Albert P. Singh, MBA, CGA
VP, Finance & CFO

WATERLOO NORTH HYDRO INC.

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November 22, 2011

Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto, Ontario
M4P 1E4

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms Walli:

Re: May 1, 2012 IRM Rate Application / EB-2011-0201

Waterloo North Hydro has attached two copies of the Financial Statements submitted with the Tax Returns for the Years 2001 through 2005.

If there are any questions, please contact Chris Amos at 519-888-5541, camos@wnhydro.com or myself, Albert Singh at 519-888-5542, asingh@wnhydro.com .

Yours truly,

Original Signed By

Albert P. Singh, MBA, CGA
Vice-President, Finance and CFO

Financial Statements

WATERLOO NORTH HYDRO INC.

Unaudited – See Notice to Reader
December 31, 2001

NOTICE TO READER

We have compiled the balance sheet of **North Waterloo Hydro Inc.** as at December 31, 2001 and the statement of operations for the three month period then ended from information provided by management. We have not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such information. Readers are cautioned that these statements may not be appropriate for their purposes.

Ernst & Young LLP

Kitchener, Canada,
June 6, 2002.

Chartered Accountants

Waterloo North Hydro Inc.

BALANCE SHEET

Unaudited - See Notice to Reader

	As at December 31, 2001 $
ASSETS	
Current	
Cash and cash equivalents	1,022,803
Accounts receivable	9,882,439
Unbilled energy receivable	8,933,236
Inventories	3,895,939
Prepaid expenses	214,571
Total current assets	23,948,988
Capital assets - net of accumulated amortization	81,032,467
Total assets	104,981,455
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current	
Accounts payable and accrued liabilities	11,098,221
Due to related party	1,399,535
Other	70,165
Construction deposits	88,304
Current portion of:	
Customer deposits	54,703
Total current liabilities	12,710,928
Long-term	
Long-term debt	61,864,332
Customer deposits	75,542
Vested sick leave	287,503
Post employment benefits	2,303,711
Total long-term liabilities	64,531,088
Shareholders' equity	
Share capital - common shares	24,370,424
Retained earnings	3,369,015
Total shareholders' equity	27,739,439
Total liabilities and shareholders' equity	104,981,455

See accompanying notes

On behalf of the Board:

Director Director

Waterloo North Hydro Inc.

STATEMENT OF OPERATIONS

Unaudited - See Notice to Reader

	Three months ended December 31, 2001 $
REVENUES	
Sale of energy	
Residential	**7,590,592**
General service	**13,688,728**
Large user	**1,645,361**
Street lighting	**224,310**
	23,148,991
Power purchased	**21,940,082**
Gross margin	**1,208,909**
Other revenues	
Rental revenue	**92,151**
Billing services	**71,886**
Late payment charges	**126,600**
Miscellaneous	**319,529**
	610,166
	1,819,075
EXPENSES	
Distribution	**1,285,578**
Billing and collecting	**363,250**
General administration	**1,075,408**
Amortization	**981,218**
Community relations	**94,148**
	3,799,602
Loss before interest expense and provision for payments in lieu of corporate income taxes	**(1,980,527)**
Interest expense	**(262,882)**
Loss before provision for payments in lieu of corporate income taxes	**(2,243,409)**
Provision for payments in lieu of corporate income taxes	**(58,538)**
Net loss for the period	**(2,301,947)**

See accompanying notes

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2001 Unaudited - See Notice to Reader

1. INCORPORATION

Waterloo North Hydro Inc. [the Company] is a regulated electricity distribution company incorporated under the Business Corporations Act (Ontario) on May 1, 2000. The incorporation was required in accordance with the provincial government's Electricity Competition Act [Bill 35]. The Company is wholly-owned by Waterloo North Hydro Holding Corporation whose shareholders are the City of Waterloo and the Townships of Wellesley and Woolwich.

Under a municipal by-law, the former Hydro-Electric Commission of Waterloo, Wellesley and Woolwich and the City of Waterloo and the Townships of Wellesley and Woolwich transferred at book value the assets, liabilities and employees, associated with the distribution of electricity and associated business activities, to the new corporations.

Effective October 1, 2001, all electric utilities companies in Ontario are subject to a number of taxes, which will be used to repay the stranded debt incurred by the former Ontario Hydro prior to the introduction of Bill 35.

2. GENERAL

These financial statements may not contain certain disclosures required by Canadian generally accepted accounting principles.

Financial Statements

Waterloo North Hydro Inc.

December 31, 2002

AUDITORS' REPORT

To the Shareholders of
Waterloo North Hydro Inc.

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

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

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

Ernst & Young LLP

Kitchener, Canada,
April 3, 2003.

Chartered Accountants

Waterloo North Hydro Inc.

BALANCE SHEET

As at December 31

	2002 $	2001 $
ASSETS		
Current		
Cash and cash equivalents	**2,035,210**	1,022,803
Accounts receivable *[note 5]*	**10,596,837**	9,882,439
Unbilled energy receivable	**11,209,255**	8,933,236
Inventories	**2,040,091**	3,895,939
Prepaid expenses	**278,906**	214,571
Total current assets	**26,160,299**	23,948,988
Capital assets - net of accumulated amortization *[note 6]*	**83,650,163**	81,032,467
Regulatory Assets *[notes 2 and 7]*	**3,758,629**	916,657
Reserve for impairment of regulatory assets *[note 7]*	**(2,489,280)**	(916,657)
Other	**66,923**	—
Total assets	**111,146,734**	104,981,455
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	**10,566,789**	11,098,221
Due to related party *[note 8]*	**1,363,112**	1,399,535
Other	**22,050**	70,165
Construction deposits	**69,729**	88,304
Current portion of:		
Customer deposits	**152,292**	54,703
Total current liabilities	12,173,972	12,710,928
Long-term		
Long-term debt *[note 9]*	**61,864,332**	61,864,332
Customer deposits	**391,076**	75,542
Vested sick leave	**223,215**	287,503
Regulatory liability *[notes 2 and 7]*	**2,105,217**	—
Post employment benefits *[note 11]*	**2,465,168**	2,303,711
Total long-term liabilities	**67,049,008**	64,531,088
Shareholders' equity		
Share capital - common shares *[note 12]*	**24,370,424**	24,370,424
Retained earnings	**7,553,330**	3,369,015
Total shareholders' equity	**31,923,754**	27,739,439
Total liabilities and shareholders' equity	**111,146,734**	104,981,455

See accompanying notes

On behalf of the Board:

Eugene Moser, Director

D. Charles Martin, Director

Waterloo North Hydro Inc.

STATEMENT OF RETAINED EARNINGS

Year ended December 31

	2002 $	2001 $
Retained earnings, beginning of year	**3,369,015**	2,529,715
Net income	**4,184,315**	839,300
Retained earnings, end of year	**7,553,330**	3,369,015

See accompanying notes

Waterloo North Hydro Inc.

STATEMENT OF OPERATIONS

Year ended December 31

	2002 $	2001 $
REVENUES		
Sales of electricity	**92,658,590**	79,388,419
Distribution services revenue	**20,349,135**	13,580,086
	113,007,725	92,968,505
Power purchased	**92,447,418**	78,471,762
Operating revenue	**20,560,307**	14,496,743
Other revenues		
Rental revenue	**160,168**	273,382
Billing services	**440,308**	408,182
Late payment charges	**321,878**	463,371
Gain on disposal of capital assets	**276,591**	70,306
Miscellaneous	**138,499**	167,709
	1,337,444	1,382,950
	21,897,751	15,879,693
EXPENSES		
Distribution	**4,240,244**	4,347,612
Billing and collecting	**1,985,162**	1,619,635
General administration	**1,837,828**	1,886,635
Reserve for impairment of regulatory assets *[note 7]*	**1,572,623**	916,657
Amortization	**5,153,483**	4,611,498
Community relations	**226,100**	334,103
Provincial capital taxes	**301,952**	72,652
	15,317,392	13,788,792
Income before interest and provision for payments in lieu of corporate income taxes	**6,580,359**	2,090,901
Interest expense - net *[note 13]*	**(1,393,332)**	(1,193,063)
Income before provision for payments in lieu of corporate income taxes	**5,187,027**	897,838
Provision for payments in lieu of corporate income taxes *[note 14]*	**(1,002,712)**	(58,538)
Net income	**4,184,315**	839,300

See accompanying notes

Waterloo North Hydro Inc.

STATEMENT OF CASH FLOWS

Year ended December 31

	2002 $	2001 $
OPERATING ACTIVITIES		
Net income	**4,184,315**	839,300
Add (deduct) charges to operations not requiring a current cash payment:		
Amortization	**5,689,645**	5,087,823
Decrease in provision for vested sick leave benefits	**(64,289)**	(31,656)
Amortization of debenture discount	—	1,523
Gain on disposal of capital assets	**(276,591)**	(70,306)
Increase in regulatory assets	**(1,269,349)**	—
Increase in regulatory liabilities	**2,105,217**	—
Increase in other assets	**(66,922)**	—
Increase in post employment benefits liability	**161,457**	144,158
Net change in non-cash operating working capital	**(1,735,860)**	(2,609,615)
Cash provided by operating activities	**8,727,623**	3,361,227
INVESTING ACTIVITIES		
Additions to capital assets	**(10,844,093)**	(11,132,333)
Proceeds on disposal of capital assets	**353,889**	70,306
Cash applied to investing activities	**(10,490,204)**	(11,062,027)
FINANCING ACTIVITIES		
Increase in customer deposits	**315,534**	—
Increase in long-term debt	—	5,000,000
Increase in contributed capital	**2,459,454**	1,535,052
Repayment of debenture debt	—	(408,000)
Cash provided by financing activities	**2,774,988**	6,127,052
Net cash increase (applied) during year	**1,012,407**	(1,573,748)
Cash and cash equivalents, beginning of year	**1,022,803**	2,596,551
Cash and cash equivalents, end of year	**2,035,210**	1,022,803
Supplementary information:		
Interest paid	**1,431,969**	1,304,561
Interest received	**38,637**	111,498

See accompanying notes

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

1. INCORPORATION

Waterloo North Hydro Inc. [the Company] is a regulated electricity distribution company incorporated under the Business Corporations Act (Ontario) on May 1, 2000. The incorporation was required in accordance with the provincial government's Electricity Competition Act [Bill 35]. The Company is wholly-owned by Waterloo North Hydro Holding Corporation whose shareholders are the City of Waterloo and the Townships of Wellesley and Woolwich.

Under a municipal by-law, the former Hydro-Electric Commission of Waterloo, Wellesley and Woolwich and the City of Waterloo and the Townships of Wellesley and Woolwich transferred at book value the assets, liabilities and employees, associated with the distribution of electricity and associated business activities, to the new corporations.

