

1 **HYDRO ONE GOVERNANCE AND CONTROL FRAMEWORK**

2
3 **1.0 OVERVIEW**

4
5 The Corporate Governance structure and Internal Control Framework of Hydro One Inc.
6 provide reasonable assurance regarding Hydro One Distribution's effective and efficient
7 operations, reliable financial reporting, and compliance with applicable laws and regulations.
8 In the past few years, federal and provincial governments and regulators have moved
9 decisively to increase the robustness and transparency of corporate governance, as well as
10 expand the requirements for internal control and disclosure (for example, Ontario's Bill 198).

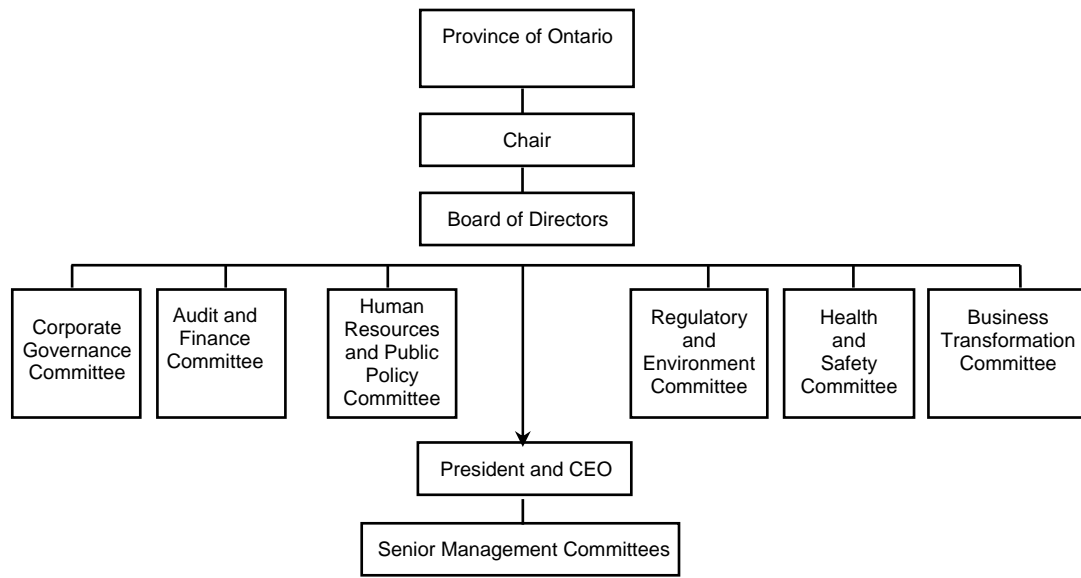
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12 **2.0 CORPORATE GOVERNANCE**

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14 Corporate governance is the mechanism by which a corporation ensures independent
15 oversight of management activities on behalf of the shareholder(s). For Hydro One Inc., the
16 Board of Directors and its associated committees fulfill this objective, and provide direction
17 and accountability to senior officers to prudently and ethically manage the company's
18 business and affairs, as well as the review and/or approval of mission, goals and business
19 objectives, organizational authorities and business plans.

20
21 The company's corporate governance structure is illustrated in Figure 1. Hydro One's Board
22 and Senior Management committees are also described in detail below.

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2
3

Figure 1
Hydro One Corporate Governance



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The Hydro One Board of Directors

7 The Board is responsible for the stewardship of our company and the supervision of
8 management of the business and affairs of our company. The Board's accountabilities and
9 responsibilities include development of our company's approach to corporate governance,
10 strategy and risk management.

11

Committees of the Board of Directors

13 The Board has established various committees to address specific areas and responsibilities.
14 However, the Board retains its oversight function and ultimate responsibility for all matters
15 delegated to committees. The Committees of the Board include the Corporate Governance
16 Committee, Audit and Finance Committee, the Human Resources and Public Policy
17 Committee, the Regulatory and Environment Committee, the Health and Safety Committee
18 and the Business Transformation Committee.

