

Lakefront Utilities Inc. Notes to Financial Statements

December 31, 2002

1. Due from Related Party

The balance is due from Lakefront Utilities Services Inc. (LUSI), a company under common control, and represents cash held by LUSI that will be transferred to the Company to meet future financial obligations. The amount is due on demand.

2. Income Taxes

The Company became obligated to make payments-in-lieu of taxes on October 1, 2001. There were no income or capital taxes in the period prior to October 1, 2001. The provision for income taxes under the taxes payable method for the year is \$62,703 (2001 - nil) represents payments-in-lieu of corporate taxes.

Future income tax benefits of \$256,000 (2001 - \$246,000) have not been recorded in the accounts. Significant components of the Company's future taxes as at December 31 are as follows:

	2002	2001
Tax benefit of loss carry forwards	\$ 216,000	\$ 309,000
Capital assets	40,000	(63,000)
	<u>\$ 256,000</u>	<u>\$ 246,000</u>

3. Capital Assets

	2002		2001	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Land	\$ 219,284	\$ -	\$ 219,284	\$ -
Buildings	517,818	370,909	517,818	341,917
Distribution stations	2,539,002	916,495	2,517,601	833,685
Distribution lines - overhead	6,860,852	3,158,990	6,637,129	2,887,792
Distribution lines - underground	3,277,394	1,166,624	3,158,307	1,036,716
Distribution transformers	3,135,661	997,367	3,034,167	876,894
Distribution meters	688,169	294,786	665,191	266,638
Other capital assets	377,588	323,797	367,019	302,927
	<u>17,615,768</u>	<u>7,228,968</u>	<u>17,116,516</u>	<u>6,546,569</u>
Less: Contributions in aid of of construction	(514,495)	(32,961)	(283,533)	(12,381)
	<u>\$ 17,101,273</u>	<u>\$ 7,196,007</u>	<u>\$ 16,832,983</u>	<u>\$ 6,534,188</u>
Net book value		<u>\$ 9,905,266</u>		<u>\$ 10,298,795</u>

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2002

4. Regulatory Assets

	<u>2002</u>	<u>2001</u>
Qualifying transition costs	\$ 1,196,403	\$ 843,901
Retail settlement variance accounts	619,824	-
Pre-market opening energy variance accounts	882,946	-
	<u>2,699,173</u>	<u>843,901</u>
Provision	(2,453,984)	-
	<u>\$ 245,189</u>	<u>\$ 843,901</u>

Although these assets are expected to be recovered through future rate increases, there remains uncertainty as to the timing and amount that will be approved for recovery. Legislation in the form of Bill 210 was implemented December 9, 2002, which froze rates effective May 1, 2002 until May 2006. Accordingly, a provision for uncertainty of recovery of \$2,453,984 has been set up by a charge to operations.

5. Accounts Payable and Accrued Liabilities

	<u>2002</u>	<u>2001</u>
Accounts payable - energy purchased	\$ 1,677,727	\$ 1,818,689
Other accounts payable and accrued liabilities	442,722	174,785
	<u>\$ 2,120,449</u>	<u>\$ 1,993,474</u>

6. Due to Related Parties

In addition to the promissory note payable described in Note 7, as at year end, the Company had an amount of \$3,735 (2001 - \$82,680) payable to the Town of Cobourg. The amount is non-interest bearing and due on demand. Also, \$840,986 (2001 - \$938,496) was payable to the Town of Cobourg - Water Department, and the remaining balance of \$1,193,649 (2001 - \$1,166,030) represents a payable to a company under common control. These amounts are due on demand and bear interest at a floating rate based on the current bank rate.

The fair value of the amounts due to related parties could not be reasonably determined as there is no comparable market data for these amounts.

7. Note Payable

	<u>2002</u>	<u>2001</u>
Promissory note payable, Town of Cobourg interest at 7.25% per annum, interest payable monthly, principal due on demand	<u>\$ 7,000,000</u>	<u>\$ 7,000,000</u>

The Town of Cobourg does not intend to demand repayment until replacement term financing is in place.