Effective October 1, 2001, all electric utilities companies in Ontario are subject to a number of taxes, which will be used to repay the stranded debt incurred by the former Ontario Hydro prior to the introduction of Bill 35. Details of these taxes are included in note 14.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting

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

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 repair parts, supplies and material held for future capital expansion and are valued at weighted average cost.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Capital assets and amortization

Capital assets are stated at cost, including material and labour and are removed from the accounts at the end of their estimated average service lives, except in those instances where specific identification allows their removal at retirement or disposition. Gains or losses at retirement or disposition of such assets are credited or charged to other revenue.

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	1.7%
Transformer and substation equipment	4%
SCADA equipment	4%
Distribution system	4%
Meters	4%
General equipment	10 - 30%

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 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.

Pension plan

Waterloo North 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 *[note 10]*. The Company recognizes the expense related to this plan as contributions are made.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Other post-employment benefits

Employee future benefits provided by WNHI include medical and life insurance benefits and accumulated sick leave credits. These plans provide benefits to certain employees when they are no longer providing active service. Employee future benefit expense is recognized in the period in which the employees render the services.

Employee future benefits are recorded on an accrual basis. The accrued benefit obligations and current service cost are calculated using the projected 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.

Contributed capital

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

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

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.

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Use of estimates

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Corporate income taxes and capital taxes cont'd

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 $4,387,050, relating to the valuation of the Company's assets at October 1, 2001, has not been recorded in the accounts.

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 that 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.

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/liabilities:

Bill 210 deems certain costs and variance account balances to be accounted for as regulatory assets. The OEB will review these costs no later than the end of 2003. The OEB will be providing direction on the method and timing for the recovery of these costs. No recovery can commence prior to fiscal 2006.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

[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 may not qualify for deferral or recovery, these costs have been expensed during the period they were incurred.

Cumulative transition costs of $903,623 [2001-$707,314] were accounted for as part of capital assets. Transition costs are being amortized over their estimated service lives, at a 5-year straight-line amortization rate, with the amortization charge recorded to the capital asset account.

[ii] Pre-market Opening Energy variance (COP):
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 7]*. 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.

[iii] Settlement variances:
The Corporation has recognized settlement variances for the period May 1, 2002 to December 31, 2002 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 7]*. 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.

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 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 began to sell electricity.

The OEB has regulatory authority over the electricity distribution sector. The Act sets out the OEB's powers to issue a distribution licence which must be obtained by any person owning or operating a distribution system under the Ontario Energy Board Act, 1998. The OEB may prescribe licence 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.

[a] Rates for the electricity commodity are 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, and for a designated customer class effective May 1, 2002. LDCs have been billing their customers at the capped rate and accumulating the difference between market prices and the capped rate in a variance account. In December 2002, this variance account was fully eliminated with funding from the Province of Ontario. With full funding from the Province of Ontario, electricity retailers have partially rebated their customers the difference between the capped rate and its retail contract as at December 31, 2002 and will provide full rebates in 2003.

[b] The Corporation's electricity distribution rates, in effect on November 11, 2002, are capped to 2006. With this distribution rate cap, the Corporation cannot recover its regulatory assets of $1,653,412 (regulatory assets of $3,758,659 net of regulatory liabilities of $2,105,217)until at least 2006 *[notes 2 and 7]*.

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

4. BANK INDEBTEDNESS

Waterloo North Hydro Inc. has a line of credit available to it in the amount of $10,000,000, which was not utilized at December 31, 2002 [2001 - nil]. The line is unsecured and bears interest at the bank prime rate less 0.65%. At December 31, 2002, bank prime was 4.5% [2001 - 4.0%].

5. ACCOUNTS RECEIVABLE

Accounts receivable are net of an allowance for bad debts of $100,000 [2001 - $100,000].

6. CAPITAL ASSETS

	2002		2001	
	Cost $	Accumulated amortization $	Cost $	Accumulated amortization $
Land and easements	**1,757,220**	**—**	1,735,398	—
Buildings	**7,014,066**	**1,637,772**	6,991,489	1,509,822
Transformer and substation equipment,	**22,606,341**	**6,440,798**	21,440,467	5,864,862
SCADA equipment	**1,975,210**	**1,024,391**	1,971,729	914,295
Distribution system	**92,642,289**	**35,851,858**	84,643,580	32,254,108
Meters	**6,885,353**	**3,311,802**	6,268,068	3,057,292
General equipment	**9,688,283**	**5,610,125**	8,920,314	4,488,726
Water heaters and controls	**—**	**—**	124,729	48,060
Construction-in-progress	**154,703**	**—**	—	—
Contributed capital	**(5,529,153)**	**(332,597)**	(3,069,698)	(143,556)
	137,194,312	**53,544,149**	129,026,076	47,993,609
Less accumulated depreciation	**53,544,149**		47,993,609	
Net book value	**83,650,163**		81,032,467	

Water heaters and controls were disposed of in 2002.

7. REGULATORY ASSETS/LIABILITIES

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

	2002 $	2001 $
Regulatory assets		
2001 Pre-market opening energy variance	**916,657**	916,657
2002 Pre-market opening energy variance	**1,439,248**	—
Settlement variances	**1,269,349**	—
Transition costs		
IMO requirements	**80,474**	—
Bill 210 implementation	**52,901**	—
	3,758,629	916,657
Regulatory liabilities		
Settlement variance	**(2,105,217)**	—
	(2,105,217)	—
2001 Reserve for impairment of regulatory assets	**(916,657)**	(916,657)
2002 Reserve for impairment of regulatory assets	**(1,572,623)**	—
	(2,489,280)	(916,657)

In 2002, transition costs to date of $903,623 were accounted for as part of capital assets.

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

8. RELATED PARTY TRANSACTIONS

The Company conducted transactions with related parties during the year ended December 31, 2002. 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.

During the year, WNHI provided street lighting energy and street lighting maintenance services to the City of Waterloo in the amounts of $349,866 and $110,165 respectively [2001 - $307,420 and $99,999, respectively]. In addition, the Company performs regular billing and collections services on behalf of the City of Waterloo for municipal water and sewer charges. In 2002, the Company collected $17,131,516 [2001 - $16,475,356] on behalf of the City of Waterloo relating to these charges. The Company charged administrative fees in the amount of $440,308 [2001 - $408,182] to the City of Waterloo for this service. The City of Waterloo is the majority shareholder of Waterloo North Hydro Holding Corporation.

At year-end, the Company owed the City of Waterloo $1,363,112 [2001 - $1,399,535] in unremitted collections.

9. LONG-TERM DEBT

	2002 $	2001 $
Senior long-term note payable [a]	**40,617,392**	40,617,392
Junior long-term note payable [b]	**16,246,940**	16,246,940
Demand loan [c]	**5,000,000**	5,000,000
	61,864,332	61,864,332

[a] The senior long-term note payable is due to Waterloo North Hydro Holding Corporation, the Company's parent, bears interest at a rate of 1/8% per annum above the interest rate on debt which the Ontario Energy Board permits the corporation to pay for rate-making purposes in the establishment of distribution rates [7.25% as at December 31], has no set principal repayment terms and is due on demand.

Waterloo North Hydro Holding Corporation has waived the right to demand repayment of any portion of the note during the next fiscal year and has waived all interest in excess of $1,250,000 for the year on this debt.

[b] The junior long-term note payable is due to Waterloo North Hydro Holding Corporation, bears interest at a rate of 1 1/8% per annum above the interest rate on debt which the Ontario Energy Board permits the corporation to pay for rate making purposes in the establishment of distribution rates, has no set principal repayment terms and is due on demand.

Waterloo North Hydro Holding Corporation has waived the right to demand repayment of any portion of the note during the next fiscal year and has waived all interest for the year on this debt.

[c] In 2001, Waterloo North Hydro Holding Corporation loaned $5,000,000 to the Company. This debt bears interest at the prime rate of the Corporation's banker minus 65 basis points per annum and has no set repayment terms. At year-end the prime rate was 4.5%. WNHI has provided a financial guarantee on behalf of Waterloo North Hydro Holding Corporation totaling $7,000,000 at year-end relating to this loan. This guarantee is incorporated in the loan agreement between Waterloo North Hydro Holding Corporation and the bank.

Waterloo North Hydro Holding Corporation has waived the right to demand repayment of any portion of this debt during the next fiscal year. Total interest in the amount of $176,626 was paid on this debt during the year.

10. PENSION PLAN

WNHI did not incur current service pension costs for the year ended December 31, 2002 [2001 – nil]. Effective August 1, 1998, OMERS provided a temporary contribution holiday, with no Company or employee pension contributions required until after December 31, 2002. In January 2003, OMERS contributions resumed on a phased-in basis.

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

11. POST EMPLOYMENT BENEFITS

The Company has a number of unfunded defined benefit plans providing other retirement and post-employment benefits to most of its employees. These plans include both life insurance and health and dental benefits.

Information about these defined benefit plans are as follows:

	2002 $	2001 $
Accrued benefit obligation		
Balance, beginning of year	**2,303,711**	2,159,553
Current service cost	**97,853**	87,369
Interest cost	**148,718**	132,784
Actuarial losses	**10,321**	9,215
Benefits Paid	**(95,435)**	(85,210)
Balance, end of year	**2,465,168**	2,303,711
Projected accrued benefit obligation at December 31	**2,465,168**	2,303,246
Unamortized actuarial gain	**—**	465

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

	2002 %	2001 %
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	**4.5**	4.5
Medical costs increase	CPI rate plus a further 4% increase in 2002, graded down to 1% in 2004 and thereafter	CPI rate plus a further 4% increase in 2001, graded down to 1% in 2004 and thereafter

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

12. SHARE CAPITAL

	2002 $	2001 $
Authorized		
Unlimited common shares		
Issued		
1,000 common shares	**24,370,424**	24,370,424

13. INTEREST (EXPENSE) INCOME

The Company has interest (expense) income relating to the following:

	2002 $	2001 $
Interest on debt with Waterloo North Hydro Holding Corporation		
Senior long-term notes payable	**(1,250,000)**	(1,000,000)
Junior long-term notes payable	**—**	—
Other debt	**(176,626)**	(254,001)
Other interest expense, including interest on debenture debt	**(5,343)**	(50,560)
Interest income	**38,637**	111,498
Net interest (expense) income	**(1,393,332)**	(1,193,063)

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

14. 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

	2002 $	2001 $
Rate reconciliation		
Income from continuing operations before income taxes	**5,187,027**	897,838
Statutory Canadian federal and provincial income tax rate	**38.62%**	40.62%
Expected taxes on income	**2,003,230**	364,702
Taxes associated with non-taxable pre-October 1, 2001 income	**—**	(1,275,975)
Increase (decrease) in income taxes resulting from:		
Large corporations tax net of surtax	**170,276**	58,538
Post-October 1, 2001, loss not benefited	**—**	649,958
Utilization on non-capital loss previously not benefited	**(649,958)**	
Other timing differences not benefited	**(122,737)**	103,435
Effect of rate changes on timing differences	**(398,099)**	157,880
Income tax expense	**1,002,712**	58,538
Effective tax rate	**19.33%**	6.5%
Components of income tax expense		
Income Tax	**832,436**	—
Current tax expense [Large Corporations Tax]	**170,276**	58,538
Income tax expense	**1,002,712**	58,538

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, 2002, future income tax assets of $3,965,816, based on substantively enacted income tax rates, have not been recorded.

