
ATTACHMENT I

Audited 2001 Financial statements

London Hydro Inc.
(formerly London Hydro Utilities Services Inc.)

Financial Statements
For the Year Ended December 31, 2001



KPMG LLP
Chartered Accountants
140 Fullarton Street Suite 1400
PO Box 2305
London ON N6A 5P2
Canada

Telephone (519) 672-4880
Telefax (519) 672-5684
www.kpmg.ca

AUDITORS' REPORT TO THE SHAREHOLDER:

We have audited the balance sheet of London Hydro Inc. as at December 31, 2001 and the statements of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2001 and the results of its operations and cash flows for the year then ended in accordance with accounting principles generally accepted in Canada.

Chartered Accountants

London, Canada

February 22, 2002



KPMG LLP, a Canadian owned limited liability partnership established under the laws of Ontario, is a member firm of KPMG International, a Swiss association.

London Hydro Inc.

Statement of Operations (in thousands of dollars) For the Year Ended December 31, 2001

	<u>2001</u>	<u>2000</u> (Note 15)
Distribution revenue	\$ <u>29,561</u>	\$ <u>1,286</u>
Operating expenses		
Plant operating and maintenance	8,214	1,480
General and administrative	15,124	2,482
Amortization of capital assets	<u>11,047</u>	<u>1,248</u>
	34,385	5,210
Less: Costs recovered (Note 10)	<u>(3,228)</u>	<u>(715)</u>
	<u>31,157</u>	<u>4,495</u>
Operating loss	<u>(1,596)</u>	<u>(3,209)</u>
Other income (expense) (Note 11)		
Interest and other revenue	5,372	651
Provision for non-recoverable regulatory amounts	<u>(3,142)</u>	<u>-</u>
	<u>2,230</u>	<u>651</u>
Earnings (loss) before income taxes	634	(2,558)
Income tax recovery (Note 12)	<u>(755)</u>	<u>-</u>
Net earnings (loss) for the year	<u>\$ 1,389</u>	<u>\$ (2,558)</u>

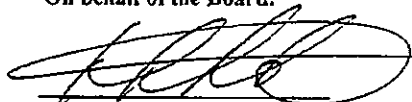
See accompanying notes to the financial statements

London Hydro Inc.

Balance Sheet
(in thousands of dollars)
As at December 31, 2001

ASSETS	<u>2001</u>	<u>2000</u>
Current assets		
Cash and equivalents (Note 3)	\$ 7,201	\$ 23,545
Accounts receivable (Note 4)	37,150	36,120
Inventories	3,527	4,736
Prepaid expenses	365	573
Income taxes recoverable	857	-
	<u>49,100</u>	<u>64,974</u>
Transitional costs recoverable (Note 5)	<u>1,695</u>	<u>-</u>
Capital assets (Note 6)	<u>159,946</u>	<u>153,307</u>
	<u>\$ 210,741</u>	<u>\$ 218,281</u>
 LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Accounts payable and accrued liabilities -		
Due to Ontario Power Generation	\$ 20,482	\$ 22,701
Other	7,126	5,798
Due to related parties (Note 10)	3,248	11,498
	<u>30,856</u>	<u>39,997</u>
Long-term liabilities		
Customer and other deposits (Note 7)	7,163	6,001
Employee future benefits (Note 13)	7,775	8,725
Long-term debt (Note 8)	70,000	95,000
	<u>84,938</u>	<u>109,726</u>
Shareholder's equity		
Share capital (Note 9)	96,116	71,116
Deficit	(1,169)	(2,558)
	<u>94,947</u>	<u>68,558</u>
	<u>\$ 210,741</u>	<u>\$ 218,281</u>

On behalf of the Board:


Director


Director

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Deficit
(in thousands of dollars)
For the Year Ended December 31, 2001

	<u>2001</u>	<u>2000</u> <u>(Note 15)</u>
Deficit, beginning of year	\$ (2,558)	\$ -
Net earnings (loss) for the year	<u>1,389</u>	<u>(2,558)</u>
Deficit, end of year	<u>\$ (1,169)</u>	<u>\$ (2,558)</u>

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Cashflows
(in thousands of dollars)

For the Year Ended December 31, 2001

	<u>2001</u>	<u>2000</u> (Note 15)
Operating activities		
Net earnings (loss) for the year	\$ 1,389	\$ (2,558)
Charges to operations not affecting cash		
Amortization of capital assets	11,047	1,248
Loss (gain) on disposal of capital assets	<u>(1,055)</u>	<u>70</u>
	11,381	(1,240)
Net change in non-cash working capital balances related to operations	(4,444)	4,444
Decrease in employee future benefits	(950)	-
Increase in customer and other deposits	<u>1,162</u>	<u>70</u>
Cash provided by operating activities	<u>7,149</u>	<u>3,274</u>
Financing (Note 8)		
Advances to shareholder	(5,168)	(347)
Contributions to capital costs	<u>2,116</u>	<u>742</u>
Cash provided by (used in) financing activities	<u>(3,052)</u>	<u>395</u>
Investing activities		
Additions to capital assets	(20,750)	(6,088)
Proceeds on disposal of capital assets	2,004	4
Increase in recoverable transitional costs	<u>(1,695)</u>	<u>-</u>
Cash used in investing activities	<u>(20,441)</u>	<u>(6,084)</u>
Decrease in cash and equivalents during the year	(16,344)	(2,415)
Cash and equivalents, beginning of the year	<u>23,545</u>	<u>25,960</u>
Cash and equivalents, end of the year	<u>\$ 7,201</u>	<u>\$ 23,545</u>

See accompanying notes to the financial statements

London Hydro Inc.
Notes to the Financial Statements
(in thousands of dollars)
For the Year Ended December 31, 2001

1. Business Operations

The Company is a wholly owned subsidiary company of the Corporation of the City of London and commenced active operations on November 1, 2000, providing regulated electrical distribution services, as regulated by the Ontario Energy Board, to the inhabitants of the City of London. On May 15, 2001 the Company name was changed to London Hydro Inc.

2. Summary of Significant Accounting Policies

The financial statements have been prepared in accordance with accounting principles generally accepted in Canada.

a) Revenue recognition

In accordance with Ontario Energy Board regulations, the Company recognizes as revenue the regulated distribution tariffs associated with energy distributed and variances between energy purchase costs and energy billed are recorded as regulatory assets or liabilities for future distribution rate application consideration.

The Company follows the practice of cycle billing of customers' accounts and revenue is recognized in the period billed. An accrual is made in the accounts at December 31 for power supplied but not billed to customers between the date the meters were last read and the end of the year.

b) Inventories

Inventories of materials and supplies are valued at the lower of laid down cost on the average cost basis and net realizable value.

c) Capital assets

Capital assets are amortized over their estimated useful lives using the straight-line method over the following periods:

Buildings	50 to 60 years
Other construction	25 to 30 years
Substation equipment	30 years
Distribution lines, transformers and meters	25 years
System supervisory equipment	15 to 25 years
Service, office and other equipment	8 to 10 years
Automotive equipment	4 to 8 years
Computer equipment	5 years

London Hydro Inc.
Notes to the Financial Statements
(in thousands of dollars)
For the Year Ended December 31, 2001

2. Summary of Significant Accounting Policies, continued

When a capital asset is sold or otherwise disposed of, the related cost and accumulated amortization are removed from the respective accounts and any gain or loss on disposition is recognized in earnings.

Capital assets that by their nature are not readily identifiable as individual assets are grouped together. Under this method, the related cost and accumulated amortization are removed from their respective grouping account at the end of the asset's estimated useful life, regardless of actual service life. Any proceeds on disposition are recognized in earnings in the year of disposition.

d) Contributions to capital costs

Contributions are received from developers and contractors for capital costs incurred by the Company. These contributions are included as a reduction to the cost of the related capital assets when those assets are placed in service.

e) Cash and equivalents

Cash on hand and on deposit with banks, and short-term investments with maturity of three months or less, are considered cash and equivalents.

f) Income taxes

The Company follows the tax allocation basis of accounting for income taxes whereby income tax expense (recovery) is recorded in the years the income and expense are recognized for accounting purposes regardless of when the related taxes are actually paid or recovered.

g) Measurement uncertainty

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities at the date of the financial statements. Certain estimates are also required as regulations, which will ultimately determine the actual results, have yet to be finalized and are dependent on the completion of regulatory proceedings or decisions. Due to these uncertainties, actual results might differ from those estimates and the impact will be recorded in the current period when the actual results are known.

h) Employee future benefits

The Company has adopted the following policies for future benefits provided to both active and retired employees:

(i) Pension benefits

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer contributory defined benefit plan. Company contributions to the plan are recognized as pension expense in the period that they are incurred.

London Hydro Inc.
Notes to the Financial Statements
(in thousands of dollars)
For the Year Ended December 31, 2001

2. Summary of Significant Accounting Policies, continued

(ii) Other Post-Retirement and Post-Employment benefits

The Company provides other benefits to active and retired employees including group life insurance and health-care benefits. Recognition of these benefits are actuarially determined using the projected benefit method pro rated on service using management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

3. Cash and Equivalents

	<u>2001</u>	<u>2000</u>
Short-term investments	\$ -	\$ 25,500
Cash (overdraft)	7,201	(1,955)
	<u>\$ 7,201</u>	<u>\$ 23,545</u>

4. Accounts Receivable

	<u>2001</u>	<u>2000</u>
Accounts receivable -		
Energy and products	\$ 36,150	\$ 34,081
Sundry	2,256	3,178
	<u>38,406</u>	<u>37,259</u>
Less: Allowance for doubtful accounts	1,256	1,139
	<u>\$ 37,150</u>	<u>\$ 36,120</u>

5. Transitional Costs Recoverable

In preparation for opening of the electricity market and to comply with regulations, the company has incurred costs that are eligible for recovery in future rates, subject to the approval by the Ontario Energy Board.

6. Capital Assets

	<u>2001</u>			<u>2000</u>
	Cost	Accumulated Amortization	Net	Net
Land and land rights	\$ 963	\$ 203	\$ 760	\$ 803
Buildings	17,243	5,914	11,329	11,285
Plant and equipment	28,886	16,179	12,707	12,797
Transmission and distribution system	209,367	80,647	128,720	125,348
Work in progress	6,430	-	6,430	3,074
	<u>\$ 262,889</u>	<u>\$ 102,943</u>	<u>\$ 159,946</u>	<u>\$ 153,307</u>

London Hydro Inc.
Notes to the Financial Statements
(in thousands of dollars)
For the Year Ended December 31, 2001

6. Capital Assets, continued

During the year and in accordance with the Electricity Act (1998) and the Development Charges by-law C.P. 1350-57, a Hydro Reserve Fund was transferred from the City of London to the Company to finance future growth-related capital costs incurred in providing hydro electric service in the City of London. The balance of these funds was used during the year to offset the cost of qualifying growth-related capital expenditures.

7. Customer and Other Deposits

Customer deposits held as security for energy consumption bear interest at a rate of prime less 2% per annum. Interest is paid at the time of refund of the deposit to the customer.

8. Long-term Debt

Long-term debt is comprised of a non-interest bearing promissory note payable to the Corporation of the City of London with a maturity date of July 1, 2003. On August 7, 2001 the City of London approved a \$25 million reduction of the promissory note in exchange for an equivalent increase in the stated capital of the issued and outstanding common shares of the Company.

9. Share Capital

Authorized

An unlimited number of common shares

An unlimited number of non-voting, non-cumulative preference shares, redeemable at the paid-up amount

Issued	<u>Number</u>	<u>Value</u>
Balance, December 31, 2000	1,001	\$ 71,116
Increase in stated capital (Note 8)	-	25,000
Balance, December 31, 2001	<u>1,001</u>	<u>\$ 96,116</u>

10. Related Party Transactions and Balances

a) Transactions

During the year and within the course of normal operations, the Company provided services to the City of London on an estimated cost recovery basis at an amount of \$3.2 million (2000 - \$0.7 million).

b) Due to Related Parties

The balances due to related parties are non-interest bearing and without stated repayment terms.

London Hydro Inc.
Notes to the Financial Statements
(in thousands of dollars)
For the Year Ended December 31, 2001

11. Other Income (Expense)

a) Other income is comprised of the following:

	<u>2001</u>	<u>2000</u>
Interest	\$ 904	\$ 295
Late payment charges	1,202	162
Gain (loss) on disposal of assets	1,055	(70)
Cost of power rebate	904	-
Rentals	356	44
Sundry	591	94
Scrap sales	145	32
Billable services	215	94
	<u>\$ 5,372</u>	<u>\$ 651</u>

b) Provision for non-recoverable regulatory amounts

Effective January 1, 2001, and until the opening of the electricity market place in Ontario, the Ontario Energy Board ("OEB") accounting policies and procedures require the Company to record all variances between the cost of energy purchased and energy billed as regulatory assets or liabilities.

The OEB has indicated by virtue of requiring regulated utilities to capture these variances that the amounts will ultimately be recoverable (payable) by the regulated utilities through future rate application procedures. At the present time, the OEB has not clearly confirmed by regulatory decision whether these amounts will be fully recoverable (payable) or what the process, timing and methodology for recovery or payment will be. In accordance with generally accepted accounting principles, the Company has fully provided for the non-recovery of these amounts in the amount of \$3.1 million until such time as certainty by way of regulatory decision is provided.

12. Income Taxes

As a wholly owned subsidiary Company of the Corporation of the City of London, the Company is exempt from income taxes under the Income Tax Act (Canada). Effective October 1, 2001 and pursuant to the Electricity Act (1998) (Ontario) the Company is required to make payments in lieu of tax to the Ontario Electricity Financial Corporation. The amount of payments in lieu of tax will be approximately equivalent to the income and capital taxes that would have to be paid if the Company was a taxable corporation under the Income Tax Act (Canada).

The Company's effective income tax rates differed from the statutory combined federal and provincial rates primarily due to the following:

Earnings before income taxes	\$ <u>634</u>
Income tax expense based on combined federal and provincial statutory income tax rate of 40.62%	257
Federal large corporations tax	102
Non-taxable accounting income earned prior to October 1, 2001	(892)
Permanent non-taxable gains included in accounting income	(411)
Other items	189
Income tax recovery recognized	<u>\$ (755)</u>

London Hydro Inc.
Notes to the Financial Statements
(in thousands of dollars)
For the Year Ended December 31, 2001

13. Employee Future Benefits

a) Pension plan

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer plan, on behalf of its employees. The plan is a contributory defined benefit plan which specifies the amount of retirement benefit to be received by the employees based on the length of service and rates of pay. Effective August 1, 1998, OMERS declared a contribution holiday, which temporarily suspended payments to the plan until July of 2002.

b) Medical and life insurance benefits

The Company provides medical and life insurance benefit coverage to certain retirees of the Company. Based on an actuarial valuation performed as at September 30, 1999, the unfunded accumulated benefit obligation is \$6.8 million. The annualized service and interest costs are estimated to be \$0.9 million per annum, and the annualized benefit payments are estimated to be \$0.5 million per annum.

The principal actuarial assumptions underlying the valuations are as follows:

(i) Discount rate

The present value of future liabilities recognized at year-end and the expense for the year ended, were determined using a discount rate of 7.25%.