19

1 **2.1 Corporate Governance Committee**

2
3 The Corporate Governance Committee acts as the nominating committee of the Board and
4 recommends director candidates, committee assignments, director compensation and
5 corporate governance policy for Committees and the Board as a whole. The Committee
6 reviews the general and specific criteria applicable to candidates to be considered for
7 nomination to the Board, as well as an annual review of the mandates of each Committee of
8 the Board or subsidiary Boards. Other obligations include recommending issues for
9 discussion at Board meetings, monitoring the quality of management's relationship with the
10 Board and reviewing Board effectiveness. The Committee is composed of independent
11 directors.

12
13 **2.2 Audit and Finance Committee**

14
15 The Audit and Finance Committee is mainly responsible for overseeing the integrity of
16 accounting policies and financial reporting, internal controls, auditing practices and
17 significant corporate risk exposures for Hydro One Inc. and its subsidiaries. Specifically,
18 the Committee makes recommendations regarding financial objectives and plans and risk
19 management strategies of the company. It is also accountable for reviewing and
20 recommending to the Board for approval interim and annual audited consolidated financial
21 statements; management discussion and analysis disclosures; and financial statements in debt
22 securities offering documents and other related matters. In addition, the Committee reviews
23 the internal audit procedures of the company and advises the Board on its auditing practices
24 and procedures, selects and oversees the work of external auditors and obtains assurance that
25 internal controls are adequate. The Committee also reviews, at least annually but more
26 frequently if necessary, specific complaints brought forward under the Code of Business
27 Conduct. All members of the Committee are independent.

1 **2.3 Human Resources and Public Policy Committee**

2
3 The Human Resources and Public Policy Committee’s responsibilities include reviewing the
4 appropriateness of current and future organization structures, succession plans for corporate
5 and divisional officers and conducts an annual review of the Code of Business Conduct. The
6 Committee further identifies, assesses and provides advice to the Board on public policy
7 issues that may have a significant impact on the company. The Committee is composed of
8 independent directors.

9
10 **2.4 Regulatory and Environment Committee**

11
12 The Regulatory and Environment Committee monitors the company’s compliance with
13 regulatory and environmental requirements and related risks and seeks to ensure that
14 management is effectively managing those risks. The Committee is also responsible for
15 reviewing management's regulatory proposals for transmission and distribution rate
16 applications, as well as the status of outstanding applications. It also plays an advisory role
17 with respect to changes or additions to environmental policies, standards, accountabilities
18 and programs, and recommends such to the Board for approval. The Committee is composed
19 of a majority of independent directors.

20
21 **2.5 Health and Safety Committee**

22
23 The Health and Safety Committee is responsible for reviewing and ensuring compliance with
24 occupational health and safety legislation, policies, standards and programs. They annually
25 review the company's state of readiness to respond to crisis situations, as well as reports of
26 any occupational accidents. They may also review such other health and safety matters,
27 including public health and safety, as appropriate. The Committee is composed of a majority
28 of independent directors.

1 **2.6 Business Transformation Committee**

2
3 The Business Transformation Committee is responsible for assisting the Board of Directors
4 in its oversight responsibility on matters related to the Enterprise Application Systems
5 Replacement Strategy. The strategy addresses the replacement of existing customized
6 business applications with commercially available software system applications to simplify
7 the information technology infrastructure and improve functionality in business processes.
8 The Committee is composed of independent directors.

9
10 **3.0 SENIOR MANAGEMENT COMMITTEES**

11
12 Prudent decision-making, operational effectiveness and business transparency are supported
13 by four key senior management committees: Executive Committee, Operations Committee,
14 Pension Committee, Disclosure Committee.

15
16 **3.1 Executive Committee**

17
18 This committee is a decision-making body established to review and approve business plans,
19 capital projects and investments, key operating decisions, regulatory filings, labour strategy,
20 financial performance indicators and other items as required. The Executive Committee also
21 reviews all project approvals prior to going to the Board.