NOTES TO FINANCIAL STATEMENTS

December 31, 2002

15. PRUDENTIAL SUPPORT OBLIGATION

Waterloo North Hydro Inc. purchases power from the Independent Market Operator (IMO) on behalf of its customers and retailers. The IMO is responsible for ensuring that prudential support is posted by all market participants to mitigate the impact of an event of default by a market participant on the rest of the market. In this regard Waterloo North Hydro Inc. posted an irrevocable standby letter of credit in the amount of $17,879,763 underwritten by the Company's principal bank. This instrument expires April 15, 2003.

16. COMPARATIVE FIGURES

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

Financial Statements

WATERLOO NORTH HYDRO INC.

December 31, 2003

KPMG LLP
Chartered Accountants
20 Erb Street West
Marsland Centre 3rd Floor
Waterloo ON N2L 1T2

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AUDITORS' REPORT TO THE SHAREHOLDER

We have audited the balance sheet of Waterloo North Hydro Inc. as at December 31, 2003 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, these financial statements present fairly, in all material respects, the financial position of the Company 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.

KPMG LLP

Chartered Accountants

Waterloo, Canada
March 26, 2004

Waterloo North Hydro Inc.

BALANCE SHEET

As at December 31

	2003 $	2002 $
ASSETS		
Current		
Cash and cash equivalents	9,098,948	2,035,210
Accounts receivable *[note 5]*	8,192,445	10,596,837
Unbilled energy receivable	11,264,823	11,209,255
Inventories	2,282,907	2,040,091
Prepaid expenses	264,350	278,906
Total current assets	31,103,473	26,160,299
Capital assets - net of accumulated amortization *[note 6]*	82,066,083	83,650,163
Loan receivable *[note 8]*	1,600,000	—
Other	66,923	66,923
Total assets	114,836,479	109,877,385
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities	10,222,041	10,566,789
Due to related party *[note 8]*	1,402,889	1,385,162
Interest Payable – shareholder	2,856,214	—
Customer deposits	338,447	222,021
Total current liabilities	14,819,591	12,173,972
Long-term		
Long-term debt *[note 9]*	56,864,332	61,864,332
Customer deposits	1,412,315	391,076
Regulatory liabilities *[note 7]*	4,651,555	835,868
Post employment benefits *[note 11]*	2,840,366	2,688,383
Total long-term liabilities	65,768,568	65,779,659
Shareholder's equity		
Share capital - common shares *[note 12]*	24,370,424	24,370,424
Retained earnings	9,877,896	7,553,330
Total shareholder's equity	34,248,320	31,923,754
Total liabilities and shareholder's equity	114,836,479	109,877,385

See accompanying notes

On behalf of the Board:

Eugene Moser, Director

D. Charles Martin, Director

Waterloo North Hydro Inc.

STATEMENT OF RETAINED EARNINGS

Year ended December 31

	2003 $	2002 $
Retained earnings, beginning of year	**7,553,330**	3,369,015
Net income	**2,324,566**	4,184,315
Retained earnings, end of year	**9,877,896**	7,553,330

See accompanying notes

Waterloo North Hydro Inc.

STATEMENT OF OPERATIONS

Year ended December 31

	2003 $	2002 $
REVENUES		
Sales of electricity	84,250,573	92,658,590
Distribution services revenue	21,623,743	20,349,135
	105,874,316	113,007,725
Power purchased	84,250,573	92,447,418
Operating Revenue	21,623,743	20,560,307
Other revenues		
Rental revenue	161,842	160,168
Billing services	476,626	440,308
Late payment charges	219,616	321,878
Gain on disposal of capital assets	50,507	276,591
Miscellaneous	102,716	138,499
	1,011,307	1,337,444
	22,635,050	21,897,751
EXPENSES		
Distribution	5,324,026	4,763,953
Billing and collecting	2,120,534	1,985,162
General administration	1,158,382	1,314,119
Reserve for impairment of regulatory assets *[note 7]*	—	1,572,623
Amortization	5,321,384	5,153,483
Community relations	157,340	226,100
Provincial capital taxes	302,058	301,952
	14,383,724	15,317,392
Income before interest and provision for payments in lieu of corporate income taxes	8,251,326	6,580,359
Interest expense - net *[note 13]*	(4,224,700)	(1,393,332)
Income before provision for payments in lieu of corporate income taxes	4,026,626	5,187,027
Provision for payments in lieu of corporate income taxes *[note 14]*	(1,702,060)	(1,002,712)
Net income	2,324,566	4,184,315

See accompanying notes

Waterloo North Hydro Inc.

STATEMENT OF CASH FLOWS

Year ended December 31

	2003 $	2002 $
OPERATING ACTIVITIES		
Net income	**2,324,566**	4,184,315
Add (deduct) charges to operations not requiring a current cash payment:		
Amortization	**5,884,797**	5,689,645
Gain on disposal of capital assets	**(50,507)**	(276,591)
Increase in regulatory liabilities	**3,815,687**	835,868
Increase in other assets	**—**	(66,922)
Increase in post employment benefits liability	**151,983**	97,168
Net change in non-cash operating working capital	**4,649,755**	(1,735,860)
Cash provided by operating activities	**16,776,281**	8,727,623
INVESTING ACTIVITIES		
Additions to capital assets	**(8,160,377)**	(10,844,093)
Proceeds on disposal of capital assets	**50,507**	353,889
Cash (applied to) investing activities	**(8,109,870)**	(10,490,204)
FINANCING ACTIVITIES		
Increase in customer deposits	**1,137,666**	315,534
Decrease in long-term debt	**(5,000,000)**	—
Increase in loan receivable	**(1,600,000)**	—
Increase in contributed capital	**3,859,661**	2,459,454
Cash (applied to) provided by financing activities	**(1,602,673)**	2,774,988
Net cash increase during the year	**7,063,738**	1,012,407
Cash and cash equivalents, beginning of year	**2,035,210**	1,022,803
Cash and cash equivalents, end of year	**9,098,948**	2,035,210
Supplementary information:		
Interest paid	**1,618,141**	1,431,969
Interest received	**249,655**	38,637
Payments in lieu of corporate income taxes	**1,081,751**	634,489

See accompanying notes

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

1. INCORPORATION

Waterloo North Hydro Inc. [the Company] is a regulated electricity distribution company incorporated under the Business Corporations Act [Ontario] on May 1, 2000. The incorporation was required in accordance with the provincial government's Electricity Competition Act [Bill 35]. The Company is wholly-owned by Waterloo North Hydro Holding Corporation whose shareholders are the City of Waterloo and the Townships of Wellesley and Woolwich.

Under a municipal by-law, the former Hydro-Electric Commission of Waterloo, Wellesley and Woolwich and the City of Waterloo and the Townships of Wellesley and Woolwich transferred the net book value the assets, liabilities, and the employees, associated with the distribution of electricity and associated business activities, to the new corporations.

Effective October 1, 2001, all electric utilities companies in Ontario are subject to a number of taxes, which will be used to repay the stranded debt incurred by the former Ontario Hydro prior to the introduction of Bill 35. Details of these taxes are included in note 14.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles [GAAP], as well as guidance prescribed by the Ontario Energy Board [the OEB] in the handbook "*Accounting Procedures Handbook for Electric Distribution Utilities*" and reflect the significant accounting policies summarized below.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Inventories

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

Capital assets and amortization

Capital assets are stated at cost, including material and labour and are removed from the accounts at the end of their estimated average service lives, except in those instances where specific identification allows their removal at retirement or disposition. Gains or losses at retirement or disposition of such assets are credited or charged to other revenue.

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	1.7%
Transformer and substation equipment	4%
SCADA equipment	4%
Distribution system	4%
Meters	4%
General equipment	10 - 30%

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 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. Construction in process is not amortized until the assets are put in use.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Pension plan

Waterloo North 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 *[note 10]*. The Company recognizes the expense related to this plan as contributions are made.

Post-employment benefits

Post-employment benefits provided by WNHI include medical and life insurance benefits and accumulated sick leave credits. These plans provide benefits to certain employees when they are no longer providing active service. Post-employment benefit expense is recognized in the period in which the employees render the services.

Post-employment 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 that are 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.

Contributed capital

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". Capital contributions received from outside sources are used to finance additions to capital assets. 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.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Revenue recognition

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

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 affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the year. Actual results could differ from 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 capital tax 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Corporate income taxes and capital taxes cont'd

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 its 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 allowed 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 Ontario Energy Board Act, 1998 [Ontario] [OEBA], conferred on 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 consumers, and the responsibility for ensuring that distribution companies fulfill obligations to connect and service customers. The OEB may also prescribe license requirements and conditions to electricity distributors which may include, among other things, specified accounting records, regulatory accounting principles, separation of accounts for distinct businesses and filing and process requirements for rate setting purposes.

In response to volatile and rising electricity prices in 2002, the Province of Ontario enacted The Electricity Pricing, Conservation and Supply Act, 2002 [EPCSA]. Under the EPSCA, the electricity distribution rates charged by the Corporation had been effectively frozen at current levels until 2006. The EPCSA directed electricity distribution utilities, such as the Corporation, to continue deferral of regulatory assets.

On December 18, 2003, a newly elected government in the Province passed legislation, the *Ontario Energy Board Amendment Act [Electricity Pricing], 2003* [the Amendment Act], which is based on a principle that the price of electricity should better reflect its true cost. The Amendment Act, which has not yet been proclaimed in force, will effectively remove the cap on the commodity price of electricity imposed by the EPCSA in favour of an interim two tiered and fixed commodity price structure. The fixed commodity price will be 4.7¢ per kWh for the first 750 kWh of consumption per month and 5.5¢ per kWh for any incremental monthly consumption thereafter. The interim structure will remain in place until no later than May 1, 2005 after which the OEB will assume responsibility for setting the commodity price for electricity under a process yet to be developed.

In conjunction with the passing of the Amendment Act, the Minister of Energy issued a letter dated December 19, 2003 [the Minister's Letter] stating an intention to allow electricity distribution companies to recover regulatory assets and proceed to earn the original, full regulatory rate of return as follows:

Commencing March 1, 2004, electricity distribution companies may, through a rate filing with the OEB in accordance with its prescribed rate filing guidelines, request rate increases to permit the recovery of regulatory assets over a four year period. However, there are also provisions in these OEB rate filing guidelines that serve to have a significant offsetting impact on the amount of rate increase otherwise related to regulatory assets. The Corporation filed a rate application with the OEB in January 2004 and anticipates recovering its regulatory assets over a four year period commencing March 1, 2004 with such recovery subject to the OEB's approval following its review of these amounts;

Commencing March 1, 2005, electricity distribution companies will be permitted to adjust rates to achieve the full theoretical regulatory rate of return, currently 9.88%. However, the Minister's Letter imposes a condition that the electricity distribution companies invest the equivalent of one year of the amount of the adjustment in conservation and demand-side management initiatives, to be prescribed in future regulation. The Corporation estimates the annualized impact of the rate adjustment to be approximately $1,205,000 following the implementation date.