(ii) Medical cost increases

Medical costs are estimated to initially increase at an annual rate of 9% until year 2004 at which time future annual increases will be at a rate of 5% per annum.

(iii) Salary levels

Future general salary and wage levels were assumed to increase at 4% per year.

c) Worker's Compensation Benefits

The Company has provided worker's compensation benefits as a self-insured employer under the Ontario Workplace Safety and Insurance Board ("WSIB"). An actuarially estimated obligation of \$1.7 million has been recognized using the projected benefit method for events that have occurred up to September 30, 1999. Pursuant to WSIB requirements and effective January 1, 2002, the Company will no longer self insure its WSIB claims and will become a WSIB defined Schedule 1 employer. As part of this transition the WSIB requires the Company to pay an estimate of the actuarial settlement in the amount of \$0.9 million which has been reflected as a reduction of the existing obligation recognized by the Company. It is expected that the final settlement will be determined in year ended December 31, 2002.

14. Financial Instruments

Management estimates that the fair values of all financial assets and liabilities are not materially different from their carrying values.

London Hydro Inc.
Notes to the Financial Statements
(in thousands of dollars)
For the Year Ended December 31, 2001

15. Prior Period Figures

The prior period figures presented for comparison purposes in the statements of operations, deficit and cashflows are for the two-month period from the date of incorporation and commencement of operations on November 1, 2000, to December 31, 2000. Certain prior period figures presented have been restated to conform with the current year's presentation.

ATTACHMENT J

Audited 2002 Financial statements

London Hydro Inc.

Financial Statements
For the Year Ended December 31, 2002



KPMG LLP
Chartered Accountants
140 Fullarton Street Suite 1400
PO Box 2305
London ON N6A 5P2
Canada

Telephone (519) 672-4880
Telefax (519) 672-5684
www.kpmg.ca

AUDITOR'S REPORT

To the Shareholder of London Hydro Inc.

We have examined the balance sheet of London Hydro Inc. as at December 31, 2002 and the statements of earnings, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of Hydro's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of London Hydro Inc. as at December 31, 2002 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

London, Canada

February 21, 2003



London Hydro Inc.

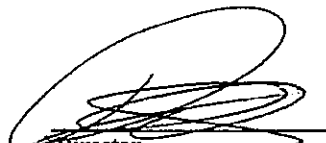
Balance Sheet
(in thousands of dollars)
As at December 31, 2002

ASSETS	<u>2002</u>	<u>2001</u>
Current assets		
Cash and equivalents	\$ -	\$ 7,201
Accounts receivable (Note 3)	49,400	37,150
Inventories	3,340	3,527
Prepaid expenses	448	365
Future income taxes (Note 12)	<u>488</u>	<u>857</u>
	<u>53,676</u>	<u>49,100</u>
Regulatory amounts recoverable (Notes 4, 11 and 14)	<u>15,629</u>	<u>1,695</u>
Capital assets (Note 5)	<u>161,375</u>	<u>159,946</u>
Future income taxes (Note 12)	<u>3,185</u>	<u>5,400</u>
	<u>\$ 233,865</u>	<u>\$ 216,141</u>
 LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Bank indebtedness (Note 6)	\$ 10,659	\$ -
Accounts payable and accrued liabilities -		
Due to Independent Electricity Market Operator	18,559	20,482
Other	9,367	7,126
Due to shareholder (Note 7)	<u>3,418</u>	<u>3,248</u>
	<u>42,003</u>	<u>30,856</u>
Long-term liabilities		
Due to shareholder (Note 7)	70,000	70,000
Customer and other deposits (Note 8)	10,304	7,163
Employee future benefits (Note 13)	<u>7,048</u>	<u>7,775</u>
	<u>87,352</u>	<u>84,938</u>
Shareholder's equity		
Share capital (Note 9)	96,116	96,116
Retained earnings	<u>8,394</u>	<u>4,231</u>
	<u>104,510</u>	<u>100,347</u>
	<u>\$ 233,865</u>	<u>\$ 216,141</u>

On behalf of the Board:



Director



Director

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Earnings
(in thousands of dollars)

For the Year Ended December 31, 2002

	<u>2002</u>	<u>2001</u>
Distribution revenue	\$ <u>39,705</u>	\$ <u>29,561</u>
Operating expenses		
Plant operating and maintenance	7,429	8,214
General and administrative	17,195	14,843
Amortization of capital assets	<u>11,611</u>	<u>11,047</u>
	36,235	34,104
Less: Costs recovered (Note 7)	<u>(2,948)</u>	<u>(3,228)</u>
	<u>33,287</u>	<u>30,876</u>
Operating income (loss)	<u>6,418</u>	<u>(1,315)</u>
Other income (expense)		
Interest and other revenue (Note 10)	4,147	5,372
Interest expense (Note 6)	(608)	(281)
Provision for regulatory amounts (Notes 11 and 14)	<u>(2,553)</u>	<u>(3,142)</u>
	<u>986</u>	<u>1,949</u>
Earnings before income taxes	<u>7,404</u>	<u>634</u>
Income taxes (recovery) (Note 12)		
Current	1,350	102
Future	<u>1,891</u>	<u>(857)</u>
	<u>3,241</u>	<u>(755)</u>
Net earnings for the year	\$ <u><u>4,163</u></u>	\$ <u><u>1,389</u></u>

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Retained Earnings
(in thousands of dollars)
For the Year Ended December 31, 2002

	<u>2002</u>	<u>2001</u>
Retained earnings (deficit), beginning of year	\$ 4,231	\$ (2,558)
Restatement for recognition of future income taxes (Note 2(f))	-	5,400
Net earnings for the year	<u>4,163</u>	<u>1,389</u>
Retained earnings, end of year	<u>\$ 8,394</u>	<u>\$ 4,231</u>

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Cashflows (in thousands of dollars) For the Year Ended December 31, 2002

	2002	2001
Operating activities		
Net earnings for the year	\$ 4,163	\$ 1,389
Charges to operations not affecting cash		
Amortization of capital assets	11,611	11,047
Gain on disposal of capital assets	(299)	(1,055)
Gain on settlement of employee future benefit plan	(607)	-
Future income taxes	1,891	(755)
	16,759	10,626
Net increase in non-cash working capital balances related to operations	(10,964)	(3,689)
Decrease in employee future benefits	(120)	(950)
Increase in customer and other deposits	3,141	1,162
	8,816	7,149
Cash provided by operating activities		
Financing activities		
Proceeds from bank term debt	10,000	-
Repayment of bank term debt	(250)	-
Advances to shareholder	-	(5,168)
Developer contributions to capital asset costs	1,739	2,116
	11,489	(3,052)
Cash provided by (used in) financing activities		
Investing activities		
Additions to capital assets	(18,748)	(20,750)
Proceeds on disposal of capital assets	339	2,004
Increase in recoverable regulatory amounts	(10,006)	(1,695)
	(28,415)	(20,441)
Cash used in investing activities		
Decrease in cash and equivalents during the year	(8,110)	(16,344)
Cash and equivalents, beginning of the year	7,201	23,545
Cash and equivalents (bank indebtedness), end of the year (Note 6)	\$ (909)	\$ 7,201
Supplemental cashflow information		
Interest paid	\$ 439	\$ 48
Income taxes paid	\$ 955	\$ 435

See accompanying notes to the financial statements

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2002

1. Business Operations

The Company is a wholly owned subsidiary company of the Corporation of the City of London providing electrical distribution services to the inhabitants of the City of London, as regulated by the Ontario Energy Board.

2. Summary of Significant Accounting Policies

The financial statements have been prepared in accordance with accounting principles generally accepted in Canada.

a) Revenue recognition

In accordance with Ontario Energy Board regulations, the Company recognizes as revenue the regulated distribution tariffs associated with energy distributed and variances between energy purchase costs and energy billed are recorded as regulatory assets or liabilities for future distribution rate application consideration.

The Company follows the practice of cycle billing of customers' accounts and revenue is recognized in the period billed. An accrual is made in the accounts at December 31 for power supplied but not billed to customers between the date the meters were last read and the end of the year.

b) Inventories

Inventories of materials and supplies are valued at the lower of laid down cost on the average cost basis and net realizable value.

c) Capital assets

Capital assets are amortized over their estimated useful lives using the straight-line method over the following periods:

Buildings	50 to 60 years
Other construction	25 to 30 years
Substation equipment	30 years
Distribution lines, transformers and meters	25 years
System supervisory equipment	15 to 25 years
Service, office and other equipment	8 to 10 years
Automotive equipment	4 to 8 years
Computer equipment	5 years

When a capital asset is sold or otherwise disposed of, the related cost and accumulated amortization are removed from the respective accounts and any gain or loss on disposition is recognized in earnings.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2002

2. Summary of Significant Accounting Policies, continued

Capital assets that by their nature are not readily identifiable as individual assets are grouped together. Under this method, the related cost and accumulated amortization are removed from their respective grouping account at the end of the asset's estimated useful life, regardless of actual service life. Any proceeds on disposition are recognized in earnings in the year of disposition.

d) Contributions to capital costs

Contributions are received from developers and contractors for capital costs incurred by the Company. These contributions are included as a reduction to the cost of the related capital assets when those assets are placed in service.

e) Cash and equivalents

Cash on hand and on deposit with banks, and short-term investments with maturity of three months or less, are considered cash and equivalents.

f) Income taxes

Effective January 1, 2002, and in accordance with the recommendations of the Canadian Institute of Chartered Accountants, the Company retroactively adopted the liability method for accounting for income taxes. Under this method, future income tax assets and liabilities are recognized for differences between the financial statement carrying amounts of existing assets and liabilities and their respective values for income tax purposes. These differences are measured using substantively enacted tax rates in effect in the period in which those differences are expected to be recovered or settled. To the extent that there is uncertainty regarding the recovery of a future income tax asset a valuation allowance reducing the future income tax asset is recorded. This change in accounting policy resulted in a retroactive increase as at December 31, 2001 to both long-term future income tax assets and retained earnings in the amount of \$5.4 million.

g) Measurement uncertainty

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities at the date of the financial statements. Certain estimates are also required as regulations, which will ultimately determine the actual results, have yet to be finalized and are dependent on the completion of regulatory proceedings or decisions. Due to these uncertainties, actual results might differ from those estimates and the impact will be recorded in the current period when the actual results are known.

h) Employee future benefits

The Company has adopted the following policies for future benefits provided to both active and retired employees:

(i) Pension benefits

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer contributory defined benefit plan. Company contributions to the plan are recognized as pension expense in the period that they are incurred.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2002

2. Summary of Significant Accounting Policies, continued

(ii) Other Post-Retirement and Post-Employment benefits

The Company provides other benefits to active and retired employees including group life insurance and health-care benefits. Recognition of these benefits are actuarially determined using the projected benefit method pro rated on service using management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

3. Accounts Receivable

	<u>2002</u>	<u>2001</u>
Accounts receivable -		
Energy and water	\$ 48,751	\$ 36,150
Sundry	2,021	2,256
	50,772	38,406
Less: Allowance for doubtful accounts	1,372	1,256
	\$ 49,400	\$ 37,150

Included in accounts receivable is approximately \$4.8 million (2001- \$4.1 million) of customer receivables for water consumption that the Company bills and collects on behalf of the Corporation of the City of London. As the company does not assume liability for collection of these amounts, no allowance for doubtful collection has been provided for these accounts.

4. Regulatory Amounts Recoverable

	<u>2002</u>	<u>2001</u>
Transitional costs	\$ 6,918	\$ 1,695
Retail settlement variance account	8,711	-
	\$ 15,629	\$ 1,695

In preparation for opening of the electricity market and to comply with regulations, the Company has incurred costs that are eligible for recovery in future distribution rates, subject to the approval by the Ontario Energy Board. During the year, the Company placed into service \$3.9 million of capital assets and incurred \$1.3 million in transitional costs that are all eligible for such recovery.

The Retail Settlement Variance Account represents amounts that have accumulated since market opening and comprise variances between amounts charged by the Independent Electricity Market Operator for the operation of the wholesale electricity market and the supply and transmission of energy commodities and the amounts billed to customers by the Company based on the Ontario Energy Board approved rates. Ontario Energy Board policy indicates that such variances will be recovered in future rate setting decisions.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2002

5. Capital Assets

	2002			2001
	Cost	Accumulated Amortization	Net	Net
Land and land rights	\$ 925	\$ 241	\$ 684	\$ 760
Buildings	17,483	6,320	11,163	11,329
Plant and equipment	30,829	16,762	14,067	12,707
Distribution system	222,414	89,156	133,258	128,720
Work in progress	2,203	-	2,203	6,430
	<u>\$ 273,854</u>	<u>\$ 112,479</u>	<u>\$ 161,375</u>	<u>\$ 159,946</u>

6. Bank Indebtedness

	<u>2002</u>	<u>2001</u>
Unsecured demand revolving bank facility, bearing interest at the Prime Rate less 0.8% per annum	\$ 909	\$ -
Unsecured demand bank term debt, repayable in monthly principal instalments of \$83,333 per month, bearing interest at the Prime Rate less 0.5% per annum	9,750	-
	<u>\$ 10,659</u>	<u>\$ -</u>

The Company has utilized \$50.0 million in bank standby letters of credit issued to the Independent Electricity Market Operator, as required by regulation. The Company has recently received regulatory approval to reduce the standby letters of credit to \$13.2 million.

Interest paid during the year on the bank term debt amounted to \$0.1 million. Bank term debt principal repayments over the next five years are in the amount of \$1.0 million per annum for an aggregate repayment of \$5.0 million.

7. Due to Shareholder

	<u>2002</u>	<u>2001</u>
Non-interest bearing trade balances due to shareholder, without stated repayment terms	\$ 3,418	\$ 3,248
Unsecured promissory note, bearing interest at 6% per annum commencing July 1, 2003, payable in interest only, maturing July 1, 2008 (2001 - non-interest bearing, maturing July 1, 2003)	70,000	70,000
	<u>73,418</u>	<u>73,248</u>
Less: Current portion	3,418	3,248
	<u>\$ 70,000</u>	<u>\$ 70,000</u>

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2002

7. Due to Shareholder, continued

During the year and within the course of normal operations, the Company provided services to the City of London on an estimated cost recovery basis at an amount of \$2.9 million (2001 - \$3.2 million).

8. Customer and Other Deposits

Customer and other deposits include security deposits for energy consumption bearing interest at a rate of prime less 2% per annum and developer deposits held in accordance with regulation.

9. Share Capital

Authorized

An unlimited number of common shares

An unlimited number of non-voting, non-cumulative preference shares, redeemable at the paid-up amount

Issued	<u>2002</u>	<u>2001</u>
1,001 common shares	<u>\$ 96,116</u>	<u>\$ 96,116</u>

10. Interest and Other Revenue

	<u>2002</u>	<u>2001</u>
Late payment charges	\$ 1,477	\$ 1,202
Interest	412	904
Customer billing service fees	433	9
Gain on disposal of assets	299	1,055
Rentals and scrap sales	352	501
Sundry	567	797
Gain on settlement of employee future benefit plan (Note 13)	607	-
Cost of power rebate	-	904
	<u>\$ 4,147</u>	<u>\$ 5,372</u>

11. Provision for Regulatory Amounts

Effective January 1, 2001, and until the opening of the electricity market place in Ontario, the Ontario Energy Board ("OEB") accounting policies and procedures require the Company to record all variances between the cost of energy purchased and energy billed as regulatory assets or liabilities.

