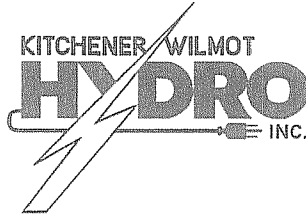




**FINANCIAL STATEMENTS**  
**KITCHENER-WILMOT HYDRO INC.**  
**January 1 - December 31, 2003**



March 10, 2004

**REPORT TO SHAREHOLDERS:**

**CORPORATION OF THE CITY OF KITCHENER**

**CORPORATION OF THE TOWNSHIP OF WILMOT**

We are pleased to provide you with the third Annual Report of Kitchener-Wilmot Hydro Inc. for the period ending December 31, 2003.

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 third full fiscal year of operations for the new Corporation.

2003 was again a year of enormous change for Ontario's electricity industry and Kitchener-Wilmot Hydro Inc. again met the challenge of responding effectively and in a timely manner to numerous changes requested by the Ontario Energy Board.


Following market opening on May 1, 2002 customers response was vocal in their reaction to rising volatile prices. In response, the Government of Ontario changed the rules for industry participants through Bill 210, the Electricity Pricing Conservation and Supply Act. Most significantly was the freezing of electricity commodity prices at 4.3¢ per kWh for many customers, including all residential, low volume and designated customers through to 2006. Regulated distribution rates were also capped through that period and our planned distribution rate increase for March 2003 was subsequently cancelled.

More recently, the Government of Ontario has passed Bill 4 which will see the 4.3¢ energy price cap lifted in the spring of 2004.

On August 14, 2003, the majority of the Province of Ontario experienced a system wide blackout. Kitchener-Wilmot Hydro staff implemented the utility's emergency plans designed for such events and the plans proved effective in returning the system to normal.

Your Corporation continues to deliver electricity to the citizens of our communities with the lowest local residential retail rates. By controlling costs the Corporation continues to have the lowest local distribution costs amongst all the major utilities in the province. At the same time, the system infrastructure is continually being refurbished and enhanced in order to continue to provide a reliable and a 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 and provides a supporting base for economic development in the communities we serve.

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 and its ever changing environment.

  
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B. LEE, CHAIR  
\_\_\_\_\_  
R. CHARIE, PRESIDENT & C.E.O.



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**Chartered Accountants**

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## **AUDITORS' REPORT**

We have audited the balance sheet of Kitchener-Wilmot Hydro Inc. as at December 31, 2003 and the statements of operations, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of 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.

The comparative figures were audited by another firm of Chartered Accountants.

Chartered Accountants

London, Canada  
February 20, 2004





## BALANCE SHEET

As at December 31st

	<u>2003</u> \$	<u>2002</u> \$
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	25,779,810	18,792,725
Accounts receivable (note 4)	12,313,456	17,081,797
Accounts receivable from related parties (note 5)	496,563	120,777
Unbilled revenue receivable	14,646,500	14,374,300
Inventories	2,428,205	2,389,343
Prepaid expenses	419,889	412,323
Accrued interest receivable	52,212	32,014
<b>Total current assets</b>	<u>56,136,635</u>	<u>53,203,279</u>
Capital assets - net of accumulated amortization (note 6)	124,912,415	124,183,068
Computer software - net of accumulated amortization (note 7)	421,102	479,552
Regulatory assets (note 8)	6,060,949	5,581,699
Reserve for impairment of regulatory assets (notes 2 & 3)	<u>(3,444,911)</u>	<u>(3,444,911)</u>
<b>Total assets</b>	<u><u>184,086,190</u></u>	<u><u>180,002,687</u></u>
<b>LIABILITIES and SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities (note 9)	16,097,112	18,806,592
Payments-in-lieu of corporate income taxes payable	127,761	1,736,642
Current portion of customers deposits	2,155,000	1,458,000
Construction and property deposits	<u>3,362,404</u>	<u>4,072,710</u>
<b>Total current liabilities</b>	<u>21,742,277</u>	<u>26,073,944</u>
<b>Long-term liabilities</b>		
Long-term debt (note 10)	76,962,142	76,962,142
Customer deposits	2,155,097	1,458,002
Retailer prudential deposits	372,098	369,435
Post-employment benefits (note 12)	4,392,363	4,067,523
Regulatory liabilities (note 8)	<u>3,322,873</u>	<u>-</u>
<b>Total long-term liabilities</b>	<u>87,204,573</u>	<u>82,857,102</u>
<b>Total liabilities</b>	<u>108,946,850</u>	<u>108,931,046</u>
<b>Shareholders' equity</b>		
Share capital, - common shares (note 13)	63,689,499	63,689,499
Retained earnings	<u>11,449,841</u>	<u>7,382,142</u>
<b>Total shareholders' equity</b>	<u>75,139,340</u>	<u>71,071,641</u>
<b>Total liabilities and shareholders' equity</b>	<u><u>184,086,190</u></u>	<u><u>180,002,687</u></u>

See accompanying notes

Kitchener-Wilmot Hydro Inc.