4. BANK INDEBTEDNESS

Waterloo North Hydro Inc. has a line of credit available to it in the amount of $10,000,000, which was not utilized at December 31, 2003 [2002 - nil]. The line is unsecured and bears interest at the bank prime rate less 0.65%. At December 31, 2003, bank prime was 4.5% [2002 - 4.5%].

5. ACCOUNTS RECEIVABLE

Accounts receivable are net of an allowance for bad debts of $104,000 [2002 - $100,000].

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

6. CAPITAL ASSETS

	2003		2002	
	Cost $	Accumulated amortization $	Cost $	Accumulated amortization $
Land and easements	1,775,247	—	1,757,220	—
Buildings	7,046,598	1,766,373	7,014,066	1,637,772
Transformer and substation equipment,	22,685,680	6,996,368	22,606,341	6,440,798
SCADA equipment	1,984,508	1,135,107	1,975,210	1,024,391
Distribution system	99,957,356	39,742,211	92,642,289	35,851,858
Meters	7,148,164	3,576,826	6,885,353	3,311,802
General equipment	9,998,385	6,575,293	9,688,283	5,610,125
Construction-in-progress	—	—	154,703	
Contributed capital	(9,388,813)	(651,136)	(5,529,153)	(332,597)
	141,207,125	59,141,042	137,194,312	53,544,149
Less accumulated amortization	59,141,042		53,544,149	
Net book value	82,066,083		83,650,163	

7. REGULATORY ASSETS/LIABILITIES

Regulatory assets represent costs incurred by the Corporation for the purpose of supporting the deregulation of the electricity industry in Ontario. These amounts have been accumulated pursuant to regulation underlying the Electricity Act [EA] and deferred in anticipation of their future recovery in electricity distribution rates.

The Corporation has not recognized interest income related to transition costs and the retail settlement variance accounts. The Corporation intends to seek recovery of these interest amounts in future rate applications.

Transition costs - represent specific and incremental costs to the Corporation for systems and process changes to support the opening of the competitive electricity market in Ontario on May 1, 2002 [Market Opening]. These costs have been deferred pursuant to regulation underlying the EA and are subject to review and approval for recovery by the Ontario Energy Board [OEB].

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

Pre-market opening cost of power variances - represent the excess of the cost of the commodity electricity to the Corporation over the amount billed to its customers prior to Market Opening.

Post-market opening retail settlement variances - represent amounts that have accumulated since Market Opening and comprise:

a) variances between amounts charged by the Independent Electricity Market Operator [IMO] for the operation of the wholesale electricity market and grid, various wholesale market settlement charges and transmission charges, and the amounts billed to customers by the Corporation based on the OEB approved wholesale market service rate; and,

b) variances between the amounts charged by the IMO to allow for purchases of imported electricity and the amounts billed to customers by the Corporation based on OEB approved rates.

Regulatory liabilities consist of the following:

	2003 $	2002 $
Regulatory assets		
Transition costs	1,038,396	1,036,998
Pre-market opening variances	2,355,905	2,355,905
	3,394,301	3,392,903
Reserve for Impairment	(3,392,903)	(3,392,903)
	1,398	-
Post market opening variances	(4,652,953)	(835,868)
Regulatory liabilities	(4,651,555)	(835,868)

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

8. RELATED PARTY TRANSACTIONS

The Company conducted transactions with related parties during the year ended December 31, 2003. 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.

During the year, WNHI provided street lighting energy and street lighting maintenance services to the City of Waterloo in the amounts of $342,584 and $87,921 respectively [2002 - $349,866 and $110,165, respectively]. In addition, the Company performs regular billing and collections services on behalf of the City of Waterloo for municipal water and sewer charges. In 2003, the Company collected $17,584,268 [2002 - $17,131,516] on behalf of the City of Waterloo relating to these charges. The Company charged administrative fees in the amount of $474,876 [2002 - $440,308] to the City of Waterloo for this service. The City of Waterloo is the majority shareholder of Waterloo North Hydro Holding Corporation.

At year-end, the Company owed the City of Waterloo $1,402,889 [2002 - $1,363,112] in un-remitted collections.

In 2003 the company loaned $1,600,000 to Waterloo North Hydro Holding Corporation. This debt bears interest at the prime rate of the Corporation's banker minus 65 basis points per annum and has no set repayment terms. At year end the prime rate was 4.5%. Total interest in the amount of $31,358 was received on this debt during the year.

9. LONG-TERM DEBT

	2003 $	2002 $
Senior long-term note payable [a]	**40,617,392**	40,617,392
Junior long-term note payable [b]	**16,246,940**	16,246,940
Demand loan [c]	**-**	5,000,000
	56,864,332	61,864,332

[a] The senior long-term note payable is due to Waterloo North Hydro Holding Corporation, the Company's parent, bears interest at a rate of 1/8% per annum above the interest rate on debt which the Ontario Energy Board permits the corporation to pay for rate-making purposes in the establishment of distribution rates [7.25% as at December 31], has no set principal repayment terms and is due on demand.

Waterloo North Hydro Holding Corporation has waived the right to demand repayment of any portion of the note during the next fiscal year.

The company is considering refinancing with an unrelated third party approximately $15 million of this note payable during 2004.

[b] The junior long-term note payable is due to Waterloo North Hydro Holding Corporation, bears interest at a rate of 1 1/8% per annum above the interest rate on debt which the Ontario Energy Board permits the corporation to pay for rate making purposes in the establishment of distribution rates, has no set principal repayment terms and is due on demand.

Waterloo North Hydro Holding Corporation has waived the right to demand repayment of any portion of the note during the next fiscal year.

[c] In 2001, Waterloo North Hydro Holding Corporation loaned $5,000,000 to the Company. This debt was repaid in 2003. Total interest in the amount of $103,890 was paid on this debt during the year.

10. PENSION PLAN

WNHI incurred current service pension costs of $129,646 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. In January 2003, OMERS contributions resumed on a phased-in basis with full contributions starting in January 2004.

11. POST EMPLOYMENT BENEFITS

The Company has a number of unfunded defined benefit plans providing other retirement and post-employment benefits to most of its employees. These plans include both life insurance and health and dental benefits. The last actuarial valuation was done as at December 31, 2001.

Information about these defined benefit plans are as follows:

	2003 $	2002 $
Accrued benefit obligation		
Balance, beginning of year	2,688,383	2,591,214
Current service cost	122,389	97,853
Interest cost	147,910	148,718
Actuarial losses	11,560	10,321
Benefits Paid	(129,876)	(159,723)
Balance, end of year	2,840,366	2,688,383
Projected accrued benefit obligation at December 31	2,840,366	2,688,383

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

11. POST EMPLOYMENT BENEFITS cont'd

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

	%
Discount rate	6.0
Future general salary and wage levels increase	2.0
Future general inflation increase	3.5
Dental costs increase	4.5
Medical costs increase	CPI rate plus a further 4% increase in 2002, graded down to 1% in 2004

12. SHARE CAPITAL

		2003 $	2002 $
Authorized			
Unlimited	common shares		
Issued			
1,000	common shares	24,370,424	24,370,424

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

13. INTEREST (EXPENSE) INCOME

The Company has interest [expense] income relating to the following:

	2003 $	2002 $
Interest on debt with Waterloo North Hydro Holding Corporation		
Senior long-term notes payable	(2,995,533)	(1,250,000)
Junior long-term notes payable	(1,360,681)	—
Other debt	(118,141)	(176,626)
Other interest expense, including interest on debenture debt	-	(5,343)
Interest income	249,655	38,637
Net interest expense	(4,224,700)	(1,393,332)

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

14. 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 $
Rate reconciliation		
Income from continuing operations before income taxes	4,026,626	5,187,027
Statutory Canadian federal and provincial income tax rate	36.62%	38.62%
Expected taxes on income	1,474,550	2,003,230
Increase (decrease) in income taxes resulting from:		
Large corporations tax net of surtax	145,746	170,276
Utilization on non-capital loss previously not benefited	—	(649,958)
Permanent differences	3,579	—
Other timing differences not benefited	77,117	(122,737)
Effect of rate changes on timing differences	1,068	(398,099)
Income tax expense	1,702,060	1,002,712
Effective tax rate	42.27%	19.33%
Components of income tax expense		
Income Tax	1,556,314	832,436
Large Corporations Tax	145,746	170,276
Income tax expense	1,702,060	1,002,712

Balance sheet

Future income taxes relating to the regulated businesses have not been recorded in the accounts. As at December 31, 2003, future income tax assets of $6,712,304 [2002 - $3,965,816] based on substantively enacted income tax rates, have not been recorded.

15. PRUDENTIAL SUPPORT OBLIGATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

Waterloo North Hydro Inc. purchases power from the Independent Market Operator [IMO] on behalf of its customers and retailers. The IMO is responsible for ensuring that prudential support is posted by all market participants to mitigate the impact of an event of default by a market participant on the rest of the market. In this regard Waterloo North Hydro Inc. posted an irrevocable standby letter of credit in the amount of $15,927,424 underwritten by the corporations's principal bank. This instrument expires April 15, 2004.

16. FINANCIAL INSTRUMENTS

The carrying values of cash and cash equivalents, accounts receivable, unbilled energy receivable, accounts payable and accrued liabilities, and amounts due to related party approximate fair values because of the short maturity of these instruments. The carrying value of the loan receivable approximates fair value because this instrument bears interest at current rates. No fair value is available for the long-term debt since there are no specified repayment terms.

Financial assets held by the Corporation, such as accounts receivable, expose it to credit risk.

The Corporation earns its revenue from a broad base of customers located in the City of Waterloo and the Townships of Wellesley and Woolwich. No one customer, accounts for more than 1% of revenue.

17. CONTINGENT LIABILITY

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

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

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

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

18. GENERAL LIABILITY INSURANCE

The Corporation is a member of the Municipal Electric Association Reciprocal Insurance Exchange [MEARIE] which is a pooling of general liability insurance risks. Members of MEARIE would be assessed on a pro-rata basis should losses be experienced by MEARIE, for the years in which the Commission was a member.

To December 31, 2003, the Corporation has not been made aware of any additional assessments. Participation in MEARIE expires December 31, 2004. Notice to withdraw from MEARIE must be given six months prior to the commencement of the next underwriting term.

19. COMPARATIVE FIGURES

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

KPMG

Financial Statements

WATERLOO NORTH HYDRO INC.