The OEB has indicated by virtue of requiring regulated utilities to capture these variances that the amounts will ultimately be recoverable (payable) by the regulated utilities through future rate application procedures. At the present time, the OEB has not clearly confirmed by regulatory decision whether these amounts will be fully recoverable (payable) or what the process, timing and methodology for recovery or payment will be. In accordance with generally accepted accounting principles, the Company has fully provided for the non-recovery of these amounts in the amount of \$2.6 million in 2002 (\$3.1 million in 2001) until such time as certainty by way of regulatory decision is provided.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2002

12. Income Taxes

a) Income tax status

As a wholly owned subsidiary Company of the Corporation of the City of London, the Company is exempt from income taxes under the Income Tax Act (Canada). Effective October 1, 2001 and pursuant to the Electricity Act (1998)(Ontario) the Company is required to make payments in lieu of tax to the Ontario Electricity Financial Corporation. The amount of payments in lieu of tax will be approximately equivalent to the income and capital taxes that would have to be paid if the Company was a taxable corporation under the Income Tax Act (Canada).

b) Income tax rate

The Company's effective income tax rates differed from the statutory combined federal and provincial rates primarily due to the following:

	<u>2002</u>	<u>2001</u>
Earnings before income taxes	<u>\$ 7,404</u>	<u>\$ 634</u>
Income tax expense based on combined federal and provincial statutory income tax rate of 38.6% (2001- 40.62%)	2,858	257
Federal large corporations tax	367	102
Non-taxable gains included in accounting income	(349)	(411)
Non-taxable accounting income earned prior to October 1, 2001	-	(892)
Recognition of previously unrecognized future income tax assets	(92)	-
Future income tax asset reduction for substantively enacted tax rates	333	-
Other items	124	189
Income tax expense (recovery) recognized	<u>\$ 3,241</u>	<u>\$ (755)</u>

13. Employee Future Benefits

a) Pension plan

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer plan, on behalf of its employees. The plan is a contributory defined benefit plan which specifies the amount of retirement benefit to be received by the employees based on the length of service and rates of pay. Effective August 1, 1998, OMERS declared a contribution holiday, which temporarily suspended payments to the plan until January of 2003. On January 1, 2003, the Company and plan members are required to resume payments which will increase gradually to normalized contribution levels in fiscal 2004.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2002

13. Employee Future Benefits, continued

b) Medical and life insurance benefits

The Company provides medical and life insurance benefit coverage to certain retirees of the Company. Based on an actuarial extrapolation of the plan's valuation of September 30, 1999, the unfunded accumulated benefit obligation is \$7.0 million. The annualized service and interest costs are estimated to be \$0.4 million per annum, and the annualized benefit payments are estimated to be \$0.5 million per annum. The pension expense for the years ended 2001 and 2002 was \$0.6 million.

The principal actuarial assumptions underlying the valuations are as follows:

(i) Discount rate

The present value of future liabilities recognized at year-end and the expense for the year ended, were determined using a discount rate of 6.75%.

(ii) Medical cost increases

Medical costs are estimated to initially increase at an annual rate of 7% until year 2004 at which time future annual increases will be at a rate of 5% per annum.

(iii) Salary levels

Future general salary and wage levels were assumed to increase at 4% per year.

c) Worker's Compensation Benefits

Prior to January 1, 2002, the Company provided worker's compensation benefits as a self-insured employer under the Ontario Workplace Safety and Insurance Board ("WSIB"), recognized the actuarially estimated liability of \$1.7 million. Pursuant to WSIB requirements and effective January 1, 2002, the Company no longer self-insures its WSIB claims and has become a WSIB defined Schedule 1 employer. As part of this transition the WSIB required the Company to pay amount of \$1.1 million as settlement of the obligation as a self-insured employer under the plan. With the transition to Schedule 1 under the WSIB plan, and the payment of this settlement amount, the Company is no longer responsible for the previously recognized liability. The difference between that liability and the final settlement payment in the amount of \$0.6 million has been reflected as a gain on settlement of the plan and included in the statement of earnings for the year.

14. Financial Instruments and Credit Risk

(a) Financial Instruments

Management estimates that the fair values of all financial assets and liabilities are not materially different from their carrying values.

(b) Credit Risk

Credit risk is the risk that a counterparty will fail to discharge its obligation to the Company reducing the expected cash inflow from Company assets recorded at the balance sheet date. Credit risk can be concentrated in debtors that are similarly affected by economic or other conditions.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2002

14. Financial Instruments and Credit Risk, continued

The Company has assessed that there are no significant concentrations of credit risk other than the present uncertainty relating to the collection of amounts subject to regulatory approval and disposition. In November, 2002, the Government of Ontario passed legislation which effectively froze previously announced distribution rate increases and cast significant uncertainty over previously announced government direction and policy pertaining to the collection of regulatory assets and variance accounts. As at December 31, 2002 the Company has \$8.7 million (2001 - \$nil) in Retail Settlement Account variances, \$6.9 million (2001-\$1.7 million) in transitional costs recoverable, for total financial assets of \$15.6 million (2001-\$1.7 million) that are subject to this regulatory uncertainty. Additionally, the Company has expensed \$2.6 million (2001- \$3.1 million) of costs that are subject to recovery once regulatory certainty is provided.

15. Prior Period Figures

Certain prior period figures presented have been restated to conform with the current year's presentation.

ATTACHMENT K

Audited 2003 Financial statements

London Hydro Inc.

Financial Statements
For the Year Ended December 31, 2003



KPMG LLP
Chartered Accountants
140 Fullarton Street Suite 1400
PO Box 2305
London ON N6A 5P2
Canada

Telephone (519) 672-4880
Telefax (519) 672-5684
www.kpmg.ca

AUDITOR'S REPORT

To the Shareholder of London Hydro Inc.

We have examined the balance sheet of London Hydro Inc. as at December 31, 2003 and the statements of earnings and retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of Hydro's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of London Hydro Inc. as at December 31, 2003 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

London, Canada

February 13, 2004




London Hydro Inc.

Balance Sheet
(in thousands of dollars)
As at December 31, 2003

	<u>2003</u>	<u>2002</u>
ASSETS		
Current assets		
Cash and equivalents	\$ 7,829	\$ -
Accounts receivable (Note 3)	37,214	49,400
Regulatory amounts recoverable (Note 4)	5,223	-
Inventories	3,567	3,340
Prepaid expense and other	<u>796</u>	<u>936</u>
	<u>54,629</u>	<u>53,676</u>
Regulatory amounts recoverable (Notes 4, and 14)	<u>8,953</u>	<u>15,629</u>
Capital assets (Note 5)	<u>163,874</u>	<u>161,375</u>
Future income taxes (Note 12)	<u>3,105</u>	<u>3,185</u>
	<u>\$ 230,561</u>	<u>\$ 233,865</u>
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Bank indebtedness (Note 6)	\$ -	\$ 10,659
Accounts payable and accrued liabilities -		
Due to Independent Electricity Market Operator	16,563	18,559
Other	10,562	9,367
Due to shareholder (Note 7)	<u>3,958</u>	<u>3,418</u>
	<u>31,083</u>	<u>42,003</u>
Long-term liabilities		
Due to shareholder (Note 7)	70,000	70,000
Customer and other deposits (Note 8)	12,860	10,304
Employee future benefits (Note 13)	<u>7,177</u>	<u>7,048</u>
	<u>90,037</u>	<u>87,352</u>
Shareholder's equity		
Share capital (Note 9)	96,116	96,116
Retained earnings	<u>13,325</u>	<u>8,394</u>
	<u>109,441</u>	<u>104,510</u>
	<u>\$ 230,561</u>	<u>\$ 233,865</u>

On behalf of the Board:


Director


Director

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Earnings and Retained Earnings (in thousands of dollars) For the Year Ended December 31, 2003

	<u>2003</u>	<u>2002</u>
Distribution revenue (Note 10)	<u>\$ 39,840</u>	<u>\$ 39,705</u>
Operating expenses		
Plant operating and maintenance	7,894	7,429
General and administrative	17,637	17,195
Amortization of capital assets	<u>12,133</u>	<u>11,611</u>
	37,664	36,235
Less: Costs recovered (Note 7)	<u>(3,945)</u>	<u>(2,948)</u>
	<u>33,719</u>	<u>33,287</u>
Operating income	<u>6,121</u>	<u>6,418</u>
Other Income (expense)		
Interest and other revenue (Note 11)	3,850	4,147
Interest expense (Notes 6 and 7)	(2,704)	(608)
Provision for regulatory amounts (Note 4)	<u>-</u>	<u>(2,553)</u>
	<u>1,146</u>	<u>986</u>
Earnings before income taxes	7,267	7,404
Income taxes (Note 12)	<u>2,336</u>	<u>3,241</u>
Net earnings for the year	4,931	4,163
Retained earnings, beginning of year	<u>8,394</u>	<u>4,231</u>
Retained earnings, end of year	<u>\$ 13,325</u>	<u>\$ 8,394</u>

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Cashflows
(in thousands of dollars)

For the Year Ended December 31, 2003

	2003	2002
Operating activities		
Net earnings for the year	\$ 4,931	\$ 4,163
Charges to operations not affecting cash		
Amortization of capital assets	12,133	11,611
Gain on disposal of capital assets	(21)	(299)
Gain on settlement of employee future benefit plan	-	(607)
Future income taxes	568	1,891
	17,611	16,759
Net decrease (increase) in non-cash working capital balances related to operations	11,351	(10,964)
Increase (decrease) in employee future benefits	129	(120)
Increase in customer and other deposits	2,556	3,141
Cash provided by operating activities	31,647	8,816
Financing activities		
Proceeds of bank term debt	-	10,000
Repayment of bank term debt	(9,750)	(250)
Developer contributions to capital asset costs	1,561	1,739
Cash (used in) provided by financing activities	(8,189)	11,489
Investing activities		
Additions to capital assets	(16,240)	(18,748)
Proceeds on disposal of capital assets	67	339
Decrease (increase) in regulatory amounts recoverable	1,453	(10,006)
Cash used in investing activities	(14,720)	(28,415)
Increase (decrease) in cash and equivalents during the year	8,738	(8,110)
Cash and equivalents, beginning of the year	(909)	7,201
Cash and equivalents, end of the year (Note 6)	\$ 7,829	\$ (909)
Supplemental cashflow information		
Interest paid	\$ 2,446	\$ 439
Income taxes paid	\$ 2,170	\$ 955

See accompanying notes to the financial statements

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2003

1. Business Operations

The Company is a wholly owned subsidiary company of the Corporation of the City of London providing electrical distribution services to the inhabitants of the City of London, as regulated by the Ontario Energy Board.

2. Summary of Significant Accounting Policies

The financial statements have been prepared in accordance with accounting principles generally accepted in Canada.

a) Revenue recognition

In accordance with Ontario Energy Board regulations, the Company recognizes as revenue the regulated distribution tariffs associated with energy distributed and variances between energy purchase costs and energy billed are recorded as regulatory assets or liabilities for future rate application consideration.

The Company follows the practice of cycle billing customers' accounts and revenue is recognized in the period billed. An accrual is made in the accounts at December 31 for power supplied but not billed to customers between the date the meters were last read and the end of the year.

b) Inventories

Inventories of materials and supplies are valued at the lower of laid down cost on the average cost basis and net realizable value.

c) Capital assets

Capital assets are amortized over their estimated useful lives using the straight-line method over the following periods:

Buildings	50 to 60 years
Other construction	25 to 30 years
Substation equipment	30 years
Distribution lines, transformers and meters	25 years
System supervisory equipment	15 to 25 years
Service, office and other equipment	8 to 10 years
Automotive equipment	4 to 8 years
Computer equipment	5 years

When a capital asset is sold or otherwise disposed of, the related cost and accumulated amortization are removed from the respective accounts and any gain or loss on disposition is recognized in earnings.

Capital assets that by their nature are not readily identifiable as individual assets are grouped together. Under this method, the related cost and accumulated amortization are removed from their respective grouping account at the end of the asset's estimated useful life, regardless of actual service life. Any proceeds on disposition are recognized in earnings in the year of disposition.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2003

2. Summary of Significant Accounting Policies, continued

d) Contributions to capital costs

Contributions are received from developers and contractors for capital costs incurred by the Company. These contributions are included as a reduction to the cost of the related capital assets when those assets are placed in service.

e) Cash and equivalents

Cash on hand and on deposit with banks, and short-term investments with maturity of three months or less, are considered cash and equivalents.

f) Income taxes

The Company follows the liability method for accounting for income taxes whereby future income tax assets and liabilities are recognized for differences between the financial statement carrying amounts of existing assets and liabilities and their respective values for income tax purposes. These differences are measured using substantively enacted tax rates in effect in the period in which those differences are expected to be recovered or settled. To the extent that there is uncertainty regarding the recovery of a future income tax asset a valuation allowance reducing the future income tax asset is recorded.

g) Measurement uncertainty

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities at the date of the financial statements. Certain estimates are also required as regulations, which will ultimately determine the actual results, have yet to be finalized and are dependent on the completion of regulatory proceedings or decisions. Due to these uncertainties, actual results might differ from those estimates and the impact will be recorded in the current period when the actual results are known.

h) Employee future benefits

The Company has adopted the following policies for future benefits provided to both active and retired employees:

(i) Pension benefits

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer contributory defined benefit plan. Company contributions to the plan are recognized as pension expense in the period that they are incurred.

(ii) Other Post-Retirement and Post-Employment benefits

The Company provides other benefits to active and retired employees including group life insurance and health-care benefits. Recognition of these benefits are actuarially determined using the projected benefit method pro rated on service using management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2003

3. Accounts Receivable

	<u>2003</u>	<u>2002</u>
Accounts receivable -		
Energy and water	\$ 37,678	\$ 48,751
Sundry	1,241	2,021
	38,919	50,772
Less: Allowance for doubtful accounts	1,705	1,372
	\$ 37,214	\$ 49,400

Included in accounts receivable is approximately \$4.4 million (2002 - \$4.8 million) of customer receivables for water consumption that the Company bills and collects on behalf of the Corporation of the City of London. As the company does not assume liability for collection of these amounts, no allowance for doubtful collection has been provided for these accounts.

4. Regulatory Amounts Recoverable

	<u>2003</u>	<u>2002</u>
Transitional costs	\$ 6,863	\$ 6,918
Retail Settlement Variance Account	9,248	8,711
	16,111	15,629
Less: Provision for regulatory rate adjustments	(1,935)	-
	14,176	15,629
Less: Current portion recoverable	(5,223)	-
	\$ 8,953	\$ 15,629

a) Transitional costs and Retail Settlement Variance Account

In preparation for opening of the electricity market and to comply with regulations, the Company has incurred transitional costs that are eligible for recovery in future distribution rates, subject to the approval by the Ontario Energy Board (OEB). In addition and pursuant to regulation, the Company has accumulated in the Retail Settlement Variance Account amounts that have accumulated since market opening comprised of variances between amounts charged by the Independent Electricity Market Operator for the operation of the wholesale electricity market and the supply and transmission of energy commodities, and the amounts billed to customers by the Company based on the OEB approved rates. These variances are also eligible for recovery in future rates.