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2002

8. Share Capital

Authorized Unlimited	Common shares		
Issued		2002	2001
10,000,000	Common shares	<u>\$ 4,684,456</u>	<u>\$ 4,684,456</u>

9. Public Liability Insurance

The Company is a member of the Municipal Electrical Association Reciprocal Insurance Exchange.

The Municipal Electrical Association Reciprocal Insurance Exchange is a pooling of the public liability insurance risks of the municipal utilities in Ontario. All members of the pool are subject to assessment for losses experienced by the pool for the years in which they were members on a pro-rata basis, based on the total of their respective service revenues. It is anticipated that should such an assessment occur, it would be funded over a period of up to five years. No assessments have been made with respect to 2002.

10. Contingency

A class action claiming \$500 million in restitution 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 electrical utilities in Ontario which have charged late payment charges on overdue 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 defence of this action. Town of Cobourg Holdings Inc. assumed all of the liabilities of the former utilities on the transfer of electrical distribution assets on May 1, 2000. At this time it is not possible to quantify the effect, if any, on the financial statements of the Town of Cobourg Holdings Inc. As such, no accrual of any potential liability has been recognized.

11. Pension Agreements

The Town makes contributions to the Ontario Municipal Employees Retirement Fund (OMERS), which is a multi-employer plan, on behalf of its staff. The plan is a defined benefit plan which specifies the amount of the retirement benefit to be received by the employees based on the length of service and rates of pay.

In June 1998, OMERS announced a contribution holiday. For the period commencing August 1998 and ending December 31, 2002, the Town is not required to make contributions to the plan on behalf of its staff.

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2002

12. Bill 210 - Energy Rebates

Bill 210 received Royal Assent on November 25, 2002. One of the major premises of the Bill was to retroactively freeze the costs of electricity for designated users at 4.3 cents per kwh. As required by Bill 210, the Company issued the first series of rebates by way of a \$75 cheque or credit to customer accounts prior to December 31, 2002. In turn, the amounts refunded to customers were received from the IMO by way of a credit on the Company's power bill.

The amounts received from the IMO have the effect of reducing the Corporation's sales and cost of power equally by \$628,752. As the cost of power is intended to be a pass-through to the end customer, there is no net income affect arising from the energy rebates.

13. Comparative Figures

Certain comparative figures presented in the financial statements have been restated to conform to the current year's presentation.

Appendix 37

2003 Financial Statements

Lakefront Utilities Inc.
Financial Statements
For the year ended December 31, 2003

	Contents
Auditors' Report	2
Financial Statements	
Balance Sheet	3
Statement of Operations and Retained Earnings	4
Statement of Cash Flows	5
Summary of Significant Accounting Policies	6-8
Notes to Financial Statements	9-12



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Chartered Accountants
and Consultants

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Auditors' Report

To the Shareholder of Lakefront Utilities Inc.

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

BDO Dunwoody LLP

Chartered Accountants

Markham, Ontario
August 12, 2004

Lakefront Utilities Inc. Balance Sheet

December 31

2003

2002

Assets

Current

Cash	\$ 198,878	\$ 210,258
Due from related party (Note 1)	3,717,521	1,799,235
Accounts receivable	1,308,279	1,737,479
Unbilled revenue	2,357,754	2,611,177
Consumable inventory	186,528	209,106
Payment-in-lieu of income taxes recoverable (Note 2)	-	48,000
Prepaid expenses	31,587	17,751

7,800,547 6,633,006

Capital assets (Note 3)

9,982,107 9,905,266

Regulatory assets (Note 4)

142,596 245,189

\$ 17,925,250 \$ 16,783,461

Liabilities and Shareholder's Equity

Current

Accounts payable and accrued liabilities (Note 5)	\$ 2,444,326	\$ 2,120,449
Payment-in-lieu of income taxes payable (Note 2)	325,114	-
Due to related parties (Note 6)	1,255,987	2,038,370
Current portion of customer deposits	91,636	90,000

4,117,063 4,248,819

Customer deposits

470,271 323,338

Note payable (Note 7)

