



FINANCIAL STATEMENTS
KITCHENER-WILMOT HYDRO INC.
January 1 - December 31, 2001



April 19, 2002

REPORT TO SHAREHOLDERS:

CORPORATION OF THE CITY OF KITCHENER

CORPORATION OF THE TOWNSHIP OF WILMOT

We are pleased to provide you with the second Annual Report of Kitchener-Wilmot Hydro Inc. for the period ending December 31, 2001.

As required by Provincial Legislation the former Hydro-Electric Commission of Kitchener-Wilmot ceased operations on July 31, 2000 and the new successor local distribution company Kitchener-Wilmot Hydro Inc. was created effective August 1, 2000 by Municipal Transfer By-Laws of the City and Township. This Annual Report represents the first full fiscal year of operations for the new Corporation.

The Board and Staff of the Corporation are to be commended for their dedication and commitment in preparing for the implementation of a fully deregulated electrical industry in Ontario. The preparation has been accomplished in an efficient and cost effective manner.

Your Corporation continues to deliver electricity to the citizens of our communities with the lowest local residential retail rates. The Corporation also has the lowest local distribution costs while at the same time the infrastructure is continually being refurbished and enhanced in order to continue to provide a reliable and safe supply of electricity. The Corporation continues to provide value to its shareholders, the City of Kitchener and the Township of Wilmot, as well as to its customers.

In conclusion we wish to thank the Board and all staff for their dedication, support and commitment to excellence which has provided us with a solid base to meet future challenges as we move along the path of deregulation.

B. SIMS, CHAIR

R. CHARIE, PRESIDENT & C.E.O.

AUDITORS' REPORT

To the Shareholders of
Kitchener-Wilmot Hydro Inc.

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

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

In our opinion, except for the fact that comparative financial statements have not been provided, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2001 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 LLP

Kitchener, Canada,
March 1, 2002.

Chartered Accountants



BALANCE SHEET

As at December 31st

| | <u>2001</u> \$ | <u>2000</u> \$ |
|-------------------------------------------------------------|--------------------|--------------------|
| <u>ASSETS</u> | | |
| Current assets | | |
| Cash and cash equivalents | 17,365,963 | 14,396,056 |
| Accounts receivable (note 3) | 12,696,196 | 10,726,236 |
| Accounts receivable from related parties (note 4) | 112,435 | 960,177 |
| Unbilled revenue receivable | 10,121,300 | 9,933,400 |
| Inventories | 2,171,342 | 2,365,243 |
| Prepaid expenses | 146,646 | 204,373 |
| Accrued interest receivable | 28,992 | 54,073 |
| Total current assets | 42,642,874 | 38,639,558 |
| Capital assets - net of accumulated amortization (note 5) | 122,604,242 | 121,630,799 |
| Deferred charges - net of accumulated amortization (note 6) | 585,722 | 635,921 |
| Total assets | 165,832,838 | 160,906,278 |
| <u>LIABILITIES and SHAREHOLDERS' EQUITY</u> | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities (note 7) | 14,765,093 | 14,283,799 |
| Current portion of customers deposits | 865,000 | 604,000 |
| Construction and property deposits | 2,156,824 | 1,145,777 |
| Total current liabilities | 17,786,917 | 16,033,576 |
| Long-term liabilities | | |
| Long-term debt (note 8) | 76,962,142 | 76,962,142 |
| Customer deposits | 868,167 | 603,712 |
| Post-employment benefits (note 10) | 3,834,696 | 3,730,682 |
| Total long-term liabilities | 81,665,005 | 81,296,536 |
| Shareholders' equity | | |
| Share capital, - common shares (note 11) | 63,689,499 | 63,689,499 |
| Retained earnings | 2,691,417 | (113,333) |
| Total shareholders' equity | 66,380,916 | 63,576,166 |
| Total liabilities and shareholders' equity | 165,832,838 | 160,906,278 |

See accompanying notes



STATEMENT OF RETAINED EARNINGS

For the Year Ended December 31st

| | <u>2001</u> | <u>2000</u> |
|----------------------------------------------------------------------|------------------|------------------|
| | \$ | \$ |
| (Deficit) retained earnings, beginning of period | (113,333) | 134,677,073 |
| Change in accounting policy | - | (3,496,220) |
| Retained earnings, beginning of period restated | (113,333) | 131,180,853 |
| Net Income | 2,804,750 | 3,995,345 |
| Paid in capital | - | 24,989,568 |
| Corporate reorganization adjustments: | | |
| Transfer of surplus assets to the City of Kitchener | - | (419,992) |
| Transfer of surplus funds to City of Kitchener & Twp. of Wilmot | - | (12,500,000) |
| Transfer of assets to Kitchener Power Corporation | - | (677,983) |
| Transfer of net assets to FibreTech (Kitchener) Inc. | - | (2,029,473) |
| Transfer of funds to Kitchener Energy Services Inc. | - | (10) |
| Recapitalization-long term notes payable to City of Kitchener | - | (70,997,576) |
| Recapitalization-long term notes payable to Twp. Of Wilmot | - | (5,964,566) |
| Recapitalization-FibreTech (Kitchener) Inc- long term notes payable; | | |
| to City of Kitchener | - | (3,505,500) |
| to Twp. of Wilmot | - | (294,500) |
| Dividends paid | - | (200,000) |
| Add: Common Shares | - | (63,689,499) |
| Retained earnings (deficit), end of year | <u>2,691,417</u> | <u>(113,333)</u> |