## STATEMENT OF RETAINED EARNINGS

For the Year Ended December 31st

	<u>2003</u>	<u>2002</u>
	\$	\$
Retained earnings, beginning of year	7,382,142	2,691,417
Net Income	4,067,699	4,690,725
Retained earnings, end of year	<u>11,449,841</u>	<u>7,382,142</u>

See accompanying notes



# STATEMENT OF OPERATIONS

For the Year Ended December 31st

	<u>2003</u>	<u>2002</u>
	\$	\$
<b><u>REVENUE</u></b>		
<b>Sales revenue</b>		
Distribution services revenue	29,792,692	29,008,419
Electricity sales	101,927,448	113,198,998
Wholesale market services	12,400,637	8,452,246
Transmission services	14,452,040	11,238,980
Retailer services	96,209	46,557
	<u>158,669,026</u>	<u>161,945,200</u>
<b>Other revenue</b>		
Investment income	523,597	548,619
Late payment penalties	201,756	399,693
Miscellaneous (note 14)	822,118	892,658
	<u>1,547,471</u>	<u>1,840,970</u>
<b>Total revenue</b>	<u>160,216,497</u>	<u>163,786,170</u>
<b><u>EXPENSES</u></b>		
Electricity purchases	101,927,448	113,198,998
Reserve for impairment of regulatory assets	-	2,526,968
Wholesale market services	12,400,637	8,452,246
Transmission services	14,452,040	11,238,980
Retailer services	96,209	46,557
Distribution operations	2,299,963	2,086,117
Distribution maintenance	2,854,332	2,880,289
General administration	2,316,149	1,988,213
Customer accounts	2,158,237	2,372,665
Community relations	311,082	129,987
Property and capital taxes	972,486	980,218
Amortization (note 15)	7,510,231	7,184,857
<b>Total expenses</b>	<u>147,298,814</u>	<u>153,086,095</u>
<b>Income before interest and provision for payments in lieu of corporate income taxes</b>	<u>12,917,683</u>	<u>10,700,075</u>
Interest expense	5,530,672	3,715,810
<b>Income before provision for payments in lieu of corporate income taxes</b>	<u>7,387,011</u>	<u>6,984,265</u>
Provision for payments in lieu of corporate income taxes (note 16)	3,319,312	2,293,540
<b>NET INCOME</b>	<u>4,067,699</u>	<u>4,690,725</u>
See accompanying notes		



# STATEMENT OF CASH FLOWS

For the Year Ended December 31st

	<u>2003</u>	<u>2002</u>
	\$	\$
<b><u>OPERATING ACTIVITIES</u></b>		
Net income	4,067,699	4,690,725
Add (deduct) charges to operations not requiring a current cash payment:		
Gain on disposal of capital assets	(20,123)	(80,491)
Amortization (note 15)	8,034,173	7,713,430
Increase in post-employment benefits obligation (note 12)	324,840	232,827
Increase in non-current customer deposits	699,759	959,269
Net change in non-cash operating working capital (note 17)	(277,938)	1,680,352
<b>Cash provided by operating activities</b>	<u>12,828,410</u>	<u>15,196,112</u>
<b><u>INVESTING ACTIVITIES</u></b>		
Additions to capital assets	(12,959,980)	(12,314,357)
Decrease (additions) to regulatory assets/liabilities	2,843,623	(4,270,927)
Proceeds on disposals of capital assets	24,064	88,020
<b>Cash (applied to) investing activities</b>	<u>(10,092,293)</u>	<u>(16,497,264)</u>
<b><u>FINANCING ACTIVITIES</u></b>		
Increase in contributed capital	4,250,968	2,727,914
<b>Cash provided by financing activities</b>	<u>4,250,968</u>	<u>2,727,914</u>
Net cash provided during year	6,987,085	1,426,762
Cash and cash equivalents, beginning of year	18,792,725	17,365,963
<b>Cash and cash equivalents, end of year</b>	<u>25,779,810</u>	<u>18,792,725</u>
<b>Cash and cash equivalents is represented by:</b>		
Cash	279,810	1,792,725
Cash equivalents	25,500,000	17,000,000
	<u>25,779,810</u>	<u>18,792,725</u>
<b>Supplemental cash flow information</b>		
Interest paid	5,435,473	3,601,828
Payments in lieu of corporate income taxes and capital taxes	3,642,734	1,018,258

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. on November 1, 2000 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.

### 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 ["AP Handbook"] and reflect the significant accounting policies as summarized below:

#### **Rate regulation**

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.

On December 9, 2002, Royal Assent was given to Bill 210 [the "Electricity Pricing, Conservation and Supply Act, 2002"] that made amendments to the Ontario Energy Board Act, 1998.