7,000,000 7,000,000

11,587,334 11,572,157

Shareholder's equity

Share capital (Note 8)	4,684,456	4,684,456
Retained earnings	1,653,460	526,848

6,337,916 5,211,304

\$ 17,925,250 \$ 16,783,461

On behalf of the Board:

Director

Director

Lakefront Utilities Inc.
Statement of Operations and Retained Earnings

For the year ended December 31	2003	2002
Service revenue	\$ 21,268,980	\$ 23,196,408
Cost of power purchased	17,490,864	20,480,636
Gross margin on service revenue	3,778,116	2,715,772
Other operating revenue	236,929	181,565
	4,015,045	2,897,337
Operating and maintenance expense		
Distribution	429,336	482,432
Billing and collection	273,895	315,189
General and administration	502,075	544,293
	1,205,306	1,341,914
Income before amortization, interest and taxes	2,809,739	1,555,423
Amortization	685,742	662,166
Interest on note payable	507,500	507,500
Other interest expense	64,215	60,958
	1,257,457	1,230,624
Income before income taxes	1,552,282	324,799
Income taxes		
Payment-in-lieu of income taxes (Note 2)	425,670	62,703
Net income	1,126,612	262,096
Retained earnings, beginning of the year	526,848	264,752
Retained earnings, end of the year	\$ 1,653,460	\$ 526,848

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

Lakefront Utilities Inc.
Statement of Cash Flows

For the year ended December 31 **2003** **2002**

Cash provided by (used in)

Operating activities

Net income	\$ 1,126,612	\$ 262,096
Amortization	685,742	662,166
Provision - regulatory assets (Note 4)	(606,398)	2,453,984
Changes in non-cash working capital balances		
Accounts receivable	429,200	(219,275)
Unbilled revenue	253,423	(1,470,177)
Consumable inventory	22,578	39,704
Payment-in-lieu of income taxes	373,114	(30,000)
Prepaid expenses	(13,836)	992
Accounts payable and accrued liabilities	323,877	126,975
Customer deposits	148,569	158,213
	<u>2,742,881</u>	<u>1,984,678</u>

Investing activities

Advances to (repayments from) related party	(1,918,286)	285,558
Purchase of capital assets	(762,583)	(499,599)
Decrease (increase) in regulatory assets	708,991	(1,855,272)
	<u>(1,971,878)</u>	<u>(2,069,313)</u>

Financing activities

Repayments to related parties	(782,383)	(148,836)
Contributions and grants received	-	230,962
	<u>(782,383)</u>	<u>82,126</u>

Net change in cash

(11,380) (2,509)

Cash, beginning of year

210,258 212,767

Cash, end of year

\$ 198,878 \$ 210,258

Supplemental Cash Flow Information

Cash paid for interest	\$ 571,715	\$ 568,458
Cash paid for payments-in-lieu of income taxes	\$ 52,556	\$ 92,702

Lakefront Utilities Inc.

Summary of Significant Accounting Policies

December 31, 2003

Nature of Business	The Company was incorporated under the Business Corporations Act (Ontario) on April 12, 2000 and is engaged in the distribution of electricity and associated business activities.														
Basis of Preparation	The financial statements have been prepared in accordance with accounting principles for electrical utilities in Ontario as required by the Ontario Energy Board under the authority of Sections 52, 70(2) and (78) of the Ontario Energy Board Act, 1998, and reflect the policies as set forth in the "Accounting Procedures Handbook for Utilities in Ontario". All principles employed are in accordance with Canadian generally accepted accounting principles.														
Use of Estimates	The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's best estimates as additional information becomes available in the future.														
Revenue	Revenue is recognized in the financial statements on the accrual basis when the energy is supplied to the users, whether billed or unbilled.														
Consumable Inventory	Consumable inventory is stated at the lower of cost and net realizable value, where cost is generally determined on the average cost basis.														
Capital Assets	<p>Capital assets are recorded at cost less accumulated amortization. Amortization is provided over the estimated useful life of the assets at rates established by the Ontario Energy Board. Capital assets are amortized on a straight line basis using the following rates:</p> <table><tr><td>Buildings</td><td>5.0%</td></tr><tr><td>Distribution stations</td><td>3.3%</td></tr><tr><td>Distribution lines - overhead</td><td>4.0%</td></tr><tr><td>Distribution lines - underground</td><td>4.0%</td></tr><tr><td>Distribution transformers</td><td>4.0%</td></tr><tr><td>Distribution meters</td><td>4.0%</td></tr><tr><td>Other capital assets</td><td>10.0 - 20.0%</td></tr></table>	Buildings	5.0%	Distribution stations	3.3%	Distribution lines - overhead	4.0%	Distribution lines - underground	4.0%	Distribution transformers	4.0%	Distribution meters	4.0%	Other capital assets	10.0 - 20.0%
Buildings	5.0%														
Distribution stations	3.3%														
Distribution lines - overhead	4.0%														
Distribution lines - underground	4.0%														
Distribution transformers	4.0%														
Distribution meters	4.0%														
Other capital assets	10.0 - 20.0%														