See accompanying notes



STATEMENT OF OPERATIONS

For the Year Ended December 31st

| | <u>2001</u> | <u>2000</u> |
|--------------------------------------------------------------------------------------------|--------------------|--------------------|
| | \$ | \$ |
| <u>REVENUE</u> | | |
| Sale of energy | | |
| Residential | 49,391,670 | 45,064,929 |
| General service | 80,436,367 | 76,217,400 |
| Large user | 14,539,253 | 10,991,898 |
| Street lighting | 1,072,121 | 974,398 |
| Revenue adjustment | 313,187 | 197,576 |
| | <u>145,752,598</u> | <u>133,446,201</u> |
| Other revenue | | |
| Investment income | 719,982 | 1,386,283 |
| Late payment penalties | 658,863 | 694,548 |
| Miscellaneous (note 12) | 1,190,884 | 533,861 |
| | <u>2,569,729</u> | <u>2,614,692</u> |
| Total revenue | <u>148,322,327</u> | <u>136,060,893</u> |
| <u>EXPENSES</u> | | |
| Power supply | 126,688,379 | 116,038,196 |
| Distribution operations | 1,692,527 | 1,789,781 |
| Distribution maintenance | 2,601,497 | 2,177,810 |
| General administration | 1,573,891 | 1,684,031 |
| Customer accounts | 1,980,497 | 2,102,398 |
| Community relations | 123,365 | 97,766 |
| Property and capital taxes | 884,169 | 659,050 |
| Amortization (note 13) | 6,925,128 | 6,685,761 |
| Total expenses | <u>142,469,453</u> | <u>131,234,793</u> |
| Income before interest and provision for payments in lieu of corporate income taxes | <u>5,852,874</u> | <u>4,826,100</u> |
| Interest expense | 2,970,171 | 830,755 |
| Income before provision for payments in lieu of corporate income taxes | <u>2,882,703</u> | <u>3,995,345</u> |
| Provision for payments in lieu of corporate income taxes (note 15) | 77,953 | - |
| NET INCOME | <u>2,804,750</u> | <u>3,995,345</u> |
| See accompanying notes | | |



STATEMENT OF CASH FLOWS

For the Year Ended December 31st

| | <u>2001</u> | <u>2000</u> |
|--------------------------------------------------------------------------|---------------------|---------------------|
| | \$ | \$ |
| <u>OPERATING ACTIVITIES</u> | | |
| Net income | 2,804,750 | 3,995,345 |
| Add (deduct) charges to operations not requiring a current cash payment: | | |
| (Gain) on disposal of capital assets | (77,959) | (103,613) |
| Amortization (note 13) | 7,462,237 | 7,203,211 |
| Increase in post-employment benefits obligation (note 10) | 104,014 | 234,462 |
| Increase (decrease) in non-current customer deposits | 264,455 | (20,598) |
| Net change in non-cash operating working capital (note 16) | 719,932 | (2,243,426) |
| Cash provided by operating activities | <u>11,277,429</u> | <u>9,065,381</u> |
| <u>INVESTING ACTIVITIES</u> | | |
| Additions to capital assets | (11,933,927) | (10,504,055) |
| Proceeds on disposals of capital assets | 78,045 | 118,039 |
| Additions prior to FibreTech transfer | - | (1,173,752) |
| Amortization on FibreTech assets prior to transfer | - | 107,884 |
| Additions prior to Power Corp transfer | - | (69,983) |
| Cash (applied to) investing activities | <u>(11,855,882)</u> | <u>(11,521,867)</u> |
| <u>FINANCING ACTIVITIES</u> | | |
| Increase in contributed capital | 3,548,360 | 2,477,691 |
| Funds transferred to City of Kitchener & Twp. of Wilmot | - | (12,500,000) |
| Funds transferred to Kitchener Power Corporation | - | (500,000) |
| Funds transferred to Fibretech (Kitchener) Inc. | - | (2,221,926) |
| Funds transferred to Kitchener Energy Services Inc. | - | (10) |
| Dividends paid to Kitchener Power Corporation | - | (200,000) |
| Cash provided by (applied to) financing activities | <u>3,548,360</u> | <u>(12,944,245)</u> |
| Net cash provided (applied) during year | 2,969,907 | (15,400,731) |
| Cash and cash equivalents, beginning of year | 14,396,056 | 29,796,787 |
| Cash and cash equivalents, end of year | <u>17,365,963</u> | <u>14,396,056</u> |
| Cash and cash equivalents is represented by: | | |
| Cash | 865,963 | (103,944) |
| Cash equivalents | 16,500,000 | 14,500,000 |
| | <u>17,365,963</u> | <u>14,396,056</u> |
| Supplemental cash flow information | | |
| Interest paid | 2,886,080 | 754,904 |
| Payments in lieu of corporate income taxes and capital taxes | 227,092 | - |

See accompanying notes

NOTES TO FINANCIAL STATEMENTS

1. INCORPORATION

On July 1, 2000, Kitchener Power Corporation was incorporated under the Business Corporation Act (Ontario) along with three wholly-owned subsidiary companies, Kitchener-Wilmot Hydro Inc., Kitchener Energy Services Inc. and FibreTech (Kitchener) Inc. The incorporation was required in accordance with the provincial government's Electricity Competition Act (Bill 35). The City of Kitchener and the Township of Wilmot both passed by-laws which transferred the net assets of the former Hydro-Electric Commission of Kitchener-Wilmot to the new corporations on August 1, 2000. Certain surplus property assets and cash funds were excluded from the transfer and were retained by the City and the Township. The net assets of FibreTech (Kitchener) Inc. were subsequently transferred to Fibretech Telecommunications Inc. as a result of a statutory amalgamation with Fibretech Telecommunications (Cambridge) Inc. and Fibretech Waterloo Inc. The City of Kitchener and the Township of Wilmot are the shareholders of Kitchener Power Corporation.