December 31, 2004

KPMG LLP
Chartered Accountants
20 Erb Street West
Marsland Centre 3rd Floor
Waterloo ON N2L 1T2

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AUDITORS' REPORT TO THE SHAREHOLDER

We have audited the balance sheet of Waterloo North Hydro Inc. as at December 31, 2004 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, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Waterloo, Canada
March 31, 2005

Waterloo North Hydro Inc.

BALANCE SHEET

As at December 31

	2004 $	2003 $
ASSETS		
Current		
Cash and cash equivalents	**8,640,038**	9,098,948
Accounts receivable	**10,200,844**	8,192,445
Unbilled energy receivable	**12,987,736**	11,264,823
Inventories	**2,159,762**	2,282,907
Prepaid expenses	**498,253**	264,350
Total current assets	**34,486,633**	31,103,473
Capital assets - net of accumulated amortization *[note 5]*	**83,801,434**	82,066,083
Loan receivable *[note 7]*	**1,200,000**	1,600,000
Other	**50,779**	66,923
Total assets	**119,538,846**	114,836,479
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities	**12,095,579**	10,222,041
Due to related party *[note 7]*	**1,577,775**	1,402,889
Interest Payable – shareholder	**4,216,894**	2,856,214
Customer deposits	**1,187,228**	338,447
Bank Debt *[note 8]*	**9,766,667**	—
Total current liabilities	**28,844,144**	14,819,591
Long-term		
Long-term debt *[note 9]*	**41,707,432**	56,864,332
Customer deposits	**1,723,043**	1,412,315
Net Regulatory liabilities *[note 6]*	**6,956,418**	4,651,555
Post employment benefits *[note 11]*	**3,037,234**	2,840,366
Total long-term liabilities	**53,424,127**	65,768,568
Shareholder's equity		
Share capital - common shares *[note 12]*	**24,370,424**	24,370,424
Retained earnings	**12,900,152**	9,877,896
Total shareholder's equity	**37,270,576**	34,248,320
Total liabilities and shareholder's equity	**119,538,846**	114,836,479

See accompanying notes

On behalf of the Board:

Eugene Moser, Director

D. Charles Martin, Director

Waterloo North Hydro Inc.

STATEMENT OF RETAINED EARNINGS

Year ended December 31

	2004 $	2003 $
Retained earnings, beginning of year	**9,877,896**	7,553,330
Net income	**3,022,256**	2,324,566
Retained earnings, end of year	**12,900,152**	9,877,896

See accompanying notes

Waterloo North Hydro Inc.

STATEMENT OF OPERATIONS

Year ended December 31

	2004 $	2003 $
REVENUES		
Sales of electricity	**86,255,158**	84,250,573
Distribution services revenue	**22,033,560**	21,623,743
	108,288,718	105,874,316
Power purchased	**86,255,158**	84,250,573
Operating Revenue	**22,033,560**	21,623,743
Other revenues		
Rental revenue	**227,358**	161,842
Billing services	**571,632**	476,626
Late payment charges	**160,296**	219,616
Gain on disposal of capital assets	**24,808**	50,507
Miscellaneous	**151,093**	102,716
	1,135,187	1,011,307
	23,168,747	22,635,050
EXPENSES		
Distribution	**5,044,549**	5,324,026
Billing and collecting	**2,210,445**	2,120,534
General administration	**1,600,686**	1,158,382
Amortization	**5,468,550**	5,321,384
Community relations	**230,345**	157,340
Provincial capital taxes	**307,777**	302,058
	14,862,352	14,383,724
Income before interest and provision for payments in lieu of corporate income taxes	**8,306,395**	8,251,326
Interest expense - net *[note 13]*	**(3,326,755)**	(4,224,700)
Income before provision for payments in lieu of corporate income taxes	**4,979,640**	4,026,626
Provision for payments in lieu of corporate income taxes *[note 14]*	**(1,957,384)**	(1,702,060)
Net income	**3,022,256**	2,324,566

See accompanying notes

Waterloo North Hydro Inc.

STATEMENT OF CASH FLOWS

Year ended December 31

	2004 $	2003 $
OPERATING ACTIVITIES		
Net income	3,022,256	2,324,566
Add (deduct) charges to operations not requiring a current cash payment:		
Amortization	6,023,732	5,884,797
Gain on disposal of capital assets	(24,808)	(50,507)
Increase in regulatory liabilities	2,304,863	3,815,687
Decrease in other assets	16,143	—
Increase in post employment benefits liability	196,868	151,983
Net change in non-cash operating working capital	(432,963)	4,649,755
Cash provided by operating activities	11,106,091	8,727,623
INVESTING ACTIVITIES		
Additions to capital assets	(10,791,993)	(8,160,377)
Proceeds on disposal of capital assets	30,857	50,507
Cash (applied to) investing activities	(10,761,136)	(8,109,870)
FINANCING ACTIVITIES		
Increase in customer deposits	1,159,508	1,137,666
Decrease in long-term debt	(15,156,900)	(5,000,000)
Increase in bank debt	9,766,667	—
Decrease in loan receivable	400,000	(1,600,000)
Increase in contributed capital	3,026,860	3,859,661
Cash (applied to) financing activities	(803,865)	(1,602,673)
Net cash increase (decrease) during the year	(458,910)	7,063,738
Cash and cash equivalents, beginning of year	9,098,948	2,035,210
Cash and cash equivalents, end of year	8,640,038	9,098,948
Supplementary information:		
Interest paid	2,225,890	1,618,141
Interest received	259,816	249,655
Payments in lieu of corporate income taxes	2,060,712	1,081,751

See accompanying notes

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

1. INCORPORATION

Waterloo North Hydro Inc. [the Company] is a regulated electricity distribution company incorporated under the Business Corporations Act [Ontario] on May 1, 2000. The incorporation was required in accordance with the provincial government's Electricity Competition Act [Bill 35]. The Company is wholly-owned by Waterloo North Hydro Holding Corporation whose shareholders are the City of Waterloo and the Townships of Wellesley and Woolwich.

Under a municipal by-law, the former Hydro-Electric Commission of Waterloo, Wellesley and Woolwich and the City of Waterloo and the Townships of Wellesley and Woolwich transferred the net book value the assets, liabilities, and the employees, associated with the distribution of electricity and associated business activities, to the new corporations.

Effective October 1, 2001, all electric utilities companies in Ontario are subject to a number of taxes, which will be used to repay the stranded debt incurred by the former Ontario Hydro prior to the introduction of Bill 35. Details of these taxes are included in note 14.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles [GAAP], as well as guidance prescribed by the Ontario Energy Board [the OEB] in the handbook "*Accounting Procedures Handbook for Electric Distribution Utilities*" and reflect the significant accounting policies summarized below.

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.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Inventories

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

Capital assets and amortization

Capital assets are stated at cost, including material and labour and are removed from the accounts at the end of their estimated average service lives, except in those instances where specific identification allows their removal at retirement or disposition. Gains or losses at retirement or disposition of such assets are credited or charged to other revenue.

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	1.7%
Transformer and substation equipment	4%
SCADA equipment	4%
Distribution system	4%
Meters	4%
General equipment	10 - 30%

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 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. Construction in process is not amortized until the assets are put in use.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Pension plan

Waterloo North 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 *[note 10]*. The Company recognizes the expense related to this plan as contributions are made.

Post-employment benefits

Post-employment benefits provided by WNHI include health, dental and life insurance benefits and accumulated sick leave credits. These plans provide benefits to certain employees when they are no longer providing active service. Post-employment benefit expense is recognized in the period in which the employees render the services.

Post-employment 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 that are 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.

Contributed capital

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". Capital contributions received from outside sources are used to finance additions to capital assets. 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.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Revenue recognition

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

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 affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the year. Actual results could differ from 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 capital tax 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.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Corporate income taxes and capital taxes cont'd

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 its 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 allowed 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.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

3. ELECTRIC INDUSTRY RESTRUCTURING AND REGULATION

The Ontario Energy Board Act, 1998 [Ontario] [OEBA], conferred on 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 consumers, and the responsibility for ensuring that distribution companies fulfill obligations to connect and service customers. The OEB may also prescribe license requirements and conditions to electricity distributors which may include, among other things, specified accounting records, regulatory accounting principles, separation of accounts for distinct businesses and filing and process requirements for rate setting purposes.

In response to volatile and rising electricity prices in 2002, the Province of Ontario enacted The Electricity Pricing, Conservation and Supply Act, 2002 [EPCSA]. Under the EPSCA, the electricity distribution rates charged by the Corporation had been effectively frozen at current levels until 2006. The EPCSA directed electricity distribution utilities, such as the Corporation, to continue deferral of regulatory assets.

On December 18, 2003, a newly elected government in the Province passed legislation, the *Ontario Energy Board Amendment Act [Electricity Pricing], 2003* [the Amendment Act], which is based on a principle that the price of electricity should better reflect its true cost. The Amendment Act, removed the cap on the commodity price of electricity imposed by the EPCSA in favour of an interim two tiered and fixed commodity price structure. The fixed commodity price effective April 1, 2004 was 4.7¢ per kWh for the first 750 kWh of consumption per month and 5.5¢ per kWh for any incremental monthly consumption thereafter. This interim structure will remain in place until no later than May 1, 2005 after which the OEB will assume responsibility for setting the commodity price for electricity.

In conjunction with the passing of the Amendment Act, the Minister of Energy issued a letter dated December 19, 2003 [the Minister's Letter] stating an intention to allow electricity distribution companies to recover regulatory assets and proceed to earn the original, full regulatory rate of return as follows:

Commencing March 1, 2004, electricity distribution companies may, through a rate filing with the OEB in accordance with its prescribed rate filing guidelines, request rate increases to permit the recovery of regulatory assets over a four year period. However, there are also provisions in these OEB rate filing guidelines that serve to have a significant offsetting impact on the amount of rate increase otherwise related to regulatory assets. The Corporation's rate application was approved by the OEB in March 2004. This application allowed the corporation to recover its regulatory assets over a four year period.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

3. ELECTRIC INDUSTRY RESTRUCTURING AND REGULATION cont'd

Commencing March 1, 2005, electricity distribution companies will be permitted to adjust rates to achieve the full theoretical regulatory rate of return, currently 9.88%. However, the Minister's Letter imposes a condition that the electricity distribution companies invest the equivalent of one year of the amount of the adjustment in conservation and demand-side management initiatives, to be prescribed in future regulation. The Corporation estimates the annualized impact of the rate adjustment to be approximately $1,205,000 following the implementation date.

4. BANK INDEBTEDNESS

Waterloo North Hydro Inc. has a line of credit available to it in the amount of $10,000,000, which was not utilized at December 31, 2004 [2003 - nil]. The line is unsecured and bears interest at the bank prime rate less 0.65%. At December 31, 2004, bank prime was 4.25% [2003 - 4.5%].