Lakefront Utilities Inc.

Summary of Significant Accounting Policies

December 31, 2003

Capital Contributions

Capital contributions in aid of construction consist of third party contributions toward the cost of constructing distribution assets and are recorded with capital assets as a contra account. Contributions are amortized at rates corresponding with the useful life of the related capital assets.

Regulatory Assets

The Ontario Government, through the establishment of rules affecting the electricity industry, allows for the establishment or contribution of deferral accounts for certain items until disposition can be addressed by the Ontario Energy Board ("OEB") during its rate setting process. In November 2003, the Province announced its intention to permit electricity distributors to make applications to the OEB for recovery of the regulatory assets (based on year-end balances as at December 31, 2002) to be phased in over a four-year period effective March 1, 2004 (Note 4).

The Company records regulatory assets for amounts that it believes are likely to be collected in the future as a result of the OEB's rate setting process. Regulatory assets that have been accrued for include qualifying transition costs, retail settlement variance accounts, and pre-market opening energy variance account. It is the Company's intention to seek recovery of the regulatory assets, plus accrued interest in the allowable amount in its next rate application.

If as a result of future changes to the regulatory environment, it is unlikely that the Company will recover the regulatory assets, the accounts would be charged to operations in the period in which that determination is made.

Qualifying Transition Costs

These costs reflect amounts incurred to prepare for the opening of the electricity market to competition and the incremental costs to support the market opening.

Retail Settlement Variance Accounts

These accounts reflect the difference between the cost of electricity and the amounts billed to consumers beginning May 1, 2002, the date the market became open to competition.

Pre-Market Opening Energy Variance Accounts

These accounts reflect the difference between the cost of electricity paid to Ontario Power Generation and the amount billed to customers for electricity usage for the period January 1, 2001 to April 30, 2002.

Lakefront Utilities Inc.

Summary of Significant Accounting Policies

December 31, 2003

Payment-in-lieu of Income Taxes

Under the Electricity Act, 1998, the Company is required to make payments-in-lieu of corporate taxes to the Ontario Electricity Financial Corporation (OEFC). These payments are recorded 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) and modified by the Electricity Act, 1998 and related regulations.

The Company provides for payments-in-lieu of corporate income taxes using the taxes payable method. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. Future income taxes are expected to be reflected in future rates and accordingly, are not recognized in the financial statements.

Financial Instruments

Unless otherwise noted, it is management's opinion that the company is not exposed to significant interest, currency or credit risks arising from its financial instruments, and the fair values of the financial instruments approximate their carrying values.

Lakefront Utilities Inc. Notes to Financial Statements

December 31, 2003

1. Due from Related Party

The balance is due from Lakefront Utilities Services Inc. (LUSI), a company under common control, and represents cash held by LUSI that will be transferred to the Company to meet future financial obligations. The amount is due on demand, unsecured and bears interest at a floating rate based on the current bank rate. The company received \$86,400 (2002 - \$49,500) in interest during the year.

2. Payment-in-lieu of income Taxes

The provision for income taxes under the taxes payable method for the year is \$425,670 (2002 - \$62,703) which represents payments-in-lieu of corporate taxes.

