initiative, the OFA facilitated the establishment of a low-cost $1.0 billion global short-term banking facility. The facility will be available to all school boards on an unsecured basis.

Projects

The OFA provided advice to ministries, Crown agencies and other public bodies on a variety of policies and projects for managing the Province's financial assets and liabilities, including effective leasing policies and structures, asset reviews, value-for-money benchmarks and interest rate evaluations.

The OFA advised the Minister of Finance on the structuring of Infrastructure Ontario (the Ontario Infrastructure Projects Corporation), a new public-sector organization with a mandate to provide expertise and implement best business practices for infrastructure planning, financing, construction and management.

Advice was also given on the implementation of the GTTA, an agency that will improve the planning and coordination of public transportation in the Greater Toronto Area, and the Move Ontario Trust, the vehicle to be used to disburse the government's one-time $1.2 billion investment in transportation infrastructure. Both initiatives were announced in the 2006 Ontario Budget.

Assistance was provided on initiatives for Ontario's forestry sector and in a review of the Ontario Clean Water Agency (OCWA).

Financial policy advice and analysis were provided on the electricity sector and the impact of policies and initiatives on the OEFC's finances, including electricity supply initiatives and management of the NUG contracts. The OFA continued to provide analysis and advice on the financial performance of OPG, Hydro One and the OEFC.

Financial advice and analysis were also provided on financing for OPG based on its cashflow requirements, as well as for the Niagara Tunnel Project and the conversion of the Thunder Bay Generating Station to operate on natural gas. In addition, the OFA provided financial analysis and advice on other electricity supply initiatives, such as the Bruce Power Refurbishment Implementation Agreement to refurbish and restart Units 1 and 2, refurbish Unit 3 and install new steam generators in Unit 4 of the Bruce A Nuclear Station.

The financial position of the OPA was monitored with regard to the regulated price plan variance account and its credit facility. A credit facility of $500 million was provided to the OPA and was later increased to $975 million in response to the larger-than-expected regulated price plan variance account.

Objectives for 2006–07

In 2006–07, the OFA will continue to fulfill its mandate in providing financial advice and assistance to the Minister of Finance, provincial ministries, Crown agencies and other public bodies regarding corporate finance and electricity finance policies and initiatives.

Activities will include providing advice to ministries and agencies on cost-effective leasing policies and structures, appropriate due diligence on financing aspects of asset management projects, comprehensive advice on structuring and completing financial transactions and accurate determination of value-for-money benchmarks and interest rate evaluations.

In 2006–07, the OFA will focus on public infrastructure financing initiatives, including projects pertaining to public transit, roads, highways, bridges and borders, as well as pooled capital procurement for the school renewal funding formulae and asset reviews.

Advice also will be provided to support any capital markets borrowing by public sector organizations to ensure that cost-effective borrowing rates are secured. OFA advice concerning the financing activities of broader public sector (BPS) entities (particularly school boards, hospitals and colleges) will be considered in the context of the upcoming consolidation of BPS financial statements with those of the Province.

As well, the OFA will continue to provide financial analysis and advice to the Minister of Finance regarding the electricity sector and the impact of related policy initiatives on the finances of the Province including OEFC, and on their debt and liabilities, such as the performance of the Ontario Hydro successor companies, management of the NUG contracts and transitional support for the OPA. Finally, the OFA will continue to contribute financial advice to the government regarding electricity supply initiatives.

Summary of Financial Results

The OFA manages the Province's debt and investments of liquid reserves and recovers its costs for these services. The OFA also provides treasury and administrative services to Crown agencies and recovers its costs on a fee-for-service basis.

The OFA's income from operations for the year ended March 31, 2006 was $4,000 (March 31, 2005 – $5,000). Net capital assets of the OFA as at March 31, 2006 were $2.0 million, representing a balance as at March 31, 2005 of $2.2 million, plus purchases of $1.2 million (mainly computer hardware) and less amortization of $1.4 million. Retained earnings of the OFA of $140,000 represent notional amounts. Annually, the OFA's financial results are consolidated on a line-by-line basis with those of the Province. This consolidation is in accordance with the Public Sector Accounting Board (PSAB) of the CICA, under which the OFA is considered a government organization.

At the direction of the Province, the OFA made loans to public bodies, the repayment of which is to be funded through third-party revenues. The outstanding balance of these loans as at March 31, 2006 was $1,328 million, a net increase of $521 million from the $807 million reported in 2005 (see Note 5(i) to the Financial Statements). The increase is mainly due to the increase in net short-term loans to the OPA of $705 million partially offset by $150 million in repayments from the Ontario Lottery and Gaming Corporation. In addition, the loan balance declined further on August 18, 2005, when the Province of Ontario approved the release of the Toronto District School Board's obligations relating to its loan from the OFA, as at March 31, 2005.