5. CAPITAL ASSETS

	2004		2003	
	Cost $	Accumulated amortization $	Cost $	Accumulated amortization $
Land and easements	1,785,889	—	1,775,247	—
Buildings	7,261,750	1,899,277	7,046,598	1,766,373
Transformer and substation equipment,	22,951,671	7,554,664	22,685,680	6,996,368
SCADA equipment	2,048,811	1,250,111	1,984,508	1,135,107
Distribution system	108,303,136	43,966,393	99,957,356	39,742,211
Meters	7,860,994	3,870,363	7,148,164	3,576,826
General equipment	11,167,615	7,769,712	9,998,385	6,575,293
Contributed capital	(12,415,674)	(1,147,762)	(9,388,813)	(651,136)
	148,964,192	65,162,758	141,207,125	59,141,042
Less accumulated amortization	65,162,758		59,141,042	
Net book value	83,801,434		82,066,083	

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

6. NET REGULATORY ASSETS/LIABILITIES

Regulatory assets and liabilities represent costs incurred and revenues collected by the Corporation for the purpose of supporting the deregulation of the electricity industry in Ontario. These amounts have been accumulated pursuant to regulation underlying the Electricity Act [EA] and deferred in anticipation of their future recovery in electricity distribution rates.

The Corporation has not recognized interest income related to transition costs and the retail settlement variance accounts. The Corporation intends to seek recovery of these interest amounts in future rate applications.

Transition costs - represent specific and incremental costs to the Corporation for systems and process changes to support the opening of the competitive electricity market in Ontario on May 1, 2002 [Market Opening]. These costs have been deferred pursuant to regulation underlying the EA and are subject to review and approval for recovery by the Ontario Energy Board [OEB].

Pre-market opening cost of power variances - represent the excess of the cost of the commodity electricity to the Corporation over the amount billed to its customers prior to Market Opening.

Post-market opening retail settlement variances - represent amounts that have accumulated since Market Opening and comprise:

a) variances between amounts charged by the Independent Electricity Market Operator [IMO] for the operation of the wholesale electricity market and grid, various wholesale market settlement charges and transmission charges, and the amounts billed to customers by the Corporation based on the OEB approved wholesale market service rate; and,

b) variances between the amounts charged by the IMO to allow for purchases of imported electricity and the amounts billed to customers by the Corporation based on OEB approved rates.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

Net regulatory assets and liabilities consist of the following:

	2004 $	2003 $
Regulatory assets		
Transition costs	**1,038,396**	1,038,396
Pre-market opening variances	**2,355,905**	2,355,905
	3,394,301	3,394,301
Reserve for Impairment	**(3,392,903)**	(3,392,903)
	1,398	1,398
Post market opening variances	**(7,287,478)**	(4,652,953)
Regulatory Recoveries	**329,662**	—
Net regulatory assets and liabilities	**(6,956,418)**	(4,651,555)

7. RELATED PARTY TRANSACTIONS

The Company conducted transactions with related parties during the year ended December 31, 2004. 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.

During the year, WNHI provided street lighting energy and street lighting maintenance services to the City of Waterloo in the amounts of $421,030 and $195,938 respectively [2003 - $342,584 and $87,921, respectively]. In addition, the Company performs regular billing and collections services on behalf of the City of Waterloo for municipal water and sewer charges. In 2004, the Company collected $18,591,288 [2003 - $17,584,268] on behalf of the City of Waterloo relating to these charges. The Company charged administrative fees in the amount of $534,170 [2003 - $474,876] to the City of Waterloo for this service. The City of Waterloo is the majority shareholder of Waterloo North Hydro Holding Corporation.

At year-end, the Company owed the City of Waterloo $1,577,775 [2003 - $1,402,889] in un-remitted collections.

In 2003 the company loaned $1,600,000 to Waterloo North Hydro Holding Corporation. This debt bears interest at the prime rate of the Corporation's banker minus 65 basis points per annum and has no set repayment terms. In 2004, $400,000 of this debt was repaid. At year end the prime rate was 4.25%. Total interest in the amount of $53,726 [2003 - $31,358] was received on this debt during the year.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

8. BANK DEBT

In 2004, the company borrowed $10,000,000 from the CIBC bank. This loan is at a variable interest rate plus a stamping fee of .45% with principal repayment amortized over 25 years. This rate is hedged by way of an interest rate swap at 4.932%. This debt is secured by a General Security Agreement in favour of the CIBC bank. Total interest in the amount of $358,431 was paid on this debt during the year. The replacement cost of the interest rate swap as at December 31, 2004 was $357,475

9. LONG-TERM DEBT

	2004 $	2003 $
Senior long-term note payable [a]	**25,460,492**	40,617,392
Junior long-term note payable [b]	**16,246,940**	16,246,940
	41,707,432	56,864,332

[a] The senior long-term note payable is due to Waterloo North Hydro Holding Corporation, the Company's parent, bears interest at a rate of 6.0% per annum, has no set principal repayment terms and is due on demand.

Waterloo North Hydro Holding Corporation has waived the right to demand repayment of any portion of the note during the next fiscal year.

The company repaid $15,156,900 of this debt in 2004.

[b] The junior long-term note payable is due to Waterloo North Hydro Holding Corporation, bears interest at a rate of 1 1/8% per annum above the interest rate on debt which the Ontario Energy Board permits the corporation to pay for rate making purposes in the establishment of distribution rates, has no set principal repayment terms and is due on demand.

Waterloo North Hydro Holding Corporation has waived the right to demand repayment of any portion of the note during the next fiscal year.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

10. PENSION PLAN

WNHI incurred current service pension costs of $410,659 for the year ended December 31, 2004 [2003 – $129,646]. Effective August 1, 1998, OMERS provided a temporary contribution holiday, with no Company or employee pension contributions required until after December 31, 2002. In January 2003, OMERS contributions resumed on a phased-in basis with full contributions starting in January 2004.

11. POST EMPLOYMENT BENEFITS

The Company has a number of unfunded defined benefit plans providing other retirement and post-employment benefits to most of its employees. These plans include life insurance, health and dental benefits and accumulated sick leave. The last actuarial valuation was done as at December 31, 2004.

Information about these defined benefit plans are as follows:

	2004 $	2003 $
Accrued benefit obligation		
Balance, beginning of year	**2,840,366**	2,688,383
Current service cost	**68,524**	122,389
Interest cost	**170,818**	147,910
Actuarial gain	**81,392**	11,560
Benefits Paid	**(123,866)**	(129,876)
Balance, end of year	**3,037,234**	2,840,366
Actuarial benefit obligation at December 31	**2,937,342**	2,840,366

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

11. POST EMPLOYMENT BENEFITS cont'd

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

	%
Discount rate	**5.75**
Future general salary and wage levels increase	**3.0**
Dental costs increase	**4.0**
Medical costs increase	**7.5% in 2004, then 5.0% thereafter**

The approximate effect on the accrued benefit obligation and the estimated net benefit expense if the health care trend rate assumption was increased or decreased by 1% is as follows:

	Accrued Benefit Obligation	Periodic Cost
1% increase in health care trend rate	**$190,820**	**$25,702**
1% decrease in health care	**($172,409)**	**($22,961)**

12. SHARE CAPITAL

	2004 $	2003 $
Authorized		
Unlimited common shares		
Issued		
1,000 common shares	**24,370,424**	24,370,424

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

13. INTEREST (EXPENSE) INCOME

The Company has interest [expense] income relating to the following:

	2004 $	2003 $
Interest on debt with Waterloo North Hydro Holding Corporation		
Senior long-term notes payable	(1,828,282)	(2,995,533)
Junior long-term notes payable	(1,360,681)	(1,360,681)
Other debt	(397,608)	(118,141)
Interest income	259,816	249,655
Net interest expense	(3,326,755)	(4,224,700)

14. 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

	2004 $	2003 $
Rate reconciliation		
Income from continuing operations before income taxes	4,979,640	4,026,626
Statutory Canadian federal and provincial income tax rate	36.12%	36.62%
Expected taxes on income	1,798,646	1,474,550
Increase (decrease) in income taxes resulting from:		
Large corporations tax net of surtax	25,413	145,746
Permanent differences	3,289	3,579
Other temporary differences not benefited	130,036	77,117
Effect of rate changes on timing differences	—	1,068
Income tax expense	1,957,384	1,702,060
Effective tax rate	39.31%	42.27%

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

14. CORPORATE INCOME AND CAPITAL TAXES cont'd

Components of income tax expense		
Income Tax	**1,931,971**	1,556,314
Large Corporations Tax	**25,413**	145,746
Income tax expense	**1,957,384**	1,702,060

Balance sheet

Future income taxes relating to the regulated businesses have not been recorded in the accounts. As at December 31, 2004, future income tax assets of $6,806,976 [2003 - $6,712,304] based on substantively enacted income tax rates, have not been recorded.

15. PRUDENTIAL SUPPORT OBLIGATION

Waterloo North Hydro Inc. purchases power from the Independent Market Operator [IMO] on behalf of its customers and retailers. The IMO is responsible for ensuring that prudential support is posted by all market participants to mitigate the impact of an event of default by a market participant on the rest of the market. In this regard Waterloo North Hydro Inc. posted an irrevocable standby letter of credit in the amount of $15,927,424 underwritten by the corporations's principal bank. This instrument expires April 15, 2005.

16. FINANCIAL INSTRUMENTS

The carrying values of cash and cash equivalents, accounts receivable, unbilled energy receivable, accounts payable and accrued liabilities, and amounts due to related party approximate fair values because of the short maturity of these instruments. The carrying value of the loan receivable and the bank loan approximates fair value because these instruments bear interest at current rates. No fair value is available for the long-term note payable since there are no specified repayment terms.

Financial assets held by the Corporation, such as accounts receivable, expose it to credit risk.

The Corporation earns its revenue from a broad base of customers located in the City of Waterloo and the Townships of Wellesley and Woolwich. No one customer accounts for more than 1% of revenue.

NOTES TO FINANCIAL STATEMENTS

December 31, 2004

17. CONTINGENT LIABILITY

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

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

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

18. GENERAL LIABILITY INSURANCE

The Corporation is a member of the Municipal Electric Association Reciprocal Insurance Exchange [MEARIE] which is a pooling of general liability insurance risks. Members of MEARIE would be assessed on a pro-rata basis should losses be experienced by MEARIE, for the years in which the Commission was a member.

To December 31, 2004, the Corporation has not been made aware of any additional assessments. Participation in MEARIE expires December 31, 2005. Notice to withdraw from MEARIE must be given six months prior to the commencement of the next underwriting term.

Financial Statements

WATERLOO NORTH HYDRO INC.
December 31, 2005

KPMG

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Waterloo ON N2L 1T2

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AUDITORS' REPORT TO THE SHAREHOLDER

We have audited the balance sheet of Waterloo North Hydro Inc. as at December 31, 2005 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, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Waterloo, Canada
March 31, 2006

Waterloo North Hydro Inc.