22
23 **3.2 Operations Committee**

24
25 This committee provides direction and coordination among the various lines of business,
26 including resourcing strategy, alignment of business plans, health and safety policy, support
27 for regulatory filings and implementation of corporate strategies. The committee also
28 reviews and coordinates operational issues and reviews project and program expenditures.

1 Any required changes to project or program schedules are coordinated across all lines of
2 business.

3

4 **3.3 Pension Committee**

5

6 The Pension Committee is responsible for approving appropriate pension policies, standards
7 and programs. It is also responsible for ensuring compliance with all applicable legislation,
8 policies and standards.

9

10 **3.4 Disclosure Committee**

11

12 The Disclosure Committee operates under the principle that communications to the public
13 should be timely, factual and accurate and broadly disseminated in accordance with all
14 applicable legal and securities regulatory requirements in Canada. The committee meets
15 quarterly to review consolidated financial statements and management's discussion and
16 analysis disclosures, offering documents for debt securities, as well as risk assessments
17 prepared for credit rating agencies and government.

18

19 **4.0 INTERNAL CONTROL FRAMEWORK**

20

21 Internal controls ensure the company achieves its mission and goals, by enabling
22 management to deal with rapidly changing economic and competitive environments,
23 customer demands and priorities, and restructuring for future growth. Internal controls
24 promote efficiency, reduce risk of asset loss, and help ensure the integrity and reliability of
25 financial statements and compliance with laws and regulations.

26

27 Hydro One Inc.'s Internal Control Framework has five components, including: the Control
28 Environment, Risk Assessment, Control Activities, Information and Communication, and

1 Monitoring. The framework further addresses the appropriate elements of each component at
2 the entity (Board) level, corporate (senior management) level and operational (local) level.
3 The framework is consistent with accepted external standards and control criteria set out by
4 such standard setting bodies as the Canadian Institute of Chartered Accountants and the US
5 Committee of Sponsoring Organizations. Key components of the framework are described in
6 more detail below:

7
8 The "Control Environment" refers to direction and oversight from the top of the organization.
9 The control environment component in the framework captures the notion of ethical and
10 prudent financial management as established by the Board of Directors and senior
11 management (see Section 2.0 above), and sets the tone for all financial and project
12 management policies and practices established at lower levels. Regular education sessions on
13 policies, processes and practices/procedures are also provided.

14
15 Hydro One Inc. has a formal Code of Business Conduct and a Disclosure Policy which have
16 been issued to all staff. The Code of Business Conduct requires all management employees
17 to sign an annual compliance form to document that they have read, understood and
18 complied with the Code, and that all conflicts or potential conflicts of interest have been
19 disclosed. The Corporate Ethics Officer ensures that this process is performed on a timely
20 basis and that a compliance register is maintained and submitted to the President and CEO of
21 Hydro One Inc. Lastly, individual performance contracts of management employees are
22 intended to capture the understanding between a manager and a direct report as to the results
23 expected and the means by which such performance results will be achieved.

24
25 "Risk Assessment" involves the identification and analysis by management of the key risks
26 to achieving the company's business objectives. Such an assessment is performed, at least,
27 annually, and provides the basis for business planning decisions. Programs that mitigate
28 existing risks to acceptable residual levels, or provide mitigation for emerging risks, are

1 captured in business plans. Risk assessment extends to individual investment decisions
2 through the Work Program Prioritization process (see Exhibit A, Tab 14, Schedule 6) and its
3 associated Justification for Programs/Projects (Exhibit D2, Tab 2, Schedule 3). This process
4 assesses whether any proposed solutions for a specific operational need will achieve a level
5 of residual risk acceptable to senior management and the company's shareholder. Projects
6 and programs underway are regularly assessed for new and changing risks. Moreover, at the
7 operational level, extensive emergency and contingency plans exist and are regularly tested
8 and updated.

9
10 "Control Activities" refers to the systems, policies and procedures that ensure management's
11 objectives are achieved and risk mitigation plans are carried out. Policies and procedures
12 exist to govern annual, monthly and day to day operations at the business unit and local
13 levels. Many of these policies were imported from Ontario Hydro, and revised to focus on
14 the core activities of transmission and distribution. Each revised policy has an issue date and
15 expected review date. In many locations, policies and procedures are available on internal
16 web sites. More information on Hydro One's distribution policies may be found in Exhibit
17 A, Tab 12, Schedule 2.