The OFA continued to provide investment management services to other public bodies such as OSIFA, Ontario Immigrant Investor Corporation and the Northern Ontario Heritage Fund. In addition, investment management services were also provided to Pension Benefits Guarantee Fund starting April 1, 2005 and to Deposit Insurance Corporation of Ontario starting October 1, 2005. As at March 31, 2006, the OFA managed investments totalling $2,329 million (2005 – $2,560 million) on behalf of those entities as reported in Note 5(ii) to the Financial Statements.

The OFA also administers the loans receivable and payable of the former Ontario Municipal Improvement Corporation (OMIC). OMIC assets of $79 million consist of debentures receivable from various municipalities and school boards. The majority of liabilities are payable to Canada Pension Plan (CPP) through the Province. The majority of loan repayments will occur in the fiscal years ended March 31, 2012 and 2013. The interest earned and paid annually on account of OMIC assets and liabilities amounts to $7.6 million and is expected to remain at this level until CPP loans start maturing.

The OFA has been involved in providing financial advice to the government on various asset optimization initiatives as well as strategic advice on financial and investment policy issues associated with the electricity sector reform. The OFA staff also continue to manage post-sale activities of the Province of Ontario Savings Office (POSO), including legal requirements and liaison with former POSO clients, to ensure that the needs of former POSO account holders are adequately met. Upon the sale of the former POSO, the Province provided a maximum 5-year guarantee up to March 31, 2008, for POSO term deposits purchased up to March 31, 2003. The remaining outstanding amount of term deposits guaranteed as at March 31, 2006 was $215 million.

The OFA recovers operating and capital costs from OEFC and OSIFA and these are reported in the Financial Statements and in the notes to the Financial Statements. The operating and capital cost recovery as at March 31, 2006, was $3.5 million (2005 – $3.3 million).

Financial Statements

Responsibility for Financial Reporting

The accompanying financial statements of the Ontario Financing Authority have been prepared in accordance with Canadian generally accepted accounting principles and are the responsibility of Management. The preparation of financial statements necessarily involves the use of estimates based on Management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to June 16, 2006.

Management maintains a system of internal controls designed to provide reasonable assurance that the assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. An internal audit function independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to Management and the Audit Committee of the Board of Directors.

The Board of Directors, through the Audit Committee, is responsible for overseeing that Management fulfils its responsibilities for financial reporting and internal controls. The Audit Committee meets periodically with Management, the internal auditors and the external auditor to deal with issues raised by them and to review the financial statements before recommending approval by the Board of Directors.

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

On behalf of Management:

Gadi Mayman
Chief Executive Officer and Vice-Chair
Ontario Financing Authority

Auditor's Report

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

Auditor's Report

To the Ontario Financing Authority
and to the Minister of Finance

I have audited the balance sheet of the Ontario Financing Authority as at March 31, 2006, and the statement of net income and retained earnings, and the cash flow statement for the year then ended. These financial statements are the responsibility of the Authority's management. My responsibility is to express an opinion on these financial statements based on my audit.

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

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Authority as at March 31, 2006 and the results of its operations and its cash flows for the year then ended, in accordance with Canadian generally accepted accounting principles.

Toronto, Ontario
June 16, 2006

Gary R. Peall, CA
Deputy Auditor General

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Balance Sheet

As at March 31, 2006

(in thousands of dollars)		2006		2005
ASSETS				
Current assets				
Cash	$	150	$	146
Due from the Province of Ontario		2,858		3,155
Due from agencies (Note 5 (iii))		1,119		805
Current portion of loans receivable (Note 2)		—		6
Total current assets	**$**	**4,127**	**$**	**4,112**
Capital assets (Note 3)		2,058		2,225
Loans receivable (Note 2)		79,021		79,021
Total assets	**$**	**85,206**	**$**	**85,358**
LIABILITIES AND RETAINED EARNINGS				
Current liabilities				
Due to the Province of Ontario	$	2,858	$	3,155
Due to the Province of Ontario - Agencies (Note 5 (iii))		1,119		805
Due to the Province of Ontario - OMIC debt (Note 2)		—		6
Total current liabilities	**$**	**3,977**	**$**	**3,966**
Long-term debt				
Due to CPP and the Province of Ontario (Note 2)		79,031		79,031
Deferred revenue for capital assets (Note 4)		2,058		2,225
Retained earnings		140		136
Total liabilities and retained earnings	**$**	**85,206**	**$**	**85,358**

See accompanying notes to financial statements.

Approved on behalf of the Board:

Colin Andersen
Chair

Gadi Mayman
Chief Executive Officer and Vice-Chair

Statement of Net Income and Retained Earnings

For the year ended March 31, 2006

(in thousands of dollars)	**2006**	**2005**
REVENUE		
Interest	$ 7,599	$ 7,600
Cost recovery from the Province of Ontario (Note 5(ii))	14,876	14,837
Total revenue	**$ 22,475**	**$ 22,437**
EXPENSES		
Salaries, wages and benefits	$ 13,512	$ 13,362
Interest on long-term debt	7,595	7,595
Administrative and general	3,482	3,665
Amortization	1,378	1,083
Subtotal	**$ 25,967**	**$ 25,705**
Less: Cost recovery from Agencies (Note 5 (iii))	(3,496)	(3,273)
Total Expenses	**$ 22,471**	**$ 22,432**
Net income	4	5
Retained earnings, beginning of year	136	131
Retained earnings, end of year	**$ 140**	**$ 136**

See accompanying notes to financial statements.