Future income tax benefits of \$158,000 (2002 - \$256,000) have not been recorded in the accounts. Significant components of the Company's future taxes as at December 31 are as follows:

	2003	2002
Tax benefit of loss carry forwards	\$ -	\$ 216,000
Capital assets	158,000	40,000
	<u>\$ 158,000</u>	<u>\$ 256,000</u>

3. Capital Assets

	2003		2002	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Land	\$ 219,284	\$ -	\$ 219,284	\$ -
Buildings	541,053	401,287	517,818	370,909
Distribution stations	2,517,601	997,593	2,539,002	916,495
Distribution lines - overhead	7,048,828	3,436,901	6,860,852	3,158,990
Distribution lines - underground	3,562,745	1,299,145	3,277,394	1,166,624
Distribution transformers	3,201,620	1,121,333	3,135,661	997,367
Distribution meters	736,711	324,876	688,169	294,786
Other capital assets	550,509	354,155	377,588	323,797
	<u>18,378,351</u>	<u>7,935,290</u>	<u>17,615,768</u>	<u>7,228,968</u>
Less: Contributions in aid of of construction	<u>(514,495)</u>	<u>(53,541)</u>	<u>(514,495)</u>	<u>(32,961)</u>
	<u>\$ 17,863,856</u>	<u>\$ 7,881,749</u>	<u>\$ 17,101,273</u>	<u>\$ 7,196,007</u>
Net book value		<u>\$ 9,982,107</u>		<u>\$ 9,905,266</u>

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2003

4. Regulatory Assets

	2003	2002
Qualifying transition costs	\$ 1,435,995	\$ 1,196,403
Retail settlement variance accounts	(328,759)	619,824
Pre-market opening energy variance accounts - 1571	882,946	882,946
	<u>1,990,182</u>	<u>2,699,173</u>
Provision	(1,847,586)	(2,453,984)
1569 - 342,154.91	(1570)	(1570)
	<u>\$ 142,596</u>	<u>\$ 245,189</u>

In a letter dated December 19, 2003, the Ministry of Energy granted approval for distributors to make application to the OEB with regard to rate recovery of certain distribution regulatory assets whose inclusion in rates was delayed by the *Electricity Pricing, Conservation and Supply Act, 2002 (Electric Pricing, Conservation and Supply Act)*. As a result of the Company's distribution rate application dated January 22, 2004, these distribution regulatory assets are expected to be recovered over a four-year period, effective March 1, 2004 with an implementation date for consumption of April 1, 2004. However, the amount to be recovered will be subject to a yet to be determined OEB review and approval process, expected to occur later in 2004.

The Company has made a provision to mitigate the risk of non-recovery of the full amount of regulatory assets recorded.

5. Accounts Payable and Accrued Liabilities

	2003	2002
Accounts payable - energy purchased	\$ 1,735,448	\$ 1,677,727
Other accounts payable and accrued liabilities	708,878	442,722
	<u>\$ 2,444,326</u>	<u>\$ 2,120,449</u>

Lakefront Utilities Inc. Notes to Financial Statements

December 31, 2003

6. Due to Related Parties

In addition to the promissory note payable described in Note 7, as at year end, the Company had the following amounts due to related parties:

	<u>2003</u>	<u>2002</u>
Cobourg Networks Inc.	\$ 1,253,309	\$ 1,193,649
Waterworks of the Town of Cobourg	-	840,986
The Corporation of the Town of Cobourg	<u>2,678</u>	<u>3,735</u>
	<u>1,255,987</u>	<u>2,038,370</u>

The amount due to the Corporation of the Town of Cobourg, the ultimate parent entity, is non-interest bearing, unsecured and due on demand. The remaining balances due to entities under common control are due on demand, unsecured and bear interest at a floating rate based on the current bank rate.

The company was charged \$34,000 (2002 - \$49,000) in interest on the above loans during the year.