During the year, the Company incurred additional transitional costs of \$0.2 million and received an interim recovery of \$0.3 million through distribution rates.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2003

4. Regulatory Amounts Recoverable, continued

b) Recovery of regulatory amounts

In December 2003, the Ontario Energy Board permitted the Company to commence recovery of regulatory assets through distribution rates over a four-year period commencing March 1, 2004. During fiscal 2004, the Company will receive an interim recovery until such time as the Ontario Energy Board undertakes a detailed review to validate the amounts available for final recovery. In accordance with this direction, the Company has filed an application for the first year recovery of \$6.4 million, commencing March 1, 2004, which will amount to an approximate recovery of \$5.2 million during the Company's fiscal 2004 year.

c) Provision for regulatory rate adjustments

During the period January 1, 2001 until the May 1, 2002 opening of the electricity market place in Ontario, the Company incurred pre-market opening energy cost variances totaling \$5.7 million. Due to the absence of any regulatory decisions or procedures in place during fiscal 2001 or 2002 regarding the recovery of these variances through future rate applications, the Company fully provided for the non-recovery of these amounts in the amount of \$2.6 million in 2002 and \$3.1 million in 2001. The recent direction received from the OEB indicates that these amounts will now be potentially eligible for recovery over the four-year period, and accordingly, the Company's recent regulatory application for recovery includes these amounts. Any collection of these amounts previously expensed, will be reflected in future fiscal years as they are recovered in distribution rates.

With the implementation of Bill 210 in December of 2002, distribution rates were frozen at their existing levels, which included a one-time adjustment for the recovery of 2001 income taxes. Due to the rate freeze, this adjustment was not removed from the rates received in fiscal 2003 and the regulator has not provided a clear decision on whether the Company will be required to refund in future years the 2001 income taxes received in fiscal 2003. Until regulatory certainty is provided on this matter, the Company has established a provision reducing regulatory amounts otherwise recoverable in the amount of \$1.9 million for the potential refund of these taxes.

The Company has not made any further provision for any portion of those costs recorded as regulatory assets which may be disallowed by the regulator in future years.

5. Capital Assets

	2003			2002
	Cost	Accumulated Amortization	Net	Net
Land and land rights	\$ 967	\$ 280	\$ 687	\$ 684
Buildings	17,713	6,733	10,980	11,163
Plant and equipment	31,465	17,054	14,411	14,067
Distribution system	233,516	98,151	135,365	133,258
Work in progress	2,431	-	2,431	2,203
	\$ 286,092	\$ 122,218	\$ 163,874	\$ 161,375

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2003

6. Bank Indebtedness

	<u>2003</u>	<u>2002</u>
Unsecured demand revolving bank facility, bearing interest at the Prime Rate less 0.8% per annum	\$ -	\$ 909
Unsecured demand bank term debt, repayable in monthly principal instalments of \$83,333 per month, bearing interest at the Prime Rate less 0.5% per annum	-	9,750
	<u>\$ -</u>	<u>\$ 10,659</u>

The Company has utilized \$13.2 million in bank standby letters of credit issued to the Independent Electricity Market Operator, as required by regulation.

Interest paid during the year on the bank term debt amounted to \$0.3 million (2002 - \$0.1 million).

7. Related Party Balances and Transactions

	<u>2003</u>	<u>2002</u>
Non-interest bearing trade balances due to shareholder, without stated repayment terms	\$ 3,958	\$ 3,418
Unsecured promissory note, bearing interest at 6% per annum commencing July 1, 2003, payable in interest only, maturing July 1, 2008	70,000	70,000
	<u>73,958</u>	<u>73,418</u>
Less: Current portion	3,958	3,418
	<u>\$ 70,000</u>	<u>\$ 70,000</u>

During the year and within the course of normal operations, the Company provided services to the City of London on an estimated cost recovery basis at an amount of \$3.9 million (2002 - \$2.9 million), and paid interest to the City in the amount of \$2.1 million (2002 - \$nil).

8. Customer and Other Deposits

Customer and other deposits include security deposits for energy consumption bearing interest at a rate of prime less 2% per annum and developer deposits held in accordance with regulation.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2003

9. Share Capital

Authorized

An unlimited number of common shares

An unlimited number of non-voting, non-cumulative preference shares, redeemable at the paid-up amount

Issued	<u>2003</u>	<u>2002</u>
1,001 common shares	<u>\$ 96,116</u>	<u>\$ 96,116</u>

10. Distribution Revenue

In addition to distribution revenues of \$39.8 million (2002 - \$39.7 million), by regulation the Company is responsible for billing, collecting and settling energy purchase costs in the amount of \$243.3 million (2002 - \$247.4 million).

11. Interest and Other Revenue

	<u>2003</u>	<u>2002</u>
Late payment charges	\$ 1,209	\$ 1,477
Interest	871	412
Customer billing service fees	603	433
Gain on disposal of assets	21	299
Rentals and scrap sales	274	352
Sundry	872	567
Gain on settlement of employee future benefit plan	-	607
	<u>\$ 3,850</u>	<u>\$ 4,147</u>

12. Income Taxes

a) Income tax status

As a wholly owned subsidiary Company of the Corporation of the City of London, the Company is exempt from income taxes under the Income Tax Act (Canada). Effective October 1, 2001 and pursuant to the Electricity Act (1998)(Ontario) the Company is required to make payments in lieu of tax to the Ontario Electricity Financial Corporation. The amount of payments in lieu of tax will be approximately equivalent to the income and capital taxes that would have to be paid if the Company was a taxable corporation under the Income Tax Act (Canada).

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2003

12. Income Taxes, continued

b) Income tax rate

The Company's effective income tax rates differed from the statutory combined federal and provincial rates primarily due to the following:

	<u>2003</u>	<u>2002</u>
Earnings before income taxes	<u>\$ 7,267</u>	<u>\$ 7,404</u>
Income tax expense based on combined federal and provincial statutory income tax rate of 36.6% (2002 - 38.6%)	2,661	2,858
Federal large corporations tax	400	367
Effect of changes to substantively enacted tax rates	(415)	333
Non-taxable gains included in accounting income	-	(349)
Other items	<u>(310)</u>	<u>32</u>
Income tax expense recognized	<u>\$ 2,336</u>	<u>\$ 3,241</u>

	<u>2003</u>	<u>2002</u>
Income tax expense is comprised of the following:		
Current income tax	\$ 1,768	\$ 1,350
Future income tax	<u>568</u>	<u>1,891</u>
	<u>\$ 2,336</u>	<u>\$ 3,241</u>

13. Employee Future Benefits

a) Pension plan

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer plan, on behalf of its employees. The plan is a contributory defined benefit plan which specifies the amount of retirement benefit to be received by the employees based on the length of service and rates of pay. Effective August 1, 1998, OMERS declared a contribution holiday, which temporarily suspended payments to the plan until January of 2003. On January 1, 2003, the Company and plan members were required to resume payments which will increase gradually to normalized contribution levels in fiscal 2004. During the year, the Company contributed \$0.4 million.

b) Medical and life insurance benefits

The Company provides medical and life insurance benefit coverage to certain retirees of the Company. An actuarial valuation as at September 30, 2003 has estimated the Plan's unfunded accumulated benefit obligation at \$9.4 million, of which the Company has recorded an accrued pension liability of \$7.2 million. No accounting recognition has been given to the remainder of the accumulated benefit obligation of \$2.2 million as the balance pertains to changes in actuarial assumptions and actuarial experience losses.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2003

13. Employee Future Benefits, continued

In accordance with current pension accounting practices, approximately \$1.2 million of that amount will be recognized in future years commencing in fiscal 2004, on a straight-line basis over a sixteen-year period, being the expected annual remaining service life of plan members. These changes will increase the Company's 2003 pension expense of \$0.6 million (2002 - \$0.6 million) to approximately \$0.8 million in fiscal 2004. The annualized plan service and interest costs are \$0.6 million per annum, and the annualized benefit payments are \$0.5 million per annum.

The principal actuarial assumptions underlying the September 30, 2003 valuation are as follows:

(i) Discount rate

The present value of future liabilities recognized at year-end and the expense for the year ended, were determined using a discount rate of 6.0%.

(ii) Medical and dental cost increases

Medical costs are estimated to initially increase at an annual rate of 12% until year 2010 at which time future annual increases will be at a rate of 5% per annum. Dental costs are estimated to initially increase at an annual rate of 5%

(iii) Salary levels

General salary and wage levels were estimated to increase at the future rate of inflation.

14. Financial Instruments and Credit Risk

(a) Financial Instruments

Management estimates that the fair values of all financial assets and liabilities are not materially different from their carrying values.

(b) Credit Risk

Credit risk is the risk that a counterparty will fail to discharge its obligation to the Company reducing the expected cash inflow from Company assets recorded at the balance sheet date. Credit risk can be concentrated in debtors that are similarly affected by economic or other conditions.

The Company has assessed that there are no significant concentrations of credit risk other than the present uncertainty relating to the recovery of regulatory assets. The final regulatory amount recoverable will be assessed in future years by the regulator after the audit of those costs during 2004.

15. Prior Period Figures

Certain prior period figures presented have been restated to conform with the current year's presentation.

ATTACHMENT L

Audited 2004 Financial statements

London Hydro Inc.

Financial Statements
For the Year Ended December 31, 2004



KPMG LLP
Chartered Accountants
140 Fullarton Street Suite 1400
PO Box 2305
London ON N6A 5P2
Canada

Telephone (519) 672-4880
Fax (519) 672-5684
Internet www.kpmg.ca

AUDITOR'S REPORT

To the Shareholder of London Hydro Inc.

We have examined the balance sheet of London Hydro Inc. as at December 31, 2004 and the statements of earnings and retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of Hydro's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of London Hydro Inc. as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

London, Canada

February 18, 2005

London Hydro Inc.

Balance Sheet
(in thousands of dollars)
As at December 31, 2004

	<u>2004</u>	<u>2003</u>
ASSETS		
Current assets		
Cash and equivalents	\$ 17,771	\$ 7,829
Accounts receivable (Notes 3, 8 and 10)	41,276	37,214
Regulatory amounts recoverable (Note 4)	6,466	5,223
Inventories	3,330	3,567
Prepaid expenses	913	796
	<u>69,756</u>	<u>54,629</u>
Regulatory amounts recoverable (Note 4)	<u>12,030</u>	<u>8,953</u>
Capital assets (Note 5)	<u>166,252</u>	<u>163,874</u>
Future income tax assets (Note 12)	<u>3,212</u>	<u>3,105</u>
	<u>\$ 251,250</u>	<u>\$ 230,561</u>
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities (Note 6)		
Accounts payable and accrued liabilities -		
Due to Independent Electricity System Operator	\$ 19,233	\$ 16,563
Other	10,763	6,828
Income taxes payable	1,895	274
Customer and other deposits (Note 7)	8,812	3,460
Due to shareholder (Note 8)	5,009	3,958
Future income tax liabilities (Note 12)	967	-
	<u>46,679</u>	<u>31,083</u>
Long-term liabilities		
Customer and other deposits (Note 7)	9,667	12,860
Due to shareholder (Note 8)	70,000	70,000
Employee future benefits (Note 13)	7,355	7,177
	<u>87,022</u>	<u>90,037</u>
Shareholder's equity		
Share capital (Note 9)	96,116	96,116
Retained earnings	21,433	13,325
	<u>117,549</u>	<u>109,441</u>
	<u>\$ 251,250</u>	<u>\$ 230,561</u>

Subsequent event (Note 15)

On behalf of the Board:


Director


Director

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Earnings and Retained Earnings (in thousands of dollars) For the Year Ended December 31, 2004

	<u>2004</u>	<u>2003</u>
Distribution revenue (Note 10)	\$ 40,015	\$ 39,840
Operating expenses		
Plant operating and maintenance	8,485	7,894
General and administrative	17,033	17,637
Amortization of capital assets	<u>12,578</u>	<u>12,133</u>
	38,096	37,664
Less: Costs recovered (Note 8)	<u>(3,895)</u>	<u>(3,945)</u>
	<u>34,201</u>	<u>33,719</u>
Operating income	<u>5,814</u>	<u>6,121</u>
Other Income (expense)		
Interest and other revenue (Note 11)	4,399	3,850
Interest expense (Note 8)	<u>(4,473)</u>	<u>(2,704)</u>
	<u>(74)</u>	<u>1,146</u>
Earnings before the following	5,740	7,267
Recovery of regulatory amounts (Note 4)	<u>6,498</u>	<u>-</u>
Earnings before income taxes	12,238	7,267
Income taxes (Note 12)	<u>4,130</u>	<u>2,336</u>
Net earnings for the year	8,108	4,931
Retained earnings, beginning of year	<u>13,325</u>	<u>8,394</u>
Retained earnings, end of year	<u>\$ 21,433</u>	<u>\$ 13,325</u>

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Cashflows
(in thousands of dollars)

For the Year Ended December 31, 2004

	<u>2004</u>	<u>2003</u>
Operating activities		
Net earnings for the year	\$ 8,108	\$ 4,931
Charges to operations not affecting cash		
Amortization of capital assets	12,578	12,133
Gain on disposal of capital assets	(19)	(21)
Future income taxes	<u>860</u>	<u>568</u>
	21,527	17,611
Net decrease in non-cash working capital balances related to operations	5,335	10,531
Increase in employee future benefits	178	129
Increase in customer and other deposits	<u>2,159</u>	<u>3,376</u>
Cash provided by operating activities	<u>29,199</u>	<u>31,647</u>
Financing activities		
Repayment of bank term debt	-	(9,750)
Developer contributions to capital asset costs	<u>1,627</u>	<u>1,561</u>
Cash provided by (used in) financing activities	<u>1,627</u>	<u>(8,189)</u>
Investing activities		
Additions to capital assets	(16,633)	(16,240)
Proceeds on disposal of capital assets	69	67
Decrease (increase) in regulatory amounts recoverable	<u>(4,320)</u>	<u>1,453</u>
Cash used in investing activities	<u>(20,884)</u>	<u>(14,720)</u>
Increase in cash and equivalents during the year	9,942	8,738
Cash and equivalents, beginning of the year	<u>7,829</u>	<u>(909)</u>
Cash and equivalents, end of the year	<u>\$ 17,771</u>	<u>\$ 7,829</u>
Supplemental cashflow information		
Interest paid	<u>\$ 4,218</u>	<u>\$ 2,446</u>
Income taxes paid	<u>\$ 2,250</u>	<u>\$ 2,170</u>

See accompanying notes to the financial statements

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2004

1. Business Operations

The Company is a wholly owned subsidiary company of the Corporation of the City of London providing electrical distribution services to the inhabitants of the City of London, as regulated by the Ontario Energy Board.

2. Summary of Significant Accounting Policies

The financial statements have been prepared in accordance with accounting principles generally accepted in Canada.

a) Revenue recognition

In accordance with Ontario Energy Board regulations, the Company recognizes as revenue the regulated distribution tariffs associated with energy distributed, and variances between energy purchase costs and energy billed are recorded as regulatory assets or liabilities for future rate application consideration.

