

Financial Statements

**Thunder Bay Hydro Electricity
Distribution Inc.**

December 31, 2002



Thunder Bay Hydro Electricity Distribution Inc.

TABLE OF CONTENTS

December 31, 2002

| | Page |
|---|------|
| Auditors' Report | 1 |
| Balance Sheet | 2 |
| Statement of Operations and Retained Earnings (Deficit) | 4 |
| Statement of Cash Flows | 5 |
| Notes to Financial Statements | 6 |
| Schedule - Operation, Maintenance and Administration Expenses | 18 |

AUDITORS' REPORT

To the Shareholder of
Thunder Bay Hydro Electricity Distribution Inc.

We have audited the balance sheet of **Thunder Bay Hydro Electricity Distribution Inc.** as at December 31, 2002 and the statements of operations and retained earnings (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, 2002 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young, Thunder Bay LLP

Thunder Bay, Canada,
March 13, 2003.

Chartered Accountants

| | 2002 | 2001 |
|---|-------------------|-------------------|
| | \$ | \$ |
| LIABILITIES AND SHAREHOLDER'S EQUITY | | |
| Current | | |
| Accounts payable and accrued liabilities | 8,181,447 | 9,603,547 |
| Accrued interest on long-term note payable | 457,000 | — |
| Debt retirement charge | 623,292 | — |
| Deferred revenue | 62,221 | — |
| Accrued vacation pay payable | 826,620 | 751,353 |
| Customer deposits | 1,737,053 | 1,246,813 |
| Total current liabilities | 11,887,633 | 11,601,713 |
| Long-term | | |
| Employee future benefits <i>[note 5]</i> | 2,217,118 | 2,216,618 |
| Long-term note payable <i>[note 6]</i> | 34,931,625 | 34,931,625 |
| Total long-term liabilities | 37,148,743 | 37,148,243 |
| Shareholder's equity | | |
| Share capital | | |
| Authorized | | |
| Unlimited common shares | | |
| Issued | | |
| 1,000 common shares | 34,931,625 | 34,931,625 |
| Retained earnings (deficit) | 838,980 | (115,202) |
| Total shareholder's equity | 35,770,605 | 34,816,423 |
| | 84,806,981 | 83,566,379 |



Thunder Bay Hydro Electricity Distribution Inc.

**STATEMENT OF OPERATIONS AND RETAINED EARNINGS
(DEFICIT)**

Year ended December 31

| | 2002 \$ | 2001 \$ |
|---|-------------------|-------------------|
| Activities - Market opening - May 1, 2002 | | |
| Revenue from the sale of energy <i>[note 7]</i> | 32,207,606 | 83,572,003 |
| Cost of bulk power purchased | 27,511,737 | 70,544,466 |
| Gross margin on energy sales | 4,695,869 | 13,027,537 |
| Activities - Post-market opening | | |
| Flow-through charges plus distribution revenues | 53,805,467 | — |
| Flow-through costs of energy | (43,976,766) | — |
| Distribution revenues | 9,828,701 | — |
| | 14,524,570 | 13,027,537 |
| Other operating revenue <i>[note 8]</i> | 2,332,780 | 2,782,258 |
| | 16,857,350 | 15,809,795 |
| Expenses | | |
| Operation and maintenance <i>[schedule]</i> | 5,767,046 | 5,765,197 |
| Administration <i>[schedule]</i> | 5,411,884 | 4,748,520 |
| Amortization <i>[note 9]</i> | 3,868,372 | 3,537,395 |
| | 15,047,302 | 14,051,112 |
| Earnings before the following | 1,810,048 | 1,758,683 |
| Interest on long-term debt | 457,000 | 900,726 |
| Earnings before provision for taxes | 1,353,048 | 857,957 |
| Provision for taxes in lieu of corporate income taxes | 398,866 | 86,000 |
| Earnings for year | 954,182 | 771,957 |
| Deficit, beginning of year | (115,202) | (887,159) |
| Retained earnings (deficit), end of year | 838,980 | (115,202) |

See accompanying notes



Thunder Bay Hydro Electricity Distribution Inc.

STATEMENT OF CASH FLOWS

Year ended December 31

| | 2002 | 2001 |
|--|--------------------|-------------|
| | \$ | \$ |
| <hr/> | | |
| OPERATING ACTIVITIES | | |
| Earnings for year | 954,182 | 771,957 |
| Add charges (deduct credits) to earnings not involving a current payment (receipt) of cash | | |
| Amortization [note 9] | 4,365,198 | 4,214,615 |
| Increase in employee future benefits | 500 | 50,000 |
| Gain on disposal of capital assets | (11,949) | (39,852) |
| Change in non-cash working capital balances related to operations [note 11] | (4,296,031) | (269,554) |
| Cash provided by operating activities | 1,011,900 | 4,727,166 |
| <hr/> | | |
| INVESTMENT ACTIVITIES | | |
| Proceeds on sale of capital assets | 12,599 | 39,852 |
| Additions to capital assets, net of capital contributions | (6,112,582) | (4,355,920) |
| Decrease in investments | — | 4,000,000 |
| Cash used in investment activities | (6,099,983) | (316,068) |
| <hr/> | | |
| FINANCING ACTIVITY | | |
| Regulatory assets | (817,033) | — |
| Cash used in financing activity | (817,033) | — |
| <hr/> | | |
| Increase (decrease) in cash and cash equivalents for year | (5,905,116) | 4,411,098 |
| Cash and cash equivalents, beginning of year | 9,498,332 | 5,087,234 |
| Cash and cash equivalents, end of year | 3,593,216 | 9,498,332 |

See accompanying notes



NOTES TO FINANCIAL STATEMENTS

December 31, 2002

1. ELECTRICITY ACT, 1998 AND ELECTRICITY PRICING CONSERVATION AND SUPPLY ACT 2002 (BILL 210)

The electricity market opened to competition on May 1, 2002 [note 17]. Rate setting and activities to this date have been segregated on the Statement of Operations and Retained Earnings (Deficit).

Upon market opening, the cost of power and all costs related to the operations of the electricity grid including transmission, connection and administration costs are to be flowed through to the consumer. Rates are typically established each year as set out in the Distribution Rate Handbook.

Bill 210 became law on December 9, 2002 and effectively implements a rate cap for the cost of electricity consumed (as well as for delivery costs) by low volume and designated customers. Retail settlement variance accounts and certain other accounts prescribed by the Ontario Energy Board ("OEB") have been defined as "Regulatory Assets" under Bill 210. Given that the rate cap imposed by Bill 210 will remain in place until 2006, the classification of regulatory assets is long-term.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), including accounting principles prescribed by the OEB in the handbook "Accounting Procedures Handbook for Electric Distribution Utilities", and reflect the significant accounting policies summarized below.

Rate setting

The Ontario Energy Board Act, 1998 gave the OEB increased powers and responsibilities to regulate the electricity industry. These powers and responsibilities include the power to approve or fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity customers, and the responsibility for ensuring the distribution companies fulfill obligations to connect and service customers. In its capacity to approve or fix rates, the OEB has specified the following regulatory treatments that have resulted in accounting treatments differing from Canadian GAAP for enterprises operating in a non-regulated environment:

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

- [a] Costs incurred to align systems and practices with the requirements of the future competitive electricity market in Ontario (Transition costs or Market Ready costs) may be deferred in accordance with the criteria set out in the OEB's Electricity Distribution Rate Handbook and the Accounting Procedures Handbook for Electric Distribution Utilities. Under such regulation, certain costs are allowed to be deferred that would be expensed when incurred under GAAP (see accounting policy "Deferred Transition Costs"). Thunder Bay Hydro Electricity Distribution Inc. ("TBHEDI") may apply for the recovery of these costs in accordance with the guidelines and timetable for this process to be established by the OEB.
- [b] TBHEDI provides for payments in lieu of corporate income taxes relating to its regulated business using the taxes payable method as directed by the OEB.
- [c] Regulatory assets

- [i] Retail settlement variance accounts track the differences between the amount billed plus accrued unbilled revenue and the purchased cost of power since market opening. Adjustments to record the variances have been added (deducted) from gross revenue or cost of power as appropriate to reflect the "flow-through" nature of the costs.
- [ii] Pre-market opening cost of power variance

Traditionally, customers who were not billed using time-of-use rates were charged an average rate for their power throughout the year to incorporate the winter and summer rates that were charged to the Corporation on the purchase of power. Upon market opening, May 1, 2002, the Corporation commenced charging customers at approved rates for Debt Retirement, Transmission, Connection, Distribution and Wholesale Market Services plus the hourly Ontario Energy price for commodity consumption. As a result of the timing of market opening, the Corporation experienced a loss on the energy sales to the non-time-of-use customers. This loss has been recorded as an asset and is expected to be recovered from future rates.

- [d] Rebates to customers

Bill 210 required distributors to make a payment of \$75 in accordance with section 79.1 of the Act to each low-volume customer who had an account on November 25, 2002. The payment of the rebates has been recorded as a reduction of our billings to customers. The funding for the rebates was recorded as a reduction in our flow-through cost of energy.

Further reductions as prescribed by the regulations will be made to customers' accounts for low-volume and designated customers.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and in banks.

Stores inventory

Stores inventory consists principally of maintenance and construction materials and is valued at the lower of cost and net realizable value. Cost is determined using the average cost method.

Capital assets

Capital assets are stated at cost. Gains or losses at retirement or disposition of such assets are credited or charged to other operating revenue. Amortization is provided on a straight-line basis for capital assets over their estimated service lives at the following annual rates:

| | |
|----------------------|------------|
| General plant | 2% to 4% |
| Other capital assets | 10% to 20% |

Pension plan

TBHEDI provides a pension plan for its employees through the Ontario Municipal Employees Retirement System ("OMERS"). OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund (the "Fund"), and provides pensions for employees of Ontario municipalities, local boards, public utilities and school boards. The Fund is a contributory defined benefit pension plan which is financed by equal contributions from participating employers and employees, and by the investment earnings of the Fund [note 10]. TBHEDI recognizes the expense related to this plan as contributions are made.

Thunder Bay Hydro Electricity Distribution Inc.**NOTES TO FINANCIAL STATEMENTS**

December 31, 2002

Other post-employment benefits

Employee future benefits provided by TBHEDI include medical and life insurance benefits and accumulated sick leave credits. These plans provide benefits to certain employees when they are no longer providing active service. Employee future benefit expense is recognized in the period in which the employees render the services. Employee future benefits are recorded on an accrual basis. The accrued benefit obligations and current service cost are calculated using the projected benefit method pro-rated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value of benefits attributed to employees' services rendered in the period. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. Actuarial gains (losses) are amortized into expense on a straight-line basis over the average remaining service period of active employees to full eligibility. The effects of a curtailment gain or loss are recognized in earnings in the year of the event giving rise to the curtailment. The effects of a settlement gain or loss are recognized in earnings for the period in which a settlement occurs.

Revenue recognition

Revenue is recorded on the basis of regular meter readings. Estimates of customer usage since the last meter reading date to the end of the year are recorded as unbilled revenue.

Contributions in aid of construction

Effective January 1, 2001, TBHEDI prospectively adopted the change in accounting policy for contributions received in aid of construction [contributed capital], as prescribed by the OEB "Accounting Procedures Handbook for Electric Distribution Utilities". Capital contributions are required contributions received from outside sources, used to finance additions to capital assets. Capital contributions received after January 1, 2001 are treated as a "credit" contra account included in the determination of capital assets. The amount is subsequently amortized by a charge to accumulated amortization and a credit to amortization expense, at an equivalent rate to that used for the amortization of the related capital assets. Capital contributions received for capital assets prior to January 1, 2001 were treated as contributed capital, a permanent component of equity which was not amortized.

Customer deposits

Customers' advance deposits are cash collections from customers or Energy Retailers to guarantee the payment of energy related bills. The deposits bear interest that is paid to the customer's account.

Thunder Bay Hydro Electricity Distribution Inc.**NOTES TO FINANCIAL STATEMENTS**

December 31, 2002

Organization costs

Organization costs are legal and other professional costs associated with the corporate restructuring and the transfer of assets from the Hydro-Electric Commission of Thunder Bay. The organization costs will be amortized on a straight-line basis over five years.

Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the year. Actual results could differ from those estimates.

Corporate income taxes and capital taxes

The current tax-exempt status of TBHEDI under the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) reflects the fact that TBHEDI is wholly-owned by a municipality. This tax-exempt status might be lost in a number of circumstances, including if the municipality ceases to own 90% or more of the shares or capital of TBHEDI, or if a non-government entity has rights immediately or in the future, either absolutely or contingently, to acquire more than 10% of the shares of TBHEDI.

Commencing October 1, 2001, TBHEDI is required, under the Electricity Act, 1998, to make payments in lieu of corporate taxes to Ontario Electricity Financial Corporation ("OEFC"). These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) as modified by the Electricity Act, 1998, and related regulations.

TBHEDI provides for PILs relating to its regulated business using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of TBHEDI at that time.

In addition to these amounts of future income taxes, an asset of \$4,590,000 relating to the regulated business has not been recorded in the accounts as an opening retained earnings adjustment.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

3. REGULATORY ASSETS (LIABILITIES)

| | 2002 \$ |
|------------------------------------|------------------|
| Rebate costs | 56,287 |
| Pre-market opening cost of power | 1,204,790 |
| | 1,261,077 |
| Connection charges | (589,508) |
| Transmission charges | (1,107,078) |
| Wholesale market services | 955,823 |
| Commodity | 254,212 |
| Retail settlement variances | (486,551) |
| Carrying charges | 42,507 |
| Regulatory assets | 817,033 |

4. BANK CREDITS

- [a] TBHEDI has a revolving operating term of credit available to them in the amount of \$12,000,000 [2001 - \$1,000,000] of which \$nil was utilized at December 31, 2002 [2001 - \$nil]. The credit bears interest at bank prime. Prime at December 31, 2002 was 4.5 % [2001 - 4.0%].
- [b] TBHEDI has a revolving term credit available to them in the amount of \$17,718,662 [2001 - \$nil] of which \$nil was utilized at December 31, 2002. This credit will be used by TBHEDI to assist in meeting its prudential obligations to the IMO. The credit bears interest at bank prime. Prime at December 31, 2002 was 4.5%.



Thunder Bay Hydro Electricity Distribution Inc.**NOTES TO FINANCIAL STATEMENTS**

December 31, 2002

5. EMPLOYEE FUTURE BENEFITS

TBHEDI has a number of unfunded benefit plans providing retirement and post-employment benefits (excluding pension) to most of its employees.

Information about TBHEDI's defined benefit plans is as follows:

| | 2002 | 2001 |
|---|------------------|-------------|
| | \$ | \$ |
| Accrued benefit liability at December 31 | 2,216,618 | 2,166,618 |
| Expense for the year | 214,274 | 204,424 |
| Benefits paid for the year or moved to current liability | (213,774) | (154,424) |
| Projected accrued benefit obligation at December 31, as determined by actuarial valuation using a 6.0% discount rate | 2,217,118 | 2,216,618 |

The main actuarial assumptions employed for the valuations are as follows:

[a] General inflation

Future general inflation levels, as measured by changes in the Consumer Price Index ("CPI"), were assumed at 3.5% in 2002 and thereafter.

[b] Interest (discount) rate

The obligation as at December 31, 2002 [December 31, 2001], of the present value of future liabilities and the expense for the year, were determined using an annual discount rate of 6.0%. This corresponds to the assumed CPI rate plus an assumed real rate of return of 2.5%.

[c] Salary levels

Future general salary and wage levels were assumed to increase at 2% per annum.

[d] Medical costs

Medical costs were assumed to increase at the CPI rate plus a further increase of 5% in 2002 graded down to 1% in 2004 and thereafter.

Thunder Bay Hydro Electricity Distribution Inc.**NOTES TO FINANCIAL STATEMENTS**

December 31, 2002

[e] Dental costs

Dental costs were assumed to increase at the CPI rate plus a further increase of 1% in 2002 and thereafter.

6. LONG-TERM NOTE PAYABLE

| | 2002 | 2001 |
|------------------------|-------------------|-------------|
| | \$ | \$ |
| Long-term note payable | 34,931,625 | 34,931,625 |

The long-term note is payable to The Corporation of the City of Thunder Bay (sole shareholder of Thunder Bay Hydro Corporation, TBHEDI's parent company). Principal repayments in the next twelve months is expected to be \$nil.

