

generators effective January 1, 2009. Participants in the Midwestern Greenhouse Gas Reduction Accord, which involves six states and one province, are developing a regional strategy for reducing members' GHG emissions that will include a multi-sector cap and trade mechanism.

The Company anticipates a number of its facilities will be affected by these legislative initiatives. Under the RGGI, both the Ravenswood and OSP facilities will be required to submit allowances by December 31, 2011. It is expected that the costs will be recovered from the market and the net impact to TransCanada will be minimal. Company assets located in regions affected by the WCI and Midwestern Greenhouse Gas Reduction Accord and in California are most likely to be covered by GHG reduction measures put in place, however, the level of impact is uncertain as key policy details remain outstanding.

TransCanada monitors climate change policy developments and, when warranted, participates in policy discussions in jurisdictions where the Company has operations. The Company is also continuing its programs to manage GHG emissions from its facilities and to evaluate new processes and technologies that result in improved efficiencies and lower GHG emission rates.

CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in reports filed with, or submitted to, securities regulatory authorities is recorded, processed, summarized and reported within the time periods specified under Canadian and U.S. securities laws. The information is accumulated and communicated to management, including the President and Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure.

As at December 31, 2008, an evaluation of the effectiveness of TransCanada's disclosure controls and procedures as defined under the rules adopted by the Canadian securities regulatory authorities and by the SEC was carried out under the supervision and with the participation of management, including the President and Chief Executive Officer and the Chief Financial Officer. Based on this evaluation, the President and Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of TransCanada's disclosure controls and procedures were effective as at December 31, 2008.

Management's Annual Report on Internal Control over Financial Reporting

Internal control over financial reporting is a process designed by or under the supervision of senior management and effected by the Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and preparation of consolidated financial statements for external purposes in accordance with Canadian GAAP, including a reconciliation to U.S. GAAP.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting, no matter how well designed, has inherent limitations and can only provide reasonable assurance with respect to the preparation and fair presentation of published financial statements. Under the supervision and with the participation of the President and Chief Executive Officer and the Chief Financial Officer, management conducted an evaluation of the effectiveness of its internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company acquired Ravenswood in August 2008 and began consolidating the operations of Ravenswood from that date. Management has excluded this business from its evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. The net income attributable to this business represented less than one per cent of the Company's consolidated net income for the year ended December 31, 2008, and its aggregate total assets represented approximately nine per cent of the Company's consolidated total assets as at December 31, 2008.

Based on this evaluation, management concluded that internal control over financial reporting is effective as at December 31, 2008, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes.

In 2008, there was no change in TransCanada's internal control over financial reporting that materially affected or is reasonably likely to materially affect TransCanada's internal control over financial reporting.

CEO and CFO Certifications

TransCanada's President and Chief Executive Officer and Chief Financial Officer have filed with the SEC and the Canadian securities regulators certifications regarding the quality of TransCanada's public disclosures relating to its fiscal 2008 reports filed with the SEC and the Canadian securities regulators.

SIGNIFICANT ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

To prepare financial statements that conform with Canadian GAAP, TransCanada is required to make estimates and assumptions that affect both the amount and timing of recording assets, liabilities, revenues and expenses. The Company uses the most current information available and exercises careful judgment in making these estimates and assumptions. The Company believes the following accounting policies and estimates require it to make assumptions about highly uncertain matters and changes in these estimates could have a material impact to the Company's financial information.

Regulated Accounting

The Company accounts for the impacts of rate regulation in accordance with GAAP. Three criteria must be met to use these accounting principles:

- the rates for regulated services or activities must be subject to approval by a regulator;
- the regulated rates must be designed to recover the cost of providing the services or products; and
- it must be reasonable to assume that rates set at levels to recover the cost can be charged to and will be collected from customers in view of the demand for services or products and the level of direct and indirect competition.

The Company's management believes all three of these criteria have been met with respect to each of the regulated natural gas pipelines accounted for using regulated accounting principles. The most significant impact from the use of these accounting principles is that the timing of recognition of certain expenses and revenues in the regulated businesses may differ from that otherwise expected under GAAP in order to appropriately reflect the economic impact of the regulators' decisions regarding the Company's revenues and tolls.

Effective January 1, 2009, the Company's accounting for its future income taxes recorded on rate-regulated operations will change as discussed in the "Accounting Changes" section of this MD&A.

Financial Instruments and Hedges

Financial Instruments

Effective January 1, 2007, the Company adopted the accounting requirements for the Canadian Institute of Chartered Accountants (CICA) Handbook Sections 1530 "Comprehensive Income", 3855 "Financial Instruments – Recognition and Measurement", and 3865 "Hedges". Effective December 31, 2007, the Company adopted the accounting requirements for CICA Handbook Sections 3862 "Financial Instruments – Disclosure", 3863 "Financial Instruments – Presentation", and 1535 "Capital Disclosures". Adjustments to the consolidated financial statements for 2007 were made on a prospective basis.

The CICA Handbook requires that all financial instruments initially be included on the balance sheet at their fair value. Subsequent measurement of the financial instruments is based on their classification. Financial assets are classified into the following categories: held for trading, available for sale, held-to-maturity investments and loans and receivables.