The financial statements are compared to the operating performance of the former Hydro Electric Commission of Kitchener-Wilmot for the period of January 1, 2000 - July 31, 2000 and the operating performance of Kitchener-Wilmot Hydro Inc. for the period of August 1, 2000 - December 31, 2000.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ["GAAP"] including accounting principles prescribed by the Ontario Energy Board ["OEB"] in the handbook "Accounting Procedures Handbook for Electric Distribution Utilities" and reflect the significant accounting policies as 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:

[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] have been 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. Kitchener-Wilmot Hydro Inc. will apply for the recovery of these costs in accordance with the guidelines and timetable for this process to be established by the OEB.

[b] Kitchener-Wilmot Hydro Inc. provides for payments in lieu of corporate income taxes using the taxes payable method as directed by the OEB.

Cash and cash equivalents

Cash equivalents are readily convertible investments with maturities of three months or less from their date of acquisition. Investments are carried at cost, which approximates market value.

Inventories

Inventories consist of parts, supplies and material held for the future capital expansion and are valued at the lower of average weighted cost and net realizable value.

Spare transformers and meters

Spare transformers and meters are classified as capital assets based on the CICA Handbook's definition of inventory.

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital assets and amortization

Capital assets are valued at cost. Costs for assets installed or erected by the Corporation include material, labour and overhead.

Amortization is provided on a straight-line basis for capital assets available for use over their estimated service lives, at the following annual rates:

| | |
|--------------------------------|----------|
| Buildings | 2% |
| Transformer station equipment | 2.5% |
| Distribution station equipment | 3.33% |
| SCADA equipment | 6.67% |
| Distribution system | 4% |
| Meters | 4% |
| General equipment | 10 - 25% |

Amortization on general equipment directly used in the installation of other capital assets, is capitalized to the new assets based on a pro-ration of the time during the year they are used for such purposes.

Full amortization is recorded in the year of acquisition and none in the year of disposal, except for readily identified assets which are amortized on a monthly basis.

For readily identifiable assets retired or disposed of, the asset and related accumulated amortization are removed from the records. Differences between the proceeds, if any, and the unamortized asset amount plus removal costs are recorded as a gain or loss in the year of disposal.

For grouped assets, the assets and accumulated amortization are removed from the records at the end of their estimated average service life, regardless of actual service life.

Construction-in-progress

Capital assets under construction at year-end are referred to as construction in progress and disclosed as a component of capital assets. Construction-in-progress is recognized as a capital asset and amortized when the asset is either put into service or construction is substantially completed.

Deferred charges

The acquisition costs of major computer software systems are amortized by the straight-line method at an annual rate of 20%, which approximates their estimated useful lives.

Contributed capital

Prior to January 1, 2000, contractor's capital contributions toward the construction or acquisition of capital assets by the Corporation were referred to as miscellaneous paid-in capital and disclosed as a permanent component of utility equity.

Effective May 1, 2000, the Company 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". Contributed capital contributions are required contributions received from outside sources, used to finance additions to capital assets. Contributed capital contributions received 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.

Revenue recognition and cost of electrical energy

The Corporation records revenue from the sale of energy on the basis of regular meter readings and estimates of customer usage since the last meter reading to the end of the year. The cost of power is recognized when the energy is consumed.

NOTES TO FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Pension plan

Kitchener-Wilmot Hydro Inc. 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. The Company recognizes the expense related to this plan as contributions are made.

Post-employment benefits

Employee future benefits provided by KWH Inc. include medical and life insurance benefits. 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 benefits 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 over the average remaining service period of active employees to full eligibility.

Customer deposits

Customer deposits are cash collections from customers to guarantee the payment of energy bills. Deposits expected to be refunded to customers within the next fiscal year are classified as a current liability.

Deferred transition costs

Kitchener-Wilmot Hydro Inc. has incurred costs related to the transition to a competitive electricity market mandated by the Electricity Act, 1998. The OEB has established rules in respect of transition costs which qualify for deferral and amortization against future revenue. To the extent that transition costs have been incurred which do not qualify for deferral, these costs have been expensed during the period they were incurred.

Transition costs which are capital in nature, such as computer software, are accounted for as part of capital assets. These assets are initially recorded as part of construction in progress until placed into service. Once completed, the costs will be transferred to a deferred transition cost account and amortization will commence with the amortization charge recorded to the deferred transition cost account.

Use of estimates

The preparation of financial statements, in conformance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that effect 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 estimates.

Corporate income taxes and capital taxes

The current tax-exempt status of the Company under the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) reflects the fact that the Company is wholly owned by municipalities. 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 the Company, 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 the Company.

Commencing October 1, 2001, the Company is required, under the Electricity Act, 1998, to make payments in lieu of corporate taxes to Ontario Electricity Financial Corporation. 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.