The Company follows the practice of cycle billing customers' accounts and revenue is recognized in the period billed. An accrual is made in the accounts at December 31 for power supplied but not billed to customers between the date the meters were last read and the end of the year.

b) Inventories

Inventories of materials and supplies are valued at the lower of laid down cost on the average cost basis and net realizable value.

c) Capital assets

Capital assets are amortized over their estimated useful lives using the straight-line method over the following periods:

Buildings	50 to 60 years
Other construction	25 to 30 years
Substation equipment	30 years
Distribution lines, transformers and meters	25 years
System supervisory equipment	15 to 25 years
Service, office and other equipment	8 to 10 years
Automotive equipment	4 to 8 years
Computer equipment	5 years

When a capital asset is sold or otherwise disposed of, the related cost and accumulated amortization are removed from the respective accounts and any gain or loss on disposition is recognized in earnings.

Capital assets that by their nature are not readily identifiable as individual assets are grouped together. Under this method, the related cost and accumulated amortization are removed from their respective grouping account at the end of the asset's estimated useful life, regardless of actual service life. Any proceeds on disposition are recognized in earnings in the year of disposition.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2004

2. **Summary of Significant Accounting Policies, continued**

d) Contributions to capital costs

Contributions are received from developers and contractors for capital costs incurred by the Company. These contributions are included as a reduction to the cost of the related capital assets when those assets are placed in service.

e) Cash and equivalents

Cash on hand and on deposit with banks, and short-term investments with maturity of three months or less, are considered cash and equivalents.

f) Income taxes

The Company follows the liability method for accounting for income taxes whereby future income tax assets and liabilities are recognized for differences between the financial statement carrying amounts of existing assets and liabilities and their respective values for income tax purposes. These differences are measured using substantively enacted tax rates in effect in the period in which those differences are expected to be recovered or settled. To the extent that there is uncertainty regarding the recovery of a future income tax asset a valuation allowance reducing the future income tax asset is recorded.

g) Measurement uncertainty

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities at the date of the financial statements. Certain estimates are also required as regulations, which will ultimately determine the actual results, have yet to be finalized and are dependent on the completion of regulatory proceedings or decisions. Due to these uncertainties, actual results might differ from those estimates and the impact will be recorded in the current period when the actual results are known.

h) Employee future benefits

The Company has adopted the following policies for future benefits provided to both active and retired employees:

(i) Pension benefits

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer contributory defined benefit plan. Company contributions to the plan are recognized as pension expense in the period that they are incurred.

(ii) Other Post-Retirement and Post-Employment benefits

The Company provides other benefits to active and retired employees including group life insurance and health-care benefits. Recognition of these benefits are actuarially determined using the projected benefit method pro rated on service using management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2004

3. Accounts Receivable

	<u>2004</u>	<u>2003</u>
Accounts receivable -		
Energy and water	\$ 41,407	\$ 37,478
Sundry	<u>1,572</u>	<u>1,241</u>
	42,979	38,719
Less: Allowance for doubtful accounts	<u>1,703</u>	<u>1,505</u>
	<u>\$ 41,276</u>	<u>\$ 37,214</u>

Included in accounts receivable is approximately \$4.7 million (2003 - \$4.8 million) of customer receivables for water consumption that the Company bills and collects on behalf of the Corporation of the City of London. As the company does not assume liability for collection of these amounts, no allowance for doubtful collection has been provided for these accounts.

4. Regulatory Amounts Recoverable

	<u>2004</u>	<u>2003</u>
Transitional costs	\$ 14,902	\$ 6,863
Retail Settlement Variance Account	<u>10,794</u>	<u>9,248</u>
	25,696	16,111
Provision for regulatory rate adjustments	(2,600)	(1,935)
Recoveries through rates	<u>(4,600)</u>	<u>-</u>
	18,496	14,176
Less: Current portion	<u>6,466</u>	<u>5,223</u>
	<u>\$ 12,030</u>	<u>\$ 8,953</u>

a) Transitional costs and Retail Settlement Variance Account

In preparation for opening of the electricity market and to comply with regulations, the Company has incurred Regulatory costs that are eligible for recovery through distribution rates. In addition and pursuant to regulation, the Company has accumulated in the Retail Settlement Variance Account amounts that have accumulated since market opening comprised of variances between amounts charged by the Independent Electricity System Operator for the operation of the wholesale electricity market and the supply and transmission of energy commodities, and the amounts billed to customers by the Company based on rates approved by the Ontario Energy Board. These variances are also eligible for recovery in future rates.

During the year the Company incurred additional retail settlement variances of \$1.5 million.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2004

4. Regulatory Amounts Recoverable, continued

b) Recovery of regulatory amounts

In December 2003, the Ontario Energy Board permitted the Company to commence recovery of regulatory assets through distribution rates over a four-year period commencing March 1, 2004. Under this process during fiscal 2004, the Company recovered \$4.6 million through distribution rates.

During 2004 the Ontario Energy Board completed its review of London Hydro's submission of recoverable regulatory asset amounts, and issued its decision on this matter on December 9, 2004. In prior years, due to the uncertainty with respect to the regulatory approval process and the ultimate recovery of certain of these costs, a portion of the amounts approved in the December 9, 2004 decision had been expensed for financial reporting purposes. As a result of the decision, an adjustment to fiscal 2004 earnings of \$6.5 million has been recorded to reflect the additional recoveries less the costs incurred by the Company to participate in the regulatory proceeding.

c) Provision for regulatory rate adjustments

With the implementation of Bill 210 in December of 2002, distribution rates were frozen at their existing levels, which included a one-time adjustment for the recovery of 2001 income taxes. Due to the rate freeze, this adjustment was not removed from the rates until April 1, 2004 and the regulator has not provided a clear decision on whether the Company will be required to refund in future years the 2001 income taxes received in fiscal 2003 and 2004. It is anticipated that regulatory direction will be provided on this matter with the finalization of the 2006 Distribution Rate Handbook in 2005. Until regulatory certainty is provided on this matter, the Company has established a provision reducing regulatory amounts otherwise recoverable in the amount of \$2.6 million for the potential refund of these taxes.

5. Capital Assets

	2004			2003
	Cost	Accumulated Amortization	Net	Net
Land and land rights	\$ 967	\$ 318	\$ 649	\$ 687
Buildings	17,825	7,155	10,670	10,980
Plant and equipment	33,552	18,026	15,526	14,411
Distribution system	244,047	107,597	136,450	135,365
Work in progress	2,957	-	2,957	2,431
	\$ 299,348	\$ 133,096	\$ 166,252	\$ 163,874

6. Bank Indebtedness

The Company has utilized \$13.2 million in bank standby letters of credit issued to the Independent Electricity System Operator, as required by regulation.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2004

7. Customer and Other Deposits

Customer and other deposits include security deposits for energy consumption bearing interest at a rate of prime less 2% per annum and developer deposits held in accordance with regulation.

8. Related Party Balances and Transactions

	<u>2004</u>	<u>2003</u>
Non-interest bearing trade balances due to shareholder, without stated repayment terms	\$ 5,009	\$ 3,958
Unsecured promissory note, bearing interest at 6% per annum commencing July 1, 2003, payable in interest only, maturing July 1, 2008	<u>70,000</u>	<u>70,000</u>
	75,009	73,958
Less: Current portion	<u>5,009</u>	<u>3,958</u>
	<u>\$ 70,000</u>	<u>\$ 70,000</u>

Included in the accounts receivable is \$1.0 million (2003 - \$1.0 million) of energy, water, and sundry receivables due from the Corporation of the City of London.

During the year and within the course of normal operations, the Company provided services to the City of London on an estimated cost recovery basis at an amount of \$3.9 million (2003 - \$3.9 million), and paid interest to the City in the amount of \$4.2 million (2003 - \$2.1 million).

9. Share Capital

Authorized

An unlimited number of common shares

An unlimited number of non-voting, non-cumulative preference shares, redeemable at the paid-up amount

Issued

1,001 common shares

	<u>2004</u>	<u>2003</u>
	<u>\$ 96,116</u>	<u>\$ 96,116</u>

10. Distribution Revenue

In addition to distribution revenues of \$40.0 million (2003 - \$39.8 million), by regulation the Company is responsible for billing, collecting and settling energy purchase costs in the amount of \$245.9 million (2003 - \$243.3 million).

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2004

11. Interest and Other Revenue

	<u>2004</u>	<u>2003</u>
Interest	\$ 1,490	\$ 871
Late payment charges	978	1,209
Sundry	1,018	893
Customer billing service fees	601	603
Rentals and scrap sales	312	274
	<u>\$ 4,399</u>	<u>\$ 3,850</u>

12. Income Taxes

a) Income tax status

As a wholly owned subsidiary Company of the Corporation of the City of London, the Company is exempt from income taxes under the Income Tax Act (Canada). Pursuant to the Electricity Act (1998)(Ontario) the Company is required to make payments in lieu of tax to the Ontario Electricity Financial Corporation. The amount of payments in lieu of tax will be approximately equivalent to the income and capital taxes that would have to be paid if the Company was a taxable corporation under the Income Tax Act (Canada).

b) Income tax expense

The Company's effective income tax rates differed from the statutory combined federal and provincial rates primarily due to the following:

	<u>2004</u>	<u>2003</u>
Earnings before income taxes	<u>\$ 12,238</u>	<u>\$ 7,267</u>
Income tax expense based on combined federal and provincial statutory income tax rate of 36.1% (2003 – 36.6%)	\$ 4,420	\$ 2,661
Federal large corporations tax	210	400
Unrecognized future income tax assets	(500)	-
Effect of changes to substantively enacted tax rates	-	(415)
Other items	-	(310)
Income tax expense recognized	<u>\$ 4,130</u>	<u>\$ 2,336</u>

Income tax expense is comprised of the following:

Current income tax	\$ 3,270	\$ 1,768
Future income tax	860	568
	<u>\$ 4,130</u>	<u>\$ 2,336</u>

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2004

12. Income Taxes, continued

c) Future income tax balances

The tax effects of temporary differences that give rise to significant portions of the future income tax assets and future income tax liabilities are as follows:

	<u>2004</u>	<u>2003</u>
Future income tax assets (liabilities):		
Capital assets	\$ 6,293	\$ 6,210
Deferred regulatory asset recoveries	(3,684)	(2,442)
Other	(364)	(663)
	<u>\$ 2,245</u>	<u>\$ 3,105</u>
Classified in the balance sheet as follows:		
Non-current assets	\$ 3,212	\$ 3,105
Current liabilities	(967)	-
	<u>\$ 2,245</u>	<u>\$ 3,105</u>

13. Employee Future Benefits

a) Pension plan

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer plan, on behalf of its employees. The plan is a contributory defined benefit plan which specifies the amount of retirement benefit to be received by the employees based on the length of service and rates of pay. Effective August 1, 1998, OMERS declared a contribution holiday, which temporarily suspended payments to the plan until January of 2003. On January 1, 2003, the Company and plan members were required to resume payments which increased gradually to full contribution levels in fiscal 2004. During the year, the Company contributed \$1.0 million (2003 - \$0.4 million).

b) Medical and life insurance benefits plan

The Company provides medical and life insurance benefit coverage to certain retirees of the Company. Based on a recent actuarial extrapolation of the plan's last valuation of September 30, 2003, the following information has been determined:

	<u>2004</u>	<u>2003</u>
Accrued benefit obligation		
Balance, beginning of year	\$ 9,426	\$ 7,574
Current service cost	163	124
Interest cost	558	503
Benefits paid	(591)	(492)
Actuarial loss	-	1,717
Balance, end of year	<u>\$ 9,556</u>	<u>\$ 9,426</u>

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2004

13. Employee Future Benefits, continued

	<u>2004</u>	<u>2003</u>
Accrued benefit liability		
Accrued benefit obligation	\$ 9,556	\$ 9,426
Benefits paid between measurement date of September 30, 2004 and December 31, 2004	(149)	(123)
Unamortized net actuarial loss	<u>(2,052)</u>	<u>(2,126)</u>
Accrued benefit liability, end of year	<u>\$ 7,355</u>	<u>\$ 7,177</u>

The Company's net periodic benefit cost is comprised of the following:

	<u>2004</u>	<u>2003</u>
Current service cost	\$ 163	\$ 124
Interest cost	558	503
Amortization of net actuarial loss	<u>74</u>	<u>-</u>
	<u>\$ 795</u>	<u>\$ 627</u>

The excess of the net actuarial loss in excess of ten percent of the accrued benefit obligation is amortized over the average remaining service life of employees, which is estimated to be 16 years.

The significant actuarial assumptions are as follows:

	<u>2004</u>	<u>2003</u>
Discount rate	6.0%	6.0%
Initial medical cost rate	12.0%	12.0%
Ultimate medical cost rate	5.0%	5.0%
Year ultimate rate reached	2011	2011
Dental cost rate	5.0%	5.0%
Rate of compensation increase	4.0%	4.0%

The estimated impact on fiscal 2004 reported pension amounts of a one percent increase or decrease in the health care cost assumptions is as follows:

	<u>Reported</u>	<u>+1.0%</u>	<u>-1.0%</u>
Current service cost	\$ 163	\$ 181	\$ 149
Interest cost	\$ 558	\$ 619	\$ 507
Accrued benefit obligation	\$ 9,556	\$ 10,320	\$ 8,982

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2004

14. Financial Instruments and Credit Risk

(a) Financial Instruments

Management estimates that the fair values of all financial assets and liabilities are not materially different from their carrying values.

(b) Credit Risk

Credit risk is the risk that a counterparty will fail to discharge its obligation to the Company reducing the expected cash inflow from Company assets recorded at the balance sheet date. Credit risk can be concentrated in debtors that are similarly affected by economic or other conditions. The Company has assessed that there are no significant concentrations of credit risk.

15. Subsequent Event

On February 8, 2005, the Board of Directors declared a \$2.0 million dividend payable to the sole shareholder, the Corporation of the City of London.

16. Prior Period Figures

Certain prior period figures presented have been restated to conform with the current year's presentation.

ATTACHMENT M

Audited 2005 Financial statements

London Hydro Inc.

Financial Statements
For the Year Ended December 31, 2005



KPMG LLP
Chartered Accountants
140 Fullarton Street Suite 1400
PO Box 2305
London ON N6A 5P2
Canada

Telephone (519) 672-4880
Fax (519) 672-5684
Internet www.kpmg.ca

AUDITORS' REPORT

To the Shareholder of London Hydro Inc.

We have examined the balance sheet of London Hydro Inc. as at December 31, 2005 and the statements of earnings and retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of London Hydro Inc. as at December 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

London, Canada

February 17, 2006

London Hydro Inc.