Cash Flow Statement

For the year ended March 31, 2006

(in thousands of dollars)	**2006**	**2005**
Cash flows from operating activities		
Net income	$ 4	$ 5
Adjustment for amortization	1,378	1,083
Increase/ (Decrease) in deferred revenue	(167)	359
Cash flows from operating activities	$ 1,215	$ 1,447
Cash flows from financing activities		
Repayments to the Province re: OMIC loans	(6)	(6)
Repayments from holders of OMIC loans	6	6
Cash flows from financing activities	—	—
Cash flows from investing activities		
Purchase of capital assets	(1,211)	(1,442)
Cash flows used in investing activities	(1,211)	(1,442)
Net increase in cash	4	5
Cash beginning of the year	146	141
Cash at the end of the year	**$ 150**	**$ 146**

See accompanying notes to financial statements.

Notes to Financial Statements

For the year ended March 31, 2006

BACKGROUND

The Ontario Financing Authority (OFA) was established as an agency of the Crown, on November 15, 1993, by the *Capital Investment Plan Act, 1993* (the "Act"). In accordance with the Act, the OFA:

- Conducts borrowing, investment and financial risk management for the Province of Ontario;
- Manages the Provincial debt;
- Provides financial and centralized cash management services for the Province;
- Advises ministries, Crown agencies and other public bodies on financial policies and projects;
- Assists Crown agencies and other public bodies to borrow and invest money;
- Acts at the direction of the Province in lending to certain public bodies; and
- Invests on behalf of some public bodies.

In addition, the OFA's objects include:
- Providing such other financial services as are considered advantageous to the Province or any public body; and
- Any additional objects as directed by the Lieutenant Governor in Council.

The OFA is a corporation established under the laws of Ontario. The OFA is exempt from federal and provincial income taxes under paragraph 149(1)(d) of the *Income Tax Act* (Canada).

1. SIGNIFICANT ACCOUNTING POLICIES

(i) **General:** The financial statements are prepared in accordance with Canadian generally accepted accounting principles prescribed by the Canadian Institute of Chartered Accountants.

(ii) **Capital assets:** Capital assets are stated at cost. Amortization is provided using the straight-line method over the estimated useful life of the asset, as listed below.

Furniture and equipment	5 years
Computer hardware	3 years
Leasehold improvements	Remaining life of lease

(iii) **Measurement uncertainty:** The preparation of these financial statements requires Management to make estimates that are based on the best information available at the time of preparation of the financial statements. They will be updated annually to reflect new information as it becomes available.

2. ONTARIO MUNICIPAL IMPROVEMENT CORPORATION (OMIC)

In accordance with the *Capital Investment Plan Act, 1993*, OMIC's assets and liabilities were transferred to the OFA on November 15, 1993. OMIC received loans from the Canada Pension Plan (CPP) and the Province, which OMIC used to make loans to municipalities and school boards under similar terms as its debt.

As at March 31, 2006, the portion of long-term debt maturing in 2006–07 is nil (2005 – $6,000) and is due to the Province. Long-term debt maturing primarily in 2012 and 2013 is comprised of debt due to the Province of $10,000 and to the CPP of $79 million (2005 – $10,000 and $79 million respectively).

The terms of the outstanding debt are as follows:

(in thousands of dollars)

	As at March 31, 2006		As at March 31, 2005	
Maturing in:	**Principal Maturing**	**Effective Average Interest Rate (%)**	**Principal Maturing**	**Effective Average Interest Rate (%)**
1 Year	$ —		$ 6	11.25
5 Years	5,156	10.86	—	
1 - 5 years	5,156		6	
6 - 10 years	73,875	9.52	79,031	9.61
Total	**$ 79,031**		**$ 79,037**	

3. CAPITAL ASSETS

The net book value (NBV) of capital assets is as follows:

(in thousands of dollars)

	Cost	Accumulated Amortization	NBV March 31, 2006	NBV March 31, 2005
Furniture and equipment	$ 384	$ 294	$ 90	$ 101
Computer hardware	8,375	6,822	1,553	1,651
Leasehold improvements	1,325	910	415	473
Total	**$ 10,084**	**$ 8,026**	**$ 2,058**	**$ 2,225**

4. DEFERRED REVENUE FOR CAPITAL ASSETS

Deferred revenue for capital assets represents the unamortized portion of the cost recovered from the Province and the Agencies for the acquisition of capital assets.