As a result of becoming subject to payments in lieu of corporate income taxes ["PILs"], the Company's taxation year was deemed to have ended immediately beforehand and a new taxation year was deemed to have commenced immediately thereafter. The Company was therefore deemed to have disposed of each of its assets at their then fair market value and to have reacquired such assets at that same amount for purposes of computing its future income subject to PILs. For purposes of certain provisions, the Company was

NOTES TO FINANCIAL STATEMENTS

December 31, 2001

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Corporate income taxes and capital taxes (continued)

deemed to be a new company and, as a result, tax credits or tax losses not previously utilized by the Company would not be available to it after the change in tax status. Essentially, the Company was taxed as though it had a "fresh start" at the time of its change in tax status.

The Company 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 booked for temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes as a result of temporary differences between tax basis and accounting purposes become payable, they will be charged to the statement of operations at that time. A future income tax asset of \$7,956,000, relating to the valuation of the Company's assets at October 1, 2001, has not been recorded in the accounts.

3. ACCOUNTS RECEIVABLE

| | 2001 | 2000 |
|---------------------------------------|-------------------|-------------------|
| | \$ | \$ |
| Electrical energy | 11,171,740 | 9,772,467 |
| Miscellaneous | 1,774,456 | 1,203,769 |
| | <u>12,946,196</u> | <u>10,976,236</u> |
| Less: Allowance for doubtful accounts | 250,000 | 250,000 |
| | <u>12,696,196</u> | <u>10,726,236</u> |

4. RELATED PARTY TRANSACTIONS

During the year, Kitchener-Wilmot Hydro Inc. provided capital construction, maintenance, engineering and administrative services to Fibretech Telecommunications Inc. in the amount of \$ 821,802 as well as capital and maintenance street light services billed to the City of Kitchener in the amount of \$362,505 and to the Township of Wilmot in the amount of \$18,141. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

At year-end, the related party balances are as follows:

| | 2001 | 2000 |
|--------------------------------------------|----------------|----------------|
| | \$ | \$ |
| Due from Fibretech Telecommunications Inc. | 12,086 | 960,177 |
| Due from City of Kitchener | 95,102 | — |
| Due from Township of Wilmot | 5,247 | — |
| | <u>112,435</u> | <u>960,177</u> |

5. CAPITAL ASSETS

| | Cost | Accumulated Amortization | Net Book Value |
|------------------------------------------------|--------------------|--------------------------|--------------------|
| 2001 | \$ | \$ | \$ |
| Land | 2,698,307 | — | 2,698,307 |
| Land rights | 261,699 | 225,821 | 35,878 |
| Buildings | 11,880,085 | 2,650,799 | 9,229,286 |
| Transformer stations | 28,151,032 | 7,563,405 | 20,587,627 |
| Distribution stations | 2,479,193 | 1,131,249 | 1,347,944 |
| Distribution lines - over-head and underground | 104,036,716 | 43,321,457 | 60,715,259 |
| Distribution transformers | 32,682,235 | 12,516,764 | 20,165,471 |
| Distribution meters | 8,728,411 | 3,140,008 | 5,588,403 |
| Other capital assets | 11,457,266 | 7,587,234 | 3,870,032 |
| Construction-in-progress | 4,054,806 | — | 4,054,806 |
| | <u>206,429,750</u> | <u>78,136,737</u> | <u>128,293,013</u> |
| Less: Contributed Capital | (6,026,051) | (337,280) | (5,688,771) |
| | <u>200,403,699</u> | <u>77,799,457</u> | <u>122,604,242</u> |

NOTES TO FINANCIAL STATEMENTS

December 31, 2001

5. CAPITAL ASSETS (CONTINUED)

| | Cost | Accumulated Amortization | Net Book Value |
|----------------------------------------------------|-------------|-----------------------------|-------------------|
| 2000 | \$ | \$ | \$ |
| Land | 2,698,307 | — | 2,698,307 |
| Land rights | 261,699 | 222,908 | 38,791 |
| Buildings | 11,731,148 | 2,440,173 | 9,290,975 |
| Transformer stations | 27,671,174 | 6,855,032 | 20,816,142 |
| Distribution stations | 2,479,193 | 1,047,309 | 1,431,884 |
| Distribution lines - over- head and underground | 98,707,849 | 39,353,080 | 59,354,769 |
| Distribution transformers | 30,915,247 | 11,232,472 | 19,682,775 |
| Distribution meters | 8,248,981 | 2,803,210 | 5,445,771 |
| Other capital assets | 10,775,187 | 6,993,119 | 3,782,068 |
| Construction-in-progress | 1,467,900 | — | 1,467,900 |
| | 194,956,685 | 70,947,303 | 124,009,382 |
| Less: Contributed Capital | (2,477,691) | (99,108) | (2,378,583) |
| | 192,478,994 | 70,848,195 | 121,630,799 |