On December 18, 2003, Royal Assent was given to Bill 4, [the "Ontario Energy Board Amendment Act, (Electricity Pricing), 2003"], introduced by the new Liberal government of Ontario, that will remove the commodity price freeze for low volume and designated customers on April 1, 2004 and implement an interim two-tier pricing structure. It also authorizes the Ontario Energy Board (OEB) to develop new mechanisms for setting future electricity prices for low volume and designated customers.

The economic impact of rate regulation is reported in these financial statements. Regulatory assets represent certain costs that may be recovered from customers in future periods through the rate-making process. In its capacity to approve or fix rates, the OEB has specified the following regulatory treatments, which have resulted in accounting treatments that differ from GAAP for enterprises operating in a non-regulated environment:

#### **Regulatory assets and liabilities**

Bill 210 deems certain costs and variance account balances to be accounted for as regulatory assets. Recovery of these costs are subject to OEB review and approval.

Bill 4 will allow LDC's to adjust their distribution rates to recover some of its regulatory assets starting April 1, 2004, over a four-year period.

#### **[i] Transition costs:**

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 AP Handbook. Under such regulation, certain costs are allowed to be deferred that would be expensed when incurred under GAAP. 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.

#### **[ii] Pre-market Opening Energy variance:**

At December 31, 2002, the Corporation recognized the pre-market opening energy variance [the "variance"] for the period January 1, 2001 to April 30, 2002, the date of market opening [notes 3 and 8], in accordance with the AP Handbook. The variance represents the difference between the utility's cost of power purchased based upon time-of-use ["TOU"] rates, and the amounts billed for the cost of power to non-TOU customers at an average rate for the same period.

## NOTES TO FINANCIAL STATEMENTS

### 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### [iii] Settlement variances:

The Corporation has recognized settlement variances in accordance with criteria set out in the AP Handbook. The settlement variances relate primarily to service charges, non-competitive electricity charges, and power charges [note 8]. Other than the variance for the cost of imported power, the nature of the settlement variances is such that their balance shall change each reporting period-end date.

#### 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. Inventories consist of stores \$1,717,330 (2002-\$1,721,493), transformers \$660,049 (2002-\$556,341), and meters \$50,826 (2002-\$111,510).

#### Spare transformers and meters

Spare transformers and meters are classified as capital assets in accordance with guidance in the CICA Handbook.

#### 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.

## NOTES TO FINANCIAL STATEMENTS



### 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **Computer software**

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.

#### **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 Kitchener-Wilmot Hydro 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.

#### **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 those estimates including changes as a result of future decisions made by the OEB, Minister of Energy, or the Minister of Finance.

## NOTES TO FINANCIAL STATEMENTS

### 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Payments-in-lieu of 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 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.

### 3. 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 and the regulation of the monopoly electricity delivery system in the Province of Ontario, by the Ontario Energy Board [the "OEB"]. Electricity retailers began competing for customers as of March 1, 2000. On May 1, 2002, with the electricity market opening, or "Open Access", electricity retailers, including Energy Services, began to sell electricity.

The Ontario Energy Board 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 Ontario Energy Board Act, 1998. The OEB may prescribe license requirements and conditions including, among other things, specified accounting records, regulatory accounting principles, separation of accounts for separate businesses and filing/process requirements for rate setting purposes.

On December 9, 2002, Royal Assent was given to Bill 210 [the "Electricity Pricing, Conservation and Supply Act, 2002"] Bill 210 made amendments to the Ontario Energy Board Act, 1998.

On December 18, 2003, Royal Assent was given to Bill 4, [the "Ontario Energy Board Amendment Act, (Electricity Pricing), 2003"].

[a] Effective May 1, 2002 Rates for the electricity commodity were capped at 4.3 cents per kilowatt-hour, for residential customers and small business customers with consumption of less than 150,000 kilowatt-hours per year, for a designated customer class. Bill 4 will remove the 4.3 cents commodity price freeze for low volume and designated customers. Starting April 1, 2004, a two-block pricing regime will be implemented for all customers who are currently eligible for the 4.3 cent commodity rate. The first 750 kilowatt-hour per month will be priced at 4.7 cents. Any consumption above that amount will be priced at 5.5 cents. This regime will remain in place until no later than May 1, 2005, when the OEB will take over the setting of retail prices.

[b] Under Bill 210, the Corporation's electricity distribution rates, in effect on November 11, 2002, were capped to the year 2006. With the introduction of Bill 4, the Corporation will be allowed to recover some of its' regulatory assets \$479,250 (2003), \$4,663,756 (2002) and \$917,943 (2001) under the supervision of the OEB over a four-year period starting April 1, 2004 [notes 2 and 8].