	(in thousands of dollars)		
	Province	**Agencies**	**Total**
Balance, beginning of year	$ 1,817	$ 408	$ 2,225
Capitalization	1,168	43	1,211
Amortization	(1,161)	(217)	(1,378)
Balance, end of year	**$ 1,824**	**$ 234**	**$ 2,058**

5. TRANSACTIONS WITH THE PROVINCE AND OTHER PUBLIC BODIES

(i) Financing activities directed by the Province between the OFA and other Public Bodies:
The OFA provides financing to various public bodies, the repayment of which is expected from third-party revenues. These loans are made by the OFA at the direction of the Province. The funds for these loans are advanced to the OFA by the Province under a credit facility of $2.16 billion expiring August 31, 2027 and a credit facility of $656 million expiring August 31, 2029. Repayments received from public bodies by the OFA are forwarded to the Province. These transactions are not reflected in these financial statements. In compliance with the Ontario Financing Authority Lending Policy adopted by its Board of Directors on December 17, 1997, each advance received by the OFA under the current facility bears interest at a rate that is equivalent to the rate of interest payable to the OFA on the corresponding loan to the public body.

Funds are generally advanced by the OFA to public bodies under interim financing arrangements consisting of a number of promissory notes for terms not exceeding one year. The promissory notes are later converted to term debt and repayment terms are finalized. As at March 31, 2006, the amounts receivable by the OFA on behalf of the Province represent debentures, except for the short-term loans to the OPA and line of credit to the Ontario Northland Transportation Commission.

The following represents amounts receivable by the OFA including accrued interest. These amounts are in turn owed to the Province by the OFA. These are related party transactions, with the exception of those with the Corporation of the City of Windsor and the Toronto District School Board.

	(in thousands of dollars) March 31, 2006	March 31, 2005
Ontario Power Authority	$ 711,692	$ 6,782
Ontario Lottery and Gaming Corporation	535,248	685,490
Ontario Northland Transportation Commission	49,534	35,440
Corporation of the City of Windsor	22,512	23,393
Centennial Centre of Science and Technology	9,017	250
Toronto District School Board	—	55,200
	$ 1,328,003	**$ 806,555**

The Ontario Power Authority (OPA), established in December 2004, is a not-for-profit corporation. Under the Credit Agreement with the OFA, the OPA has been provided with a revolving credit facility of $975 million expiring December 31, 2006 to be used primarily to finance the cost of reducing consumers' electricity costs to the Regulated Price Plan level. The loan outstanding as at March 31, 2006 was $712 million (2005 – $7 million). Interest rates on these loans range from 3.88 per cent to 3.92 per cent.

The Ontario Lottery and Gaming Corporation (OLGC) is a Crown agency of the Province under the *Ontario Lottery and Gaming Corporation Act, 1999*. Members of the corporation are appointed by the Lieutenant Governor in Council. The OLGC loan of $535 million (2005 – $685 million) was issued on June 30, 2004 to purchase the casino complex in Niagara Falls. This is a 5-year loan at 4.3821 per cent maturing in June 2009.

The Ontario Northland Transportation Commission (ONTC) is a Crown agency of the Province under the *Ontario Northland Transportation Commission Act, 1990*.

The ONTC debentures (outstanding at March 31, 2006 – $34.5 million, 2005 – $24.9 million) were originally issued in six stages maturing from 2008 to 2031 and bearing interest at rates varying from 4.717 per cent to 6.37 per cent.

In addition, ONTC's operating lines of credit were extended to March 2008 by Order in Council to a maximum of $15 million. As at March 31, 2006, the full amount of $15 million had been drawn bearing interest at 3.85 per cent.

The Corporation of the City of Windsor is a municipality within the meaning of the Municipal Act. The financing provided is for the acquisition, design and construction of the Windsor Justice Facility, consisting of a provincial division courthouse and city police headquarters. This is a 20-year debenture at 6.41 per cent maturing in March 2021.

The Centennial Centre of Science and Technology is a Crown agency of the Province under the *Centennial Centre of Science and Technology Act, 1990*. Net loans of $9.0 million have been advanced to the borrower as at March 31, 2006 at 4.23 per cent. The loan will be repaid in instalments to March 15, 2013.

The Toronto District School Board was incorporated under the *Education Act, 1990*. The 10-year debenture of $55.2 million was issued on March 31, 2004 at 3.999 per cent with principal and interest repayments commencing in March 2008. The Province of Ontario approved the release of this loan on August 18, 2005, in the amount of $55.2 million, retroactive to March 31, 2005.

(ii) Investing for Related Parties:

In the normal course of business, the OFA provides investment management services to other public bodies as listed below. Funds managed on behalf of these other public bodies amounted to $2.3 billion at March 31, 2006 (2005 – $2.6 billion).

Algonquin Forestry Authority
Deposit Insurance Corporation Ontario
Northern Ontario Heritage Fund Corporation
Ontario Immigrant Investor Corporation
Ontario Realty Corporation
Ontario Securities Commission
Ontario Strategic Infrastructure Financing Authority
Ontario Trillium Foundation
Pension Benefits Guarantee Fund

The OFA also manages debt and investment on behalf of the Province, including the joint management of funds owned by OPG under the ONFA. The Province, OPG and certain OPG subsidiaries entered into the agreement in March 2002 to set aside the funds necessary to dispose of nuclear waste and used fuel and to decommission nuclear power stations. The agreement came into force during 2003–04.