7. REVENUE FROM THE SALE OF ENERGY

| | 2002 | 2001 |
|---|--------------------|-------------|
| | \$ | \$ |
| Pre-market opening | | |
| Commercial and industrial | 22,740,792 | 49,553,317 |
| Residential | 17,241,349 | 32,378,148 |
| Municipal street lighting | 342,508 | 646,867 |
| Pre-market opening cost of power variance | 1,204,790 | — |
| Unbilled service adjustment | (9,321,833) | 993,671 |
| | 32,207,606 | 83,572,003 |



Thunder Bay Hydro Electricity Distribution Inc.**NOTES TO FINANCIAL STATEMENTS**

December 31, 2002

8. OTHER OPERATING REVENUE

| | 2002 \$ | 2001 \$ |
|-----------------------------|------------------|------------------|
| Water heater rentals | 503,517 | 474,657 |
| Pole line rentals | 455,584 | 455,610 |
| Competitive market revenues | 120,209 | — |
| Interest earned | 168,590 | 417,409 |
| Utility services | 391,260 | 279,755 |
| OPGI settlement | — | 340,000 |
| Sundry earnings | 693,620 | 814,827 |
| | 2,332,780 | 2,782,258 |

9. AMORTIZATION

Amortization provided during the year consists of:

| | 2002 \$ | 2001 \$ |
|--|------------------|------------------|
| Amortization of general plant | 3,744,843 | 3,355,975 |
| Amortization of capital contributions | (110,000) | (56,000) |
| Amortization of unallocated office and data processing equipment | 193,529 | 197,420 |
| Amortization of organization costs | 40,000 | 40,000 |
| | 3,868,372 | 3,537,395 |
| Amortization of other capital assets included in relevant expense categories in the Statement of Operations | 496,826 | 677,220 |
| | 4,365,198 | 4,214,615 |

10. PENSION PLAN

TBHEDI did not incur current service pension costs for the year ended December 31, 2002 [2001 - \$nil]. Effective August 1, 1998, OMERS provided a temporary contribution holiday, with no employer or employee pension contributions required until after December 31, 2002. OMERS contributions are expected to resume no sooner than January, 2003, and will be phased in over three years, starting at one-third of their normal rate.

Thunder Bay Hydro Electricity Distribution Inc.**NOTES TO FINANCIAL STATEMENTS**

December 31, 2002

11. STATEMENT OF CASH FLOWS

The net change in non-cash working capital balances related to operations is represented by the following:

| | 2002 \$ | 2001 \$ |
|---|--------------------|------------------|
| Decrease (increase) in current assets | | |
| Accounts receivable | (3,077,755) | 521,504 |
| Due from associated companies | (90,731) | — |
| Unbilled revenue | (1,148,260) | (993,671) |
| Taxes receivable | 18,000 | (18,000) |
| Accrued interest receivable | — | 139,396 |
| Stores inventory | (67,336) | 79,692 |
| Prepaid expenses | (215,869) | 58,804 |
| | (4,581,951) | (212,275) |
| Increase (decrease) in current liabilities | | |
| Accounts payable and accrued liabilities | (1,422,100) | (540,970) |
| Accrued interest on long-term note payable | 457,000 | — |
| Debt retirement charge | 623,292 | — |
| Deferred revenue | 62,221 | — |
| Accrued vacation pay payable | 75,267 | 42,757 |
| Customer deposits | 490,240 | 440,934 |
| | 285,920 | (57,279) |
| | (4,296,031) | (269,554) |

12. COMMITMENTS

TBHEDI leases computer equipment under a long-term operating lease. Future minimum payments under this commitment are \$31,000. TBHEDI is currently negotiating a renewal of this lease. As at the audit report date, no agreement has been signed.



Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

13. CONTINGENCIES

- [a] A class action claiming \$500 million in restitutionary payments plus interest was served on Toronto Hydro on November 18, 1998. The action was initiated against Toronto Hydro Electric Commission as the representative of the defendant class consisting of all municipal electric utilities in Ontario which have charged late payment charges on overdue utility bills at any time after April 1, 1981.

The claim is that late payment penalties result in the municipal electric utilities receiving interest at effective rates in excess of 60% per period, which is illegal under Section 347(1)(b) of the Criminal Code.

The Electricity Distributors Association is undertaking the defense of this class action. At this time it is not possible to quantify the effect, if any, on the financial statements of TBHEDI.

- [b] There is an outstanding claim pending against TBDHI for which the amount of settlement, if any, is not determinable and will be charged to expenditures when determined.

14. RELATED PARTY TRANSACTIONS

Due to the nature and volume of transactions between TBHEDI and The Corporation of the City of Thunder Bay, the sole shareholder, as well as with other entities controlled by the City, it is impractical to detail the transactions that take place between these organizations.

15. CORPORATE INCOME AND CAPITAL TAXES

The provision for PILs differs from the amount that would have been recorded using the combined Canadian Federal and Ontario statutory income tax rate.



Thunder Bay Hydro Electricity Distribution Inc.**NOTES TO FINANCIAL STATEMENTS**

December 31, 2002

Future income taxes relating to TBHEDI have not been recorded in the accounts as they are expected to be recovered through future revenues. As at December 31, 2002, the following future income tax assets and expense have not been recorded in the financial statements:

| | Gross \$ | Future income tax asset not recorded in financial statements \$ | Future income tax expense not recognized in financial statements \$ |
|--|-------------|--|--|
| Income tax losses available for carryforward (expiry 2008) | 72,000 | 28,000 | 457,000 |
| Deductible temporary and permanent differences | 11,930,000 | 4,600,000 | 251,000 |

16. SUBSEQUENT EVENT

Subsequent to the year-end, TBHEDI transferred all of their water heater rental assets to a newly incorporated entity. At December 31, 2002, the net equity in water heater rental assets is \$1,325,994.

17. ELECTRIC INDUSTRY RESTRUCTURING AND REGULATION

The Energy Competition Act, 1998 (the "Act") was given Royal Assent on October 30, 1998. The Act provides for a competitive market in the sale of electricity, in addition to the regulation of the monopoly electricity delivery system in the Province of Ontario, by the OEB. The electricity marketplace has been deregulated. Open Access commenced on May 1, 2002, the date on which transmitters and distributors were required to provide generators, retailers, and consumers with non-discriminatory access to the transmission and distribution systems in Ontario in accordance with their licences under the Electricity Act, 1998. TBHEDI was obligated to provide a letter of credit to the Independent Electricity Market Operator ("IMO") in the amount of \$17,718,662 two weeks prior to Open Access.

The OEB has regulatory authority over the electricity distribution sector. The Act sets out the OEB's powers to issue a distribution licence which must be obtained by any person owning or operating a distribution system under the revised Ontario Energy Board Act, 1998 [the "new OEB Act" - a component of the new Act]. The new OEB Act allows the OEB to prescribe licence requirements and conditions to electricity distributors which may include, among other considerations, specified accounting records, regulatory accounting principles, separation of accounts for separate businesses and filing/processing requirements for rate-setting purposes.

OPERATION, MAINTENANCE AND ADMINISTRATION EXPENSES

Year ended December 31

| | 2002 \$ | 2001 \$ |
|---|-------------------|-------------------|
| OPERATION AND MAINTENANCE | | |
| Customer premises/meters and devices | 806,200 | 862,551 |
| Distribution | 2,864,954 | 3,019,880 |
| Safety and training | 349,818 | 377,729 |
| System control/station maintenance | 1,096,975 | 1,127,520 |
| Transformer | 649,099 | 377,517 |
| Total operation and maintenance expenses | 5,767,046 | 5,765,197 |
| ADMINISTRATION | | |
| Customer related | | |
| Bad debts | 339,610 | 212,325 |
| Billing | 243,977 | — |
| Cashiers | 387,604 | 346,305 |
| Customer information and service | 1,541,519 | 1,536,055 |
| Data processing | 693,833 | 724,588 |
| Meter reading | 465,529 | 463,453 |
| Total customer related administration expenses | 3,672,072 | 3,282,726 |
| General | | |
| Corporate | 542,098 | 390,701 |
| Directors' expenses | 86,809 | 74,253 |
| Finance Department | 367,936 | 312,180 |
| General administration | 260,896 | 208,650 |
| General Manager's office | 239,463 | 238,880 |
| Human Resources | 242,610 | 241,130 |
| Total general administration expenses | 1,739,812 | 1,465,794 |
| Total administration expenses | 5,411,884 | 4,748,520 |
| Total operation, maintenance and administration expenses | 11,178,930 | 10,513,717 |



Financial Statements

**Thunder Bay Hydro Electricity
Distribution Inc.**

December 31, 2003

Thunder Bay Hydro Electricity Distribution Inc.

TABLE OF CONTENTS

December 31, 2003

| | Page |
|---|------|
| Auditors' Report | 1 |
| Balance Sheet | 2 |
| Statement of Operations and Retained Earnings | 4 |
| Statement of Cash Flows | 5 |
| Notes to Financial Statements | 6 |
| Schedule - Expenses | 23 |

AUDITORS' REPORT

To the Shareholder of
Thunder Bay Hydro Electricity Distribution Inc.

We have audited the balance sheet of **Thunder Bay Hydro Electricity Distribution Inc.** as at December 31, 2003 and the statements of operations and retained earnings 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, 2003 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young, Thunder Bay LLP

Thunder Bay, Canada,
March 5, 2004.

Chartered Accountants

Thunder Bay Hydro Electricity Distribution Inc.

BALANCE SHEET

As at December 31

| | 2003 \$ | 2002 \$ |
|--|--------------------|--------------------|
| ASSETS | | |
| Current | | |
| Cash and cash equivalents | 7,487,286 | 3,593,216 |
| Investment [note 3] | 973,490 | — |
| Accounts receivable | 6,606,000 | 7,688,851 |
| Unbilled revenue | 9,511,692 | 10,470,093 |
| Due from associated companies [note 4] | 355,696 | 90,731 |
| Stores inventory | 1,078,801 | 1,034,542 |
| Prepaid expenses | 288,094 | 312,064 |
| Total current assets | 26,301,059 | 23,189,497 |
| Long-term | | |
| Organization costs, net | 80,000 | 120,000 |
| Regulatory assets [note 5] | — | 817,033 |
| Total long-term assets | 80,000 | 937,033 |
| Capital assets | | |
| Buildings | 3,894,355 | 3,813,795 |
| Distribution equipment | 96,088,026 | 92,163,771 |
| General office equipment | 3,679,637 | 3,601,462 |
| Hot water heaters | — | 4,652,168 |
| Land | 133,038 | 133,038 |
| Other equipment | 2,356,024 | 2,277,438 |
| Rolling stock | 4,296,977 | 4,144,690 |
| Transformation equipment | 8,140,815 | 7,733,791 |
| | 118,588,872 | 118,520,153 |
| Less accumulated amortization | (56,078,757) | (55,417,366) |
| | 62,510,115 | 63,102,787 |
| Capital contributions, net | (3,415,915) | (2,561,969) |
| Construction-in-progress | 78,877 | 139,633 |
| Capital assets, net | 59,173,077 | 60,680,451 |
| | 85,554,136 | 84,806,981 |

Commitments [note 17]

Contingencies [note 18]

See accompanying notes

On behalf of the Board:

Director

Director

| | 2003 | 2002 |
|---|-------------------|-------------------|
| | \$ | \$ |
| LIABILITIES AND SHAREHOLDER'S EQUITY | | |
| Current | | |
| Accounts payable and accrued liabilities | 8,982,460 | 8,181,447 |
| Accrued interest on long-term note payable | — | 457,000 |
| Debt retirement charge | 636,175 | 623,292 |
| Deferred revenue | 105,277 | 62,221 |
| Accrued vacation pay payable | 760,909 | 826,620 |
| PILs tax liability | 555,911 | — |
| Customer deposits | 1,903,172 | 1,737,053 |
| Total current liabilities | 12,943,904 | 11,887,633 |
| Long-term | | |
| Regulatory liabilities <i>[note 5]</i> | 490,565 | — |
| Employee future benefits <i>[note 7]</i> | 2,167,888 | 2,217,118 |
| Long-term note payable <i>[note 8]</i> | 33,490,500 | 34,931,625 |
| Total long-term liabilities | 36,148,953 | 37,148,743 |
| Shareholder's equity | | |
| Share capital | | |
| Authorized | | |
| Unlimited common shares | | |
| Issued | | |
| 1,000 common shares | 34,931,625 | 34,931,625 |
| Retained earnings | 1,529,654 | 838,980 |
| Total shareholder's equity | 36,461,279 | 35,770,605 |
| | 85,554,136 | 84,806,981 |

Thunder Bay Hydro Electricity Distribution Inc.

STATEMENT OF OPERATIONS AND RETAINED EARNINGS

Year ended December 31

| | 2003 \$ | 2002 \$ |
|--|--------------|--------------|
| Activities - Market opening - May 1, 2002 | | |
| Revenue from the sale of energy | — | 32,207,606 |
| Cost of bulk power purchased | — | 27,511,737 |
| Gross margin on energy sales | — | 4,695,869 |
| Activities - Post-market opening | | |
| Flow-through charges plus distribution revenues | 78,339,527 | 53,805,467 |
| Flow-through costs of energy | (63,732,881) | (43,976,766) |
| Distribution revenue | 14,606,646 | 9,828,701 |
| Other operating revenue [note 9] | 2,348,541 | 2,342,764 |
| | 16,955,187 | 16,867,334 |
| Expenses | | |
| Operation and maintenance [schedule] | 5,968,953 | 5,767,355 |
| Utility services [schedule] | 507,280 | 217,660 |
| Administration [schedule] | 5,519,702 | 5,203,899 |
| Amortization [note 10] | 3,851,897 | 3,868,372 |
| Provision for payments in lieu of capital tax | 237,000 | 235,000 |
| | 16,084,832 | 15,292,286 |
| Earnings before the following | 870,355 | 1,575,048 |
| Interest (interest forgiven) on long-term debt | (457,000) | 457,000 |
| Earnings before provision for taxes | 1,327,355 | 1,118,048 |
| Provision for payments in lieu of corporate income taxes | 743,000 | 163,866 |
| Earnings for year | 584,355 | 954,182 |
| Retained earnings (deficit), beginning of year | 838,980 | (115,202) |
| Excess of redemption over cost of affiliate shares | 106,319 | — |
| Retained earnings, end of year | 1,529,654 | 838,980 |

See accompanying notes

Thunder Bay Hydro Electricity Distribution Inc.

STATEMENT OF CASH FLOWS

Year ended December 31

| | 2003 \$ | 2002 \$ |
|---|--------------------|--------------------|
| OPERATING ACTIVITIES | | |
| Earnings for year | 584,355 | 954,182 |
| Add charges (deduct credits) to earnings not involving a current payment (receipt) of cash | | |
| Amortization [note 10] | 4,379,759 | 4,365,198 |
| Increase (decrease) in employee future benefits | (49,230) | 500 |
| Gain on disposal of capital assets | — | (11,949) |
| Change in non-cash working capital balances related to operations [note 12] | 2,812,269 | (4,296,031) |
| Cash provided by operating activities | 7,727,153 | 1,011,900 |
| INVESTMENT ACTIVITIES | | |
| Proceeds on sale of capital assets | 1,441,125 | 12,599 |
| Additions to capital assets, net of capital contributions | (4,167,191) | (6,112,582) |
| Increase in investment | (973,490) | — |
| Cash used in investment activities | (3,699,556) | (6,099,983) |
| FINANCING ACTIVITIES | | |
| Increase (decrease) in regulatory assets | 1,307,598 | (817,033) |
| Reduction in long-term liability | (1,441,125) | — |
| Cash used in financing activities | (133,527) | (817,033) |
| Increase (decrease) in cash and cash equivalents for year | 3,894,070 | (5,905,116) |
| Cash and cash equivalents, beginning of year | 3,593,216 | 9,498,332 |
| Cash and cash equivalents, end of year | 7,487,286 | 3,593,216 |

See accompanying notes

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

GENERAL

Thunder Bay Hydro Electricity Distribution Inc. ("TBHEDI") is a wholly-owned subsidiary company of Thunder Bay Hydro Corporation providing electrical distribution services to the inhabitants of the City of Thunder Bay, as regulated by the Ontario Energy Board ("OEB").

1. ELECTRICITY ACT, 1998 AND ELECTRICITY PRICING CONSERVATION AND SUPPLY ACT 2003 (BILL 210)

The Energy Competition Act, 1998 (the "Act") was given Royal Assent on October 30, 1998. The Act provides for a competitive market in the sale of electricity, in addition to the regulation of the monopoly electricity delivery system in the Province of Ontario, by the OEB. Open Access commenced on May 1, 2002, the date on which transmitters and distributors were required to provide generators, retailers, and consumers with non-discriminatory access to the transmission and distribution systems in Ontario in accordance with their licences under the Electricity Act, 1998.

The OEB has regulatory authority over the electricity distribution sector. The Act sets out the OEB's powers to issue a distribution licence which must be obtained by any person owning or operating a distribution system under the revised Ontario Energy Board Act, 1998 (the "new OEB Act" - a component of the new Act). The new OEB Act allows the OEB to prescribe licence requirements and conditions to electricity distributors which may include, among other considerations, specified accounting records, regulatory accounting principles, separation of accounts for separate businesses and filing/processing requirements for rate-setting purposes.

Upon market opening, the cost of power and all costs related to the operations of the electricity grid including transmission, connection and administration costs are flowed through to the consumer. Rates are typically established each year as set out in the Distribution Rate Handbook.