## NOTES TO FINANCIAL STATEMENTS

### 3. ELECTRIC INDUSTRY RESTRUCTURING AND REGULATION (CONTINUED)

[c] Due to the uncertainty of the amount of recovery, and in light of the lengthy time span (2008) with associated political risks, management has recorded a reserve for regulatory asset impairment in the amount of \$3,444,911. This represents the pre-market opening energy variance of \$3,033,473 as well as the transition costs of \$411,438 incurred to meet the requirements of market readiness.

[d] Bill 4 also allows electricity distributors to adjust their distribution rates starting March 1, 2005, to achieve their full commercial rate of return conditional on LDCs reinvesting the equivalent of one year of these monies in conservation and demand management initiatives. The specifics of this reinvestment obligation have not yet been detailed. The maximum rate of return which had been set by the OEB before Bill 210 was 9.88%.

### 4. ACCOUNTS RECEIVABLE

	2003	2002
	\$	\$
Electrical energy	11,188,213	13,523,653
Miscellaneous	1,450,243	3,883,144
	<u>12,638,456</u>	<u>17,406,797</u>
Less: Allowance for doubtful accounts	325,000	325,000
	<u>12,313,456</u>	<u>17,081,797</u>

### 5. 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 \$290,079 (2002-\$195,917) as well as capital and maintenance street light services billed to the City of Kitchener in the amount of \$450,906 (2002-\$338,112) and to the Township of Wilmot in the amount of \$52,003 (2002-\$20,691). 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:

	2003	2002
	\$	\$
Receivable from Fibretech Telecommunications Inc.	3,965	17,171
Receivable from City of Kitchener	464,253	95,092
Receivable from Township of Wilmot	28,345	8,514
	<u>496,563</u>	<u>120,777</u>

### 6. CAPITAL ASSETS

	Cost	Accumulated Amortization	Net Book Value
2003	\$	\$	\$
Land	2,698,307	---	2,698,307
Land rights	261,699	231,646	30,053
Buildings	13,068,057	3,073,394	9,994,663
Transformer stations	31,879,137	9,070,417	22,808,720
Distribution stations	2,759,055	1,317,786	1,441,269
Distribution lines - overhead and underground	118,969,119	52,082,619	66,886,500
Distribution transformers	36,270,685	15,286,233	20,984,452
Distribution meters	9,482,610	3,856,090	5,626,520
Other capital assets	12,758,381	8,548,594	4,209,787
Construction-in-progress	2,029,442	---	2,029,442
	<u>230,176,492</u>	<u>93,466,779</u>	<u>136,709,713</u>
Less: Contributed Capital	(13,004,934)	(1,207,636)	(11,797,298)
	<u>217,171,558</u>	<u>92,259,143</u>	<u>124,912,415</u>

# NOTES TO FINANCIAL STATEMENTS

December 31, 2003

## 6. CAPITAL ASSETS (CONTINUED)

2002	Cost \$	Accumulated Amortization \$	Net Book Value \$
Land	2,698,307	---	2,698,307
Land rights	261,699	228,734	32,965
Buildings	13,051,666	2,861,933	10,189,733
Transformer stations	30,742,816	8,316,429	22,426,387
Distribution stations	2,759,055	1,224,518	1,534,537
Distribution lines - overhead and underground	109,714,547	47,516,945	62,197,602
Distribution transformers	34,188,019	13,858,403	20,329,616
Distribution meters	9,036,386	3,489,124	5,547,262
Other capital assets	12,038,413	7,941,465	4,096,948
Construction-in-progress	3,196,237	---	3,196,237
	217,687,145	85,437,551	132,249,594
Less: Contributed Capital	(8,753,965)	(687,439)	(8,066,526)
	208,933,180	84,750,112	124,183,068

## 7. COMPUTER SOFTWARE-NET OF ACCUMULATED AMORTIZATION

2003	Cost \$	Accumulated Amortization \$	Net Book Value \$
Financial System Software	551,237	391,266	159,971
Supervisory Control Software	60,620	50,529	10,091
Meter Interrogation Software	61,071	47,101	13,970
Computer Aided Design System Software	338,014	204,513	133,501
Network Software	91,017	28,777	62,240
Human Resources Software	42,362	1,033	41,329
	1,144,321	723,219	421,102

2002	Cost \$	Accumulated Amortization \$	Net Book Value \$
Financial System Software	497,926	304,800	193,126
Supervisory Control Software	60,619	42,854	17,765
Meter Interrogation Software	61,071	36,388	24,683
Computer Aided Design System Software	319,242	138,958	180,284
Network Software	76,660	12,966	63,694
	1,015,518	535,966	479,552

## 8. REGULATORY ASSETS & REGULATORY LIABILITIES

Regulatory assets consist of the following [note 2, rate regulation]:

	2003 \$	2002 \$
Transition costs	439,463	411,438
Pre-market opening energy variance	3,033,473	3,033,473
Retail settlement variances	2,450,921	2,019,655
Retail cost variances	37,384	17,425
Bill 210 rebate program costs	99,708	99,708
	6,060,949	5,581,699