BALANCE SHEET

As at December 31

	2005 $	2004 $
ASSETS		
Current		
Cash and cash equivalents	**15,390,494**	8,640,038
Accounts receivable	**8,859,541**	10,200,844
Unbilled energy receivable	**14,817,111**	12,987,736
Inventories	**2,111,244**	2,159,762
Prepaid expenses	**247,282**	498,253
Total current assets	**41,425,672**	34,486,633
Capital assets - net of accumulated amortization *[note 5]*	**84,608,533**	83,801,434
Loan receivable *[note 7]*	**1,200,000**	1,200,000
Other	**50,779**	50,779
Total assets	**127,284,984**	119,538,846
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities	**19,171,135**	12,095,579
Due to related party *[note 7]*	**1,642,565**	1,577,775
Interest Payable – shareholder	**2,719,825**	4,216,894
Customer deposits	**997,852**	1,187,228
Bank Debt *[note 8]*	**9,366,667**	9,766,667
Total current liabilities	**33,898,044**	28,844,144
Long-term		
Long-term debt *[note 9]*	**40,402,432**	41,707,432
Customer deposits	**1,375,106**	1,723,043
Net Regulatory liabilities *[note 6]*	**4,002,232**	6,956,418
Post employment benefits *[note 11]*	**3,126,842**	3,037,234
Total long-term liabilities	**48,906,612**	53,424,127
Shareholder's equity		
Share capital *[note 12]*	**26,526,424**	24,370,424
Retained earnings	**17,953,904**	12,900,152
Total shareholder's equity	**44,480,328**	37,270,576
Total liabilities and shareholder's equity	**127,284,984**	119,538,846

See accompanying notes

On behalf of the Board:

Eugene Moser

Eugene Moser, Director

D. Charles Martin, Director

Waterloo North Hydro Inc.

STATEMENT OF RETAINED EARNINGS

Year ended December 31

	2005 $	2004 $
Retained earnings, beginning of year	**12,900,152**	9,877,896
Net income	**5,053,752**	3,022,256
Retained earnings, end of year	**17,953,904**	12,900,152

See accompanying notes

Waterloo North Hydro Inc.

STATEMENT OF OPERATIONS

Year ended December 31

	2005 $	2004 $
REVENUES		
Sales of electricity	**107,717,101**	86,255,158
Distribution services revenue	**22,367,695**	22,033,560
	130,084,796	108,288,718
Power purchased	**107,717,101**	86,255,158
Operating Revenue	**22,367,695**	22,033,560
Other revenues		
Rental revenue	**213,571**	227,358
Billing services	**663,635**	571,632
Late payment charges	**174,031**	160,296
Gain (loss) on disposal of capital assets	**(20,435)**	24,808
Miscellaneous	**183,380**	151,093
	1,214,182	1,135,187
	23,581,877	23,168,747
EXPENSES		
Distribution	**4,921,721**	5,044,549
Billing and collecting	**2,103,432**	2,210,445
General administration	**1,856,947**	1,600,686
Amortization	**5,610,064**	5,468,550
Community relations	**162,251**	230,345
Provincial capital taxes	**335,161**	307,777
	14,989,576	14,862,352
Income before under noted items	**8,592,301**	8,306,395
Regulatory Asset Adjustments	**2,664,021**	-
Interest expense - net *[note 13]*	**(3,113,954)**	(3,326,755)
Income before provision for payments in lieu of corporate income taxes	**8,142,368**	4,979,640
Provision for payments in lieu of corporate income taxes *[note 14]*	**(3,088,616)**	(1,957,384)
Net income	**5,053,752**	3,022,256

See accompanying notes

Waterloo North Hydro Inc.

STATEMENT OF CASH FLOWS

Year ended December 31

	2005 $	2004 $
OPERATING ACTIVITIES		
Net income	**5,053,752**	3,022,256
Add (deduct) charges to operations not requiring a current cash payment:		
Amortization	**6,240,525**	6,023,732
Loss (gain) on disposal of capital assets	**20,435**	(24,808)
Increase in regulatory liabilities	**(2,954,186)**	2,304,863
Decrease in other assets	**-**	16,143
Increase in post employment benefits liability	**89,607**	196,868
Net change in non-cash operating working capital	**7,610,694**	(432,963)
Cash provided by operating activities	**16,060,827**	11,106,091
INVESTING ACTIVITIES		
Additions to capital assets	**(9,577,593)**	(10,791,993)
Proceeds on disposal of capital assets	**67,326**	30,857
Cash (applied to) investing activities	**(9,510,267)**	(10,761,136)
FINANCING ACTIVITIES		
Increase in customer deposits	**(537,313)**	1,159,508
Decrease in long-term debt	**(1,305,000)**	(15,156,900)
Increase in bank debt	**(400,000)**	9,766,667
Decrease in loan receivable	**—**	400,000
Increase in contributed capital	**2,442,209**	3,026,860
Cash (applied to) financing activities	**199,896**	(803,865)
Net cash increase (decrease) during the year	**6,750,456**	(458,910)
Cash and cash equivalents, beginning of year	**8,640,038**	9,098,948
Cash and cash equivalents, end of year	**15,390,494**	8,640,038
Supplementary information:		
Interest paid	**2,081,190**	2,225,890
Interest received	**326,380**	259,816
Payments in lieu of corporate income taxes	**2,126,970**	2,060,712

See accompanying notes

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

1. INCORPORATION

Waterloo North Hydro Inc. [the Company] is a regulated electricity distribution company incorporated under the Business Corporations Act [Ontario] on May 1, 2000. The incorporation was required in accordance with the provincial government's Electricity Competition Act [Bill 35]. The Company is wholly-owned by Waterloo North Hydro Holding Corporation whose shareholders are the City of Waterloo and the Townships of Wellesley and Woolwich.

Under a municipal by-law, the former Hydro-Electric Commission of Waterloo, Wellesley and Woolwich and the City of Waterloo and the Townships of Wellesley and Woolwich transferred the net book value of the assets, liabilities, and the employees, associated with the distribution of electricity and associated business activities, to the new corporations.

Effective October 1, 2001, all electric utility companies in Ontario are subject to a number of taxes, which will be used to repay the stranded debt incurred by the former Ontario Hydro prior to the introduction of Bill 35. Details of these taxes are included in note 14.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles [GAAP], as well as guidance prescribed by the Ontario Energy Board [the OEB] in the handbook "*Accounting Procedures Handbook for Electric Distribution Utilities*" and reflect the significant accounting policies summarized below.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Capital assets and amortization

Capital assets are stated at cost, including material and labour and are removed from the accounts at the end of their estimated average service lives, except in those instances where specific identification allows their removal at retirement or disposition. Gains or losses at retirement or disposition of such assets are credited or charged to other revenue.

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	1.7%
Transformer and substation equipment	4%
SCADA equipment	4%
Distribution system	4%
Meters	4%
General equipment	10 - 30%

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 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. Construction in process is not amortized until the assets are put in use.

Pension plan

Waterloo North 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

The Fund is a contributory defined benefit pension plan, which is financed by equal contributions from participating employers and employees and by the investment earnings of the Fund *[note 10]*. The Company recognizes the expense related to this plan as contributions are made.

Post-employment benefits

Post-employment benefits provided by WNHI include health, dental and life insurance benefits and accumulated sick leave credits. These plans provide benefits to certain employees when they are no longer providing active service. Post-employment benefit expense is recognized in the period in which the employees render the services.

Post-employment 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 that are 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.

Contributed capital

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". Capital contributions received from outside sources are used to finance additions to capital assets. 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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

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 affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the year. Actual results could differ from 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 capital tax 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 its 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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Corporate income taxes and capital taxes cont'd

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 allowed 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 Company is regulated by the Ontario Energy Board, under the authority granted by the Ontario Energy Board Act (1998). The OEB has the power and responsibility to approve or fix rates for the transmission and distribution of electricity, providing continued rate protection for rural and remote electricity consumers, and ensuring that distribution companies fulfill obligations to connect and service customers. The OEB may also prescribe license requirements and conditions of service to electricity distributors which may include, among other things, record keeping, regulatory accounting principles, separation of accounts for distinct businesses, and filing and process requirements for rate setting purposes. In its capacity to approve or set rates, the OEB has the authority to specify regulatory accounting treatments that may differ from Canadian generally accepted accounting principles for enterprises operating in a non-rate regulated environment.

In January 2000, the OEB established that distribution rates would be subject to Performance Based Regulation ("PBR"), a method of regulation whereby distribution rates are reduced annually to reflect productivity improvements required of the Company. Under this rate methodology, rates also include regulated amounts for return on Company equity and debt, which were initially determined by the OEB to be 9.88% and 7.25%, respectively. While the initial PBR regulatory framework provided for those regulatory rates of return, subsequent regulation and Provincial Government initiatives prevented distribution companies from fully achieving the theoretical rate of return on equity.

Distribution charges were also to be increased to permit the recovery of costs incurred by the Company to prepare for the opening of the competitive electricity market in Ontario ("Market

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

3. ELECTRIC INDUSTRY RESTRUCTURING & REGULATION cont'd

Opening"). The Company has capitalized these costs as regulatory assets. In 2004, the Company filed applications to adjust its distribution charges to provide for the recovery of its regulatory assets over a four year period. The applications were approved by the OEB effective April 1, 2004.

In 2005, the Company filed rate applications to adjust its distribution charges to provide for the full theoretical regulatory rate of return of 9.88% and continued recovery of its regulatory assets. As mandated by the OEB, the rate increase is subject to a financial commitment by the Company to invest $1,205,000 in conservation and demand management activities over the period April 1, 2005 to September 30, 2007. The rate applications and applications for the approval of its conservation and demand management programs have since been approved by the OEB.

4. BANK INDEBTEDNESS

Waterloo North Hydro Inc. has a line of credit available to it in the amount of $10,000,000, which was not utilized at December 31, 2005 [2004 - nil]. The line is unsecured and bears interest at the bank prime rate less 0.65%. At December 31, 2005, bank prime was 5.0% [2004 - 4.25%].