Bill 210, which became law on December 9, 2002, effectively implemented a rate cap for the cost of electricity consumed (as well as for delivery costs) by low-volume and designated customers. Retail settlement variance accounts and certain other accounts prescribed by the OEB have been defined as "regulatory assets" under Bill 210. The price freeze and rate caps were originally expected to continue until at least May 1, 2006; however, in November 2003, the Province announced its intention to increase (effective April 1, 2004) the price of electricity payable by low-volume and designated customers from 4.3 cents to 4.7 cents per kWh on the first 750 kWh consumed during a month and 5.5 cents thereafter and directed the OEB to develop new pricing mechanisms (to take effect no later than May 1, 2005) for setting the price of electricity payable by low-volume and designated customers.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

The Province also announced its intention in November to permit electricity distributors to make rate applications to the OEB earlier than had been contemplated under Bill 210 with respect to the:

- [a] recovery of "regulatory assets" (based on year-end balances at December 31, 2002) to be phased in over a four-year period effective March 1, 2004; and
- [b] third adjustment necessary to achieve a market-based rate of return (subject to a one-time investment in conservation and demand management initiatives equal to one year of additional revenue resulting from such rate increase), effective March 1, 2005.

In December 2003, the OEB issued filing guidelines with respect to the recovery of regulatory assets. The OEB's filing guidelines provided that:

- [a] distributors will be permitted to recover 25% of regulatory assets in rate adjustments to become effective March 1, 2004;
- [b] the 2004 rate adjustment will be implemented on April 1, 2004 (with a gross-up added to the recovered amount to allow recovery over 11 months);
- [c] the OEB will provide additional instructions with respect to the filing of evidence to facilitate the OEB's review of the balance of the regulatory assets; and
- [d] permitted recoveries will be phased in over a three-year period (2005, 2006 and 2007).

In 2004, TBHEDI filed a rate application requesting OEB authorization with respect to an increase in distribution rates to allow for the recovery of approximately \$660,000 (representing approximately 25% of TBHEDI's regulatory assets as at December 31, 2002).

During the period that the price freeze is in effect, it is expected that distributors and retailers will be compensated by the Ontario Electricity Financial Corporation ("OEFC"):

- [a] in the case of distributors, for amounts by which the price paid by distributors for electricity purchased by them in the wholesale market on behalf of low-volume and designated consumers is greater than the fixed price per kWh; and
- [b] in the case of retailers, for amounts by which the retail contract price between retailers and low-volume and designated consumers is greater than the fixed price per kWh.

Consumers other than the designated consumers who annually utilize more than 250,000 kWh continue to be eligible to receive Business Protection Plan Rebates (BPPR), (formerly received under the Market Power Mitigation Agreement) from the Ontario Power Generation Inc. ("OPG") to the extent that electricity prices exceed certain prescribed thresholds.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

The continuing restructuring of Ontario's electricity industry and other regulatory developments, including current and future possible consultations between the OEB and interested stakeholders, may affect the distribution rates, including payments in lieu collected from customers, that TBHEDI may charge and the costs that TBHEDI may recover, including the balance of its regulatory assets.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), including accounting principles prescribed by the OEB in the handbook "Accounting Procedures Handbook for Electric Distribution Utilities", and reflect the significant accounting policies summarized below.

Rate setting

The Ontario Energy Board Act, 1998 gave the OEB increased powers and responsibilities to regulate the electricity industry. These powers and responsibilities include the power to approve or fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity customers, and the responsibility for ensuring the distribution companies fulfill obligations to connect and service customers. In its capacity to approve or fix rates, the OEB has specified the following regulatory treatments that have resulted in accounting treatments differing from GAAP for enterprises operating in a non-regulated environment:

- [a] Costs incurred to align systems and practices with the requirements of the future competitive electricity market in Ontario (Transition costs or Market Ready costs) may be deferred in accordance with the criteria set out in the OEB's Electricity Distribution Rate Handbook and the Accounting Procedures Handbook for Electric Distribution Utilities. Under such regulation, certain costs are allowed to be deferred that would be expensed when incurred under GAAP (see accounting policy "Deferred Transition Costs"). TBHEDI may apply for the recovery of these costs in accordance with the guidelines and timetable for this process to be established by the OEB.
- [b] TBHEDI provides for payments in lieu of corporate income taxes relating to its regulated business using the taxes payable method as directed by the OEB.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

[c] Regulatory assets

[i] Retail settlement variance accounts track the differences between the amount billed plus accrued unbilled revenue and the purchased cost of power since market opening. Adjustments to record the variances have been added (deducted) from gross revenue or cost of power as appropriate to reflect the "flow-through" nature of the costs.

[ii] Pre-market opening cost of power variance

Traditionally, customers who were not billed using time-of-use rates were charged an average rate for their power throughout the year to incorporate the winter and summer rates that were charged to the Corporation on the purchase of power. Upon market opening, May 1, 2002, the Corporation commenced charging customers at approved rates for debt retirement, transmission, connection, distribution and wholesale market services plus the hourly Ontario Energy price for commodity consumption. As a result of the timing of market opening, the Corporation experienced a loss on the energy sales to the non-time-of-use customers. This loss has been recorded as an asset and is expected to be recovered from future rates.

[iii] The PILs deferral account tracks the variances that result from the differences between the OEB approved PILs amount and the amount of actual billings that relate to the recovery of PILs. It also allows for periodic adjustments and an allowance for deemed interest.

[d] Rebates to customers/Business Protection Plan Rebate

Bill 210 required distributors to make a payment of \$75 in accordance with section 79.1 of the Act to each low-volume customer who had an account on November 25, 2002. In 2002, the payment of the rebates was recorded as a reduction of billings to customers. The funding for the rebates was recorded as a reduction in flow-through cost of energy.

Further reductions as prescribed by the regulations were made to customers' accounts for low-volume and designated customers in 2003.

Consumers, other than designated customers who annually utilize more than 250,000 kWh, continue to be eligible to receive BPPR from the OEFC to the extent that electricity prices exceed certain prescribed thresholds.

TBHEDI and other electricity distributors are required to pass these rebates through to eligible consumers and other market participants (including retailers).

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

During the year, TBHEDI received BPPR for the 15-month period from May 1, 2002 to July 31, 2003. BPPR are currently scheduled to be distributed in quarterly instalments with the next rebate scheduled for February, 2004, covering the period May 1, 2003 to October 31, 2003, adjusted by the first instalment.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and in banks.

Stores inventory

Stores inventory consists principally of maintenance and construction materials and is valued at the lower of cost and net realizable value. Cost is determined using the average cost method.

Capital assets

Capital assets are stated at cost. Gains or losses on retirement or disposition of such assets are credited or charged to other operating revenue. Amortization is provided on a straight-line basis for capital assets over their estimated service lives at the following annual rates:

| | |
|----------------------|------------|
| General plant | 2% to 4% |
| Other capital assets | 10% to 20% |

Pension plan

TBHEDI provides a pension plan for its employees through the Ontario Municipal Employees Retirement System ("OMERS"). OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund (the "Fund"), and provides pensions for employees of Ontario municipalities, local boards, public utilities and school boards. The Fund is a contributory defined benefit pension plan which is financed by equal contributions from participating employers and employees, and by the investment earnings of the Fund [note 11]. TBHEDI recognizes the expense related to this plan as contributions are made.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

Other post-employment benefits

Employee future benefits provided by TBHEDI include medical and life insurance benefits and accumulated sick leave credits. These plans provide benefits to certain employees when they are no longer providing active service. Employee future benefit expense is recognized in the period in which the employees render the services. Employee future benefits are recorded on an accrual basis. The accrued benefit obligations and current service cost are calculated using the projected benefit method pro-rated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value of benefits attributed to employees' services rendered in the period. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. Actuarial gains (losses) are amortized into expense on a straight-line basis over the average remaining service period of active employees to full eligibility. The effects of a curtailment gain or loss are recognized in earnings in the year of the event-giving rise to the curtailment. The effects of a settlement gain or loss are recognized in earnings for the period in which a settlement occurs.

Revenue recognition

Revenue is recorded on the basis of regular meter readings. Estimates of customer usage since the last meter reading date, to the end of the year, are recorded as unbilled revenue.

Contributions in aid of construction

Effective January 1, 2001, TBHEDI prospectively adopted the change in accounting policy for contributions received in aid of construction (contributed capital), as prescribed by the OEB "Accounting Procedures Handbook for Electric Distribution Utilities". Capital contributions are required contributions received from outside sources, used to finance additions to capital assets. Capital contributions received after January 1, 2001 are treated as a "credit" contra account included in the determination of capital assets. The amount is subsequently amortized by a charge to accumulated amortization and a credit to amortization expense, at an equivalent rate to that used for the amortization of the related capital assets. Capital contributions received for capital assets prior to January 1, 2001 were treated as contributed capital, a permanent component of equity, which was not amortized.

Customer deposits

Customers' advance deposits are cash collections from customers or Energy Retailers to guarantee the payment of energy-related bills. The deposits bear interest that is paid to the customer's account.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

Organization costs

Organization costs are legal and other professional costs associated with the corporate restructuring and the transfer of assets from the Hydro-Electric Commission of Thunder Bay. The organization costs are amortized on a straight-line basis over five years.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the year. Actual results could differ from those estimates.

Corporate income taxes and capital taxes

The current tax-exempt status of TBHEDI under the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) reflects the fact that TBHEDI is wholly-owned by a municipality. This tax-exempt status might be lost in a number of circumstances, including if the municipality ceases to own 90% or more of the shares or capital of TBHEDI, or if a non-government entity has rights immediately or in the future, either absolutely or contingently, to acquire more than 10% of the shares of TBHEDI.

Commencing October 1, 2001, TBHEDI is required, under the Electricity Act, 1998, to make payments in lieu of corporate taxes to the OEFC. These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) as modified by the Electricity Act, 1998, and related regulations.

TBHEDI provides for PILs relating to its regulated business using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax bases of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of TBHEDI at that time.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

Provision for environment costs

TBHEDI will incur future costs associated with the disposal of contaminated waste and site restoration for certain of its properties. Although these costs cannot be reasonably determined for some of the properties at this time, a contingent liability exists. When reasonably determinable, TBHEDI has provided for future costs, net of expected recoveries, by charges to income. Actual costs are charged to the provision for environmental costs as incurred.

3. INVESTMENT

Investment consists of a Treasury Deposit, maturing in November, 2004, with a maturity value of \$1,000,000.

4. DUE FROM ASSOCIATED COMPANIES

The balances due from associated companies represent balances owing from the following common control enterprises:

| | 2003 | 2002 |
|--|----------------|---------------|
| | \$ | \$ |
| Thunder Bay Hydro Energy Services Inc. | 140,768 | — |
| Transmission Northwest Inc. | 105,858 | 67,414 |
| Generation Northwest Inc. | 107,465 | 23,317 |
| Thunder Bay Hydro Corporation | 1,605 | — |
| | 355,696 | 90,731 |

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

5. REGULATORY ASSETS (LIABILITIES)

| | 2003 \$ | 2002 \$ |
|--|------------------|----------------|
| Rebate costs | 56,287 | 56,287 |
| Pre-market opening cost of power | 1,204,790 | 1,204,790 |
| | 1,261,077 | 1,261,077 |
| PILs deferral | (498,678) | — |
| Connection transmission charges | (2,723,369) | (1,107,078) |
| Network transmission charges | (1,275,819) | (589,508) |
| Wholesale market services | 991,989 | 955,823 |
| Commodity | 1,728,436 | 254,212 |
| Carrying charges | 25,799 | 42,507 |
| Retail settlement variances | (1,252,964) | (444,044) |
| Regulatory assets (liabilities) | (490,565) | 817,033 |

6. BANK CREDITS

- [a] TBHEDI has a revolving operating term of credit available to them in the amount of \$16,500,000 [2002 - \$12,000,000] of which \$nil [2002 - \$nil] was utilized at December 31, 2003. The credit bears interest at bank prime. Prime at December 31, 2003 was 4.0% [2002 - 4.5%].
- [b] TBHEDI has a revolving term credit available to them in the amount of \$13,000,000 [2002 - \$17,718,662] of which \$nil [2002 - \$nil] was utilized at December 31, 2003. This credit will be used by TBHEDI to assist in meeting its prudential obligations to the IMO. The credit bears interest at bank prime. Prime at December 31, 2003 was 4.0% [2002 - 4.5%].
- [c] TBHEDI has a revolving operating term credit in the maximum principal amount of \$150,000 of which \$nil was utilized at December 31, 2003. The credit will be used by TBHEDI for VISA borrowings. The credit bears interest at bank prime. Prime at December 31, 2003 was 4.0%.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

7. EMPLOYEE FUTURE BENEFITS

TBHEDI has a number of unfunded benefit plans providing retirement and post-employment benefits (excluding pension) to most of its employees.

Information about TBHEDI's defined benefit plans is as follows:

| | 2003 \$ | 2002 \$ |
|---|------------|------------|
| Accrued benefit liability at January 1 | 2,217,118 | 2,216,618 |
| Expense for the year | 247,919 | 214,274 |
| Benefits paid for the year or moved to current liability | (297,149) | (213,774) |
| Projected accrued benefit obligation at December 31, as determined by actuarial valuation using a 6.0% discount rate | 2,167,888 | 2,217,118 |

The main actuarial assumptions employed for the valuations are as follows:

[a] General inflation

Future general inflation levels, as measured by changes in the Consumer Price Index ("CPI"), were assumed at 3.5% in 2002 and thereafter.

[b] Interest (discount) rate

The obligation as at December 31, 2003 [December 31, 2002], of the present value of future liabilities and the expense for the year, were determined using an annual discount rate of 6.0%. This corresponds to the assumed CPI rate plus an assumed real rate of return of 2.5%.

[c] Salary levels

Future general salary and wage levels were assumed to increase at 2% per annum.

[d] Medical costs

Medical costs were assumed to increase at the CPI rate plus a further increase of 5% in 2002 graded down to 1% in 2004 and thereafter.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

[e] Dental costs

Dental costs were assumed to increase at the CPI rate plus a further increase of 1% in 2002 and thereafter.

8. LONG-TERM NOTE PAYABLE

| | 2003 \$ | 2002 \$ |
|------------------------|------------|------------|
| Long-term note payable | 33,490,500 | 34,931,625 |

The long-term note is payable to The Corporation of the City of Thunder Bay (sole shareholder of Thunder Bay Hydro Corporation, TBHEDI's parent company). Principal repayment in the next twelve months is expected to be \$nil [see note 16].

9. OTHER OPERATING REVENUE

| | 2003 \$ | 2002 \$ |
|-----------------------------|------------|------------|
| Water heater rentals | — | 503,517 |
| Pole line rentals | 450,033 | 455,584 |
| Competitive market revenues | 207,166 | 120,209 |
| Interest earned | 228,574 | 168,590 |
| Utility services | 796,490 | 401,244 |
| Sundry earnings | 666,278 | 693,620 |
| | 2,348,541 | 2,342,764 |

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

10. AMORTIZATION

Amortization provided during the year consists of:

| | 2003 \$ | 2002 \$ |
|--|------------|------------|
| Amortization of general plant | 3,717,420 | 3,744,843 |
| Amortization of capital contributions | (120,000) | (110,000) |
| Amortization of unallocated office and data processing equipment | 214,477 | 193,529 |
| Amortization of organization costs | 40,000 | 40,000 |
| | 3,851,897 | 3,868,372 |
| Amortization of other capital assets included in relevant expense categories in the Statement of Operations | 527,862 | 496,826 |
| | 4,379,759 | 4,365,198 |

11. PENSION PLAN

TBHEDI's current service pension costs for the year ended December 31, 2003 were \$160,000 [2002 - \$nil]. Effective August 1, 1998, OMERS provided a temporary contribution holiday, with no employer or employee pension contributions required until after December 31, 2002. OMERS contributions resumed January, 2003, phased in at one-third of their normal rate. Full contributions resumed January 1, 2004.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

12. STATEMENT OF CASH FLOWS

The net change in non-cash working capital balances related to operations is represented by the following:

| | 2003 \$ | 2002 \$ |
|---|------------------|--------------------|
| Decrease (increase) in current assets | | |
| Accounts receivable | 1,082,851 | (3,077,755) |
| Unbilled revenue | 958,401 | (1,148,260) |
| Due from associated companies | (264,965) | (90,731) |
| Income taxes receivable | — | 18,000 |
| Stores inventory | (44,259) | (67,336) |
| Prepaid expenses | 23,970 | (215,869) |
| | 1,755,998 | (4,581,951) |
| Increase (decrease) in current liabilities | | |
| Accounts payable and accrued liabilities | 801,013 | (1,422,100) |
| Accrued interest on long-term note payable | (457,000) | 457,000 |
| Debt retirement charge | 12,883 | 623,292 |
| Deferred revenue | 43,056 | 62,221 |
| Accrued vacation pay payable | (65,711) | 75,267 |
| PILS tax liability | 555,911 | — |
| Customer deposits | 166,119 | 490,240 |
| | 1,056,271 | 285,920 |
| | 2,812,269 | (4,296,031) |

13. BUSINESS PROTECTION PLAN REBATES

During the year, the Corporation received \$6,046,426 from the IMO in connection with the BPPR for the period commencing May 1, 2002 and ending July 31, 2003. Of this balance, \$4,239,145 was allocated to customers. The remaining \$1,807,280 was forwarded to various electricity retailers.