Cost recovery from the Province for all debt management and investment activities for the year ended March 31, 2006, was $14.9 million (2005 – $14.8 million).

(iii) Due from Agencies

a) Ontario Electricity Financial Corporation (OEFC):

OEFC is responsible for servicing and retiring the debt and certain other liabilities of the former Ontario Hydro. The OFA provides financial services and advice to OEFC and manages its debt portfolio amounting to $28 billion at March 31, 2006 (2005 – $27.6 billion) on a fee-for-service basis.

b) Ontario Strategic Infrastructure Financing Authority (OSIFA):

OSIFA was established as a Crown agency under the *Ontario Municipal Economic Infrastructure Financing Act, 2002*.

The OFA manages the debt of OSIFA of $2.4 billion in total as at March 31, 2006, which includes loans from the Province of Ontario of $1.0 billion, a loan from Ontario Clean Water Agency of $120 million and third party debt instruments in the form of Ontario Opportunity Bonds of $323 million, Infrastructure Renewal Bonds of $650 million and Commercial Paper of $349 million. Investment, cash and related financial management services are also provided on a fee-for-service basis.

c) Cost Recovery from Agencies

Total costs incurred on behalf of OEFC and OSIFA and the total receivables from these agencies are as follows:

(in thousands of dollars)	March 31, 2006			March 31, 2005		
	OEFC	**OSIFA**	**Total**	**OEFC**	**OSIFA**	**Total**
Total Cost	$ 2,497	999	3,496	$ 2,220	1,053	3,273
Receivable	$ 684	435	1,119	$ 558	247	805

6. FUTURE EMPLOYEE BENEFITS

The OFA provides pension benefits to its full-time employees through participation in the Public Service Pension Plan, which is a multi-employer defined benefit pension plan established by the Province of Ontario. The Ministry of Government Services (MGS) is responsible for funding the employer's contribution to the Pension Fund and accordingly, the OFA has no additional liability for these future costs. In addition, the cost of post-retirement, non-pension benefits is paid by MGS and is not reported in these financial statements.

7. FINANCIAL INSTRUMENTS

The carrying amounts for cash, accounts receivable, loans receivable, and accounts payable and accrued liabilities approximate their fair values because of the short-term maturity of these instruments.

Given that the terms and amounts of the OFA's long-term receivables offset the OFA's long-term debt, providing fair values for these instruments would not add useful information to that which has already been presented in these financial statements.

8. CONTINGENCIES AND COMMITMENTS

At March 31, 2006, there were no claims under which the OFA would be financially liable. Civil litigation and grievance proceedings have resulted from the OFA's operations of the Province of Ontario Savings Office (POSO) until the date of its sale on March 31, 2003. However, settlements, if any, arising from these POSO claims will be accounted for by the Province in the period in which settlement occurs.

9. COMPARATIVE FIGURES

Certain of the 2004–05 comparative figures have been reclassified to conform with the financial statement presentation adopted in 2005–06.

Corporate Governance

Corporate Governance

Corporate governance at the OFA involves processes that permit the effective supervision and management of the OFA's activities by its senior Management staff, its Board of Directors and the Minister of Finance. It includes identifying those individuals and groups who are responsible for the OFA's activities and specifying their roles. The OFA's governance framework is fully described in the OFA's corporate governance policy, which is reviewed annually by the Board of Directors.

Accountability

The OFA's accountability structure flows from its governing statute, the *Capital Investment Plan Act, 1993* and from a Memorandum of Understanding between the OFA and the Minister of Finance, as well as from directives issued by Management Board of Cabinet (MBC) relating to Crown agencies. Together, these provide that the Minister of Finance is accountable to the Legislature for fulfillment of the OFA's mandate. In turn, the Chair of the OFA Board of Directors is accountable to the Minister for the performance of the OFA in fulfilling its mandate. The OFA Board of Directors is appointed by the Lieutenant Governor in Council and is accountable to the Minister of Finance, through the Chair, for supervising the management of the OFA's business affairs. The Chief Executive Officer (CEO) is accountable to the Chair of the OFA Board for the day-to-day management of the OFA's operations and the management and supervision of OFA staff. OFA staff are appointed pursuant to the *Public Service Act* and are subject to MBC policies and directives applicable to public servants. OFA staff are accountable, through OFA senior management, to the CEO.

Roles and Responsibilities

The Minister maintains communications with the OFA regarding government policies and expectations relevant to the OFA. The Minister is responsible for reviewing and approving the OFA's annual business plan and for recommending the plan for approval to MBC every three years or as otherwise required by government directives.

The Chair, who is also the Deputy Minister of Finance, provides leadership and direction to the CEO and the OFA Board and ensures the OFA's compliance with government policies and directives. The CEO is responsible for the ongoing activities of the OFA and ensures that policies and procedures remain relevant and effective.