18
19 One of the foundations of good control is the establishment of appropriate levels of authority
20 for spending and other business decisions. The delegation and exercise of authorities are
21 governed by 'Guiding Principles', the Code of Business Conduct, and policies and
22 procedures. The approval of the business plans and budgets establish authorized spending
23 levels.

24
25 The budgeting and business planning process is also a critical element of effective internal
26 controls. Annually a budget and business plan are prepared and submitted to the Board for
27 approval. The budget and business plan set the parameters of the company's activities for a
28 specific fiscal period. More information on Hydro One's planning process may be found in

1 Exhibit A, Tab 14, Schedule 1. Information on the Company's Work Program Prioritization
2 process and Project and Program approval process may be found in Exhibit A, Tab 14,
3 Schedule 6 and Exhibit A, Tab 14, Schedule 7, respectively.

4
5 The Executive Authorities Register (EAR) delegates authorities from the Board to senior
6 management. Organizational Authority Registers (OARs) exist at subsidiary and business
7 unit levels to delegate authorities from senior management to business unit and local levels.

8
9 The Inergi outsourcing agreement further provides approvals assigned by Hydro One to
10 Inergi LP for specific transactions and spending levels.

11
12 "Information and Communication" supports all other control components. Pertinent
13 information must be identified, captured and communicated in a form and timeframe that
14 enables staff to carry out their responsibilities. Communication occurs to all staff from the
15 Chief Financial Officer and from the Corporate Controller with respect to new or changed
16 policies and procedures. Presentations on various internal control matters also occur
17 regularly. And, as noted previously, policies and procedures can be found in many locations
18 on internal websites.

19
20 "Monitoring" covers the oversight of internal controls by management or independent parties
21 outside the process; or the application of independent methodologies, such as customized
22 procedures or standard checklists, by employees within a process. Monitoring also includes
23 assessing the quality of internal controls over time and implementing required changes.

24
25 Management provides assurance with respect to internal controls and the validity of financial
26 statements. This includes information on legal claims, changes in accounting policies,
27 practices, systems, and procedures that have occurred in the period, and financial accounting
28 matters that could have a significant impact on financial statements. Management also

1 provides assurance that internal control systems, policies and procedures are in place and
2 functioning properly and financial statements are a true representation of the business.

3
4 Every month, each line of business is required to conduct a detailed review of financial
5 results by comparing operating results to budgets and responding to variances. Project
6 details with major accounts are reconciled monthly to source sub-systems and suspense
7 accounts are also explained and reconciled. Monthly control reports related to key aspects of
8 operations financial and project activity are prepared centrally and delivered to managers for
9 review and follow-up action as appropriate. A month-end close schedule is established to
10 ensure timely production of financial statements. In addition, compliance testing of key
11 financial activities is performed.

12
13 Compliance monitoring with respect to codes and policies is performed by multiple groups.
14 Regulatory compliance is monitored by Regulatory Affairs (e.g. Affiliate Relationships
15 Code: see Exhibit A, Tab 8, Schedule 3). Internal Audit uses a risk-based audit approach for
16 prioritizing audits and performs audits of areas of highest risk based on an annual program
17 approved by the Hydro One Board's Audit and Finance committee. Internal controls are
18 reviewed on a recurring cycle, again linked to level of risk. Furthermore, regular review of
19 all outstanding items from past audits is performed. Annual year-end audits are also
20 conducted by the Hydro One's external auditor.

21
22 The outsourcing contract with Inergi LP requires that Inergi conduct an independent
23 confirmation of the integrity of financial controls for all Hydro One transactions, and allows
24 for auditing of processes and systems by Hydro One Internal Audit. Such audits are designed
25 to assess the appropriate occurrence, proper measurement, completeness and accuracy of
26 transactions and whether they were classified, described and disclosed in accordance with
27 generally accepted accounting principles.