14. TERMINATION COSTS

TBHEDI offered certain employees voluntary separation and retirement packages. TBHEDI incurred a total expense of \$207,000 which has been recognized at December 31, 2003.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

15. RELATED PARTIES

TBHEDI provides certain services to The Corporation of the City of Thunder Bay (TBHEDI's parent) in the normal course of business at commercial rates.

For the year ended December 31, 2003, pole rental revenue to The Corporation of the City of Thunder Bay in the amount of \$218,000 and other sundry revenues in the amount of \$36,000 were recorded. The Corporation of the City of Thunder Bay also contributed towards capital construction during the year in the amount of \$160,000. Included in "Accounts receivable" is \$45,000 receivable from The Corporation of the City of Thunder Bay related to these other activities.

For the year ended December 31, 2003, TBHEDI billed electricity revenues in the amount of \$5,254,000 from The Corporation of the City of Thunder Bay. At December 31, 2003, included in "Accounts receivable" is \$439,000 receivable from The Corporation of the City of Thunder Bay, related to this electricity revenue.

TBHEDI purchases certain services from The Corporation of the City of Thunder Bay in the normal course of business at commercial rates.

For the year ended December 31, 2003, TBHEDI incurred property taxes payable to The Corporation of the City of Thunder Bay of \$140,000.

16. TRANSFER OF WATER HEATER ASSETS

On January 1, 2003, TBHEDI transferred all of the water heater assets to Thunder Bay Hydro Energy Services Inc., a company wholly-owned by Thunder Bay Hydro Corporation (TBHEDI's parent) at fair market value. In exchange for the assets, Thunder Bay Hydro Energy Services Inc. assumed \$1,441,125 of TBHEDI's promissory note payable to The Corporation of the City of Thunder Bay (sole shareholder of Thunder Bay Hydro Corporation).

17. COMMITMENTS

TBHEDI leases computer equipment under a long-term operating lease. Future minimum payments under this commitment are \$31,000.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

18. CONTINGENCIES

- [a] A class action claiming \$500 million in restitutionary payments, plus interest, was served on Toronto Hydro on November 18, 1998. The action was initiated against Toronto Hydro Electric Commission as the representative of the defendant class consisting of all municipal electric utilities in Ontario which have charged late payment charges on overdue utility bills at any time after April 1, 1981.

The claim is that late payment penalties result in the municipal electric utilities receiving interest at effective rates in excess of 60% per period, which is illegal under Section 347(1)(b) of the Criminal Code.

The Electricity Distributors Association is undertaking the defense of this class action. At this time it is not possible to quantify the effect, if any, on the financial statements of TBHEDI.

- [b] There is an outstanding claim pending against TBHEDI for which the amount of settlement, if any, is not determinable and will be charged to expenditures when determined.

19. MEASUREMENT UNCERTAINTY

Measurement uncertainty relates to the uncertainty in the determination of the amount at which an item is recognized in the financial statements. There is a degree of uncertainty associated with the measurement of a certain accounts receivable recognized in the financial statements due to ongoing legal issues with a corporate entity which purchases services from the TBHEDI. It is reasonably possible that the recognized amount could change by a material amount in the near term. No disclosure has been made with respect to the recognized amount as disclosure of such information could have an adverse effect on TBHEDI.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

20. CORPORATE INCOME AND CAPITAL TAXES

The provision for payments in lieu differs from the amount that would have been recorded using the combined Canadian Federal and Ontario statutory income tax rate.

Future income taxes relating to TBHEDI have not been recorded in the accounts as they are expected to be recovered through future revenues. As at December 31, 2003, the following future income tax asset and expense have not been recorded in the financial statements:

| | Gross \$ | Future income tax asset not recorded in financial statements \$ | Future income tax expense not recognized in financial statements \$ |
|---|-------------|--|--|
| Deductible temporary and permanent differences | 12,100,000 | 4,400,000 | (333,000) |

21 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, except as disclosed in note 19.

[b] Credit risk

Credit risk is the risk that a counter party will fail to discharge its obligation to TBHEDI reducing the expected cash inflow from the Corporation assets recorded at the balance sheet date. Credit risk can be concentrated in debtors that are similarly affected by economic or other conditions. TBHEDI provides for an allowance for doubtful accounts to absorb credit losses. The Corporation has assessed that there are no significant concentrations of credit risk with respect of any class of financial assets.

[c] Interest rate risk

TBHEDI is exposed to interest rate risk for certain of its financial assets and liabilities. Under the revolving terms of credit, the Corporation may have short-term borrowings for working capital purposes, which would expose the Corporation to fluctuations in short-term interest rates (borrowings in the form of prime rate loans in Canadian dollars).

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

22. COMPARATIVE FIGURES

Certain of the comparative figures have reclassified to conform to the presentation adopted in the current year.

EXPENSES

Year ended December 31

| | 2003 \$ | 2002 \$ |
|---|-------------------|-------------------|
| OPERATION AND MAINTENANCE | | |
| Customer premises/meters and devices | 587,543 | 806,200 |
| Distribution | 3,277,556 | 2,865,263 |
| Safety and training | 329,660 | 349,818 |
| System control/station maintenance | 1,311,127 | 1,096,975 |
| Transformer | 463,067 | 649,099 |
| Total operation and maintenance expenses | 5,968,953 | 5,767,355 |
| UTILITY SERVICES | | |
| Meter service provider | 347,271 | 9,675 |
| Utility management services | 160,009 | 207,985 |
| Total utility services expenses | 507,280 | 217,660 |
| ADMINISTRATION | | |
| Customer related | | |
| Bad debts | 333,535 | 339,610 |
| Billing | 219,551 | 243,977 |
| Cashiers | 348,475 | 387,604 |
| Customer information and service | 1,364,000 | 1,333,534 |
| Data processing | 687,990 | 693,833 |
| Meter reading | 495,385 | 465,529 |
| Total customer related administration expenses | 3,448,936 | 3,464,087 |
| General | | |
| Corporate | 618,841 | 542,098 |
| Directors' expenses | 75,516 | 86,809 |
| Finance - accounting | 393,505 | 367,936 |
| - administration | 251,733 | 260,896 |
| Human resources | 277,427 | 242,610 |
| President's office | 323,724 | 239,463 |
| Special projects | 130,020 | — |
| Total general administration expenses | 2,070,766 | 1,739,812 |
| Total administration expenses | 5,519,702 | 5,203,899 |
| Total expenses | 11,995,935 | 11,188,914 |

Financial Statements

**Thunder Bay Hydro Electricity
Distribution Inc.**

December 31, 2004

Thunder Bay Hydro Electricity Distribution Inc.

TABLE OF CONTENTS

December 31, 2004

| | Page |
|---|------|
| Auditors' Report | 1 |
| Balance Sheet | 2 |
| Statement of Operations and Retained Earnings | 4 |
| Statement of Cash Flows | 5 |
| Notes to Financial Statements | 6 |
| Schedule - Expenses | 22 |

AUDITORS' REPORT

To the Shareholder of
Thunder Bay Hydro Electricity Distribution Inc.

We have audited the balance sheet of **Thunder Bay Hydro Electricity Distribution Inc.** as at December 31, 2004 and the statements of operations and retained earnings 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, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in cursive script that reads "Ernst & Young, Thunder Bay LLP".

Thunder Bay, Canada,
March 17, 2005.

Chartered Accountants

Thunder Bay Hydro Electricity Distribution Inc.

BALANCE SHEET

As at December 31

| | 2004 \$ | 2003 \$ |
|---|-------------------|-------------------|
| ASSETS | | |
| Current | | |
| Cash and cash equivalents | 8,611,292 | 7,487,286 |
| Investment | — | 973,490 |
| Accounts receivable | 6,863,376 | 6,606,000 |
| Payments in lieu of corporate income taxes receivable | 128,767 | — |
| Unbilled revenue | 10,426,411 | 9,511,692 |
| Due from associated companies [note 3] | 232,444 | 355,696 |
| Stores inventory | 1,064,011 | 1,078,801 |
| Prepaid expenses | 296,536 | 288,094 |
| Total current assets | 27,622,837 | 26,301,059 |
| Long-term | | |
| Organization costs, net | 40,000 | 80,000 |
| Capital assets | | |
| Buildings | 3,894,355 | 3,894,355 |
| Distribution equipment | 100,248,571 | 96,088,026 |
| General office equipment | 3,836,998 | 3,679,637 |
| Land | 133,038 | 133,038 |
| Other equipment | 2,389,544 | 2,356,024 |
| Rolling stock | 4,322,768 | 4,296,977 |
| Transformation equipment | 8,233,615 | 8,140,815 |
| | 123,058,889 | 118,588,872 |
| Less accumulated amortization | (60,088,325) | (56,078,757) |
| | 62,970,564 | 62,510,115 |
| Capital contributions, net | (3,973,687) | (3,415,915) |
| Construction-in-progress | 688,993 | 78,877 |
| Capital assets, net | 59,685,870 | 59,173,077 |
| | 87,348,707 | 85,554,136 |

See accompanying notes

On behalf of the Board:

Director

Director

| | 2004 \$ | 2003 \$ |
|--|-------------------|-------------------|
| LIABILITIES AND SHAREHOLDER'S EQUITY | | |
| Current | | |
| Accounts payable and accrued liabilities | 8,835,001 | 8,982,460 |
| Debt retirement charge | 626,147 | 636,175 |
| Deferred revenue | 196,058 | 105,277 |
| Accrued vacation payable | 730,978 | 760,909 |
| Payments in lieu of corporate income taxes liability | — | 555,911 |
| Customer deposits | 1,909,393 | 1,903,172 |
| Total current liabilities | 12,297,577 | 12,943,904 |
| Long-term | | |
| Regulatory liabilities <i>[note 4]</i> | 2,553,129 | 490,565 |
| Employee future benefits <i>[note 6]</i> | 2,167,552 | 2,167,888 |
| Long-term note payable <i>[note 7]</i> | 33,490,500 | 33,490,500 |
| Total long-term liabilities | 38,211,181 | 36,148,953 |
| Shareholder's equity | | |
| Share capital | | |
| Authorized | | |
| Unlimited common shares | | |
| Issued | | |
| 1,000 common shares | 34,931,625 | 34,931,625 |
| Retained earnings | 1,908,324 | 1,529,654 |
| Total shareholder's equity | 36,839,949 | 36,461,279 |
| | 87,348,707 | 85,554,136 |

Thunder Bay Hydro Electricity Distribution Inc.

STATEMENT OF OPERATIONS AND RETAINED EARNINGS

Year ended December 31

| | 2004 \$ | 2003 \$ |
|---|--------------|--------------|
| Revenues and flow-through charges | | |
| Flow-through charges plus distribution revenues | 81,962,494 | 78,339,527 |
| Flow-through costs of energy | (67,687,293) | (63,732,881) |
| Distribution revenue | 14,275,201 | 14,606,646 |
| Other operating revenue <i>[note 8]</i> | 2,334,862 | 2,348,541 |
| | 16,610,063 | 16,955,187 |
| Expenses | | |
| Operation and maintenance <i>[schedule]</i> | 5,641,966 | 5,968,953 |
| Utility services <i>[schedule]</i> | 397,898 | 507,280 |
| Administration <i>[schedule]</i> | 5,470,548 | 5,519,702 |
| Amortization <i>[note 9]</i> | 3,900,981 | 3,851,897 |
| Provision for payments in lieu of capital tax | 250,000 | 237,000 |
| | 15,661,393 | 16,084,832 |
| Earnings before the following | 948,670 | 870,355 |
| Interest forgiven on long-term debt | — | (457,000) |
| Earnings before provision for taxes | 948,670 | 1,327,355 |
| Provision for payments in lieu of corporate income taxes <i>[note 17]</i> | 570,000 | 743,000 |
| Earnings for year | 378,670 | 584,355 |
| Retained earnings, beginning of year | 1,529,654 | 838,980 |
| Excess of redemption over cost of affiliate shares | — | 106,319 |
| Retained earnings, end of year | 1,908,324 | 1,529,654 |

See accompanying notes

Thunder Bay Hydro Electricity Distribution Inc.

STATEMENT OF CASH FLOWS

Year ended December 31

| | 2004 \$ | 2003 \$ |
|---|--------------------|--------------------|
| OPERATING ACTIVITIES | | |
| Earnings for year | 378,670 | 584,355 |
| Add charges (deduct credits) to earnings not involving a current payment (receipt) of cash | | |
| Amortization [note 9] | 4,444,030 | 4,379,759 |
| Decrease in employee future benefits | (336) | (49,230) |
| Gain on disposal of capital assets | (10,494) | — |
| | 4,811,870 | 4,914,884 |
| Change in non-cash working capital balances related to operations [note 11] | (1,817,589) | 2,812,269 |
| Cash provided by operating activities | 2,994,281 | 7,727,153 |
| INVESTMENT ACTIVITIES | | |
| Proceeds on sale of capital assets | 12,642 | 1,441,125 |
| Additions to capital assets, net of capital contributions | (4,918,971) | (4,167,191) |
| Decrease (increase) in investment | 973,490 | (973,490) |
| Cash used in investment activities | (3,932,839) | (3,699,556) |
| FINANCING ACTIVITIES | | |
| Increase in regulatory liabilities | 2,062,564 | 1,307,598 |
| Reduction in long-term liability | — | (1,441,125) |
| Cash provided by (used in) financing activities | 2,062,564 | (133,527) |
| Increase in cash and cash equivalents for year | 1,124,006 | 3,894,070 |
| Cash and cash equivalents, beginning of year | 7,487,286 | 3,593,216 |
| Cash and cash equivalents, end of year | 8,611,292 | 7,487,286 |

See accompanying notes

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

GENERAL

Thunder Bay Hydro Electricity Distribution Inc. ("TBHEDI") is a wholly-owned subsidiary company of Thunder Bay Hydro Corporation, providing electrical distribution services to the inhabitants of the City of Thunder Bay, as regulated by the Ontario Energy Board ("OEB").

1. ELECTRICITY ACT, 1998 AND ELECTRICITY PRICING CONSERVATION AND SUPPLY ACT 2004 (BILL 210)

The Energy Competition Act, 1998 (the "Act") was given Royal Assent on October 30, 1998. The Act provides for a competitive market in the sale of electricity, in addition to the regulation of the monopoly electricity delivery system in the Province of Ontario, by the OEB. Open Access commenced on May 1, 2002, the date on which transmitters and distributors were required to provide generators, retailers and consumers with non-discriminatory access to the transmission and distribution systems in Ontario in accordance with their licences under the Electricity Act, 1998.

The OEB has regulatory authority over the electricity distribution sector. The Act sets out the OEB's powers to issue a distribution licence which must be obtained by any person owning or operating a distribution system under the revised Ontario Energy Board Act, 1998. The OEB Act allows the OEB to prescribe licence requirements and conditions to electricity distributors which may include, among other considerations, specified accounting records, regulatory accounting principles, separation of accounts for separate businesses and filing/processing requirements for rate-setting purposes.

Upon market opening, the cost of power and all costs related to the operations of the electricity grid including transmission, connection and administration costs are flowed through to the consumer. Rates are typically established each year as set out in the Distribution Rate Handbook.

Bill 210, which became law on December 9, 2002, effectively implemented a rate cap for the cost of electricity consumed (as well as for delivery costs) by low-volume and designated customers. Retail settlement variance accounts and certain other accounts prescribed by the OEB have been defined as "regulatory assets" under Bill 210. The price freeze and rate caps were originally expected to continue until at least May 1, 2006; however, in November, 2004, the Province announced its intention to increase (effective April 1, 2004) the price of electricity payable by low-volume and designated customers from 4.3 cents to 4.7 cents per kWh on the first 750 kWh consumed during a month and 5.5 cents thereafter and directed the OEB to develop new pricing mechanisms (to take effect no later than May 1, 2005) for setting the price of electricity payable by low-volume and designated customers.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

The Province also announced its intention in November, 2003 to permit electricity distributors to make rate applications to the OEB earlier than had been contemplated under Bill 210 with respect to the:

- [a] recovery of "regulatory assets" (based on year-end balances at December 31, 2002) to be phased in over a four-year period effective March 1, 2004; and
- [b] third adjustment necessary to achieve a market-based rate of return (subject to a one-time investment in conservation and demand management initiatives equal to one year of additional revenue resulting from such rate increase), effective March 1, 2005.

In December, 2003, the OEB issued filing guidelines with respect to the recovery of regulatory assets. The OEB's filing guidelines provided that:

- [a] distributors were permitted to recover 25% of regulatory assets in rate adjustments effective March 1, 2004;
- [b] the 2004 rate adjustment was implemented on April 1, 2004 (with a gross-up added to the recovered amount to allow recovery over 11 months); and
- [c] permitted recoveries will continue to be phased in over a three-year period (2005, 2006 and 2007).

In 2004, TBHEDI filed a rate application requesting OEB authorization with respect to an increase in distribution rates to allow for the recovery of approximately \$660,000 (representing approximately 25% of TBHEDI's regulatory assets as at December 31, 2002). During 2004, TBHEDI recovered \$440,428 towards its regulatory assets.