6. DEFERRED CHARGES-NET OF ACCUMULATED AMORTIZATION

| | Cost | Accumulated Amortization | Net Book Value |
|---------------------------------------|---------|-----------------------------|-------------------|
| 2001 | \$ | \$ | \$ |
| Financial System Software | 497,926 | 216,981 | 280,945 |
| Supervisory Control Software | 55,620 | 35,597 | 20,023 |
| Meter Interrogation Software | 61,071 | 25,675 | 35,396 |
| Computer Aided Design System Software | 286,542 | 79,564 | 206,978 |
| Network Software | 45,408 | 3,028 | 42,380 |
| | 946,567 | 360,845 | 585,722 |

| | Cost | Accumulated Amortization | Net Book Value |
|---------------------------------------|---------|-----------------------------|-------------------|
| 2000 | \$ | \$ | \$ |
| Financial System Software | 468,198 | 129,162 | 339,036 |
| Supervisory Control Software | 55,620 | 28,922 | 26,698 |
| Meter Interrogation Software | 61,071 | 14,963 | 46,108 |
| Computer Aided Design System Software | 251,111 | 27,032 | 224,079 |
| | 836,000 | 200,079 | 635,921 |

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

| | 2001 | 2000 |
|-------------------------------|------------|------------|
| | \$ | \$ |
| Ontario Power Generation Inc. | 12,767,959 | 13,080,287 |
| Other | 1,997,134 | 1,203,512 |
| | 14,765,093 | 14,283,799 |

8. LONG-TERM DEBT

Effective August 1, 2000, Kitchener-Wilmot Hydro Inc. incurred unsecured promissory notes payable to the City of Kitchener and to the Township of Wilmot. The amounts due at the end of the year are:

| | 2001 | 2000 |
|-----------------------------------|------------|------------|
| | \$ | \$ |
| Note payable to City of Kitchener | 70,997,576 | 70,997,576 |
| Township of Wilmot | 5,964,566 | 5,964,566 |
| | 76,962,142 | 76,962,142 |

Interest is payable annually at an annual effective rate of 2.34%, 3.75%, 4.68% for the years 2000, 2001, 2002 respectively and the OEB deemed debt rate [currently 7%] each year thereafter. There are no repayment terms and there is no intent to redeem the notes payable amount.

NOTES TO FINANCIAL STATEMENTS

December 31, 2001

9. PENSION PLAN

The Company did not incur current service pension costs for the year ended December 31, 2001 [2000 - nil]. Effective August 1, 1998, OMERS provided a temporary contribution holiday, with no Company or employee pension contributions required until after December 31, 2002. OMERS contributions are expected to resume on January 1, 2003 and will be phased in over three years and will start at one third of their normal rate.

10. POST-EMPLOYMENT BENEFITS

Kitchener-Wilmot Hydro Inc. pays certain health, dental and life insurance benefits on behalf of its retired employees.

The significant actuarial assumptions adopted in measuring the accrued benefit obligations are as follows:

| | 2001 | 2000 |
|------------------------------------------------|-------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|
| | % | % |
| Discount rate | 6.0 | 6.0 |
| Future general salary and wage levels increase | 2.0 | 2.0 |
| Future general inflation increase | 3.5 | 3.5 |
| Dental costs increase | CPI rate plus a further 3.2% increase in 2001, graded down to CPI in 2010 and thereafter | CPI rate plus a further 3.5% increase in 2000, graded down to 0.0% in 2009 and thereafter |
| Medical costs increase | CPI rate plus a further 11.0% increase in 2001, graded down to CPI in 2010 and thereafter | CPI rate plus a further 11.5% increase in 2000, graded down to 6.5% in 2009 and thereafter |

Information about the Kitchener-Wilmot Hydro's defined benefit plans is as follows:

| | 2001 | 2000 |
|-----------------------------------------------------|-----------|-----------|
| | \$ | \$ |
| Accrued benefit obligation | | |
| Balance at the beg of the year | 3,730,682 | 3,496,220 |
| Expense for the year | 227,773 | 345,851 |
| Benefits paid for the year | (123,759) | (111,389) |
| Balance at the end of the year | 3,834,696 | 3,602,018 |
| Projected accrued benefit obligation at December 31 | 3,834,696 | 3,730,682 |
| Unamortized actuarial gain | - | (128,664) |

11. SHARE CAPITAL

| | 2001 | 2000 |
|-------------------------|------------|------------|
| | \$ | \$ |
| Authorized | | |
| Unlimited common shares | | |
| Issued | | |
| 10,000 common shares | 63,689,499 | 63,689,499 |

12. MISCELLANEOUS REVENUE

| | 2001 | 2000 |
|------------------------------------------------------|-----------|---------|
| | \$ | \$ |
| Proceeds from settlement of class action [note 14] | 553,784 | - |
| Pole attachment rentals, buildings and other rentals | 237,154 | 149,608 |
| Change of occupancy charges | 107,992 | 112,260 |
| Scrap sales | 37,190 | 31,411 |
| Net gain on disposal of capital assets | 23,425 | 55,373 |
| Unsealing/reconnection charges | 18,045 | 18,830 |
| Accounts payable discounts taken | 17,080 | 26,905 |
| Return cheque charges | 12,425 | 12,111 |
| NBV of capital assets disposals | (86) | (2,302) |
| Sundry | 183,875 | 129,665 |
| | 1,190,884 | 533,861 |

NOTES TO FINANCIAL STATEMENTS

December 31, 2001

13. AMORTIZATION EXPENSE

| | 2001 | 2000 |
|--------------------------|------------------|------------------|
| | \$ | \$ |
| Amortization | 6,925,128 | 6,685,761 |
| Various expense accounts | 537,109 | 517,450 |
| | <u>7,462,237</u> | <u>7,203,211</u> |

14. PROCEEDS FROM SETTLEMENT OF CLASS ACTION

During 2001, the Company received \$553,784 representing their pro-rata share of the proceeds from the settlement in the class action against the former Ontario Hydro ["OPGI"]. The Municipal Electric Association's member utilities [MEU] launched the lawsuit in 1997. The lawsuit dealt primarily with three of Ontario Hydro's special rates and subsidies for its large industrial customers and asserted that MEU and their customers were being forced to pay higher rates in order to fund those subsidies. During 2001, the lawsuit was brought to a successful conclusion after court approval of a settlement with OPGI.