5. CAPITAL ASSETS

	2005		2004	
	Cost $	Accumulated amortization $	Cost $	Accumulated amortization $
Land and easements	**1,790,435**	**-**	1,785,889	-
Buildings	**7,388,747**	**2,023,881**	7,261,750	1,899,277
Transformer and substation equipment,	**22,711,479**	**7,917,593**	22,951,671	7,554,664
SCADA equipment	**2,091,268**	**1,367,292**	2,048,811	1,250,111
Distribution system	**115,660,684**	**48,419,948**	108,303,136	43,966,393
Meters	**8,269,271**	**4,139,493**	7,860,994	3,870,363
General equipment	**12,694,334**	**9,013,673**	11,167,615	7,769,712
Contributed capital	**(14,857,883)**	**(1,742,078)**	(12,415,674)	(1,147,762)
	155,748,335	**71,139,802**	148,964,192	65,162,758
Less accumulated amortization	**71,139,802**		65,162,758	
Net book value	**84,608,533**		83,801,434	

6. NET REGULATORY ASSETS/LIABILITIES

Net regulatory assets (liabilities) represent costs incurred by the company in excess of amounts billed to the consumer at OEB approved rates less recoveries. These amounts have been accumulated pursuant to the Electricity Act (EA) and deferred in anticipation of their future recovery in electricity distribution rates. Management assesses the future uncertainty with respect to the final regulatory disposition of those amounts, and to the extent required, makes accounting provisions to reduce the deferred balances accumulated or to increase the recorded liabilities. Upon rendering of the final regulatory decision adjusting distribution rates, the provisions are adjusted to reflect the final impact of that decision, and such adjustment is reflected in net earnings for the period.

Regulatory assets (liabilities) earn (incur) interest at the rate of 7.25% simple interest per annum.

Transition costs - represent specific and incremental costs to the Company for systems and process changes to support the opening of the competitive electricity market in Ontario on May 1, 2002 ("Market Opening"). These costs have been deferred pursuant to regulation underlying the EA and are subject to review and approval for recovery by the OEB. The Company filed for recovery of these costs in January, 2004 and it is expected that these costs will be recovered over a four year period.

Pre-market opening cost of power variances - represent the excess of the cost of the commodity electricity to the Company over the amount billed to its customers prior to Market Opening. The Company filed for recovery of these costs in January, 2004 and it is expected that these costs will be recovered over a four year period.

Post-market opening retail settlement variances - represent amounts that have accumulated since Market Opening and comprise:

a) variances between amounts charged by the Independent Electricity System Operator ("IESO") for the operation of the wholesale electricity market and grid, various wholesale market settlement charges and transmission charges, and the amounts billed to customers by the Company based on the OEB approved wholesale market service rate; and,
b) variances between the amounts charged by the IESO for energy commodity costs and the amounts billed to customers by the Company based on OEB approved rates.

The Company filed for recovery of these costs in January, 2004 over a four year period. The application was approved by the OEB effective April 1, 2005.

6. NET REGULATORY ASSETS/LIABILITIES cont'd

Deferred payments in lieu of taxes – represent variances that result from the difference between OEB approved PILs recoverable in electricity distribution services charges and the actual amount of these charges to customers that relates to the recovery of PILs.

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

In the absence of rate regulation, generally accepted accounting principles would require the Company to record the costs and recoveries described above in the operating results of the year in which they are incurred and reported earnings before income taxes would be $2,954,186 lower in 2005 and $2,304,863 higher in 2004 than reported.

Net regulatory assets and liabilities consist of the following:

	2005 $	2004 $
Regulatory assets		
Transition costs	**924,556**	1,038,396
Pre-market opening variances	**3,221,003**	2,355,905
	4,145,559	3,394,301
Reserve for Impairment	**-**	(3,392,903)
	4,145,559	1,398
Post market opening variances	**(8,740,522)**	(7,287,478)
Regulatory Repayments net of recoveries	**592,731**	329,662
Net regulatory assets and liabilities	**(4,002,232)**	(6,956,418)

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

7. RELATED PARTY TRANSACTIONS

The Company conducted transactions with related parties during the year ended December 31, 2005. 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.

During the year, the company provided street lighting energy and street lighting maintenance services to the City of Waterloo in the amounts of $426,971 and $205,781 respectively [2004 - $421,030 and $195,938, respectively]. In addition, the Company performs regular billing and collections services on behalf of the City of Waterloo for municipal water and sewer charges. In 2004, the Company collected $20,567,369 [2004 - $18,591,288] on behalf of the City of Waterloo relating to these charges. The Company charged administrative fees in the amount of $591,711 [2004 – $534,170] to the City of Waterloo for this service. The City of Waterloo is the majority shareholder of Waterloo North Hydro Holding Corporation.

At year-end, the Company owed the City of Waterloo $1,699,885 [2004 - $1,577,775] in un-remitted collections.

In 2003 the company loaned $1,600,000 to Waterloo North Hydro Holding Corporation. This debt bears interest at the prime rate of the Corporation's banker minus 65 basis points per annum and has no set repayment terms. In 2004, $400,000 of this debt was repaid. At year end the prime rate was 5.0%. Total interest in the amount of $44,836 [2004 - $53,726] was received on this debt during the year.

8. BANK DEBT

In 2004, the company borrowed $10,000,000 from the Canadian Imperial Bank of Commerce. This loan is at a variable interest rate plus a stamping fee of .45% with principal repayment amortized over 25 years. This rate is hedged by way of an interest rate swap at 4.932%. This debt is secured by a General Security Agreement in favour of the CIBC bank. Total interest in the amount of $512,602 was paid on this debt during the year. The replacement cost of the interest rate swap as at December 31, 2005 was $407,507.

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

9. LONG-TERM DEBT

	2005 $	2004 $
Senior long-term note payable [a]	**24,155,492**	25,460,492
Junior long-term note payable [b]	**16,246,940**	16,246,940
	40,402,432	41,707,432

[a] The senior long-term note payable is due to Waterloo North Hydro Holding Corporation, the Company's parent, bears interest at a rate of 6.0% per annum, has no set principal repayment terms and is due on demand.

Waterloo North Hydro Holding Corporation has waived the right to demand repayment of any portion of the note during the next fiscal year.

The company repaid $1,305,000 of this debt in 2005.

[b] The junior long-term note payable is due to Waterloo North Hydro Holding Corporation, bears interest at a rate of 1 1/8% per annum above the interest rate on debt which the Ontario Energy Board permits the corporation to pay for rate making purposes in the establishment of distribution rates, has no set principal repayment terms and is due on demand.

Waterloo North Hydro Holding Corporation has waived the right to demand repayment of any portion of the note during the next fiscal year.

10. PENSION PLAN

WNHI incurred current service pension costs of $444,774 for the year ended December 31, 2005 [2004 – $410,659]. Effective August 1, 1998, OMERS provided a temporary contribution holiday, with no Company or employee pension contributions required until after December 31, 2002. In January 2003, OMERS contributions resumed on a phased-in basis with full contributions starting in January 2004.

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

11. POST EMPLOYMENT BENEFITS

The Company has a number of unfunded defined benefit plans providing other retirement and post-employment benefits to most of its employees. These plans include life insurance, health and dental benefits and accumulated sick leave. The last actuarial valuation was done as at December 31, 2004.

Information about these defined benefit plans are as follows:

	2005 $	2004 $
Accrued benefit obligation		
Balance, beginning of year	**3,037,234**	2,840,366
Current service cost	**101,263**	68,524
Interest cost	**172,218**	170,818
Actuarial gain	-	81,392
Benefits Paid	**(183,873)**	(123,866)
Balance, end of year	**3,126,842**	3,037,234
Projected accrued benefit obligation at December 31	**3,083,613**	2,937,342

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

	%
Discount rate	**5.75**
Future general salary and wage levels increase	**3.0**
Dental costs increase	**4.0**
Medical costs increase	**7.5% in 2005, then 5.0% thereafter**

The approximate effect on the accrued benefit obligation and the estimated net benefit expense if the health care trend rate assumption was increased or decreased by 1% is as follows:

	Accrued Benefit Obligation	Periodic Cost
1% increase in health care trend rate	**$190,820**	**$25,702**
1% decrease in health care	**($172,409)**	**($22,961)**

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

12. SHARE CAPITAL

		2005 $	2004 $
Authorized			
Unlimited	common shares		
Unlimited	Class A special shares		
Issued			
1,000	common shares	**24,370,424**	24,370,424
215,600	Class A special shares - $10 Par value Non-voting, non cumulative	**2,156,000**	-
		26,526,424	24,370,424

13. INTEREST (EXPENSE) INCOME

The Company has interest [expense] income relating to the following:

	2005 $	2004 $
Interest on debt with Waterloo North Hydro Holding Corporation		
Senior long-term notes payable	**(1,525,699)**	(1,828,282)
Junior long-term notes payable	**(1,359,145)**	(1,360,681)
Other debt	**(555,491)**	(397,608)
Interest income	**326,381**	259,816
Net interest expense	**(3,113,954)**	(3,326,755)

14. 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

	2005 $	2004 $
Rate reconciliation		
Income from continuing operations before income taxes	**8,142,368**	4,979,640
Statutory Canadian federal and provincial income tax rate	**36.12%**	36.12%
Expected taxes on income	**2,941,023**	1,798,646
Increase (decrease) in income taxes resulting from:		
Large corporations tax net of surtax	-	25,413
Permanent differences	-	3,289
Other temporary differences not benefited	**147,593**	130,036
Income tax expense	**3,088,616**	1,957,384
Effective tax rate	**37.93%**	39.31%
Components of income tax expense		
Income Tax	**3,088,616**	1,931,971
Large Corporations Tax	-	25,413
Income tax expense	**3,088,616**	1,957,384

Balance sheet

Future income taxes relating to the regulated businesses have not been recorded in the accounts. As at December 31, 2005, future income tax assets of $6,923,853 [2004 - $6,806,976] based on substantively enacted income tax rates, have not been recorded.

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

15. PRUDENTIAL SUPPORT OBLIGATION

Waterloo North Hydro Inc. purchases power from the IESO on behalf of its customers and retailers. The IESO is responsible for ensuring that prudential support is posted by all market participants to mitigate the impact of an event of default by a market participant on the rest of the market. In this regard Waterloo North Hydro Inc. posted an irrevocable standby letter of credit in the amount of $15,927,424 underwritten by the corporations's principal bank. This instrument expires April 15, 2006.

16. FINANCIAL INSTRUMENTS

The carrying values of cash and cash equivalents, accounts receivable, unbilled energy receivable, accounts payable and accrued liabilities, and amounts due to related party approximate fair values because of the short maturity of these instruments. The carrying value of the loan receivable and the bank loan approximates fair value because these instruments bear interest at current rates. No fair value is available for the long-term note payable since there are no specified repayment terms.

Financial assets held by the Corporation, such as accounts receivable, expose it to credit risk.

The Corporation earns its revenue from a broad base of customers located in the City of Waterloo and the Townships of Wellesley and Woolwich. No one customer accounts for more than 1% of revenue.

17. CONTINGENT LIABILITY

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

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

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

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

18. GENERAL LIABILITY INSURANCE

The Corporation is a member of the Municipal Electric Association Reciprocal Insurance Exchange [MEARIE] which is a pooling of general liability insurance risks. Members of MEARIE would be assessed on a pro-rata basis should losses be experienced by MEARIE, for the years in which the Corporation was a member.

To December 31, 2005, the Corporation has not been made aware of any additional assessments. Participation in MEARIE expires December 31, 2006. Notice to withdraw from MEARIE must be given six months prior to the commencement of the next underwriting term.