In 2005, TBHEDI filed a rate application requesting OEB authorization with respect to an increase in distribution rates to allow for, among other items, the funding for a Conservation and Demand Side Management Plan. The regulatory balances as at December 31, 2003 had moved into a net liability position and as such, the rate application for 2005 also included a reduction to distribution rates to reflect the repayment of the amounts that have been overcollected.

During the period that the price freeze is in effect and continuing currently, distributors and retailers have been compensated by the Ontario Electricity Financial Corporation ("OEFC"):

- [a] in the case of distributors, for amounts by which the price paid by distributors for electricity purchased by them in the wholesale market on behalf of low-volume and designated consumers is greater than the fixed price per kWh; and
- [b] in the case of retailers, for amounts by which the retail contract price between retailers and low-volume and designated consumers is greater than the fixed price per kWh.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

Consumers other than the designated consumers who annually utilize more than 250,000 kWh continue to be eligible to receive Business Protection Plan Rebates ("BPPR"), (formerly received under the Market Power Mitigation Agreement) from the Ontario Power Generation Inc. ("OPG") to the extent that electricity prices exceed certain prescribed thresholds. Bill 100, referred to below, will cause the BPPR to become unnecessary and will effectively be replaced by what is referred to as a Provincial Benefit which will be billed as part of the energy billings regularly. At this time, it is not known when the BPPR rebates will cease; however, the billing of the Provincial Benefit is effective January 1, 2005.

The Government of Ontario issued Bill 100-The Electricity Restructuring Act, 2004 reinforcing the OEB's mandate to establish the commodity price to be paid for electricity. Bill 100 requires the Board to develop an annual regulated price plan ("RPP"). The plan is to be forward looking, stable and cost-reflective and blend market, regulated and contract prices. Eligibility for the RPP is set out in regulations. The Government wants to ensure that residential and small business consumers pay the true cost of electricity over time, but within a stable and predictable framework.

Bill 100 also promotes expansion of new electricity supply and capacity, encourages conservation and renewable energy.

The continuing restructuring of Ontario's electricity industry and other regulatory developments, including current and future possible consultations between the OEB and corporate interested stakeholders, may affect the distribution rates, including payments in lieu of income taxes ("PILS") collected from customers, that TBHEDI may charge and the costs that TBHEDI may recover, including the balance of its regulatory assets.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), including accounting principles prescribed by the OEB in the handbook "Accounting Procedures Handbook for Electric Distribution Utilities", and reflect the significant accounting policies summarized below.

Rate setting

The Ontario Energy Board Act, 1998 gave the OEB increased powers and responsibilities to regulate the electricity industry. These powers and responsibilities include the power to approve or fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity customers, and the responsibility for ensuring the distribution companies fulfill obligations to connect and service customers. In its capacity to approve or fix rates, the OEB has specified the following regulatory treatments that have resulted in accounting treatments differing from GAAP for enterprises operating in a non-regulated environment:

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

- [a] Costs incurred to align systems and practices with the requirements of the future competitive electricity market in Ontario (Transition costs or Market Ready costs) may be deferred in accordance with the criteria set out in the OEB's Electricity Distribution Rate Handbook and the Accounting Procedures Handbook for Electric Distribution Utilities. Under such regulation, certain costs are allowed to be deferred that would be expensed when incurred under GAAP (see accounting policy "Deferred Transition Costs").
- [b] TBHEDI provides for payments in lieu of corporate income taxes relating to its regulated business using the taxes payable method as directed by the OEB.
- [c] Regulatory assets
 - [i] Retail settlement variance accounts track the differences between the amount billed plus accrued unbilled revenue and the purchased cost of power since market opening. Adjustments to record the variances have been added (deducted) from gross revenue or cost of power as appropriate to reflect the "flow-through" nature of the costs.
 - [ii] Pre-market opening cost of power variance

Traditionally, customers who were not billed using time-of-use rates were charged an average rate for their power throughout the year to incorporate the winter and summer rates that were charged to the Corporation on the purchase of power. Upon market opening, May 1, 2002, the Corporation commenced charging customers at approved rates for debt retirement, transmission, connection, distribution and wholesale market services plus the hourly Ontario Energy price for commodity consumption. As a result of the timing of market opening, the Corporation experienced a loss on the energy sales to the non-time-of-use customers. This loss has been recorded as an asset and is expected to be recovered from future rates.
 - [iii] The PILS deferral account tracks the variances that result from the differences between the OEB approved PILS amount and the amount of actual billings that relate to the recovery of PILS. It also allows for periodic adjustments and an allowance for deemed interest.
- [d] Rebates to customers/Business Protection Plan Rebate

Funding for the rebates is recorded as a reduction in flow-through cost of energy.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and in banks.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

Stores inventory

Stores inventory consists principally of maintenance and construction materials and is valued at the lower of cost and net realizable value. Cost is determined using the average cost method.

Capital assets

Capital assets are stated at cost. Gains or losses on retirement or disposition of such assets are credited or charged to other operating revenue. Amortization is provided on a straight-line basis for capital assets over their estimated service lives at the following annual rates:

| | |
|---|-------------|
| Buildings | 2% |
| Distribution and transformation equipment | 4% |
| Other assets | 10% to 20% |
| Rolling stock | 12½% to 20% |

Pension plan

TBHEDI provides a pension plan for its employees through the Ontario Municipal Employees Retirement System ("OMERS"). OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund (the "Fund"), and provides pensions for employees of Ontario municipalities, local boards, public utilities and school boards. The Fund is a contributory defined benefit pension plan which is financed by equal contributions from participating employers and employees, and by the investment earnings of the Fund [note 10]. TBHEDI recognizes the expense related to this plan as contributions are made.

Other post-employment benefits

Employee future benefits provided by TBHEDI include medical and life insurance benefits and accumulated sick leave credits. These plans provide benefits to certain employees when they are no longer providing active service. Employee future benefit expense is recognized in the period in which the employees render the services. Employee future benefits are recorded on an accrual basis. The accrued benefit obligations and current service cost are calculated using the projected benefit method pro-rated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value of benefits attributed to employees' services rendered in the period. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. Actuarial gains (losses) are amortized into expense on a straight-line basis over the average remaining service period of active employees to full eligibility. The effects of a curtailment gain or loss are recognized in earnings in the year of the event-giving rise to the curtailment. The effects of a settlement gain or loss are recognized in earnings for the period in which a settlement occurs.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

Revenue recognition

Revenue is recorded on the basis of regular meter readings. Estimates of customer usage since the last meter reading date, to the end of the year, are recorded as unbilled revenue.

Contributions in aid of construction

Effective January 1, 2001, TBHEDI prospectively adopted the change in accounting policy for contributions received in aid of construction (contributed capital), as prescribed by the OEB "Accounting Procedures Handbook for Electric Distribution Utilities". Capital contributions are required contributions received from outside sources, used to finance additions to capital assets. Capital contributions received after January 1, 2001 are treated as a "credit" contra account included in the determination of capital assets. The amount is subsequently amortized by a charge to accumulated amortization and a credit to amortization expense, at an equivalent rate to that used for the amortization of the related capital assets. Capital contributions received for capital assets prior to January 1, 2001 were treated as contributed capital, a permanent component of equity, which was not amortized.

Customer deposits

Customers' advance deposits are cash collections from customers or Energy Retailers to guarantee the payment of energy-related bills. The deposits bear interest that is paid annually to customers.

Organization costs

The organization costs are amortized on a straight-line basis over five years.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the year. Actual results could differ from those estimates.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

Corporate income taxes and capital taxes

The current tax-exempt status of TBHEDI under the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) reflects the fact that TBHEDI is wholly-owned by a municipality. This tax-exempt status might be lost in a number of circumstances, including if the municipality ceases to own 90% or more of the shares or capital of TBHEDI, or if a non-government entity has rights immediately or in the future, either absolutely or contingently, to acquire more than 10% of the shares of TBHEDI.

Commencing October 1, 2001, TBHEDI is required, under the Electricity Act, 1998, to make payments in lieu of corporate taxes ("PILS") to the OEFC. These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) as modified by the Electricity Act, 1998, and related regulations.

TBHEDI provides for PILS relating to its regulated business using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax bases of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of TBHEDI at that time.

Provision for environment costs

TBHEDI will incur future costs associated with the disposal of contaminated waste and site restoration for certain of its properties. Although these costs cannot be reasonably determined for some of the properties at this time, a contingent liability exists. When reasonably determinable, TBHEDI has provided for future costs, net of expected recoveries, by charges to income. Actual costs are charged to the provision for environmental costs as incurred.

3. DUE FROM ASSOCIATED COMPANIES

The balances due from associated companies represent balances owing from the following common control enterprises:

| | 2004 \$ | 2003 \$ |
|--|----------------|----------------|
| Thunder Bay Hydro Energy Services Inc. | 10,017 | 140,768 |
| Transmission Northwest Inc. | 106,621 | 105,858 |
| Generation Northwest Inc. | 114,087 | 107,465 |
| Thunder Bay Hydro Corporation | 1,719 | 1,605 |
| | 232,444 | 355,696 |

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

4. REGULATORY ASSETS (LIABILITIES)

| | 2004 \$ | 2003 \$ |
|--|--------------------|--------------------|
| Rebate costs | 56,287 | 56,287 |
| Pre-market opening cost of power | 1,204,790 | 1,204,790 |
| | 1,261,077 | 1,261,077 |
| PILS deferral | (637,227) | (498,678) |
| Connection transmission charges | (4,326,629) | (2,723,369) |
| Network transmission charges | (2,193,113) | (1,275,819) |
| Wholesale market services | 1,041,243 | 991,989 |
| Commodity | 2,778,928 | 1,728,436 |
| Approved rate adjustments | (440,428) | — |
| Carrying charges | (36,980) | 25,799 |
| Retail settlement variances | (3,176,979) | (1,252,964) |
| Regulatory assets (liabilities) | (2,553,129) | (490,565) |

5. BANK CREDITS

[a] TBHEDI has an operating loan available to them in the amount of \$6,395,495 [2003 - \$16,500,000] by way of prime rate based loans or bankers' acceptances. \$Nil [2003 - \$nil] was utilized at December 31, 2004. The prime rate based loans bear interest at bank prime. Prime at December 31, 2004 was 4.25% [2003 - 4.5%]. The bankers' acceptances bear a stamping fee at 0.5% per annum.

[b] TBHEDI has a letter of credit or stand-by letters of guarantee available to them in the amount of \$11,604,505 [2003 - \$13,000,000] of which \$11,604,505 [2003 - \$11,604,505] was issued at December 31, 2004. This credit will be used by TBHEDI to assist in meeting its prudential obligations to the IMO. The credit bears interest at bank prime. Prime at December 31, 2004 was 4.25% [2003 - 4.5%].

Security for the bank credits include an unlimited guarantee of advances executed by Thunder Bay Hydro Corporation, an authorized borrowing by-law by TBHEDI, a subordination agreement with respect to the promissory note payable and a Visa indemnity agreement.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

6. EMPLOYEE FUTURE BENEFITS

TBHEDI has a number of unfunded benefit plans providing retirement and post-employment benefits (excluding pension) to most of its employees.

Information about TBHEDI's defined benefit plans is as follows:

| | 2004 | 2003 |
|---|----------------------|---------------|
| | \$ | \$ |
| Change in accrued benefit obligation | | |
| Accrued benefit obligation at January 1 | 2,167,888 | 2,217,118 |
| Current service costs | 85,799 | 97,163 |
| Interest cost | 139,540 | 134,000 |
| Actuarial losses | 27,308 | 16,756 |
| Benefits paid in the year or moved to current liability | (252,983) | (297,149) |
| Accrued benefit obligation, end of year | 2,167,552 | 2,167,888 |
| Projected accrued benefit obligation at December 31, as determined by actuarial valuation using a 5.75% [2003 - 6.0%] discount rate | 2,439,830 | 2,276,050 |
| Unamortized actuarial gain (loss) | (272,278) | (108,162) |
| | 2,167,552 | 2,167,888 |

The main actuarial assumptions employed for the valuations are as follows:

[a] General inflation

Future general inflation levels, as measured by changes in the Consumer Price Index ("CPI"), were assumed at 2.1% in 2004 and thereafter.

[b] Interest (discount) rate

The obligation as at December 31, 2004, of the present value of future liabilities and the expense for the year, were determined using an annual discount rate of 5.75% [2003 - 6.0%].

[c] Salary levels

Future general salary and wage levels were assumed to increase at 3% per annum.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

[d] Medical costs

Medical costs were assumed to increase at a rate of 10% in 2004 graded down by 1% per annum leveling off at 5% in 2013 and thereafter.

[e] Dental costs

Dental costs were assumed to increase at a rate of 5% per annum in 2004 and thereafter.

7. LONG-TERM NOTE PAYABLE

| | 2004 \$ | 2003 \$ |
|------------------------|------------|------------|
| Long-term note payable | 33,490,500 | 33,490,500 |

The non-interest bearing note is payable to The Corporation of the City of Thunder Bay (sole shareholder of Thunder Bay Hydro Corporation, TBHEDI's parent company). Principal repayment in the next twelve months is expected to be \$nil.

8. OTHER OPERATING REVENUE

| | 2004 \$ | 2003 \$ |
|-----------------------------|------------|------------|
| Pole line rentals | 447,468 | 450,033 |
| Competitive market revenues | 202,541 | 207,166 |
| Interest earned | 218,795 | 228,574 |
| Utility services | 787,833 | 796,490 |
| Sundry earnings | 678,225 | 666,278 |
| | 2,334,862 | 2,348,541 |

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

9. AMORTIZATION

Amortization provided during the year consists of:

| | 2004 | 2003 |
|---|------------------|-------------|
| | \$ | \$ |
| Amortization of general plant | 3,801,354 | 3,717,420 |
| Amortization of capital contributions | (175,000) | (120,000) |
| Amortization of unallocated office and data processing equipment | 234,627 | 214,477 |
| Amortization of organization costs | 40,000 | 40,000 |
| | 3,900,981 | 3,851,897 |
| Amortization of other capital assets included in relevant expense categories in the Statement of Operations | 543,049 | 527,862 |
| | 4,444,030 | 4,379,759 |

10. PENSION PLAN

TBHEDI's current service pension costs for the year ended December 31, 2004 were \$480,737 [2003 - \$160,000]. Effective August 1, 1998, OMERS provided a temporary contribution holiday, with no employer or employee pension contributions required until after December 31, 2002. OMERS contributions resumed January, 2003, phased in at one-third of their normal rate. Full contributions resumed January 1, 2004.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

11. STATEMENT OF CASH FLOWS

The net change in non-cash working capital balances related to operations is represented by the following:

| | 2004 \$ | 2003 \$ |
|---|--------------------|------------------|
| Decrease (increase) in current assets | | |
| Accounts receivable | (257,376) | 1,082,851 |
| Payments in lieu of corporate income taxes receivable | (128,767) | — |
| Unbilled revenue | (914,719) | 958,401 |
| Due from associated companies | 123,252 | (264,965) |
| Stores inventory | 14,790 | (44,259) |
| Prepaid expenses | (8,442) | 23,970 |
| | (1,171,262) | 1,755,998 |
| Increase (decrease) in current liabilities | | |
| Accounts payable and accrued liabilities | (147,459) | 801,013 |
| Debt retirement charge | (10,028) | 12,883 |
| Deferred revenue | 90,781 | 43,056 |
| Accrued vacation payable | (29,931) | (65,711) |
| Payments in lieu of corporate income taxes liability | (555,911) | 555,911 |
| Customer deposits | 6,221 | 166,119 |
| Accrued interest on long-term note payable | — | (457,000) |
| | (646,327) | 1,056,271 |
| | (1,817,589) | 2,812,269 |

12. BUSINESS PROTECTION PLAN REBATES

During the year, the Corporation received \$3,150,287 [2003 - \$6,046,426] from the Independent Electricity System Operator in connection with the BPPR for the periods commencing May 1, 2003 and ending April 30, 2004 and May 1, 2004 to July 31, 2004. Of this balance, \$2,134,706 was allocated to customers. The remaining \$1,015,581 was forwarded to various electricity retailers.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

13. TERMINATION COSTS

TBHEDI offered certain employees voluntary separation and retirement packages. TBHEDI incurred a total expense of \$50,000 [2003 - \$207,000] which has been charged to operations in 2004.

14. RELATED PARTIES

TBHEDI provides certain services to The Corporation of the City of Thunder Bay (TBHEDI's parent) in the normal course of business at commercial rates.

For the year ended December 31, 2004, pole rental revenue to The Corporation of the City of Thunder Bay in the amount of \$217,000 [2003 - \$218,000] and other sundry revenues in the amount of \$45,000 [2003 - \$36,000] were recorded. The Corporation of the City of Thunder Bay also contributed towards capital construction during the year in the amount of \$58,000 [2003 - \$160,000]. Included in "Accounts receivable" is \$31,500 [2003 - \$45,000] receivable from The Corporation of the City of Thunder Bay related to these other activities.