Balance Sheet
(in thousands of dollars)
As at December 31, 2005

	<u>2005</u>	<u>2004</u>
ASSETS		
Current assets		
Cash and equivalents	\$ 24,347	\$ 17,771
Accounts receivable (Notes 4, 9 and 11)	38,118	41,276
Regulatory assets (Note 5)	5,631	6,466
Inventories	3,452	3,330
Prepaid expenses	957	913
	<u>72,505</u>	<u>69,756</u>
Regulatory assets (Note 5)	<u>11,926</u>	<u>12,030</u>
Capital assets (Note 6)	<u>167,224</u>	<u>166,252</u>
Future income tax assets (Note 13)	<u>5,992</u>	<u>3,212</u>
	<u>\$ 257,647</u>	<u>\$ 251,250</u>
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities (Note 7)		
Accounts payable and accrued liabilities -		
Due to Independent Electricity System Operator	\$ 23,394	\$ 19,233
Other	10,647	10,763
Income taxes payable	1,642	1,895
Customer and other deposits (Note 8)	5,208	8,812
Due to shareholder (Note 9)	6,312	5,009
Regulatory liabilities (Note 5)	1,240	-
Future income tax liabilities (Note 13)	1,193	967
	<u>49,636</u>	<u>46,679</u>
Long-term liabilities		
Customer and other deposits (Note 8)	9,567	9,667
Due to shareholder (Note 9)	70,000	70,000
Employee future benefits (Note 14)	7,720	7,355
	<u>87,287</u>	<u>87,022</u>
Shareholder's equity		
Share capital (Note 10)	96,116	96,116
Retained earnings	24,608	21,433
	<u>120,724</u>	<u>117,549</u>
	<u>\$ 257,647</u>	<u>\$ 251,250</u>
Subsequent event (Note 16)		

On behalf of the Board:


Director


Director

London Hydro Inc.

Statement of Earnings and Retained Earnings
(in thousands of dollars)

For the Year-Ended December 31, 2005

	<u>2005</u>	<u>2004</u>
Distribution revenue (Note 11)	\$ 42,262	\$ 40,015
Operating expenses		
Plant operating and maintenance	8,596	8,485
General and administrative	17,774	17,033
Amortization of capital assets	12,848	12,578
	<u>39,218</u>	<u>38,096</u>
Less: Costs recovered (Note 9)	<u>(3,259)</u>	<u>(3,895)</u>
	<u>35,959</u>	<u>34,201</u>
Operating income	<u>6,303</u>	<u>5,814</u>
Other Income (expense)		
Interest and other revenue (Note 12)	5,277	4,399
Interest expense (Note 9)	<u>(4,496)</u>	<u>(4,473)</u>
	<u>781</u>	<u>(74)</u>
Earnings before the following	7,084	5,740
Recovery of regulatory amounts	<u>-</u>	<u>6,498</u>
Earnings before income taxes	7,084	12,238
Income taxes (Note 13)	<u>1,909</u>	<u>4,130</u>
Net earnings for the year	5,175	8,108
Retained earnings, beginning of year	21,433	13,325
Dividends	<u>(2,000)</u>	<u>-</u>
Retained earnings, end of year	<u>\$ 24,608</u>	<u>\$ 21,433</u>

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Cashflows
(in thousands of dollars)

For the Year Ended December 31, 2005

	<u>2005</u>	<u>2004</u>
Operating activities		
Net earnings for the year	\$ 5,175	\$ 8,108
Charges to operations not affecting cash		
Amortization of capital assets	12,848	12,578
Gain on disposal of capital assets	(44)	(19)
Future income taxes	<u>(2,554)</u>	<u>860</u>
	15,425	21,527
Net decrease in non-cash working capital balances related to operations	8,087	5,335
Increase in employee future benefits	365	178
Increase (decrease) in customer and other deposits	<u>(3,704)</u>	<u>2,159</u>
Cash provided by operating activities	<u>20,173</u>	<u>29,199</u>
Financing activities		
Dividends	(2,000)	-
Developer contributions to capital asset costs	<u>2,772</u>	<u>1,627</u>
Cash provided by financing activities	<u>772</u>	<u>1,627</u>
Investing activities		
Additions to capital assets	(16,712)	(16,633)
Proceeds on disposal of capital assets	164	69
Decrease (increase) in regulatory assets and liabilities	<u>2,179</u>	<u>(4,320)</u>
Cash used in investing activities	<u>(14,369)</u>	<u>(20,884)</u>
Increase in cash and equivalents during the year	6,576	9,942
Cash and equivalents, beginning of the year	<u>17,771</u>	<u>7,829</u>
Cash and equivalents, end of the year	<u>\$ 24,347</u>	<u>\$ 17,771</u>
Cash and equivalents are comprised of		
Cash	\$ 9,390	\$ 17,771
Banker's Acceptance at 3.25%	14,957	-
	<u>\$ 24,347</u>	<u>\$ 17,771</u>
Supplemental cashflow information		
Interest paid	<u>\$ 4,296</u>	<u>\$ 4,218</u>
Income taxes paid	<u>\$ 5,316</u>	<u>\$ 2,250</u>

See accompanying notes to the financial statements

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2005

1. Regulated Business Operations and Distribution Rates

The Company is a wholly owned subsidiary company of the Corporation of the City of London and provides regulated electrical distribution services to the inhabitants of the City of London.

The Company is regulated by the Ontario Energy Board ("OEB"), under the authority granted by the Ontario Energy Board Act (1998). The OEB has responsibility to set reasonable distribution rates and thereby approves all of the Company's distribution and ancillary rates. The Company's distribution revenue is determined by applying those regulated rates to customers and their consumption of electricity in the Company's distribution territory, as established by its distribution license granted by the OEB.

In January 2000, the OEB established that distribution rates would be subject to Performance Based Regulation ("PBR"), a method of regulation whereby distribution rates are reduced annually to reflect productivity improvements required of the Company. Under this rate methodology, rates also include regulated amounts for return on Company equity and debt, which were initially determined by the OEB to be 9.88% and 7%, respectively. While the initial PBR regulatory framework provided for those regulatory rates of return, subsequent regulation and Provincial Government initiatives have yet to allow distribution companies to fully achieve those returns. Commencing sometime in fiscal 2006, it is expected that the full amount for regulated return will be included in distribution rates.

2. Financial Effects of Distribution Rate Regulation

The financial results presented are in accordance with generally accepted accounting principles and within that framework the Company accounts for the impact of regulatory actions in the following manner:

a) Regulatory Decisions to Adjust Distribution Rates

In the event that a regulatory decision is rendered, providing regulatory approval and certainty to the recognition of an asset, or creation of a liability, and culminating in an adjustment to Company distribution rates, such occurrences are immediately reflected in the Company's accounts.

b) Regulatory Direction and Practice

In the absence of a regulatory decision impacting rates, and where the Company is required by regulatory accounting practice or direction to accumulate balances for future rate recovery or create liabilities for future discharge, those amounts are recorded in accordance with that regulatory direction. Management assesses the future uncertainty with respect to the final regulatory disposition of those amounts, and to the extent required, makes accounting provisions to reduce the deferred balances accumulated or to increase the recorded liabilities. Upon rendering of the final regulatory decision adjusting distribution rates, the provisions are adjusted to reflect the final impact of that decision, and such adjustment is reflected in net earnings for the period.

Amounts currently confirmed by final regulatory decision, and amounts currently accounted for in the absence of final regulatory decision together with related provisions for future uncertainty, are more fully described in note 5 to the financial statements.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2005

3. Summary of Significant Accounting Policies

a) Revenue recognition

In accordance with Ontario Energy Board regulations, the Company recognizes as revenue the regulated distribution tariffs associated with energy distributed, and variances between energy purchase costs and energy billed are recorded as regulatory assets or liabilities for future rate application consideration.

The Company follows the practice of cycle billing customers' accounts and revenue is recognized in the period billed. An accrual is made in the accounts at December 31 for distribution revenue earned on power supplied but not billed to customers between the date the meters were last read and the end of the year.

b) Inventories

Inventories of materials and supplies are valued at the lower of laid down cost on the average cost basis and net realizable value.

c) Capital assets

Capital assets are amortized over their estimated useful lives using the straight-line method over the following periods:

Buildings	50 to 60 years
Other construction	25 to 30 years
Substation equipment	30 years
Distribution lines, transformers and meters	25 years
System supervisory equipment	15 to 25 years
Service, office and other equipment	8 to 10 years
Automotive equipment	4 to 8 years
Computer equipment	5 years

When a capital asset is sold or otherwise disposed of, the related cost and accumulated amortization are removed from the respective accounts and any gain or loss on disposition is recognized in earnings.

Capital assets that by their nature are not readily identifiable as individual assets are grouped together. Under this method, the related cost and accumulated amortization are removed from their respective grouping account at the end of the asset's estimated useful life, regardless of actual service life. Any proceeds on disposition are recognized in earnings in the year of disposition.

d) Contributions to capital costs

Contributions are received from developers and contractors for capital costs incurred by the Company. These contributions are included as a reduction to the cost of the related capital assets when those assets are placed in service.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2005

3. Summary of Significant Accounting Policies, continued

e) Cash and equivalents

Cash on hand and on deposit with banks, and short-term investments with maturity of three months or less, are considered cash and equivalents.

f) Income taxes

The Company follows the liability method for accounting for income taxes whereby future income tax assets and liabilities are recognized for differences between the financial statement carrying amounts of existing assets and liabilities and their respective values for income tax purposes. These differences are measured using substantively enacted tax rates in effect in the period in which those differences are expected to be recovered or settled. To the extent that there is uncertainty regarding the recovery of a future income tax asset a valuation allowance reducing the future income tax asset is recorded.

g) Measurement uncertainty

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities at the date of the financial statements. Certain estimates are also required as regulations, which will ultimately determine the actual results, have yet to be finalized and are dependent on the completion of regulatory proceedings or decisions. Due to these uncertainties, actual results might differ from those estimates and the impact will be recorded in the current period when the actual results are known.

h) Employee future benefits

The Company has adopted the following policies for future benefits provided to both active and retired employees:

(i) Pension benefits

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer contributory defined benefit plan. Company contributions to the plan are recognized as pension expense in the period that they are incurred.

(ii) Other Post-Retirement and Post-Employment benefits

The Company provides other benefits to active and retired employees including group life insurance and health-care benefits. Recognition of these benefits are actuarially determined using the projected benefit method pro rated on service using management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2005

4. Accounts Receivable

	<u>2005</u>	<u>2004</u>
Accounts receivable -		
Energy and water	\$ 38,137	\$ 41,407
Sundry	<u>1,365</u>	<u>1,572</u>
	39,502	42,979
Less: Allowance for doubtful accounts	<u>1,384</u>	<u>1,703</u>
	<u>\$ 38,118</u>	<u>\$ 41,276</u>

Included in accounts receivable is approximately \$3.8 million (2004 - \$4.7 million) of customer receivables for water consumption that the Company bills and collects on behalf of the Corporation of the City of London. As the Company does not assume liability for collection of these amounts, no allowance for doubtful collection has been provided for these accounts.

5. Regulatory Assets and Liabilities

	<u>2005</u>	<u>2004</u>
Regulatory assets		
Amounts approved and included in distribution rates	\$ 14,534	\$ 20,094
Less: Current portion	<u>5,631</u>	<u>6,466</u>
	8,903	13,628
Amounts to be submitted for future rate approval:		
Ontario Energy Board annual assessment costs	340	106
Purchased power cost variances	<u>3,103</u>	<u>896</u>
	12,346	14,630
Provision for regulatory rate adjustments	<u>(420)</u>	<u>(2,600)</u>
	<u>\$ 11,926</u>	<u>\$ 12,030</u>
Regulatory liabilities		
Conservation and Demand Management - recoveries	\$ 2,122	\$ -
Conservation and Demand Management - expenditures	<u>(882)</u>	<u>-</u>
	<u>\$ 1,240</u>	<u>\$ -</u>

a) Amounts approved and included in distribution rates

The regulatory decision of December 9, 2004 affirmed the recovery of these amounts in rates which are being recovered through a distribution rate rider over a three-year period ending March 31, 2008.

b) Ontario Energy Board annual assessment costs

In December of 2004, electric distribution companies were allowed to establish a deferral account to record the annual costs assessed by the regulator. The amounts recorded as deferred costs are the amounts by which the annual OEB assessment costs for the period January 1, 2004 to April 30, 2006, exceed the amounts being recovered through distribution rates. It is anticipated that these costs will be reviewed by the regulator for final approval in 2006, and if approved, recovery would commence in 2007.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2005

5. Regulatory Amounts Recoverable, continued

b) Ontario Energy Board annual assessment costs, continued

In the absence of rate regulation, generally accepted accounting principles would require the Company to record such costs in the operating results of the year in which they are incurred and reported earnings before income taxes would be \$0.2 million (2004 - \$0.1 million lower) lower than reported.

c) Purchased power cost variances

As a regulated distributor of electricity, the Company is obligated to provide default energy supply to those consumers who elect not to purchase their energy from an energy retailer. The regulatory framework requires that all default energy commodity costs be billed to the consumer at regulated rates. Variances between purchase costs and amounts billed are required to be captured in a Retail Settlement Variance Account for future rate recovery. The Company has accumulated in the Retail Settlement Variance Accounts amounts that have accumulated since January 1, 2004 in the amount of \$3.1 million (2004 - \$0.9 million). Variances are eligible for recovery in future rates based upon a quarterly review process established by the regulator which determines when the balances are material enough to warrant an adjustment to rates.

Variances accumulated prior to January 1, 2004 in the amount of \$9.9 million plus allowed interest are included in the regulatory assets that were approved for rate recovery in December 2004.

d) Provision for regulatory rate adjustments

With the implementation of Bill 210 in December of 2002, distribution rates were frozen at their existing levels, which included a one-time adjustment for the recovery of 2001 income taxes. Due to the rate freeze, this adjustment was not removed from the rates until April 1, 2004. To-date, the regulator has not issued a formal decision on whether amounts collected during 2003 and 2004 for the 2001 tax component in rates, will be adjusted for in a future rate proceeding, but sufficient information was provided by the regulator during 2005 to indicate that these amounts will not be fully refundable. During 2005, this provision was reduced by \$2.2 million, and it is anticipated that final resolution on the remaining balance will be made in 2006 pending further clarification on this matter by the regulator.

e) Conservation and Demand Management expenditures and recoveries

In May of 2004, the Minister of Energy granted approval to all distributors to apply to the regulator for an increase in their 2005 distribution rates, conditional on a commitment by the Company to reinvest an equivalent amount in conservation and demand management initiatives. The Company received approval to collect approximately \$2.8 million to be spent on conservation and demand management programs over the period ending September 30, 2007. Until such amounts are fully expended, the Company has reflected these amounts as liabilities in keeping with the obligation to spend all amounts received on qualifying activities, as approved by the regulator.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2005

6. Capital Assets

	2005			2004
	Cost	Accumulated Amortization	Net	Net
Land and land rights	\$ 968	\$ 357	\$ 611	\$ 649
Buildings	17,746	7,499	10,247	10,670
Plant and equipment	35,876	20,795	15,081	15,526
Distribution system	241,251	102,740	138,511	136,450
Work in progress	2,774	-	2,774	2,957
	\$ 298,615	\$ 131,391	\$ 167,224	\$ 166,252

7. Bank Indebtedness

The Company has utilized \$13.2 million in bank standby letters of credit issued to the Independent Electricity System Operator, as required by regulation.

8. Customer and Other Deposits

Customer and other deposits include security deposits for energy consumption bearing interest at a rate of prime less 2% per annum and developer deposits held in accordance with regulation.