Regulatory liabilities consist of the following [note 2, rate regulation]:

	2003 \$	2002 \$
Retail settlement variances	(3,322,873)	---

## NOTES TO FINANCIAL STATEMENTS

### 9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2003	2002
	\$	\$
Independent Electricity Market Operator	11,664,093	11,619,341
Ontario Electricity Financial Corporation	968,370	1,277,087
Provincial Bill 210, MPMA, BPPR rebates	26,569	3,462,205
Other	3,438,080	2,447,959
	<u>16,097,112</u>	<u>18,806,592</u>

### 10. 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:

	2003	2002
	\$	\$
Note payable to City of Kitchener	70,997,576	70,997,576
Township of Wilmot	5,964,566	5,964,566
	<u>76,962,142</u>	<u>76,962,142</u>

Interest is payable annually at an annual effective rate of 7.00% for the year 2003 and the OEB deemed rate [currently 7%] each year thereafter. Repayment of all or part of the outstanding principal may be made upon eighteen months written notice. During the year, the Corporation paid \$4,969,830 (2002-\$3,322,687) interest to the City of Kitchener and \$417,520 (2002-\$279,142) to the Township of Wilmot.

### 11. PENSION PLAN

The Company incurred current service pension costs of \$197,604 for the year ended December 31, 2003 [2002 - 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 have resumed on January 1, 2003 at reduced rates and will return to full levels at higher rates than before the contribution holiday, effective January 1, 2004.

### 12. 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:

	2003	2002
	%	%
Discount rate	5.5	6.0
Future general salary and wage levels increase	3.5	2.0
Future general inflation increase	2.2	3.5
Dental costs increase	CPI rate plus a further 3.75% increase in 2003, graded down to 1.3% in 2010 and thereafter	CPI rate plus a further 2.8% increase in 2002, graded down to CPI in 2011 and thereafter
Medical costs increase	CPI rate plus a further 11.3% increase in 2003, graded down to 7.8% in 2010 and thereafter	CPI rate plus a further 10.5% increase in 2002, graded down to CPI in 2011 and thereafter

## NOTES TO FINANCIAL STATEMENTS

December 31, 2003

### 12. POST-EMPLOYMENT BENEFITS (CONTINUED)

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

	2003	2002
	\$	\$
<b>Accrued benefit obligation</b>		
Balance at the beginning of the year	4,067,523	3,834,696
Benefit cost for the year	472,108	366,114
Benefits paid for the year	(147,268)	(133,287)
Projected accrued benefit obligation at December 31 as determined by actuarial valuation	<u>4,392,363</u>	<u>4,067,523</u>
Unamortized actuarial gain	<u>-</u>	<u>-</u>

### 13. SHARE CAPITAL

	2003	2002
	\$	\$
<b>Authorized</b>		
Unlimited common shares		
<b>Issued</b>		
10,000 common shares	<u>63,689,499</u>	<u>63,689,499</u>

### 14. MISCELLANEOUS REVENUE

	2003	2002
	\$	\$
Pole attachment rentals, buildings and other rentals	482,826	473,212
Change of occupancy charges	135,601	120,794
Scrap sales	33,871	66,849
Net gain on disposal of capital assets	20,123	80,491
Unsealing/reconnection charges	14,550	14,855
Accounts payable discounts taken	22,057	11,892
Return cheque charges	13,525	13,608
Sundry	99,565	110,957
	<u>822,118</u>	<u>892,658</u>

### 15. AMORTIZATION

	2003	2002
	\$	\$
Amortization	7,510,231	7,184,857
Various expense accounts	523,942	528,573
	<u>8,034,173</u>	<u>7,713,430</u>



## NOTES TO FINANCIAL STATEMENTS

### 16. 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

	2003	2002
	\$	\$
<b>Rate reconciliation</b>		
Income from continuing operations before income taxes	7,387,012	6,984,265
Statutory Canadian federal and provincial income tax rate	36.62%	38.62%
Expected taxes on income	2,705,124	2,697,323
Taxes associated with non-taxable pre-October 1, 2001 income	-	-
Other permanent differences	5,780	(5,141)
Increase (decrease) in income taxes resulting from:		
Tax on non-deductible reserves	-	975,915
Utilization of temporary differences previously unbenefited	-	(1,878,682)
Large corporations tax net of surtax	251,052	274,258
Post-October 1, 2001, loss not benefited	-	-
Other current year timing differences not benefited	296,270	(226,243)
Effect of rate changes on timing differences	-	456,110
Increase tax on investment income	61,086	-
<b>Income tax expense</b>	<b>3,319,312</b>	<b>2,293,540</b>
<b>Effective tax rate</b>	<b>44.93%</b>	<b>32.84%</b>
<b>Components of income tax expense</b>		
Current tax expense [including Large Corporations Tax]	3,319,312	2,293,540
Future income tax expense related to the origination and reversal of temporary differences	-	-
<b>Income tax expense</b>	<b>3,319,312</b>	<b>2,293,540</b>

#### 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, 2003, future income tax assets of \$9,417,796 (2002 - \$8,674,771), based on substantively enacted income tax rates, have not been recorded.