For the year ended December 31, 2004, TBHEDI billed electricity revenues in the amount of \$5,951,027 [2003 - \$5,254,000] to The Corporation of the City of Thunder Bay. At December 31, 2004, included in "Accounts receivable" is \$486,696 [2003 - \$439,000] receivable from The Corporation of the City of Thunder Bay, related to this electricity revenue.

TBHEDI purchases certain services from The Corporation of the City of Thunder Bay in the normal course of business at commercial rates.

For the year ended December 31, 2004, TBHEDI incurred property taxes payable to The Corporation of the City of Thunder Bay of \$157,000 [2003 - \$140,000].

TBHEDI manages and administers the rental water heater operations for Thunder Bay Hydro Energy Services Inc. (TBHESI). During 2004, TBHEDI charged TBHESI administration fees of \$45,000 [2003 - \$45,000].

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

15. CONTINGENCIES

A class action claiming \$500 million in restitutionary payments, plus interest, was served on Toronto Hydro on November 18, 1998. The action was initiated against Toronto Hydro Electric Commission as the representative of the defendant class consisting of all municipal electric utilities in Ontario which have charged late payment charges on overdue utility bills at any time after April 1, 1981.

The claim is that late payment penalties result in the municipal electric utilities receiving interest at effective rates in excess of 60% per period, which is illegal under Section 347(1)(b) of the Criminal Code.

The Electricity Distributors Association is undertaking the defense of this class action. At this time it is not possible to quantify the effect, if any, on the financial statements of TBHEDI.

16. MEASUREMENT UNCERTAINTY

Measurement uncertainty relates to the uncertainty in the determination of the amount at which an item is recognized in the financial statements. There is a degree of uncertainty associated with the measurement of a certain accounts receivable recognized in the financial statements due to ongoing legal issues with a corporate entity which purchases services from the TBHEDI. It is reasonably possible that the recognized amount could change by a material amount in the near term. No disclosure has been made with respect to the recognized amount as disclosure of such information could have an adverse effect on TBHEDI.

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

17. CORPORATE INCOME AND CAPITAL TAXES

The provision for payments in lieu differs from the amount that would have been recorded using the combined Canadian Federal and Ontario statutory income tax rate.

The impact of differences between TBHEDI's reported income tax expense on operating income and the expense that would otherwise result from the application of statutory rates is as follows:

| | 2004 \$ | 2003 \$ |
|---|------------|------------|
| Earnings before provision for taxes | 948,670 | 1,327,355 |
| Statutory Canadian federal and provincial income tax rate | 36.12% | 36.62% |
| Expected provision | 342,659 | 486,077 |
| Increase in income taxes resulting from Large Corporations Tax net of surtax | 37,000 | 126,300 |
| Decrease in income taxes resulting from Corporate Minimum Tax Carryover | — | (44,559) |
| Timing differences | | |
| Amortization and capital cost allowance | 335,903 | 302,259 |
| Amortization and eligible capital expenditure amortization | 11,709 | 11,662 |
| Other | (157,271) | (138,739) |
| Provision for payments in lieu of corporate income taxes | 570,000 | 743,000 |
| Effective tax rate | 60.08% | 55.98% |

Future income taxes relating to TBHEDI have not been recorded in the accounts as they are expected to be recovered through future revenues. As at and for the year ended December 31, 2004, the following future income tax asset and expense (recovery) have not been recorded in the financial statements:

| | Gross \$ | Future income tax asset not recorded in financial statements \$ | Future income tax expense (recovery) not recognized in financial statements \$ |
|---|-------------|--|---|
| Deductible temporary and permanent differences | 14,000,000 | 5,060,000 | (350,000) |

Thunder Bay Hydro Electricity Distribution Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

18. 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, except as disclosed in note 16.

[b] Credit risk

Credit risk is the risk that a counter party will fail to discharge its obligation to TBHEDI reducing the expected cash inflow from the Corporation assets recorded at the balance sheet date. Credit risk can be concentrated in debtors that are similarly affected by economic or other conditions. TBHEDI provides for an allowance for doubtful accounts to absorb credit losses. The Corporation has assessed that there are no significant concentrations of credit risk with respect of any class of financial assets.

[c] Interest rate risk

TBHEDI is exposed to interest rate risk for certain of its financial assets and liabilities. Under the revolving terms of credit, the Corporation may have short-term borrowings for working capital purposes, which would expose the Corporation to fluctuations in short-term interest rates (borrowings in the form of prime rate loans in Canadian dollars).

19. COMPARATIVE FIGURES

Certain of the comparative figures have reclassified to conform to the presentation adopted in the current year.

EXPENSES

Year ended December 31

| | 2004 \$ | 2003 \$ |
|---|-------------------|-------------------|
| OPERATION AND MAINTENANCE | | |
| Customer premises/meters and devices | 539,776 | 587,543 |
| Distribution | 3,260,013 | 3,277,556 |
| Safety and training | 335,716 | 329,660 |
| System control/station maintenance | 1,131,827 | 1,311,127 |
| Transformer | 374,634 | 463,067 |
| Total operation and maintenance expenses | 5,641,966 | 5,968,953 |
| UTILITY SERVICES | | |
| Meter service provider | 272,690 | 347,271 |
| Utility management services | 125,208 | 160,009 |
| Total utility services expenses | 397,898 | 507,280 |
| ADMINISTRATION | | |
| Customer related | | |
| Bad debts | 404,453 | 333,535 |
| Billing | 246,541 | 219,551 |
| Cashiers | 344,062 | 348,475 |
| Customer information and service | 1,220,815 | 1,364,000 |
| Data processing | 735,788 | 687,990 |
| Meter reading | 487,575 | 495,385 |
| Total customer related administration expenses | 3,439,234 | 3,448,936 |
| General | | |
| Corporate | 705,194 | 661,973 |
| Directors' expenses | 54,341 | 75,516 |
| Finance - accounting | 392,450 | 393,505 |
| - administration | 209,732 | 208,601 |
| Human resources | 279,518 | 277,427 |
| President's office | 282,450 | 323,724 |
| Special projects | 107,629 | 130,020 |
| Total general administration expenses | 2,031,314 | 2,070,766 |
| Total administration expenses | 5,470,548 | 5,519,702 |
| TOTAL EXPENSES | 11,510,412 | 11,995,935 |

Thunder Bay Hydro Electricity Distribution Inc.
Financial Statements
December 31, 2005

Grant Thornton 

Contents

| | Page |
|---|--------|
| Auditors' Report | 1 |
| Balance Sheet | 2 |
| Statement of Operations and Retained Earnings | 4 |
| Statement of Cash Flows | 5 |
| Notes to the Financial Statements | 6 - 23 |
| Schedule - Expenses | 24 |

Grant Thornton LLP
Chartered Accountants
Management Consultants

Auditors' Report

To the Shareholder of
Thunder Bay Hydro Electricity Distribution Inc.

We have audited the balance sheet of **Thunder Bay Hydro Electricity Distribution Inc.** as at December 31, 2005 and the statements of operations and retained earnings 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, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Grant Thornton LLP

Thunder Bay, Canada
March 14, 2006.

Chartered Accountants

979 Alloy Drive
Thunder Bay, Ontario
P7B 5Z8
T (807) 345-6571
F (807) 345-0032
E ThunderBay@GrantThornton.ca
W www.GrantThornton.ca

Thunder Bay Hydro Electricity Distribution Inc.

Balance Sheet

| As at December 31 | 2005 | 2004 |
|---|--------------------|---------------------|
| | \$ | \$ [as restated] |
| ASSETS | | |
| Current | | |
| Cash and cash equivalents | 13,520,477 | 8,611,292 |
| Investment [note 3] | 4,000,000 | — |
| Accounts receivable | 5,284,446 | 7,396,555 |
| Unbilled revenue | 12,653,597 | 10,426,411 |
| Payments in lieu of corporate income taxes receivable | — | 128,767 |
| Due from associated companies [note 4] | 259,157 | 232,444 |
| Stores inventory | 1,217,460 | 1,064,011 |
| Prepaid expenses | 132,902 | 296,536 |
| Total current assets | 37,068,039 | 28,156,016 |
| Long-term | | |
| Organization costs, net | — | 40,000 |
| Regulatory assets [note 5] | 5,640,422 | 3,323,469 |
| Total long-term assets | 5,640,422 | 3,363,469 |
| Capital assets | | |
| Buildings | 3,894,355 | 3,894,355 |
| Distribution equipment | 104,899,772 | 100,248,571 |
| General office equipment | 4,149,200 | 3,836,998 |
| Land | 133,038 | 133,038 |
| Other equipment | 2,443,620 | 2,389,544 |
| Rolling stock | 4,418,756 | 4,322,768 |
| Transformation equipment | 8,403,526 | 8,233,615 |
| | 128,342,267 | 123,058,889 |
| Less accumulated amortization | (64,425,736) | (60,088,325) |
| | 63,916,531 | 62,970,564 |
| Capital contributions, net | (4,932,881) | (3,973,687) |
| Construction-in-progress | 670,783 | 688,993 |
| Capital assets, net | 59,654,433 | 59,685,870 |
| | 102,362,894 | 91,205,355 |

See accompanying notes to the consolidated financial statements.

On behalf of the Board:

Director

Director

| | 2005 | 2004 |
|--|--------------------|---------------------|
| | \$ | \$ [as restated] |
| LIABILITIES AND SHAREHOLDER'S EQUITY | | |
| Current | | |
| Accounts payable and accrued liabilities | 12,800,975 | 7,128,884 |
| Debt retirement charge | 606,395 | 626,147 |
| Deferred revenue | 220,499 | 196,058 |
| Accrued vacation payable | 794,125 | 730,978 |
| Payments in lieu of corporate income taxes liability | 605,874 | — |
| Customer deposits | 1,844,942 | 1,909,393 |
| Current portion of capital lease obligation [note 9] | 35,707 | — |
| Total current liabilities | 16,908,517 | 10,591,460 |
| Long-term | | |
| Regulatory liabilities [note 5] | 11,149,977 | 8,115,894 |
| Employee future benefits [note 7] | 2,171,076 | 2,167,552 |
| Note payable to City of Thunder Bay [note 8] | 33,490,500 | 33,490,500 |
| Capital lease obligation [note 9] | 46,209 | — |
| Total long-term liabilities | 46,857,762 | 43,773,946 |
| Shareholder's equity | | |
| Share capital | | |
| Authorized | | |
| Unlimited common shares | | |
| Issued | | |
| 1,000 common shares | 34,931,625 | 34,931,625 |
| Retained earnings | 3,664,990 | 1,908,324 |
| Total shareholder's equity | 38,596,615 | 36,839,949 |
| | 102,362,894 | 91,205,355 |

Thunder Bay Hydro Electricity Distribution Inc. Statement of Operations and Retained Earnings

Year ended December 31

2005

2004

| | \$ | \$ [as restated] |
|--|--------------|---------------------|
| Revenues and flow-through charges | | |
| Flow-through charges plus distribution revenues | 89,819,640 | 80,946,913 |
| Flow-through costs of energy | (74,155,766) | (66,671,712) |
| Distribution revenue [note 11] | 15,663,874 | 14,275,201 |
| Other operating revenue [note 10] | 2,666,267 | 2,334,862 |
| | 18,330,141 | 16,610,063 |
| Expenses | | |
| Operation and maintenance [schedule] | 5,858,159 | 5,641,966 |
| Utility services [schedule] | 341,489 | 397,898 |
| Conservation and Demand Management [note 11] | 346,516 | — |
| Administration [schedule] | 4,628,087 | 5,407,768 |
| Amortization [note 12] | 4,105,449 | 3,900,981 |
| Provision for payments in lieu of capital tax | 139,116 | 250,000 |
| | 15,418,816 | 15,598,613 |
| Earnings before the following | 2,911,325 | 1,011,450 |
| Interest on capital lease obligation | 1,954 | — |
| Carrying charges on regulatory assets/liabilities | (212,295) | 62,780 |
| Earnings before provision for taxes | 3,121,666 | 948,670 |
| Provision for payments in lieu of corporate income taxes [note 18] | 1,365,000 | 570,000 |
| Earnings for year | 1,756,666 | 378,670 |
| Retained earnings, beginning of year | 1,908,324 | 1,529,654 |
| Retained earnings, end of year | 3,664,990 | 1,908,324 |

See accompanying notes to the consolidated financial statements.

Thunder Bay Hydro Electricity Distribution Inc. Statement of Cash Flows

| Year ended December 31 | 2005 | 2004 |
|--|--------------------|---------------------|
| | \$ | \$ [as restated] |
| OPERATING ACTIVITIES | | |
| Earnings for year | 1,756,666 | 378,670 |
| Add charges (deduct credits) to earnings not involving a current payment (receipt) of cash | | |
| Amortization [note 12] | 4,665,100 | 4,444,030 |
| Increase (decrease) in employee future benefits | 3,524 | (336) |
| Gain on disposal of capital assets | (4,700) | (10,494) |
| | 6,420,590 | 4,811,870 |
| Change in non-cash working capital balances related to operations [note 14[a]] | 6,278,512 | (2,221,915) |
| Cash provided by operating activities | 12,699,102 | 2,589,955 |
| INVESTMENT ACTIVITIES | | |
| Proceeds on sale of capital assets | 7,727 | 12,642 |
| Additions to capital assets, net [note 14[b]] | (4,491,573) | (4,918,971) |
| Decrease (increase) in investment | (4,000,000) | 973,490 |
| Cash used in investment activities | (8,483,846) | (3,932,839) |
| FINANCING ACTIVITIES | | |
| Increase in regulatory assets | (2,316,953) | (985,137) |
| Increase in regulatory liabilities | 3,034,083 | 3,452,027 |
| Capital lease obligation repayments | (23,201) | — |
| Cash provided by financing activities | 693,929 | 2,466,890 |
| Increase in cash and cash equivalents during year | 4,909,185 | 1,124,006 |
| Cash and cash equivalents, beginning of year | 8,611,292 | 7,487,286 |
| Cash and cash equivalents, end of year | 13,520,477 | 8,611,292 |

See accompanying notes to the consolidated financial statements.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

GENERAL

Thunder Bay Hydro Electricity Distribution Inc. ("TBHEDI") is a wholly-owned subsidiary company of Thunder Bay Hydro Corporation, providing electrical distribution services to the inhabitants of the City of Thunder Bay, as regulated by the Ontario Energy Board ("OEB").

1. ELECTRICITY ACT, 1998 AND ELECTRICITY PRICING CONSERVATION AND SUPPLY ACT 2004 (BILL 210)

The Energy Competition Act, 1998 (the "Act") was given Royal Assent on October 30, 1998. The Act provides for a competitive market in the sale of electricity, in addition to the regulation of the monopoly electricity delivery system in the Province of Ontario, by the OEB. Open Access commenced on May 1, 2002, the date on which transmitters and distributors were required to provide generators, retailers and consumers with non-discriminatory access to the transmission and distribution systems in Ontario in accordance with their licences under the Electricity Act, 1998.

The OEB has regulatory authority over the electricity distribution sector. The Act sets out the OEB's powers to issue a distribution licence which must be obtained by any person owning or operating a distribution system under the revised OEB Act, 1998. The OEB Act allows the OEB to prescribe licence requirements and conditions to electricity distributors which may include, among other considerations, specified accounting records, regulatory accounting principles, separation of accounts for separate businesses and filing/processing requirements for rate-setting purposes.

Upon market opening, the cost of power and all costs related to the operations of the electricity grid including transmission, connection and administration costs are flowed through to the consumer. Rates are typically established each year as set out in the Distribution Rate Handbook.

TBHEDI is required to charge its customers for the following amounts (all of which, other than the distribution rate, represent a pass through of amounts payable to third parties):

- [i] Electricity Price. The electricity price represents a pass through of the commodity cost of electricity.
- [ii] Distribution Rate. The distribution rate is designed to recover the costs incurred by TBHEDI in delivering electricity to customers and provide TBHEDI with the OEB allowed rate of return. Distribution rates are regulated by the OEB and typically comprise a fixed charge and a usage-based (consumption) charge. The volume of electricity consumed by TBHEDI's customers during any period is governed by events largely outside TBHEDI's control (principally sustained periods of hot or cold weather which increase the consumption of electricity and sustained periods of moderate weather which decrease the consumption of electricity).
- [iii] Retail Transmission Rate. The retail transmission rate represents a pass through of wholesale costs incurred by distributors in respect of the transmission of electricity from generating stations to local areas. Retail transmission rates are regulated by the OEB.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

- [iv] Wholesale Market Service Charge. The wholesale market service charge represents a pass through of various wholesale market support costs. Retail rates for the recovery of wholesale market service charges are regulated by the OEB.

Bill 210, which became law on December 9, 2002, effectively implemented a rate cap for the cost of electricity consumed (as well as for delivery costs) by low-volume and designated customers (retroactive to May 1, 2002). Retail settlement variance accounts ("RSVA") and certain other accounts prescribed by the OEB have been defined as "regulatory assets" under Bill 210. The price freeze and rate caps were originally expected to continue until at least May 1, 2006; however, in November, 2003, the Province announced its intention to increase (effective April 1, 2004) the price of electricity payable by low-volume and designated customers from 4.3 cents to 4.7 cents per kWh on the first 750 kWh consumed during a month and 5.5 cents thereafter and directed the OEB to develop new pricing mechanisms (to take effect no later than May 1, 2005) for setting the price of electricity payable by low-volume and designated customers.