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. Reconciliation between the statutory and effective tax rates is provided as follows:

Statement of operations

| | 2001 |
|--------------------------------------------------------------------------------------------|---------------|
| | \$ |
| Rate reconciliation | |
| Income from continuing operations before income taxes | 3,031,842 |
| Statutory Canadian federal and provincial income tax rate | 40.62% |
| Expected taxes on income | 1,231,534 |
| Taxes associated with non-taxable pre-October 1, 2001 income | (2,473,799) |
| Other permanent differences | (10,450) |
| Increase (decrease) in income taxes resulting from: | |
| Large corporations tax net of surtax | 77,953 |
| Post-October 1, 2001, loss not benefited | 986,564 |
| Other timing differences not benefited | (107,380) |
| Effect of rate changes on timing differences | 373,531 |
| Income tax expense | 77,953 |
| | |
| Effective tax rate | 2.57% |
| Components of income tax expense | |
| Current tax expense [Large Corporations Tax] | 77,953 |
| Future income tax expense related to the origination and reversal of temporary differences | - |
| Income tax expense | 77,953 |

Balance Sheet

Future income taxes relating to the regulated businesses have not been recorded in the accounts as they are expected to be recovered through future revenues. As at December 31, 2001, future income tax assets of \$8,835,000, based on substantively enacted income tax rates, have not been recorded.



NOTES TO FINANCIAL STATEMENTS

December 31, 2001

16. NET CHANGE IN NON-CASH OPERATING WORKING CAPITAL

| | 2001 | 2000 |
|-----------------------------------------------------------------|----------------|--------------------|
| | \$ | \$ |
| (Increase) in accounts receivable | (1,122,218) | (2,177,053) |
| Increase in construction and property deposits | 1,011,047 | 112,516 |
| Increase (decrease) in accounts payable and accrued liabilities | 481,294 | (688,047) |
| Increase (decrease) in current portion of customer deposits | 261,000 | (21,000) |
| (Increase) in unbilled revenue receivable | (187,900) | (183,400) |
| Decrease in inventories | 193,901 | 579,759 |
| Decrease prepaid expense and accrued interest rec. | 82,808 | 133,799 |
| | <u>719,932</u> | <u>(2,243,426)</u> |

17. 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 Ontario Energy Board [the "OEB"]. The electricity marketplace will be deregulated and electricity retailers began completing for customers as of March 1, 2000. Electricity retailers cannot begin to sell electricity until the electricity market opening or "Open Access". Open Access commences on the date on which transmitters and distributors are required to provide generators, retailers and consumers with non-discriminatory access to the transmission and distribution systems in Ontario in accordance with their licenses under the Electricity Act, 1998. This date has been determined as May 1, 2002.

The Ontario Energy Board has regulatory authority over the electricity distribution sector. The Act sets out the Board'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 Board 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/process requirements for rate setting purposes.

The market which was originally scheduled to open in November 2000, will open May 1, 2002. Customers will have the choice of continuing to be served by their local distribution companies or to purchase their electricity through a licensed energy retailer when the market opens. The local distribution company will continue to supply electricity to customers who choose not to sign a contract with an electricity retailer.

Transition costs amounting to \$562,793 were incurred during the year 2001, as a result of moving toward a competitive electricity market.

18. COMPARATIVE FIGURES

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



SUPPLEMENTARY FINANCIAL STATEMENTS
KITCHENER-WILMOT HYDRO INC.
January 1 - December 31, 2001

ACCOUNTANTS' REPORT

Our examination of the financial statements of the **Kitchener-Wilmot Hydro Inc.** as at December 31, 2001 was made for the purpose of forming an opinion on the basic financial statements referred to in our auditors' report to the shareholders dated March 7, 2002.

The schedules of year in brief, source and application of revenue dollars, operating statistics, statement of capital assets, statement of transformer station building and equipment, capital expenditures and changes in working capital components are provided for the purpose of additional analysis and are not a required part of the basic financial statements. This information has not been subjected to the auditing procedures applied in the examination of the basic financial statements and, accordingly, we do not express an opinion of the fair presentation of the information referred to above.

Ernst & Young LLP

Kitchener, Canada,
March 7, 2002.