The Board of Directors meets at least quarterly and receives regular reports from the CEO and other OFA staff concerning the operations of the OFA and its compliance with applicable laws and policies. The Audit Committee of the OFA Board approves an annual internal audit plan for the OFA and liaises with the internal auditors and the Province's Auditor General regarding the OFA's financial reporting and controls. It also reviews and recommends financial policies and the OFA's financial statements to the Board. Standards of conduct for Board members are set out in a Board-approved Code of Conduct.

Financial Reporting

The OFA prepares annual financial statements in accordance with generally accepted accounting principles for approval by the Audit Committee and the Board of Directors. Unaudited financial statements are prepared quarterly and presented to the Audit Committee and the Board. The annual financial statements are reviewed by the Provincial Auditor who expresses an opinion on whether they are presented fairly and in accordance with GAAP. The findings are reviewed by the Audit Committee and the Board of Directors. These audited financial statements are tabled in the Ontario Legislature as part of the OFA's Annual Report and are included as a schedule to the Public Accounts of the Province.

Board of Directors

The following individuals were members of the Ontario Financing Authority's Board of Directors in 2005–06:

Colin Andersen, Chair of the Ontario Financing Authority and Deputy Minister of Finance. Colin was appointed Deputy Minister of Finance in February 2004. His appointment expires when a successor Deputy Minister is appointed.

Colin was formerly Deputy Minister, Policy, Cabinet Office. He also has served as the Associate Deputy Minister, Ministry of Health and Long-Term Care, the Assistant Deputy Minister, Integrated Policy and Planning, Ministry of Health and Long-Term Care and Assistant Deputy Minister, Fiscal and Financial Policy, Ministry of Finance. Colin has a B.A. in Economics (Honours) from the University of Calgary and an M.A. in Economics from the University of Toronto.

Gadi Mayman, Chief Executive Officer of the Ontario Financing Authority. Gadi was appointed to the OFA Board of Directors in November 2003; his appointment expires in July 2008.

Gadi is responsible for the Province of Ontario's medium and long-term borrowing strategy, banking relationships and policies related to debt management. He advises the Province on the use of the Provincial credit and relations with capital markets and investors. Gadi is also Chief Executive Officer of the OEFC, responsible for its day-to-day operations.

Prior to joining the Ontario Ministry of Finance in 1991, he worked as a treasury officer at the Export Development Corporation (EDC) in Ottawa for three years and in the International Division of the Toronto Dominion Bank for five years. Gadi received a B.A. Sc. in Industrial Engineering from the University of Toronto in 1981, and an M.B.A. from the University of Western Ontario in 1988.

Lorraine Bell is a member of the Institute of Corporate Directors. Lorraine was appointed to the Board of Directors from October 2005 to October 2008.

Lorraine has over twenty years of financial experience, including over thirteen years' experience in the derivatives markets. She currently is a Trustee, Chair of the Audit Committee and member of the Governance Committee for Royal LePage Franchises Services Fund. Lorraine was formerly Vice-President and Director with General Re Financial Products Canada (GRFP). Prior to joining GRFP, she worked as a financial consultant and held positions with Confederation Treasury Services Limited (CTSL), Prudential Global Funding and Citibank Canada. Before joining Citibank Canada, Lorraine was with Touche Ross & Company (now Deloitte & Touche) as a member of the audit group and obtained her C.A. designation at that time.

Lorraine is an active volunteer for a number of charitable organizations in Ontario and serves on the Finance and Investment Committee of the Mount Sinai Hospital.

Robert Brown, B.Com, M.A., FCA, is a past Chair and past Chief Executive Office of Price Waterhouse (now PricewaterhouseCoopers). Robert was appointed to the Board of Directors from April 2005 to April 2008.

He has served as Chair of the Canadian Tax Foundation and the Canadian Institute of Chartered Accountants. Robert has an extensive background in tax, fiscal and governance issues. He was a member of the Toronto Stock Exchange Committee on Corporate Governance. Robert also served a term as the Clifford Clark Visiting Economist to the Department of Finance, providing advice to the Department and the Minister on fiscal, tax and economic policy issues. More recently, Robert served as co-chair of a federal committee to review tax assistance for the disabled. He is a director of Canadian Apartment Properties Real Estate Investment Trust and has served as a director of other public Canadian companies.

Robert has served in a number of volunteer positions and is a past Chair of the C.D. Howe Institute and a frequent speaker and writer on economic and tax policy issues. He is a director of Canadian Policy Research Networks and a past director of the Institute of Corporate Directors. Robert is a graduate of the University of Toronto (B.Com.) and of the University of Chicago (M.A., Economics).

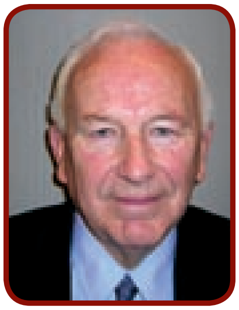
Tye W. Burt, President, CEO and Director, Kinross Gold Corporation. Tye was appointed to the Board of Directors from June 2000 to July 2006.