During the period that the price protection is in effect, it is expected that electricity distributors and retailers will be compensated by the Ontario Electricity Financial Corporation:

- [i] in the case of electricity distributors, for amounts by which the purchase price of the electricity purchased by them in the Independent Electricity System Operator (IESO) - administered wholesale market on behalf of low-volume consumers and designated consumers is greater than the fixed price per kWh charged to customers; and
- [ii] in the case of electricity retailers, for amounts by which the retail contract price agreed to between retailers and low-volume consumers and designated consumers is greater than the fixed price per kWh charged to customers.

In November, 2003, the Province also announced its intention in to permit electricity distributors to make rate applications to the OEB earlier than had been contemplated under Bill 210 with respect to the:

- [a] recovery of "regulatory assets" (based on year-end balances at December 31, 2002) to be phased in over a four-year period effective March 1, 2004; and
- [b] third adjustment necessary to achieve a market-based rate of return (subject to a one-time investment in conservation and demand management initiatives equal to one year of additional revenue resulting from such rate increase), effective March 1, 2005.

In December, 2003, the OEB issued filing guidelines with respect to the recovery of regulatory assets. The OEB's filing guidelines provided that:

- [a] distributors were permitted to recover 25% of regulatory assets in rate adjustments effective March 1, 2004;
- [b] the 2004 rate adjustment was implemented on April 1, 2004 (with a gross-up added to the recovered amount to allow recovery over 11 months); and
- [c] permitted recoveries will continue to be phased in over a three-year period (2005, 2006 and 2007).

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

In 2004, TBHEDI filed a rate application requesting OEB authorization with respect to an increase in distribution rates to allow for the recovery of approximately \$688,000 (representing approximately 25% of TBHEDI's regulatory assets as at December 31, 2002). The regulatory balances as at December 31, 2003 had moved into a net liability position and as such, the rate application for 2005 included a reduction to distribution rates to reflect the repayment of the amounts that have been overcollected. Approved in the rates was the recovery of 70% of our non-RSVA regulatory assets and repayment of 100% of our RSVA regulatory liabilities for a net repayment of approximately \$887,000. During 2005, TBHEDI repaid \$867,323 towards its RSVA regulatory liabilities (recovered \$440,428 towards its RSVA regulatory assets in 2004) and recovered \$485,836 towards its non-RSVA regulatory assets.

The 2005 rate application also requested OEB authorization with respect to an increase in distribution rates to allow for, among other items, the funding for a Conservation and Demand Side Management Plan (CDM). TBHEDI's approved plan for CDM was for expenditures totaling \$1,606,665. It is expected that TBHEDI will complete the CDM initiative spending by September, 2007. Approximately \$1,567,000 has been recognized as part of distribution revenue for 2005 for this rate adjustment [see note 11].

Consumers other than the designated consumers who annually utilize more than 250,000 kWh continue to be eligible to receive Business Protection Plan Rebates ("BPPR"), (formerly received under the Market Power Mitigation Agreement) from the Ontario Power Generation Inc. ("OPG") to the extent that electricity prices exceed certain prescribed thresholds. Bill 100, referred to below, will cause the BPPR to become unnecessary and will effectively be replaced by what is referred to as a Provincial Benefit which will be billed as part of the energy billings regularly.

In December, 2004, the Province initiated a further restructuring of Ontario's electricity industry with the passage of the Electricity Restructuring Act, 2004 ["Bill 100"]. The restructuring was intended, among other things, to ensure efficient and effective management of electricity, promote the expansion of new electricity supply and capacity, encourage electricity conservation and renewable energy and regulate prices in parts of the electricity sector.

Under Bill 100, the commodity cost of electricity for certain customer classes will be regulated by the OEB. Customers who did not wish to or were not eligible to participate in the regulated plan purchased electricity in the competitive market or through licenced retailers.

Effective January 1, 2005, the IESO implemented, pursuant to Bill 100, a new price adjustment applicable to customers not subject to price protection and rate caps. The new price adjustment, referred to as Global Adjustment, is a variable rate calculated by the IESO based on the difference between electricity market prices and the mix of regulated and contract prices paid to electricity generators. This calculation results in positive or negative bill adjustments depending on prevailing electricity market conditions. The difference between the amount credited to customers and the amount received from the IESO by TBHEDI is being tracked in a variance account and is currently reflected as a RSVA regulatory liability. The disposition of the variance account balance shall be in accordance with the OEB's guidelines for reviewing variance and deferral accounts.

On February 23, 2005, the Minister of Energy announced a new fixed pricing structure for electricity supplied by OPG. The new pricing structure, effective April 1, 2005 through March 31, 2008, is based on a blended price for electricity supplied by OPG's regulated and unregulated assets.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

The new pricing structure had an immediate impact on large industrial and commercial electricity customers who use more than 250,000 kWh per year. While residential, small business and other consumers were not immediately affected by the new pricing structure, the OEB blended the various prices paid to generators into a new fixed price that these consumers now pay under the Regulated Price Plan ["RPP"], which took effect on April 1, 2005.

The OEB has formulated two pricing plans for RPP-eligible customers, depending on how a customers' electricity consumption is metered – a pricing plan for customers without smart meters, and a pricing plan for customers with smart meters. For both plans, prices were effective April 1, 2005.

The continuing restructuring of Ontario's electricity industry and other regulatory developments, including current and future possible consultations between the OEB and corporate interested stakeholders, may affect the distribution rates, including payments in lieu of income taxes ("PILS") collected from customers that TBHEDI may charge and the costs that TBHEDI may recover, including the balance of its regulatory assets.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), including accounting principles prescribed by the OEB in the handbook "Accounting Procedures Handbook for Electric Distribution Utilities ("AP Handbook")", and reflect the significant accounting policies summarized below.

Rate setting and regulation

The OEB Act, 1998 gave the OEB increased powers and responsibilities to regulate the electricity industry. These powers and responsibilities include the power to approve or fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity customers, and the responsibility for ensuring the distribution companies fulfill obligations to connect and service customers. In its capacity to approve or fix rates, the OEB has specified the following regulatory treatments that have resulted in accounting treatments differing from GAAP for enterprises operating in a non-regulated environment:

[a] Regulatory Assets and Liabilities

Effective December 31, 2005, TBHEDI adopted the Canadian Institute of Chartered Accountants Accounting Guideline 19 "Disclosures by Entities Subject to Rate Regulation". Certain costs and variance account balances are deemed to be "regulatory assets" or "regulatory liabilities" and are reflected on the balance sheet until the manner and timing of the disposition is determined by the OEB [note 5].

[b] Rebates to customers/Business Protection Plan Rebate

Funding for the rebates is recorded as a reduction in the flow-through cost of energy.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and in banks.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

Investments

Investments are accounted for using the cost method. The carrying value of an investment is written-down to its net recoverable amount if a decline in market value is judged to be other than temporary.

Stores inventory

Stores inventory consists principally of maintenance and construction materials and is valued at the lower of cost and net realizable value. Cost is determined using the average cost method.

Capital assets

Capital assets are stated at cost. Gains or losses on retirement or disposition of such assets are credited or charged to other operating revenue. Amortization is provided on a straight-line basis for capital assets over their estimated service lives at the following annual rates:

| | |
|---|-------------|
| Buildings | 2% |
| Distribution and transformation equipment | 3% to 4% |
| Other assets | 10% to 20% |
| Rolling stock | 12½% to 20% |

Pension plan

TBHEDI provides a pension plan for its employees through the Ontario Municipal Employees Retirement System ("OMERS"). OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund (the "Fund"), and provides pensions for employees of Ontario municipalities, local boards, public utilities and school boards. The Fund is a contributory defined benefit pension plan which is financed by equal contributions from participating employers and employees, and by the investment earnings of the Fund [note 13]. TBHEDI recognizes the expense related to this plan as contributions are made.

Other post-employment benefits

Employee future benefits provided by TBHEDI include medical and life insurance benefits and accumulated sick leave credits. These plans provide benefits to certain employees when they are no longer providing active service. Employee future benefit expense is recognized in the period in which the employees render the services. Employee future benefits are recorded on an accrual basis. The accrued benefit obligations and current service cost are calculated using the projected benefit method pro-rated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value of benefits attributed to employees' services rendered in the period. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. Actuarial gains (losses) are amortized into expense on a straight-line basis over the average remaining service period of active employees to full eligibility. The effects of a curtailment gain or loss are recognized in earnings in the year of the event-giving rise to the curtailment. The effects of a settlement gain or loss are recognized in earnings for the period in which a settlement occurs.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

Revenue recognition

Distribution revenue is recognized on the basis of regular meter readings. Estimates of customer usage since the last meter reading date, to the end of the year are recorded as unbilled revenue.

Pole line revenue is recognized based on annual contracted rates and agreed-upon pole counts.

Other revenue is recognized when the requirements as to performance for transactions involving the sale of goods or services are met and ultimate collection is reasonably assured at the time of performance.

Contributions in aid of construction

Effective January 1, 2001, TBHEDI prospectively adopted the change in accounting policy for contributions received in aid of construction (contributed capital), as prescribed by the OEB "Accounting Procedures Handbook for Electric Distribution Utilities". Capital contributions are required contributions received from outside sources, used to finance additions to capital assets. Capital contributions received after January 1, 2001 are treated as a "credit" contra account included in the determination of capital assets. The amount is subsequently amortized by a charge to accumulated amortization and a credit to amortization expense, at an equivalent rate to that used for the amortization of the related capital assets. Capital contributions received for capital assets prior to January 1, 2001 were treated as contributed capital, a permanent component of equity, which was not amortized.

Customer deposits

Customers' advance deposits are cash collections from customers or Energy Retailers to guarantee the payment of energy-related bills. The deposits bear interest that is paid annually to customers.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the year. Actual results could differ from those estimates.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

Corporate income taxes and capital taxes

The current tax-exempt status of TBHEDI under the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) reflects the fact that TBHEDI is wholly-owned by a municipality. This tax-exempt status might be lost in a number of circumstances, including if the municipality ceases to own 90% or more of the shares or capital of TBHEDI, or if a non-government entity has rights immediately or in the future, either absolutely or contingently, to acquire more than 10% of the shares of TBHEDI.

Commencing October 1, 2001, TBHEDI was required, under the Electricity Act, 1998, to make payments in lieu of corporate taxes ("PILS") to the OEFC. These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) as modified by the Electricity Act, 1998, and related regulations.

TBHEDI provides for PILS relating to its regulated business using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax bases of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of TBHEDI at that time.

Provision for environmental costs

TBHEDI will incur future costs associated with the disposal of contaminated waste and site restoration for certain of its properties. Although these costs cannot be reasonably determined for some of the properties at this time, a contingent liability exists. Where reasonably determinable, TBHEDI has provided for future costs, net of expected recoveries, by charges to income. Actual costs are charged to the provision for environmental costs as incurred.

3. INVESTMENT

The investment consists of a term deposit bearing interest at 2.88%, maturing May, 2006.

4. DUE FROM ASSOCIATED COMPANIES

The balances due from associated companies represent balances owing from the following common control enterprises:

| | 2005 \$ | 2004 \$ |
|---|----------------|----------------|
| Thunder Bay Hydro Energy Services Inc. | 33,454 | 10,017 |
| Transmission Northwest Inc. | 107,400 | 106,621 |
| Thunder Bay Hydro Utility Services Inc. | 114,865 | 114,087 |
| Thunder Bay Hydro Corporation | 3,438 | 1,719 |
| | 259,157 | 232,444 |

The balances are non-interest bearing with no specific terms of repayment.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

5. REGULATORY ASSETS (LIABILITIES)

| | 2005 \$ | 2004 \$ |
|---|---------------------|----------------------|
| | | <i>[as restated]</i> |
| Regulatory Assets | | |
| Rebate costs | 68,530 | 56,288 |
| Deferral for cash pension contributions | 379,510 | — |
| Deferral for OEB annual cost assessment | 108,469 | — |
| Pre-market opening cost of power | 1,517,784 | 1,204,790 |
| | 2,074,293 | 1,261,078 |
| Wholesale market services | 1,954,231 | 1,205,239 |
| Commodity | 1,321,082 | 857,152 |
| Retail settlement variances | 3,275,313 | 2,062,391 |
| Retailer cost variance | 290,816 | — |
| Regulatory Assets | 5,640,422 | 3,323,469 |
| Regulatory Liabilities | | |
| Recovery of Regulatory Assets | (104,459) | (449,340) |
| PILS deferral | (1,214,712) | (637,227) |
| | (1,319,171) | (1,086,567) |
| Network transmission charges | (3,265,001) | (2,352,209) |
| Connection transmission charges | (6,565,805) | (4,677,118) |
| Retail settlement variances | (9,830,806) | (7,029,327) |
| Regulatory Liabilities | (11,149,977) | (8,115,894) |

In the absence of rate regulation, expenses would have been \$644,196 higher. In the absence of rate regulation, carrying charges on regulatory assets and liabilities in 2005 would have increased by \$370,000 (see Statement of Operations and Retained Earnings).

The regulatory assets and liabilities balances of TBHEDI are defined as follows:

[a] Recovery of regulatory asset balances:

This represents recoveries on the net regulatory asset balances as at December 31, 2003 [December 31, 2002 for 2004]. The approved rate adjustment account is debited or credited with paid/recovery amounts and is debited or credited by the OEB prescribed carrying charges. In the absence of rate regulation, income would have increased in 2005 by the amount of the carrying charges on regulatory liabilities of \$45,517 [2004 - \$8,913].

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

[b] Pre-market opening energy electricity variance:

Traditionally, customers who were not billed using time-of-use rates were charged an average rate for their power throughout the year to incorporate the winter and summer rates that were charged to TBHEDI on the purchase of power. Upon market opening, May 1, 2002, TBHEDI commenced charging customers at approved rates for debt retirement, transmission, connection, distribution and wholesale market services plus the hourly Ontario Energy price for commodity consumption. As a result of the timing of market opening, TBHEDI experienced a loss on the energy sales to the non-time-of-use customers.

OEB has allowed TBHEDI to recognize the pre-market opening energy electricity variance for the period January 1, 2001 to April 30, 2002, the date of market opening. Accordingly, TBHEDI has deferred these expenditures in accordance with the criteria set out in the AP Handbook. In the absence of rate regulation, income would have reduced in 2005 by the amount of the carrying charges on regulatory assets/liabilities \$312,994 [2004 - \$nil].

[c] Retail settlement variance accounts:

The OEB has allowed TBHEDI to defer settlement variances from May 1, 2002 to December 31, 2005. This balance represents the variances between amounts charged by TBHEDI to customers (based on regulated rates) and the corresponding cost of non-competitive electricity service incurred by it in the wholesale market administered by the IESO after May 1, 2002. The settlement variances relate primarily to service charges, non-competitive electricity charges, imported power charges and the global adjustment. Accordingly, TBHEDI has deferred these recoveries in accordance with the criteria set out in the AP Handbook.

[d] Retail cost variance accounts:

The OEB has allowed TBHEDI to defer the net costs of services relating to the supply of competitive electricity to retailer customers. Accordingly, TBHEDI has deferred these expenditures in accordance with the criteria set out in the AP Handbook.

Under such regulation, variances are allowed to be deferred which would be recorded as revenue and expenses when incurred under Canadian GAAP for unregulated businesses. In the absence of rate regulation, revenues in 2005 would have been \$269,845 higher [2004 - \$nil] and expenses in 2005 would have been \$527,276 higher [2004 - \$nil]. The deferred balance for settlement variances continues to be calculated and attract carrying charges in accordance with the OEB's direction.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

[e] Deferral account for cash pension contributions

The OEB has allowed for the deferral of the incremental OMERS pension expenditures for the fiscal years commencing January 1, 2005. Accordingly, TBHEDI has deferred these expenditures in accordance with the criteria set out in the AP Handbook.

Under such regulation, expenditures are allowed to be deferred which would be expensed under Canadian GAAP for unregulated businesses. In the absence of rate regulation, expenses in 2005 would have been \$373,078 higher [2004 - \$nil]. The deferred balance continues to be calculated and attract carrying charges in accordance with the OEB's direction.

[f] Deferral account for OEB annual cost assessments:

The OEB has allowed for the deferral of the incremental OMERS pension expenditures for the fiscal years commencing January 1, 2004. Accordingly, TBHEDI has deferred these expenditures in accordance with the criteria set out in the AP Handbook.

Under such regulation, expenditures are allowed to be deferred which would be expensed under Canadian GAAP for unregulated businesses. In the absence of rate regulation, expenses in 2005 would have been \$102,958 higher [2004 - \$nil]. The deferred balance continues to be calculated and attract carrying charges in accordance with the OEB's direction.