### 17. NET CHANGE IN NON-CASH OPERATING WORKING CAPITAL

	2003	2002
	\$	\$
Decrease (Increase) in accounts receivable	4,392,556	(4,393,943)
(Decrease) Increase in construction and property deposits	(710,306)	1,915,886
(Decrease) Increase in reserve-impairment of regulatory assets	-	2,526,968
(Decrease) Increase in accounts payable and accrued liabilities	(4,318,362)	5,778,141
Increase in current portion of customer deposits	697,000	593,000
(Increase) in unbilled revenue receivable	(272,200)	(4,253,000)
(Increase) in inventories	(38,862)	(218,001)
(Increase) prepaid expense and accrued interest rec.	(27,764)	(268,699)
	<b>(277,938)</b>	<b>1,680,352</b>

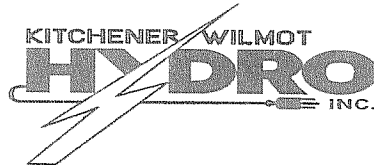
### 18. CREDIT RISK AND FINANCIAL INSTRUMENTS

#### Credit risk

For distribution retail customers, credit losses are generally low across the sector. The Company provides for an allowance for doubtful accounts to absorb credit losses. At December 31, 2003, there are no significant concentrations of credit risk with respect to any class of financial assets.

#### Fair value of financial instruments

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and promissory notes payable approximates their fair value due to the immediate or short-term maturity of these financial instruments.



**SUPPLEMENTARY FINANCIAL STATEMENTS**  
**KITCHENER-WILMOT HYDRO INC.**  
**January 1 - December 31, 2003**



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## AUDITORS' REPORT ON SUPPLEMENTARY FINANCIAL INFORMATION

Kitchener-Wilmot Hydro Inc.

We have audited and reported separately herein on the financial statements of Kitchener-Wilmot Hydro Inc. as at and for the year ended December 31, 2003.

Our audit was conducted for purposes of forming an opinion on the basic financial statements of the Company taken as a whole. The supplementary information included in the Supplementary Financial Statements is prepared for purposes of additional analysis and is not a required part of the basic financial statements. Such supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The comparative figures were audited by another firm of Chartered Accountants.

Chartered Accountants

London, Canada  
February 20, 2004





## YEAR IN BRIEF

For The Year Ended December 31st

### Financial Highlights

	<u>2003</u>	<u>2002</u>
Total Revenue	\$ 160,216,497	\$ 163,786,170
Total Expenses	156,148,798	159,095,445
Net Income	4,067,699	4,690,725
Capital Expenditures	12,959,980	12,325,157
Net Capital Assets	124,912,415	124,183,068
Long Term Debt	76,962,142	76,962,142
Shareholders Equity	75,139,340	71,071,641
Rate of Return on Net Capital Assets	6.79%	5.75%
Debt To Equity Ratio	50.6%	52.0%
Current Ratio	2.6	2.0

### Customer Data

Number of Customers	75,269	73,324
Number of Employees	166.0	163.0
Kilowatt Hour Sales	2,023,071,898	2,019,109,568
Kilowatts Purchased	3,735,369	3,839,477
Kilowatt Peak Demand	357,759	360,765

### Performance Indicators

Controllable Expenses Per Customer	\$ 132.06	\$ 128.98
Average Monthly System Load Factor	73.3%	72.5%

	<u>OEB Standard</u>	<u>Annual % Met within Minimum Standards</u>	<u>Annual % Met within Minimum Standards</u>
Connection of new services-Low Voltage	90.0%	92.0%	94.0%
Connection of new services-High Voltage	90.0%	100.0%	100.0%
Underground cable locates	90.0%	100.0%	97.0%
Telephone Accessibility	65.0%	74.0%	73.0%
Appointments Met	90.0%	94.0%	94.0%
Written responses to inquiries	80.0%	100.0%	100.0%
Emergency response-Urban areas	80.0%	96.0%	97.0%
Emergency response-Rural areas	80.0%	100.0%	95.0%