Tye was previously Vice-Chairman and Executive Director, Corporate Development with Barrick Gold Corporation. He is a Director of NRX Global Corporation, a network platform provider and portal for the global heavy equipment and parts industry. He is former Chairman of Deutsche Bank Canada and Deutsche Bank Alex. Brown Securities Canada. Before joining Deutsche Bank, he spent over a decade at Nesbitt Burns Inc. and Burns Fry Ltd. Tye is also a Member of the Law Society of Upper Canada. Tye received his law degree from Osgoode Hall Law School in 1983 and a B.A. (Honours) from the University of Guelph in 1980.

Mario Ferrara was appointed to the Board of Directors from April 2005 to April 2008.

Previously, Mario was Managing Director and Head of the Government Finance group at Scotia Capital in Toronto. The group provided a wide range of financial advice and executed financing transactions for the firm's government and government-related clients.

Mario's investment management experience includes senior positions in the private and public sector. As Vice-President, Investments at E-L Financial Corporation, he was head of the investment group with direct responsibility for managing the fixed-income portfolios of the company's life and casualty insurance subsidiaries. Prior to joining E-L Financial, Mario spent 12 years at Ontario Hydro in a number of finance-related positions including portfolio manager of the fixed-income assets of the Ontario Hydro Pension Plan. Later at Ontario Hydro, he was Assistant Treasurer–Corporate with responsibility for management, development and execution of funding plans, investor relations and corporate insurance. Mario holds a B. Comm. and M.B.A. from McMaster University.



Patrick Lavelle is Chairman and Chief Executive Officer of his own strategic management consulting firm established in 1991. Patrick was appointed to the Board of Directors from December 2005 to December 2008.

Until March of 2002, Patrick was Chairman and CEO of Unique Broadband Systems Inc. He was Chairman of Export Development Canada and served a three-year term as Chairman of the Board of the Business Development Bank of Canada. Prior to establishing his own firm, Patrick was Vice President, Corporate Development, Magna International Inc. In 1985 he was appointed Deputy Minister of Industry Trade and Technology for the Province of Ontario. At the same time, he was the first Secretary of the Premier's Council which produced an economic blueprint for the Ontario economy. Patrick served as President and CEO of the Automotive Parts Manufacturers' Association of Canada and Agent General for the Government of Ontario in Paris, France. He was also Sales and Marketing Director of Consumer's Packaging, and an executive assistant to the Federal Minister of Labour and Health and Welfare.

Patrick is a director of a number of public and private Canadian and U.S. companies. He is a member of the Advisory Board of the International M.B.A. program at York University.

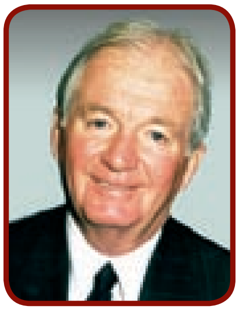
Carol Layton, Deputy Minister of Public Infrastructure Renewal. Carol was appointed to the Board of Directors from July 2003 to July 2009.

Carol was previously Deputy Minister of Results Delivery within Cabinet, Deputy Minister of Citizenship and Immigration as well as Deputy Minister Responsible for Women's Issues and Seniors. She has held various senior positions in the Management Board Secretariat and the Ministries of Health and Long-Term Care, Finance, the Attorney General and Treasury and Economics. Carol holds a Bachelor of Environmental Studies (Honours) degree from the University of Waterloo.

Jack M. Mintz, was President and Chief Executive Officer, C.D. Howe Institute throughout 2005-06. Jack was appointed to the Board of Directors from September 2003 to September 2006.

Jack also serves on various corporate and not-for-profit boards. He has published more than 180 books and articles in the fields of public economics and fiscal federalism. He serves on the Board of Governors of the National Tax Association in Washington, D.C., is an Associate Editor of Contemporary Accounting Research and International Tax and Public Finance and is a research fellow of CESifo, Munich, Germany. He is also Deloitte and Touche LLP Professor of Taxation at the Joseph L. Rotman School of Management and co-director of the International Tax Program at the Institute of International Business, both at the University of Toronto.

Jack has served as a visiting economist at the Department of Finance, Ottawa, and Chair of the federal government's Technical Committee on Business Taxation in 1996 and 1997; Associate Dean (Academic) of the Faculty of Management, University of Toronto, 1993–95; a special advisor to the Deputy Minister, Tax Policy Branch, Department of Finance, Ottawa, 1984–86; and Director of the John Deutsch Institute, Queen's University, 1987–89.



Frank Potter, Chairman of Emerging Markets Advisors Inc., Toronto. Frank was appointed to the Board of Directors from May 2000 to June 2006.

Frank sits on a number of boards, both corporate and not-for-profit. He was a former advisor to the Department of Finance (Canada), and prior to that was Executive Director of the World Bank in Washington, D.C. He also has held a number of senior positions in international banking in North America, Europe and Asia.

Risk Management Policies and Procedures

OFA risk management policies and procedures provide for the management of risk exposures created by capital market activities. Current policies and procedures address market, credit and operational risk exposure as they pertain to the Province's debt and derivatives portfolios and capital markets transactions.