The OEB has approved for disposition on an interim basis the December 31, 2003 balances (on a billed basis) of all of the foregoing, with the exception of the deferral for the cash contribution and the OEB annual cost assessment deferral. In the 2006 rate application, TBHEDI is expecting final approval on the December 31, 2004 balances for those balances that had previously been approved on an interim basis (excluding PILS deferral). Final approval for the PILS deferral account will be addressed by the Board at a later time through consultations with industry stakeholders.

The manner and timing of the disposition for the deferral for cash contributions and OEB annual cost assessment has not been determined by the OEB.

6. BANK CREDITS

[a] TBHEDI has an operating loan available to them in the amount of \$6,395,495 [2004 - \$6,395,495] by way of prime rate based loans or bankers' acceptances. \$Nil [2004 - \$nil] was utilized at December 31, 2005. The prime rate based loans bear interest at bank prime. Prime at December 31, 2005 was 5.00 % [2004 - 4.25%]. The bankers' acceptances bear a stamping fee at 0.5% per annum.

[b] TBHEDI has a letter of credit or stand-by letters of guarantee available to them in the amount of \$11,604,505 [2004 - \$11,604,505] of which \$11,604,505 [2004 - \$11,604,505] was issued at December 31, 2005. This credit will be used by TBHEDI to assist in meeting its prudential obligations to the IMO. The credit bears interest at bank prime. Prime at December 31, 2005 was 5.00% [2004 - 4.25%].

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

7. EMPLOYEE FUTURE BENEFITS

TBHEDI has a number of unfunded benefit plans providing retirement and post-employment benefits (excluding pension) to most of its employees.

Information about TBHEDI's defined benefit plans is as follows:

| | 2005 \$ | 2004 \$ |
|--|------------------|------------------|
| Change in accrued benefit obligation | | |
| Accrued benefit obligation at January 1 | 2,167,552 | 2,167,888 |
| Current service costs | 114,407 | 85,799 |
| Interest cost | 119,152 | 139,540 |
| Actuarial losses | 39,348 | 27,308 |
| Benefits paid in the year or moved to current liability | (269,383) | (252,983) |
| Accrued benefit obligation, end of year | 2,171,076 | 2,167,552 |
| Projected accrued benefit obligation at December 31, as determined by actuarial valuation using a 5.75% [2004 – 5.75%] discount rate | 2,445,782 | 2,439,830 |
| Unamortized actuarial gain (loss) | (274,706) | (272,278) |
| Accrued benefit liability | 2,171,076 | 2,167,552 |

The main actuarial assumptions employed for the valuations are as follows:

[a] General inflation

Future general inflation levels, as measured by changes in the Consumer Price Index ("CPI"), were assumed at 2.1% in 2004 and thereafter.

[b] Interest (discount) rate

The obligation as at December 31, 2005, of the present value of future liabilities and the expense for the year, were determined using an annual discount rate of 5.75% [2004 – 5.75%].

[c] Salary levels

Future general salary and wage levels were assumed to increase at 3% per annum.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

[d] Medical costs

Medical costs were assumed to increase at a rate of 10% in 2004 graded-down by 1% per annum leveling off at 5% in 2013 and thereafter.

[e] Dental costs

Dental costs were assumed to increase at a rate of 5% per annum in 2004 and thereafter.

8. NOTE PAYABLE TO CITY OF THUNDER BAY

| | 2005 \$ | 2004 \$ |
|-------------------------------------|------------|------------|
| Note Payable to City of Thunder Bay | 33,490,500 | 33,490,500 |

The note is a non-interest bearing note payable to The Corporation of the City of Thunder Bay (sole shareholder of Thunder Bay Hydro Corporation, TBHEDI's parent company). Principal repayment in the next twelve months is expected to be \$nil.

9. OBLIGATION UNDER CAPITAL LEASE

TBHEDI entered into a three-year lease agreement with IBM for computer equipment. The interest rate implicit in the lease is 3.13%. The lease agreement ends March, 2008. The future minimum annual lease payments are as follows:

| | \$ |
|---|--------|
| 2006 | 37,733 |
| 2007 | 37,733 |
| 2008 | 9,433 |
| Total amount of future minimum lease payments | 84,899 |
| Less interest | 2,983 |
| | 81,916 |
| Current portion | 35,707 |
| Long-term portion | 46,209 |

10. OTHER OPERATING REVENUE

| | 2005 \$ | 2004 \$ |
|-----------------------------|------------|------------|
| Pole line rentals | 518,897 | 447,468 |
| Competitive market revenues | 197,779 | 202,541 |
| Interest earned | 330,160 | 218,795 |
| Utility services | 805,281 | 787,833 |
| Sundry earnings | 814,150 | 678,225 |
| | 2,666,267 | 2,334,862 |

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

11. CONSERVATION AND DEMAND MANAGEMENT

The OEB approved a Conservation and Demand Management plan for \$1,606,665. During 2005, approximately \$1,567,000 has been recognized as part of distribution revenue (this represents the CDM plus the additional PILS funding relating to the CDM). The plan covered a variety of CDM initiatives including \$549,000 of capital expenditures. The funding for the planned expenditures was included as part of our 2005 approved distribution rates.

12. AMORTIZATION

Amortization provided during the year consists of:

| | 2005 \$ | 2004 \$ |
|---|------------|------------|
| Amortization of general plant | 4,124,609 | 3,872,333 |
| Amortization of capital contributions | (205,000) | (175,000) |
| Amortization of unallocated office and data processing equipment | 145,840 | 163,648 |
| Amortization of organization costs | 40,000 | 40,000 |
| | 4,105,449 | 3,900,981 |
| Amortization of other capital assets included in relevant expense categories in the Statement of Operations and Retained Earnings | 559,651 | 543,049 |
| | 4,665,100 | 4,444,030 |

13. PENSION PLAN

TBHEDI's current service pension costs for the year ended December 31, 2005 were \$502,833 [2004 - \$480,737]. Of this amount, \$373,078 has been deferred in a regulatory asset account [note 5].

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

14. STATEMENT OF CASH FLOWS

[a] The net change in non-cash working capital balances related to operations is represented by the following:

| | 2005 \$ | 2004 \$ |
|---|-------------|-------------|
| Decrease (increase) in current assets | | |
| Accounts receivable | 2,112,109 | (257,376) |
| Unbilled revenue | (2,227,186) | (914,719) |
| Payments in lieu of corporate income taxes receivable | 128,767 | (128,767) |
| Due from associated companies | (26,713) | 123,252 |
| Stores inventory | (153,449) | 14,790 |
| Prepaid expenses | 163,634 | (8,442) |
| | (2,838) | (1,171,262) |
| Increase (decrease) in current liabilities | | |
| Accounts payable and accrued liabilities | 5,672,091 | (551,785) |
| Debt retirement charge | (19,752) | (10,028) |
| Deferred revenue | 24,441 | 90,781 |
| Accrued vacation payable | 63,147 | (29,931) |
| Payments in lieu of corporate income taxes liability | 605,874 | (555,911) |
| Customer deposits | (64,451) | 6,221 |
| | 6,281,350 | (1,050,653) |
| | 6,278,512 | (2,221,915) |

[b] During the year, capital assets were acquired at an aggregate cost of \$5,760,884 [2004 - \$5,651,743], of which \$726,214 [2004 - \$604,572] was funded by cash contributions, \$437,980 [2004 - \$128,200] was funded by contributions in-kind, \$105,117 [2004 - \$nil] was funded by the proceeds from capital lease obligations and \$4,491,573 [2004 - \$4,918,971] was funded by cash.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

15. REBATES

During the year, TBHEDI received \$7,448,394 [2004 - \$3,150,287] from the IESO in connection with the Business protection plan rebate (BPPR) for the periods commencing May 1, 2004 and ending March 31, 2005 and the Ontario Price Credit relating to low-volume consumption for the period April 1, 2004 to March 31, 2005. Of this balance, \$2,337,752 related to BPPR and of this amount \$1,570,320 was allocated to customers. The remaining \$767,432 was forwarded to various electricity retailers.

16. RELATED PARTIES

TBHEDI provides certain services to The Corporation of the City of Thunder Bay (TBHEDI's parent) in the normal course of business at commercial rates.

For the year ended December 31, 2005, pole rental revenue to The Corporation of the City of Thunder Bay in the amount of \$289,937 [2004 - \$217,000] and other sundry revenues in the amount of \$133,889 [2004 - \$45,000] were recorded. The Corporation of the City of Thunder Bay also contributed towards capital construction during the year in the amount of \$82,921 [2004 - \$58,000]. Included in "Accounts receivable" is \$146,348 [2004 - \$31,500] receivable from The Corporation of the City of Thunder Bay related to these other activities.

For the year ended December 31, 2005, TBHEDI billed electricity revenues in the amount of \$6,909,635 [2004 - \$5,951,027] to The Corporation of the City of Thunder Bay. At December 31, 2005, included in "Accounts receivable" is \$11,797 [2004 - \$486,696] receivable from The Corporation of the City of Thunder Bay, related to this electricity revenue.

TBHEDI purchases certain services from The Corporation of the City of Thunder Bay in the normal course of business at commercial rates.

For the year ended December 31, 2005, TBHEDI incurred property taxes payable to The Corporation of the City of Thunder Bay of \$172,361 [2004 - \$157,000]. During 2005, TBHEDI also incurred \$241,000 for Conservation and Demand Management Activities.

TBHEDI manages and administers the rental water heater operations for Thunder Bay Hydro Energy Services Inc. (TBHESI). During 2005, TBHEDI charged TBHESI administration fees of \$45,000 [2004 - \$45,000].

17. CONTINGENCIES

Consumers' Gas Decision

On April 22, 2004, in a decision for a class action commenced against The Consumers' Gas Company Limited (now Enbridge Gas Distribution Inc.), the Supreme Court of Canada [the "Supreme Court"] ruled that The Consumers' Gas Company ["Consumers' Gas"] was required to repay the portion of certain late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the Criminal Code. Although the claim related to charges collected by Consumers' Gas after the enactment of section 347 of the Criminal Code in 1981, the Supreme Court limited recovery to charges collected after the action was initiated in 1994. The Supreme Court remitted the matter back to the Ontario Superior Court of Justice for a determination of the plaintiffs' damages.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

TBHEDI is not a party to the Consumers' Gas class action. It is, however, subject to the class action described below in which the issues are analogous.

A class action claiming \$500 million in restitutionary payments, plus interest, was served on Toronto Hydro on November 18, 1998. The action was initiated against Toronto Hydro Electric Commission as the representative of the defendant class consisting of all municipal electric utilities in Ontario which have charged late payment charges collected by them from their customers that were in excess of the interest limit stipulated in section 347 of the Criminal Code. This action is at a preliminary stage. Pleadings have closed but examinations for discovery have not been conducted and the classes have not been certified as the parties were awaiting the outcome of the Consumers' Gas class action.

It is anticipated that this will now proceed for determination in light of the reasons of the Supreme Court in the Consumers' Gas class action.

Also, the determination of whether the late payment charges collected by TBHEDI from its customers were in excess of the interest limit stipulated in section 347 of the Criminal Code is fact specific in each circumstance. Accordingly, given the preliminary status of these actions, it is not possible at this time to quantify the effect, if any, of the Consumers' Gas decision on these actions or of these actions on the financial performance of TBHEDI.

The Electricity Distributors Association is undertaking the defense of this class action. At this time it is not possible to quantify the effect, if any, on the financial statements of TBHEDI.

18. CORPORATE INCOME AND CAPITAL TAXES

The provision for payments in lieu of corporate income and capital taxes differs from the amount that would have been recorded using the combined Canadian Federal and Ontario statutory income tax rate.

The impact of differences between TBHEDI's reported income tax expense on operating income and the expense that would otherwise result from the application of statutory rates is as follows:

| | 2005 \$ | 2004 \$ |
|--|------------|------------|
| Earnings before provision for taxes | 3,121,666 | 948,670 |
| Statutory Canadian federal and provincial income tax rate | 36.12% | 36.12% |
| Expected provision | 1,127,545 | 342,659 |
| Increase in income taxes resulting from | | |
| Large Corporations Tax net of surtax | 12,259 | 37,000 |
| Timing differences | | |
| Amortization and capital cost allowance | 363,065 | 335,903 |
| Amortization and eligible capital expenditure amortization | 11,901 | 11,709 |
| Other | (149,770) | (157,271) |
| Provision for payments in lieu of corporate income taxes | 1,365,000 | 570,000 |
| Effective tax rate | 43.73% | 60.08% |

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

Future income taxes relating to TBHEDI have not been recorded in the accounts as they are expected to be recovered through future revenues. As at and for the year ended December 31, 2005, the following future income tax asset and expense (recovery) have not been recorded in the financial statements:

| | Gross \$ | Future income tax asset not recorded in financial statements \$ | Future income tax expense (recovery) not recognized in financial statements \$ |
|---|-------------|--|---|
| Deductible temporary and permanent differences | 13,000,000 | 4,680,000 | (380,000) |

19. 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, except as disclosed in note 20.

[b] Credit risk

Credit risk is the risk that a counter party will fail to discharge its obligation to TBHEDI reducing the expected cash inflow from the Corporation assets recorded at the balance sheet date. Credit risk can be concentrated in debtors that are similarly affected by economic or other conditions. TBHEDI provides for an allowance for doubtful accounts to absorb credit losses. TBHEDI has assessed that there are no significant concentrations of credit risk with respect of any class of financial assets.

[c] Interest rate risk

TBHEDI is exposed to interest rate risk for certain of its financial assets and liabilities. Under the revolving terms of credit, TBHEDI may have short-term borrowings for working capital purposes, which would expose TBHEDI to fluctuations in short-term interest rates (borrowings in the form of prime rate loans in Canadian dollars).

20. MEASUREMENT UNCERTAINTY

Measurement uncertainty relates to the uncertainty in the determination at which an item is recognized in the financial statements. There is a degree of uncertainty associated with the measurement of certain regulatory assets in the financial statements (OEB annual cost assessment and deferral for cash pension contributions) due to the fact that the OEB has not yet allowed for disposition of these accounts, nor has it indicated that disposition is assured through future rates or other mechanisms. It is reasonably possible that the recognized amount could change by a material amount in the near term should the OEB determine that disposition of these balances will not be allowed through future rates. The assets subject to uncertainty total \$487,979 and are recorded on the Balance Sheet.

Thunder Bay Hydro Electricity Distribution Inc.

Notes to the Financial Statements

December 31, 2005

21. COMPARATIVE FIGURES

An error in the calculation of the annual payable/receivable from the IESO relating to claims for Fixed Rate Settlement Funding from the Ontario Electricity Financial Corporation was made during fiscal year 2003 and 2004. This error resulted in an overstatement of the commodity variance, which is a regulatory asset and an overstatement of the current accounts payable to the IESO. The amount of the reduction of the payable to the IESO as at December 31, 2003 should have been \$594,795 versus the recorded increase in the payable of \$1,240,175. This error continued into 2004. The decrease in the payable from the IESO should have been \$704,230 versus the recorded decrease of \$299,904. The cumulative total reduction in the accounts payable and accrued liabilities as at December 31, 2004 and the corresponding increase in the regulatory liabilities is \$2,239,296. The prior year's figures have been restated to correct this error.

Certain of the 2004 comparative balances have been restated to conform with current year's presentation.

22. SUBSEQUENT EVENTS

Subsequent to the year end, TBHEDI transferred all of their Utility Services assets to an affiliated company, Thunder Bay Hydro Utility Services Inc. (formerly Generation Northwest Inc.).

Thunder Bay Hydro Electricity Distribution Inc.

Schedule - Expenses

Year ended December 31

| | 2005 \$ | 2004 \$ |
|---|-------------------|-------------------|
| OPERATION AND MAINTENANCE | | |
| Customer premises/meters and devices | 779,102 | 539,776 |
| Distribution | 2,947,563 | 3,260,013 |
| Safety and training | 289,895 | 335,716 |
| System control/station maintenance | 1,451,905 | 1,131,827 |
| Transformer | 389,694 | 374,634 |
| Total operation and maintenance expenses | 5,858,159 | 5,641,966 |
| UTILITY SERVICES | | |
| Meter service provider | 245,978 | 272,690 |
| Utility management services | 95,511 | 125,208 |
| Total utility services expenses | 341,489 | 397,898 |
| ADMINISTRATION | | |
| Customer related | | |
| Bad debts | 236,697 | 404,453 |
| Billing | 177,952 | 246,541 |
| Cashiers | 307,707 | 344,062 |
| Customer information and service | 1,099,193 | 1,220,815 |
| Data processing | 662,722 | 735,788 |
| Meter reading | 492,951 | 487,575 |
| Total customer related administration expenses | 2,977,222 | 3,439,234 |
| General | | |
| Corporate | 482,168 | 642,414 |
| Directors' expenses | 60,675 | 54,341 |
| Finance- accounting | 362,043 | 392,450 |
| - administration | 208,284 | 209,732 |
| Human resources | 245,245 | 279,518 |
| President's office | 292,450 | 282,450 |
| Special projects | — | 107,629 |
| Total general administration expenses | 1,650,865 | 1,968,534 |
| Total administration expenses | 4,628,087 | 5,407,768 |
| TOTAL EXPENSES | 10,827,735 | 11,447,632 |