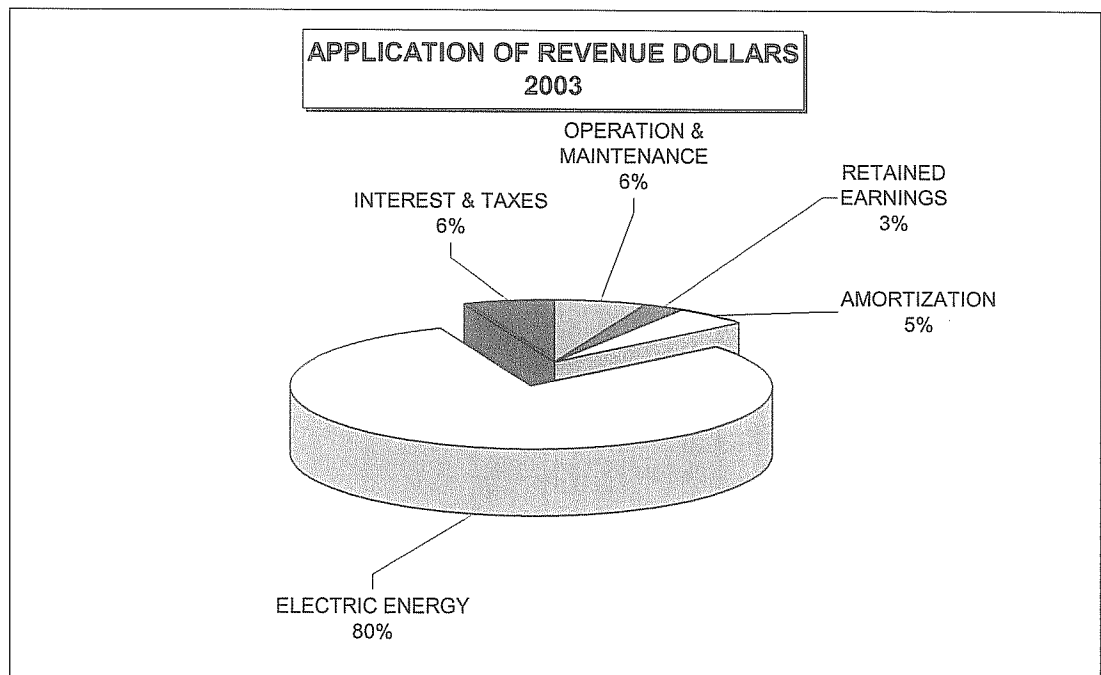
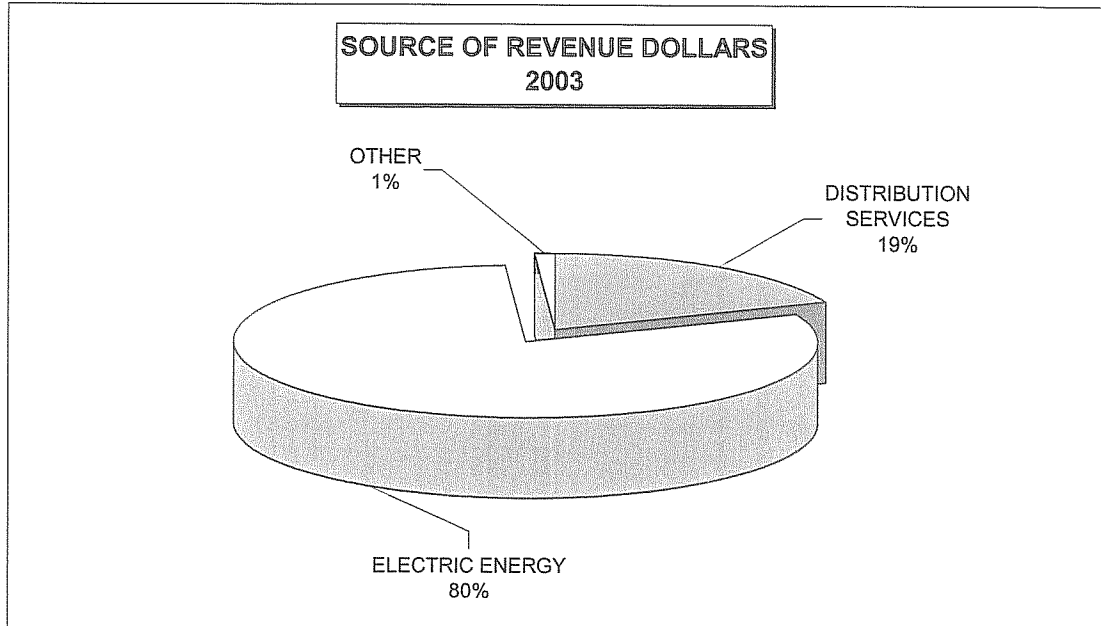
### Service Reliability Indices

System Average Interruption Duration (minutes)	57.8	42.0
System Average Interruption Frequency Index - (average number of interruptions per customer)	1.41	0.77
Customer Average Interruption Duration (minutes)	41.1	54.6