Chartered Accountants

YEAR IN BRIEF



For The Year Ended December 31st

Financial Highlights

| | <u>2001</u> | <u>2000</u> |
|--------------------------------------|----------------|----------------|
| Total Revenue | \$ 148,322,327 | \$ 136,060,893 |
| Total Expenses | 145,517,577 | 132,065,548 |
| Net Income | 2,804,750 | 3,995,345 |
| Capital Expenditures | 11,933,927 | 10,504,055 |
| Net Fixed Assets | 122,604,242 | 121,630,799 |
| Long Term Debt | 76,962,142 | 76,962,142 |
| Shareholders Equity | 66,380,916 | 63,576,166 |
| Rate of Return on Net Capital Assets | 4.2% | 3.4% |
| Debt To Equity Ratio | 53.7% | 55.0% |
| Current Ratio | 2.4 | 2.4 |

Customer Data

| | | |
|----------------------|---------------|---------------|
| Number of Customers | 71,907 | 71,276 |
| Number of Employees | 160.0 | 158.0 |
| Kilowatt Hour Sales | 1,927,085,552 | 1,871,205,310 |
| Kilowatts Purchased | 3,682,802 | 3,588,029 |
| Kilowatt Peak Demand | 365,879 | 325,065 |

Performance Indicators

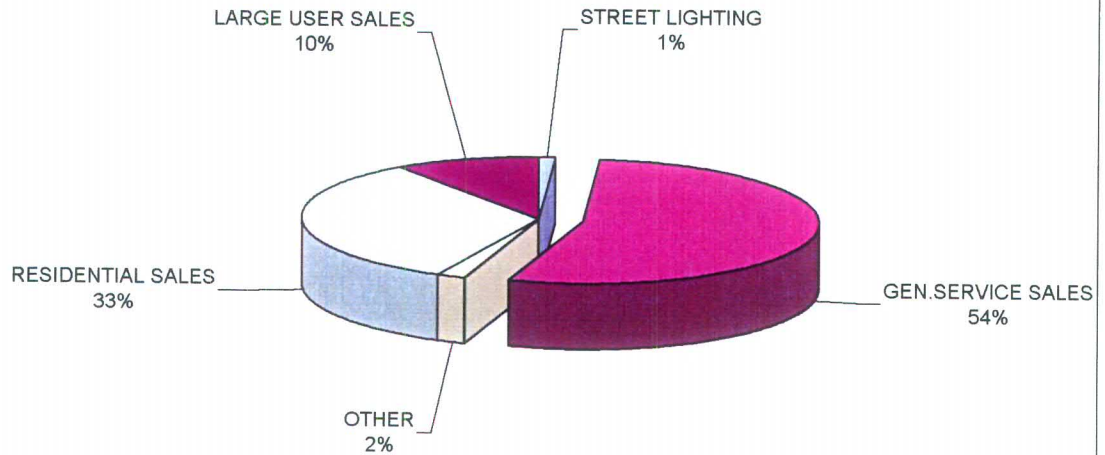
| | | |
|------------------------------------|-----------|-----------|
| Controllable Expenses Per Customer | \$ 110.86 | \$ 110.16 |
| Average Monthly System Load Factor | 73.1% | 73.2% |
| System Efficiency | 97.5% | 97.8% |



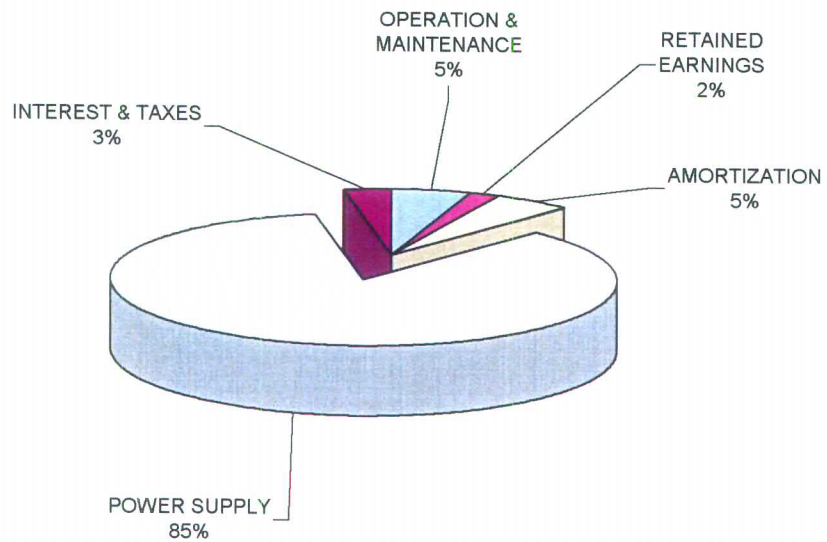
SOURCE & APPLICATION OF REVENUE DOLLARS

For The Year Ended December 31 st

**SOURCE OF REVENUE DOLLARS
2001**



**APPLICATION OF REVENUE DOLLARS
2001**





OPERATING STATISTICS

For The Year Ended December 31st

| | <u>2001</u> | <u>2000</u> |
|-----------------------------------|----------------------|----------------------|
| <u>KILOWATT HOURS SOLD</u> | | |
| Residential | 591,030,949 | 566,089,844 |
| General Service | 1,091,475,446 | 1,101,921,385 |
| Large User | 230,286,087 | 189,083,725 |
| Street Lighting | <u>14,293,070</u> | <u>14,110,356</u> |
| | <u>1,927,085,552</u> | <u>1,871,205,310</u> |
| <u>NUMBER OF CUSTOMERS</u> | | |
| Residential | 64,284 | 63,692 |
| General Service | 7,619 | 7,581 |
| Large User | <u>4</u> | <u>3</u> |
| | <u>71,907</u> | <u>71,276</u> |
| Average Monthly Kilowatts | <u>306,900.2</u> | <u>299,002.5</u> |