9. Related Party Balances and Transactions

	<u>2005</u>	<u>2004</u>
Non-interest bearing trade balances due to shareholder, without stated repayment terms	\$ 6,312	\$ 5,009
Unsecured promissory note, bearing interest at 6% per annum, payable in interest only, maturing July 1, 2008	<u>70,000</u>	<u>70,000</u>
	76,312	75,009
Less: Current portion	<u>6,312</u>	<u>5,009</u>
	<u>\$ 70,000</u>	<u>\$ 70,000</u>

Included in the accounts receivable is \$0.2 million (2004 - \$1.0 million) of energy, water, and sundry receivables due from the Corporation of the City of London.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2005

9. Related Party Balances and Transactions, continued

During the year and within the course of normal operations, the Company provided services to the City of London on an estimated cost recovery basis at an amount of \$3.3 million (2004 - \$3.9 million), and paid interest to the City in the amount of \$4.2 million (2004 - \$4.2 million).

10. Share Capital

Authorized

An unlimited number of common shares

An unlimited number of non-voting, non-cumulative preference shares, redeemable at the paid-up amount

Issued

1,001 common shares

	<u>2005</u>	<u>2004</u>
\$ 96,116	\$ 96,116	\$ 96,116

11. Distribution Revenue

In addition to distribution revenues of \$42.3 million (2004 - \$40.0 million), by regulation the Company is responsible for billing, collecting and settling energy purchase costs in the amount of \$297.4 million (2004 - \$245.9 million).

12. Interest and Other Revenue

	<u>2005</u>	<u>2004</u>
Interest	\$ 1,420	\$ 1,490
Late payment charges	982	978
Sundry	946	1,018
Customer billing service fees	598	601
Rentals	1,195	204
Scrap sales and other	136	108
	\$ 5,277	\$ 4,399

13. Income Taxes

a) Income tax status

As a wholly owned subsidiary Company of the Corporation of the City of London, the Company is exempt from income taxes under the Income Tax Act (Canada). Pursuant to the Electricity Act (1998)(Ontario) the Company is required to make payments in lieu of tax to the Ontario Electricity Financial Corporation. The amount of payments in lieu of tax will be approximately equivalent to the income and capital taxes that would have to be paid if the Company was a taxable corporation under the Income Tax Act (Canada).

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2005

13. Income Taxes, continued

b) Income tax expense

The Company's effective income tax rates differed from the statutory combined federal and provincial rates primarily due to the following:

	<u>2005</u>	<u>2004</u>
Earnings before income taxes	<u>\$ 7,084</u>	<u>\$ 12,238</u>
Income tax expense based on combined federal and provincial statutory income tax rate of 36.1% (2004 – 36.1%)	\$ 2,557	\$ 4,420
Federal large corporations tax	144	210
Unrecognized future income tax assets	(500)	(500)
Effect of changes to substantively enacted tax rates	-	-
Other items	<u>(292)</u>	<u>-</u>
Income tax expense recognized	<u>\$ 1,909</u>	<u>\$ 4,130</u>

Income tax expense is comprised of the following:

Current income tax	\$ 4,463	\$ 3,270
Future income tax	<u>(2,554)</u>	<u>860</u>
	<u>\$ 1,909</u>	<u>\$ 4,130</u>

c) Future income tax balances

The tax effects of temporary differences that give rise to significant portions of the future income tax assets and future income tax liabilities are as follows:

	<u>2005</u>	<u>2004</u>
Future income tax assets (liabilities):		
Capital assets	\$ 6,497	\$ 6,293
Employee future benefits	1,000	500
Deferred regulatory asset recoveries	(2,767)	(3,684)
Other	69	(864)
	<u>\$ 4,799</u>	<u>\$ 2,245</u>
Classified in the balance sheet as follows:		
Non-current assets	\$ 5,992	\$ 3,212
Current liabilities	<u>(1,193)</u>	<u>(967)</u>
	<u>\$ 4,799</u>	<u>\$ 2,245</u>

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2005

14. Employee Future Benefits

a) Pension plan

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer plan, on behalf of its employees. The plan is a contributory defined benefit plan which specifies the amount of retirement benefit to be received by the employees based on the length of service and rates of pay. During the year, the Company contributed \$1.1 million (2004 - \$1.0 million).

b) Medical and life insurance benefits plan

The Company provides medical and life insurance benefit coverage to certain retirees of the Company. Based on a recent actuarial extrapolation of the plan's last valuation of September 30, 2003, the following information has been determined:

	<u>2005</u>	<u>2004</u>
Accrued benefit obligation		
Balance, beginning of year	\$ 9,556	\$ 9,426
Current service cost	170	163
Interest cost	565	558
Benefits paid	(478)	(591)
Actuarial loss	<u>1,032</u>	<u>-</u>
Balance, end of year	<u>\$ 10,845</u>	<u>\$ 9,556</u>

	<u>2005</u>	<u>2004</u>
Accrued benefit liability		
Accrued benefit obligation	\$ 10,845	\$ 9,556
Benefits paid between measurement date of September 30, 2005 and December 31, 2005	(110)	(149)
Unamortized net actuarial loss	<u>(3,015)</u>	<u>(2,052)</u>
Accrued benefit liability, end of year	<u>\$ 7,720</u>	<u>\$ 7,355</u>

The Company's net periodic benefit cost is comprised of the following:

	<u>2005</u>	<u>2004</u>
Current service cost	\$ 170	\$ 163
Interest cost	565	558
Amortization of net actuarial loss	<u>68</u>	<u>74</u>
	<u>\$ 803</u>	<u>\$ 795</u>

The excess of the net actuarial loss in excess of ten percent of the accrued benefit obligation is amortized over the average remaining service life of employees, which is estimated to be 16 years.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2005

14. Employee Future Benefits, continued

The significant actuarial assumptions are as follows:

	<u>2005</u>	<u>2004</u>
Discount rate	5.1%	6.0%
Initial medical cost rate	10.0%	11.0%
Ultimate medical cost rate	5.0%	5.0%
Year ultimate rate reached	2011	2011
Dental cost rate	5.0%	5.0%
Rate of compensation increase	4.0%	4.0%

The estimated impact on fiscal 2004 reported pension amounts of a one percent increase or decrease in the health care cost assumptions is as follows:

	<u>Reported</u>	<u>+1.0%</u>	<u>-1.0%</u>
Current service cost	\$ 170	\$ 210	\$ 140
Interest cost	\$ 565	\$ 615	\$ 525
Accrued benefit obligation	\$ 10,845	\$ 11,906	\$ 10,002

15. Financial Instruments and Credit Risk

a) Financial Instruments

Management estimates that the fair values of all financial assets and liabilities are not materially different from their carrying values.

b) Credit Risk

Credit risk is the risk that a counterparty will fail to discharge its obligation to the Company reducing the expected cash inflow from Company assets recorded at the balance sheet date. Credit risk can be concentrated in debtors that are similarly affected by economic or other conditions. The Company has assessed that there are no significant concentrations of credit risk.

16. Subsequent Event

On March 21, 2006, the Board of Directors declared a \$2.0 million dividend payable to the sole shareholder, the Corporation of the City of London.

ATTACHMENT N

Audited 2006 Financial statements

London Hydro Inc.

Financial Statements
For the Year Ended December 31, 2006



KPMG LLP
Chartered Accountants
140 Fullarton Street Suite 1400
PO Box 2305
London ON N6A 5P2
Canada

Telephone (519) 672-4880
Fax (519) 672-5684
Internet www.kpmg.ca

AUDITORS' REPORT

To the Shareholder of London Hydro Inc.

We have examined the balance sheet of London Hydro Inc. as at December 31, 2006 and the statements of earnings and retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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

Chartered Accountants

London, Canada

February 23, 2007

London Hydro Inc.

Balance Sheet
(in thousands of dollars)
As at December 31, 2006


	<u>2006</u>	<u>2005</u>
ASSETS		
Current assets		
Cash and equivalents	\$ 18,991	\$ 24,347
Accounts receivable (Notes 4, 9, and 11)	46,564	38,118
Regulatory assets (Notes 5 and 16)	5,789	5,631
Inventories	3,893	3,452
Prepaid expenses	<u>988</u>	<u>957</u>
	<u>76,225</u>	<u>72,505</u>
Regulatory assets (Notes 5 and 16)	<u>4,365</u>	<u>12,690</u>
Capital assets (Note 6)	<u>168,631</u>	<u>167,224</u>
Future income tax assets (Note 13)	<u>7,563</u>	<u>5,992</u>
	<u>\$ 256,784</u>	<u>\$ 258,411</u>
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities (Note 7)		
Accounts payable and accrued liabilities -		
Due to Independent Electricity System Operator	\$ 20,431	\$ 23,394
Other	8,899	10,647
Income taxes payable	906	1,642
Regulatory liabilities (Notes 5 and 16)	172	1,240
Customer and other deposits (Note 8)	4,326	5,208
Due to shareholder (Note 9)	6,147	6,312
Future income tax liabilities (Note 13)	<u>1,765</u>	<u>1,193</u>
	<u>42,646</u>	<u>49,636</u>
Long-term liabilities		
Regulatory liabilities (Notes 5 and 16)	1,264	764
Customer and other deposits (Note 8)	10,170	9,567
Due to shareholder (Note 9)	70,000	70,000
Employee future benefits (Note 14)	<u>8,179</u>	<u>7,720</u>
	<u>89,613</u>	<u>88,051</u>
Shareholder's equity		
Share capital (Note 10)	96,116	96,116
Retained earnings	<u>28,409</u>	<u>24,608</u>
	<u>124,525</u>	<u>120,724</u>
	<u>\$ 256,784</u>	<u>\$ 258,411</u>

Subsequent event (Note 17)

On behalf of the Board



Director



Director

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Earnings and Retained Earnings
(in thousands of dollars)

For the Year Ended December 31, 2006

	<u>2006</u>	<u>2005</u>
Distribution revenue (Note 11)	\$ 47,943	\$ 42,262
Operating expenses		
Plant operating and maintenance	9,238	8,596
General and administrative	18,743	17,774
Amortization of capital assets	13,351	12,848
	<u>41,332</u>	<u>39,218</u>
Less: Costs recovered (Note 9)	<u>(3,264)</u>	<u>(3,259)</u>
	<u>38,068</u>	<u>35,959</u>
Operating income	<u>9,875</u>	<u>6,303</u>
Other Income (expense)		
Interest and other revenue (Note 12)	4,737	5,277
Interest expense (Note 9)	<u>(4,516)</u>	<u>(4,496)</u>
	<u>221</u>	<u>781</u>
Earnings before income taxes	10,096	7,084
Income taxes (Note 13)	<u>4,295</u>	<u>1,909</u>
Net earnings for the year	5,801	5,175
Retained earnings, beginning of year	24,608	21,433
Dividends	<u>(2,000)</u>	<u>(2,000)</u>
Retained earnings, end of year	<u>\$ 28,409</u>	<u>\$ 24,608</u>

See accompanying notes to the financial statements

London Hydro Inc.

Statement of Cashflows
(in thousands of dollars)

For the Year Ended December 31, 2006

	<u>2006</u>	<u>2005</u>
Operating activities		
Net earnings for the year	\$ 5,801	\$ 5,175
Charges to operations not affecting cash		
Amortization of capital assets	13,351	12,848
Gain on disposal of capital assets	(67)	(44)
Future income taxes	(999)	(2,554)
	<u>18,086</u>	<u>15,425</u>
Net (increase) decrease in non-cash working capital balances related to operations	(14,530)	8,087
Increase in employee future benefits	459	365
Decrease in customer and other deposits	(279)	(3,704)
Cash provided by operating activities	<u>3,736</u>	<u>20,173</u>
Financing activities		
Dividends	(2,000)	(2,000)
Developer contributions to capital asset costs	2,233	2,772
Cash provided by financing activities	<u>233</u>	<u>772</u>
Investing activities		
Additions to capital assets	(17,032)	(16,712)
Proceeds on disposal of capital assets	108	164
Decrease in regulatory assets and liabilities	7,599	2,179
Cash used in investing activities	<u>(9,325)</u>	<u>(14,369)</u>
Increase (decrease) in cash and equivalents during the year	(5,356)	6,576
Cash and equivalents, beginning of the year	<u>24,347</u>	<u>17,771</u>
Cash and equivalents, end of the year	<u>\$ 18,991</u>	<u>\$ 24,347</u>
Cash and equivalents are comprised of		
Cash	\$ 3,016	\$ 9,390
Banker's Acceptance at 4.15% (2005 - 3.25%)	15,975	14,957
	<u>\$ 18,991</u>	<u>\$ 24,347</u>
Supplemental cashflow information		
Interest paid	<u>\$ 4,244</u>	<u>\$ 4,296</u>
Income taxes paid	<u>\$ 6,909</u>	<u>\$ 5,316</u>

See accompanying notes to the financial statements

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2006

1. Regulated Business Operations and Distribution Rates

The Company is a wholly owned subsidiary company of the Corporation of the City of London and provides regulated electrical distribution services to the inhabitants of the City of London.

The Company is regulated by the Ontario Energy Board ("OEB"), under the authority granted by the Ontario Energy Board Act (1998). The OEB has responsibility to set just and reasonable distribution rates and thereby approves all of the Company's distribution and ancillary rates. The Company's distribution revenue is determined by applying those regulated rates to customers and their consumption of electricity in the Company's distribution territory, as established by its distribution license granted by the OEB.

2. Financial Effects of Distribution Rate Regulation

The financial results presented are in accordance with generally accepted accounting principles and within that framework the Company accounts for the impact of regulatory actions in the following manner:

a) Regulatory Decisions to Adjust Distribution Rates

In the event that a regulatory decision is rendered, providing regulatory approval and certainty to the recognition of an asset, or creation of a liability, and culminating in an adjustment to Company distribution rates, such occurrences are immediately reflected in the Company's accounts.

b) Regulatory Direction and Practice

In the absence of a regulatory decision impacting rates, and where the Company is required by regulatory accounting practice or direction to accumulate balances for future rate recovery or create liabilities for future discharge, those amounts are recorded in accordance with that regulatory direction. Management assesses the future uncertainty with respect to the final regulatory disposition of those amounts, and to the extent required, makes accounting provisions to reduce the deferred balances accumulated or to increase the recorded liabilities. Upon rendering of the final regulatory decision adjusting distribution rates, the provisions are adjusted to reflect the final impact of that decision, and such adjustment is reflected in net earnings for the period.

Amounts currently confirmed by final regulatory decision, and amounts currently accounted for in the absence of final regulatory decision together with related provisions for future uncertainty, are more fully described in note 5 to the financial statements.

3. Summary of Significant Accounting Policies

a) Revenue recognition

In accordance with Ontario Energy Board regulations, the Company recognizes as revenue the regulated distribution tariffs associated with energy distributed, and variances between energy purchase costs and energy billed are recorded as regulatory assets or liabilities for future rate application consideration.