## SOURCE & APPLICATION OF REVENUE DOLLARS



For The Year Ended December 31 st





# OPERATING STATISTICS

For The Year Ended December 31st

	<u>2003</u>	<u>2002</u>
<b><u>KILOWATT HOURS SOLD</u></b>		
Residential	628,458,654	627,482,547
General Service	1,124,929,539	1,120,041,595
Large User	254,413,811	258,723,198
Street Lighting	<u>15,269,894</u>	<u>12,862,228</u>
	<u>2,023,071,898</u>	<u>2,019,109,568</u>
<b><u>NUMBER OF CUSTOMERS</u></b>		
Residential	67,527	65,683
General Service	7,738	7,637
Large User	<u>4</u>	<u>4</u>
SL	<u>75,269</u>	<u>73,324</u>
Average Monthly Kilowatts	<u>311,280.8</u>	<u>319,956.5</u>

## STATEMENT OF CAPITAL ASSETS



As at December 31st

		<u>2003</u>
		\$
<b>LAND:</b>		2,698,307
<b>LAND EASEMENTS:</b>		261,699
<b>BUILDINGS:</b>		
Transformer Stations (as per list)	5,631,820	
Operations Centre - Victoria St. South	7,036,779	
Vehicle Maintenance Garage Building	<u>399,455</u>	
		13,068,054
<b>EQUIPMENT:</b>		
Transformer Stations (as per list)	33,309,822	
Spare Power Transformer	1,115,380	
Portable Mobile Transformer Substation	79,664	
Portable Mobile Generator	133,327	
		34,638,193
Distribution Lines & Feeders - Overhead		45,598,866
Distribution Lines & Feeders - Underground		73,370,253
Distribution Transformers	35,971,295	
Network Transformers	<u>299,390</u>	
		36,270,685
Meters Energy		9,482,610
General Office Equipment	763,974	
Computer Equipment	1,928,189	
Computer Application Software	421,102	
Stores Warehouse Equipment	109,433	
Vehicles & Equipment	6,600,596	
Major Tools, Instruments & Radios	1,459,643	
Safety Equipment	5,940	
System Supervisory Equipment	1,890,607	
Construction Work in Progress	<u>2,029,442</u>	
		15,208,926
Contributed Capital		<u>(13,004,934)</u>
		<u>217,592,659</u>
<b>INVENTORIES:</b>		<u>2003</u>
		\$
Stores Inventory		1,717,330
Transformers in Inventory		660,049
Meters in Inventory		<u>50,826</u>
		<u>2,428,205</u>



# STATEMENT OF TRANSFORMER STATION BUILDINGS AND EQUIPMENT

As at December 31st

	<u>2003</u> \$	<u>2003</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	493,728
Distribution Station #7 New Hamburg	144,047	330,440
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	817,729	6,411,480
High Tension Station #4 West Avenue	156,309	4,010,989
High Tension Station #5 Graber Place	402,273	2,759,607
High Tension Station #6 Ottawa St. S.	548,653	5,854,801
High Tension Station #7 Fairway Road	666,626	4,108,179
High Tension Station #8 Huron Road	1,146,215	1,903,524
	<u><b>5,631,820</b></u>	<u><b>33,309,822</b></u>



# CAPITAL EXPENDITURES



For The Year Ended December 31st

2003

\$

## Buildings

Operations Centre-Victoria St. S.

16,391

## High tension station equipment

High tension station # 3

11,597

High tension station # 4

12,870

High tension station # 5

14,096

High tension station # 8

1,097,758

1,136,321

## Distribution lines

Overhead

3,409,930

Underground

5,844,642

9,254,572

Distribution transformers

2,082,667

Meters

446,223

Office equipment

69,669

Computer equipment

243,591

Information systems software

132,254

Vehicles and equipment

660,593

Tools, instruments and radio equipment

47,775

Meter shop accreditation

30,779

Safety equipment

5,940

Construction in progress

(1,166,795)

12,959,980



## CHANGES IN WORKING CAPITAL COMPONENTS

As at December 31st

	<u>2003</u>		
	\$		
Current Assets	56,136,635		
Current Liabilities	<u>21,742,277</u>		
Working Capital	<u><u>34,394,358</u></u>		

	<u>2003</u>	<u>2002</u>	<u>Change</u>
	\$	\$	\$
Cash and cash equivalents	25,779,810	18,792,725	6,987,085
Accounts receivable	12,810,019	17,202,574	(4,392,555)
Unbilled revenue receivable	14,646,500	14,374,300	272,200
Inventories	2,428,205	2,389,343	38,862
Prepaid expenses	419,889	412,323	7,566
Accrued interest receivable	52,212	32,014	20,198
Accounts payable & accrued liabilities	16,224,873	20,543,234	4,318,361
Current portion of customers deposits	2,155,000	1,458,000	(697,000)
Construction and property deposits	<u>3,362,404</u>	<u>4,072,710</u>	<u>710,306</u>
Working capital	<u><u>34,394,358</u></u>	<u><u>27,129,335</u></u>	<u><u>7,265,023</u></u>