STATEMENT OF CAPITAL ASSETS



As at December 31st

| | | <u>2001</u> |
|--------------------------------------------|------------------|---------------------------|
| | | \$ |
| LAND: | | 2,698,307 |
| LAND EASEMENTS: | | 261,699 |
| BUILDINGS: | | |
| Transformer Stations (as per list) | 4,460,239 | |
| Operations Centre - Victoria St. South | 7,020,389 | |
| Vehicle Maintenance Garage Building | <u>399,455</u> | |
| | | 11,880,083 |
| EQUIPMENT: | | |
| Transformer Stations (as per list) | 29,301,854 | |
| Spare Power Transformer | 1,115,380 | |
| Portable Mobile Transformer Substation | 79,664 | |
| Portable Mobile Generator | <u>133,327</u> | |
| | | 30,630,225 |
| Distribution Lines & Feeders - Overhead | | 39,578,356 |
| Distribution Lines & Feeders - Underground | | 64,458,360 |
| Distribution Transformers | 32,333,265 | |
| Network Transformers | <u>348,971</u> | |
| | | 32,682,236 |
| Meters Energy | | 8,728,411 |
| General Office Equipment | 695,751 | |
| Computer Equipment | 1,523,853 | |
| Computer Application Software | 585,722 | |
| Stores Warehouse Equipment | 109,433 | |
| Vehicles & Equipment | 5,901,139 | |
| Major Tools, Instruments & Radios | 1,325,683 | |
| System Supervisory Equipment | 1,901,407 | |
| Transition Work in Progress | 392,830 | |
| Wires Construction Work in Progress | <u>3,661,977</u> | |
| | | 16,097,795 |
| Contributed Capital | | <u>(6,026,051)</u> |
| | | <u>200,989,421</u> |
| INVENTORIES: | | <u>2001</u> |
| | | \$ |
| Stores Inventory | | 1,708,219 |
| Transformers in Inventory | | 417,210 |
| Meters in Inventory | | <u>45,913</u> |
| | | <u>2,171,342</u> |



STATEMENT OF TRANSFORMER STATION BUILDINGS AND EQUIPMENT

As at December 31st

| | <u>2001</u> \$ | <u>2001</u> \$ |
|---------------------------------------|-------------------------|--------------------------|
| | <u>BUILDINGS</u> | <u>EQUIPMENT</u> |
| Distribution Station #1 New Hamburg | 110,211 | 403,613 |
| Distribution Station #2 New Hamburg | 31,314 | 262,291 |
| Distribution Station #3 New Dundee | 122,611 | 330,143 |
| Distribution Station #5 Josephsburg | 50,227 | 239,304 |
| Distribution Station #6 Baden | 109,666 | 219,676 |
| Distribution Station #7 New Hamburg | 144,047 | 324,630 |
| Distribution Station #8 Philipsburg | 156,153 | 486,545 |
| High Tension Station #1 West Avenue | 709,637 | 4,402,862 |
| High Tension Station #2 Bleams Road | 460,149 | 1,312,316 |
| High Tension Station #3 Bleams Road | 792,363 | 4,780,777 |
| High Tension Station #4 West Avenue | 156,309 | 3,831,206 |
| High Tension Station #5 Graber Place | 402,273 | 2,745,511 |
| High Tension Station #6 Ottawa St. S. | 548,653 | 5,854,801 |
| High Tension Station #7 Fairway Road | 666,626 | 4,108,179 |
| | <u><u>4,460,239</u></u> | <u><u>29,301,854</u></u> |



CAPITAL EXPENDITURES

For The Year Ended December 31st

2001
\$

Buildings

Operations Centre - Victoria St. S.
High tension station building # 3

49,519

99,419

148,938

High tension station equipment

High tension station # 3
High tension station # 4
High tension station # 6

147,612

331,712

534

479,858

Distribution lines

Overhead
Underground

2,266,124

3,062,744

5,328,868

Distribution transformers

1,766,988

Meters

479,430

Office equipment

53,263

Computer equipment

217,177

Information systems software

110,567

System supervisory equipment

31,752

Vehicles and equipment

614,558

Tools, instruments and radio equipment

73,010

Meter shop accreditation

42,612

Construction in progress

2,194,076

11,541,097

Market-ready transition work in progress

392,830



CHANGES IN WORKING CAPITAL COMPONENTS

As at December 31st

| | <u>2001</u> | | |
|----------------------------|--------------------------|--|--|
| | \$ | | |
| Current Assets | 42,642,874 | | |
| Current Liabilities | <u>17,786,917</u> | | |
| Working Capital | <u>24,855,957</u> | | |

| | <u>2001</u> | <u>2000</u> | <u>Change</u> |
|----------------------------------------|--------------------------|--------------------------|-------------------------|
| | \$ | \$ | \$ |
| Cash and cash equivalents | 17,365,963 | 14,396,056 | 2,969,907 |
| Accounts receivable | 12,808,631 | 11,686,414 | 1,122,217 |
| Unbilled revenue receivable | 10,121,300 | 9,933,400 | 187,900 |
| Inventories | 2,171,342 | 2,365,243 | (193,901) |
| Prepaid expenses | 146,646 | 204,372 | (57,726) |
| Accrued interest receivable | 28,992 | 54,073 | (25,081) |
| Accounts payable & accrued liabilities | 14,765,093 | 14,283,799 | (481,294) |
| Current portion of customers deposits | 865,000 | 604,000 | (261,000) |
| Construction and property deposits | <u>2,156,824</u> | <u>1,145,777</u> | <u>(1,011,047)</u> |
| Working capital | <u>24,855,957</u> | <u>22,605,982</u> | <u>2,249,975</u> |