The Company follows the practice of cycle billing customers' accounts and revenue is recognized in the period billed. An accrual is made in the accounts at December 31 for distribution revenue earned on power supplied but not billed to customers between the date the meters were last read and the end of the year.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2006

3. Summary of Significant Accounting Policies, continued

b) Inventories

Inventories of materials and supplies are valued at the lower of laid down cost on the average cost basis and net realizable value.

c) Capital assets

Capital assets are amortized over their estimated useful lives using the straight-line method over the following periods:

Buildings	50 to 60 years
Other construction	25 to 30 years
Substation equipment	30 years
Distribution lines, transformers and meters	25 years
System supervisory equipment	15 to 25 years
Service, office and other equipment	8 to 10 years
Automotive equipment	4 to 8 years
Computer equipment	5 years

When a capital asset is sold or otherwise disposed of, the related cost and accumulated amortization are removed from the respective accounts and any gain or loss on disposition is recognized in earnings.

Capital assets that by their nature are not readily identifiable as individual assets are grouped together. Under this method, the related cost and accumulated amortization are removed from their respective grouping account at the end of the asset's estimated useful life, regardless of actual service life. Any proceeds on disposition are recognized in earnings in the year of disposition.

d) Contributions to capital costs

Contributions are received from developers and contractors for capital costs incurred by the Company. These contributions are included as a reduction to the cost of the related capital assets when those assets are placed in service.

e) Cash and equivalents

Cash on hand and on deposit with banks, and short-term investments with maturity of three months or less, are considered cash and equivalents.

f) Income taxes

The Company follows the liability method for accounting for income taxes whereby future income tax assets and liabilities are recognized for differences between the financial statement carrying amounts of existing assets and liabilities and their respective values for income tax purposes. These differences are measured using substantively enacted tax rates in effect in the period in which those differences are expected to be recovered or settled. To the extent that there is uncertainty regarding the recovery of a future income tax asset a valuation allowance reducing the future income tax asset is recorded.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2006

3. Summary of Significant Accounting Policies, continued

g) Measurement uncertainty

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities at the date of the financial statements. Certain estimates are also required as regulations, which will ultimately determine the actual results, have yet to be finalized and are dependent on the completion of regulatory proceedings or decisions. Due to these uncertainties, actual results might differ from those estimates and the impact will be recorded in the current period when the actual results are known.

h) Employee future benefits

The Company has adopted the following policies for future benefits provided to both active and retired employees:

(i) Pension benefits

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer contributory defined benefit plan. Company contributions to the plan are recognized as pension expense in the period that they are incurred.

(ii) Other Post-Retirement and Post-Employment benefits

The Company provides other benefits to active and retired employees including group life insurance and health-care benefits. Recognition of these benefits are actuarially determined using the projected benefit method pro rated on service using management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

4. Accounts Receivable

	<u>2006</u>	<u>2005</u>
Accounts receivable -		
Energy and water	\$ 47,163	\$ 38,137
Sundry	861	1,365
	48,024	39,502
Less: Allowance for doubtful accounts	1,460	1,384
	\$ 46,564	\$ 38,118

Included in accounts receivable is approximately \$4.4 million (2005 - \$3.8 million) of customer receivables for water consumption that the Company bills and collects on behalf of the Corporation of the City of London. As the Company does not assume liability for collection of these amounts, any amount relating to water consumption that is determined to be uncollectible is charged to the Corporation of the City of London. At the year-end, approximately \$0.4 million (2005 - \$0.4 million) is included in the allowance for doubtful accounts for uncollectible amounts relating to water consumption.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2006

5. Regulatory Assets and Liabilities

	<u>2006</u>	<u>2005</u>
Regulatory assets		
Amounts approved and included in distribution rates	\$ 9,042	\$ 14,534
Less: Current portion	<u>5,789</u>	<u>5,631</u>
	3,253	8,903
Amounts to be submitted for future rate approval:		
Ontario Energy Board annual assessment costs	425	340
Purchased power cost variances (non-commodity)	617	3,867
Other	<u>70</u>	<u>-</u>
	4,365	13,110
Provision for regulatory rate adjustments	<u>-</u>	<u>(420)</u>
	<u>\$ 4,365</u>	<u>\$ 12,690</u>
Regulatory liabilities		
Current amounts		
Conservation and Demand Management – recoveries	\$ 2,837	\$ 2,122
Conservation and Demand Management - expenditures	<u>(2,665)</u>	<u>(882)</u>
	<u>\$ 172</u>	<u>\$ 1,240</u>
Long-term amounts		
Purchased power cost variances (commodity)	<u>\$ 1,264</u>	<u>\$ 764</u>

a) Amounts approved and included in distribution rates

The regulatory decision of December 9, 2004 affirmed the recovery of these amounts in rates which are being recovered through a distribution rate rider over a three-year period ending March 31, 2008.

b) Ontario Energy Board annual assessment costs

In December of 2004, electric distribution companies were allowed to establish a deferral account to record the annual costs assessed by the regulator. The amounts recorded as deferred costs are the amounts by which the annual OEB assessment costs for the period January 1, 2004 to April 30, 2006, exceed the amounts being recovered through distribution rates. Subsequent to April 30, 2006, the annual assessment costs have been fully borne by the Company and expensed. It is anticipated the costs deferred will be reviewed by the regulator for final approval in a future rate application process.

In the absence of rate regulation, generally accepted accounting principles would require the Company to record such costs in the operating results of the year in which they are incurred and reported earnings before income taxes would be \$0.1 million lower (2005 - \$0.2 million lower) than reported.

c) Purchased power cost variances

As a regulated distributor of electricity, the Company is obligated to provide default energy supply to those consumers who elect not to purchase their energy from an energy retailer. The regulatory framework requires that all default energy commodity and non-commodity costs be billed to the consumer at regulated rates. Variances between purchase costs and amounts billed are required to be captured in Retail Settlement Variance Accounts for disposition in future rates.

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2006

5. Regulatory Assets and Liabilities, continued

c) Purchased power cost variances

Currently, the variances accumulated are for the period commencing January 1, 2004 to December 31, 2006. Variances accumulated prior to January 1, 2004 in the amount of \$9.9 million plus allowed interest are included in the regulatory assets that were approved for rate recovery in December 2004.

The variance accounts have been further defined by the regulator into commodity related and non-commodity accounts. Those accounts defined as commodity accounts are eligible for regulatory review on a quarterly basis. All other accounts are defined as non-commodity and are currently eligible for review on an annual basis. For all variance accounts, the review period does not in itself determine whether any adjustment will be permitted as the regulator will determine when the balances are material enough to warrant an adjustment to rates. As the actual disposition is subject to unknown timing by the regulator the related regulatory assets and liabilities have been classified as long-term.

d) Provision for regulatory rate adjustments

As a result of the significant reduction of accumulated regulatory assets subject to future rate assessment, the provision for future rate approval uncertainty in the amount of \$0.4 million was removed and included in earnings for the year.

e) Conservation and Demand Management expenditures and recoveries

In May of 2004, the Minister of Energy granted approval to all distributors to apply to the regulator for an increase in their 2005 distribution rates, conditional on a commitment by the Company to reinvest an equivalent amount in conservation and demand management initiatives. The Company received approval to collect approximately \$2.8 million to be spent on conservation and demand management programs over the period ending September 30, 2007. Until such amounts are fully expended, the Company has reflected these amounts as liabilities in keeping with the obligation to spend all amounts received on qualifying activities, as approved by the regulator.

6. Capital Assets

	2006			2005
	Cost	Accumulated Amortization	Net	Net
Land and land rights	\$ 971	\$ 396	\$ 575	\$ 611
Buildings	17,897	7,922	9,975	10,247
Plant and equipment	37,432	22,229	15,203	15,081
Distribution system	249,142	110,354	138,788	138,511
Work in progress	4,090	-	4,090	2,774
	<u>\$ 309,532</u>	<u>\$ 140,901</u>	<u>\$ 168,631</u>	<u>\$ 167,224</u>

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2006

7. Bank Indebtedness

The Company has utilized \$13.2 million in bank standby letters of credit issued to the Independent Electricity System Operator, as required by regulation.

8. Customer and Other Deposits

Customer and other deposits include security deposits for energy consumption bearing interest at a rate of prime less 2% per annum and developer deposits held in accordance with regulation.

9. Related Party Balances and Transactions

	<u>2006</u>	<u>2005</u>
Non-interest bearing trade balances due to shareholder, without stated repayment terms	\$ 6,147	\$ 6,312
Unsecured promissory note, bearing interest at 6% per annum, payable in interest only, maturing July 1, 2008	<u>70,000</u>	<u>70,000</u>
	76,147	76,312
Less: Current portion	<u>6,147</u>	<u>6,312</u>
	<u>\$ 70,000</u>	<u>\$ 70,000</u>

Included in the accounts receivable is \$0.7 million (2005 - \$0.2 million) of energy, water, and sundry receivables due from the Corporation of the City of London.

During the year and within the course of normal operations, the Company provided services to the City of London on an estimated cost recovery basis at an amount of \$3.3 million (2005 - \$3.3 million), and paid interest to the City in the amount of \$4.2 million (2005 - \$4.2 million).

10. Share Capital

Authorized

An unlimited number of common shares

An unlimited number of non-voting, non-cumulative preference shares, redeemable at the paid-up amount

Issued

1,001 common shares

	<u>2006</u>	<u>2005</u>
	<u>\$ 96,116</u>	<u>\$ 96,116</u>

11. Distribution Revenue

In addition to distribution revenues of \$47.9 million (2005 - \$42.3 million), by regulation the Company is responsible for billing, collecting and settling energy purchase costs in the amount of \$296.4 million (2005 - \$297.4 million).

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2006

12. Interest and Other Revenue

	<u>2006</u>	<u>2005</u>
Interest	\$ 1,237	\$ 1,420
Late payment charges	934	982
Sundry	1,398	946
Customer billing service fees	645	598
Rentals	385	1,195
Scrap sales and other	138	136
	<u>\$ 4,737</u>	<u>\$ 5,277</u>

13. Income Taxes

a) Income tax status

As a wholly owned subsidiary Company of the Corporation of the City of London, the Company is exempt from income taxes under the Income Tax Act (Canada). Pursuant to the Electricity Act (1998)(Ontario) the Company is required to make payments in lieu of tax to the Ontario Electricity Financial Corporation. The amount of payments in lieu of tax will be approximately equivalent to the income and capital taxes that would have to be paid if the Company was a taxable corporation under the Income Tax Act (Canada).

b) Income tax expense

The Company's effective income tax rates differed from the statutory combined federal and provincial rates primarily due to the following:

	<u>2006</u>	<u>2005</u>
Earnings before income taxes	<u>\$ 10,096</u>	<u>\$ 7,084</u>
Income tax expense based on combined federal and provincial statutory income tax rate of 36.1%	\$ 3,646	\$ 2,557
Federal large corporations tax	-	144
Effect of changes to substantively enacted rates	800	-
Unrecognized future income tax assets	(300)	(500)
Other items	149	(292)
Income tax expense recognized	<u>\$ 4,295</u>	<u>\$ 1,909</u>

Income tax expense is comprised of the following:

Current income tax	\$ 5,294	\$ 4,463
Future income tax	(999)	(2,554)
	<u>\$ 4,295</u>	<u>\$ 1,909</u>

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2006

13. Income Taxes, continued

c) Future income tax balances

The tax effects of temporary differences that give rise to significant portions of the future income tax assets and future income tax liabilities are as follows:

	<u>2006</u>	<u>2005</u>
Future income tax assets (liabilities):		
Capital assets	\$ 6,135	\$ 6,497
Employee future benefits	1,362	1,000
Deferred regulatory asset recoveries	(1,699)	(2,767)
Other	-	69
	<u>\$ 5,798</u>	<u>\$ 4,799</u>
Classified in the balance sheet as follows:		
Non-current assets	\$ 7,563	\$ 5,992
Current liabilities	(1,765)	(1,193)
	<u>\$ 5,798</u>	<u>\$ 4,799</u>

14. Employee Future Benefits

a) Pension plan

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer plan, on behalf of its employees. The plan is a contributory defined benefit plan which specifies the amount of retirement benefit to be received by the employees based on the length of service and rates of pay. During the year, the Company contributed \$1.3 million (2005 - \$1.1 million).

b) Medical and life insurance benefits plan

The Company provides medical and life insurance benefit coverage to certain retirees of the Company. Based on a recent actuarial extrapolation of the plan's last valuation of September 30, 2006, the following information has been determined:

	<u>2006</u>	<u>2005</u>
Accrued benefit obligation		
Balance, beginning of year	\$ 10,845	\$ 9,556
Current service cost	224	170
Interest cost	550	565
Benefits paid	(437)	(478)
Actuarial loss (gain)	(550)	1,032
Balance, end of year	<u>\$ 10,632</u>	<u>\$ 10,845</u>

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2006

14. Employee Future Benefits, continued

	<u>2006</u>	<u>2005</u>
Accrued benefit liability		
Accrued benefit obligation	\$ 10,632	\$ 10,845
Benefits paid between measurement date of September 30, 2006 and December 31, 2006	(109)	(110)
Unamortized net actuarial loss	<u>(2,344)</u>	<u>(3,015)</u>
Accrued benefit liability, end of year	<u>\$ 8,179</u>	<u>\$ 7,720</u>

The Company's net periodic benefit cost is comprised of the following:

	<u>2006</u>	<u>2005</u>
Current service cost	\$ 224	\$ 170
Interest cost	550	565
Amortization of net actuarial loss	<u>121</u>	<u>68</u>
	<u>\$ 895</u>	<u>\$ 803</u>

The excess of the net actuarial loss in excess of ten percent of the accrued benefit obligation is amortized over the average remaining service life of employees, which is estimated to be 16 years.

The significant actuarial assumptions are as follows:

	<u>2006</u>	<u>2005</u>
Discount rate	5.2%	5.1%
Initial medical cost rate	10.0%	10.0%
Ultimate medical cost rate	5.0%	5.0%
Year ultimate rate reached	2013	2011
Dental cost rate	5.0%	5.0%
Rate of compensation increase	4.0%	4.0%

The estimated impact on fiscal 2006 reported pension amounts of a one percent increase or decrease in the health care cost assumptions is as follows:

	<u>Reported</u>	<u>+1.0%</u>	<u>-1.0%</u>
Current service cost	\$ 224	\$ 279	\$ 183
Interest cost	\$ 550	\$ 607	\$ 505
Accrued benefit obligation	\$ 10,632	\$ 11,615	\$ 9,845

London Hydro Inc.
Notes to the Financial Statements
(tabular amounts in thousands of dollars)
For the Year Ended December 31, 2006

15. Financial Instruments and Credit Risk

a) Financial Instruments

Management estimates that the fair values of all financial assets and liabilities are not materially different from their carrying values.

b) Credit Risk

Credit risk is the risk that a counterparty will fail to discharge its obligation to the Company reducing the expected cash inflow from Company assets recorded at the balance sheet date. Credit risk can be concentrated in debtors that are similarly affected by economic or other conditions. The Company has assessed that there are no significant concentrations of credit risk.

16. Comparative Figures

Certain prior year's figures presented in note 5 to the financial statements and the balance sheet have been reclassified to conform to the current year's presentation.

17. Subsequent Event

On March 20, 2007 the Board of Directors declared a \$2.0 million dividend payable to the sole shareholder, the Corporation of the City of London.