The policies were developed following the guidelines and directives of regulatory bodies, such as the Office of the Superintendent of Financial Institutions of Canada, the Bank for International Settlements (BIS) and in consultation with Canadian bank representatives on their risk management practices.

The OFA's Board and Management committees establish and approve risk management policies and monitor the performance of the OFA's capital market activities.

Market Risk Policy

Market risk is the risk of financial loss attributable to changes in interest rates, foreign exchange rates and market liquidity. This policy provides a framework for borrowing activities and integrates several aspects dealing with the management of market risk. The policy includes several limits:

- Foreign Exchange Limit – unhedged foreign currency exposure is limited to five per cent of outstanding debt. Foreign exchange exposures are limited to Group of Seven currencies or the equivalent currencies (e.g., the Euro) and the Swiss franc.

- Interest Rate Resetting Limit – the interest rate resetting risk exposure is the sum of maturities and floating-rate debt with interest resets over the next 12 months and is limited to a maximum of 25 per cent of outstanding debt.

- Debt Cost Loss Limit – the total amount of financial losses resulting from market risk and the default of counterparties shall not exceed a debt cost loss limit of three per cent of IOD. In addition, the CEO establishes a trigger level to ensure that market and credit losses will not reach the debt cost loss limit. The trigger level is included in the annual financing, debt and electricity management plan.

The OFA identifies and quantifies exposures to market risk in its annual financing and debt management plan to ensure that risk exposures and losses remain within the approved exposure and loss limits. Exposure to market, credit and liquidity risk is measured daily.

When issuing new debt on behalf of the Province, the OFA will aim for a smooth debt maturity profile to diversify the interest rate risk for the refinancing of maturing and floating rate debt.

Credit Risk

Credit risk is the risk of loss in which a counterparty does not meet, or defaults on, its obligations. Credit risk arises when the OFA undertakes financial and derivative transactions. The minimum credit rating of a counterparty for a new swap transaction is typically AA– and R1-mid for money market investments. The resulting exposure is capped at mark-to-market limits depending on the counterparty's credit rating and capital base.

Policy on the Use of Derivatives

Derivatives are used to manage exposures arising from existing and planned debt issues in a sound and cost-effective manner consistent with the Annual Financing, Debt and Electricity Management Plan. Risks arising from the use of derivatives are monitored and managed prudently.

Policy on Risk Management Reporting

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

- The CEO of the OFA provides the OFA Board of Directors with a progress report on the implementation of the Annual Financing, Debt and Electricity Management Plan, staffing and other administrative and operational matters. The CEO also reports on the OFA's compliance with applicable government directives and the OFA Legal Director reports on the OFA's compliance with applicable laws; and

- The Director of Risk Control reports on program exposures and performance as well as exceptions to policies.

In addition, OFA Management is kept informed of OFA's risk exposures and positions on a daily basis.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people or systems or external events. Each division at the OFA manages operational risk through reviews and improvements of work processes, documented policies and procedures, data processing systems, contingency plans and staff training.

The OFA maintains a Business Continuity Plan (which covers the OEFC's operations) that is regularly updated to facilitate the continuation of essential operational functions with a minimum of disruption in the event of an emergency.

Appendices

Ontario's Credit Ratings

Additional Sources of Information

Ontario's Credit Ratings

A credit rating is a current assessment of the creditworthiness of a borrower with respect to a specified obligation. It indicates the capacity and willingness of a borrower to pay interest and principal in a timely manner.

Long-Term Ratings

Long-term ratings are assigned a letter grade ranging from investment grade, to speculative grade, to highly speculative or default. Ratings within each category may include a "plus" or "minus" (or a high or low) to indicate the relative strength of rating within that category. The current long-term ratings of the Province of Ontario are as follows:

• Standard & Poor's Corporation (New York)	AA
• Moody's Investors Service (New York)	Aa2
• Dominion Bond Rating Service (Toronto)	AA

Short-Term Ratings

Short-term ratings are for debt maturities of less than one year. Ratings are graded into several categories, ranging from the highest-quality obligations to default. The current short-term ratings of the Province of Ontario are as follows:

• Standard & Poor's Corporation (New York)	A-1+
• Moody's Investors Service (New York)	P-1
• Dominion Bond Rating Service (Toronto)	R-1 (mid)

Additional Sources of Information

www.ofina.on.ca

Provides information on Ontario's borrowing program and debt, and contains publications from the Ontario Financing Authority and Ontario Ministry of Finance.

Ontario Budget

Paper D, Borrowing and Debt Management, provides a discussion of the Province's borrowing and debt management activities for the fiscal year ended and outlines the outlook for the upcoming fiscal year.

Quarterly Finances – OFA Bulletin

Quarterly updates of the government's annual budget forecast. Available on www.ofina.on.ca and the Ministry of Finance web site, www.fin.gov.on.ca.

Form 18-k

The Province's annual report to the U.S. Securities and Exchange Commission (SEC).

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ISSN 1492-854X