7. Note Payable

	<u>2003</u>	<u>2002</u>
Promissory note payable, Town of Cobourg interest at 7.25% per annum, interest payable monthly, principal due on demand	<u>\$ 7,000,000</u>	<u>\$ 7,000,000</u>

During the year, the Company was charged \$507,500 (2002 - \$507,500) in interest. The Town of Cobourg does not intend to demand repayment until replacement term financing is in place.

8. Share Capital

Authorized
Unlimited Common shares
Issued

	<u>2003</u>	<u>2002</u>
10,000,000 Common shares	<u>\$ 4,684,456</u>	<u>\$ 4,684,456</u>

Lakefront Utilities Inc.

Notes to Financial Statements

December 31, 2003

9. Public Liability Insurance

The Company is a member of the Municipal Electrical Association Reciprocal Insurance Exchange.

The Municipal Electrical Association Reciprocal Insurance Exchange is a pooling of the public liability insurance risks of the municipal utilities in Ontario. All members of the pool are subject to assessment for losses experienced by the pool for the years in which they were members on a pro-rata basis, based on the total of their respective service revenues. It is anticipated that should such an assessment occur, it would be funded over a period of up to five years. No assessments have been made with respect to 2003.

10. Contingency

A class action lawsuit claiming \$500 million in restitution 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 electrical utilities in Ontario which have charged late payment charges on overdue 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 defence of this action. Town of Cobourg Holdings Inc. assumed all of the liabilities of the former utilities on the transfer of electrical distribution assets on May 1, 2000. At this time it is not possible to quantify the effect, if any, on the financial statements of the Town of Cobourg Holdings Inc. As such, no accrual of any potential liability has been recognized.

11. Pension Agreements

The Town makes contributions to the Ontario Municipal Employees Retirement Fund (OMERS), which is a multi-employer plan, on behalf of its staff. The plan is a defined benefit plan which specifies the amount of the retirement benefit to be received by the employees based on the length of service and rates of pay.

For the year ended December 31, 2003, the current pension costs charged to expenses were \$15,210 (2002 - \$Nil). In 2002, the Company and its employees were not required to make contributions due to a contribution holiday by OMERS.

12. Comparative Figures

Certain comparative figures presented in the financial statements have been restated to conform to the current year's presentation.

Appendix 38

2004 Financial Statements

Lakefront Utilities Inc.
Financial Statements
For the year ended December 31, 2004

	Contents
Auditors' Report	2
Financial Statements	
Balance Sheet	3
Statement of Operations and Retained Earnings	4
Statement of Cash Flows	5
Summary of Significant Accounting Policies	6-8
Notes to Financial Statements	9-13



Driving growth

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Auditors' Report

To the Shareholder of Lakefront Utilities Inc.

We have audited the balance sheet of Lakefront Utilities Inc. as at December 31, 2004 and the statements of operations and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the 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.

BDO Dunwoody LLP

Chartered Accountants

Markham, Ontario
April 15, 2005

Lakefront Utilities Inc.
Balance Sheet

December 31 **2004** **2003**

Assets

Current

Cash	\$ 185,863	\$ 198,878
Due from related party (Note 1)	2,410,154	3,717,521
Accounts receivable	1,701,137	1,308,279
Unbilled revenue	2,603,363	2,357,754
Consumable inventory	226,516	186,528
Prepaid expenses	39,607	31,587

7,166,640 7,800,547

Capital assets (Note 3) 9,830,870 9,982,107

Regulatory assets (Note 4) 49,929 142,596

\$ 17,047,439 \$ 17,925,250

Liabilities and Shareholder's Equity

Current

Accounts payable and accrued liabilities (Note 5)	\$ 2,639,364	\$ 2,444,326
Payment-in-lieu of income taxes payable (Note 2)	385,114	325,114
Due to related parties (Note 6)	8,353	1,255,987
Current portion of customer deposits	230,000	91,636

3,262,831 4,117,063

Customer deposits 297,360 470,271

Employee future benefits (Note 7) 145,000 -

Note payable (Note 8) 7,000,000 7,000,000

10,705,191 11,587,334

Shareholder's equity

Share capital (Note 9)	4,684,456	4,684,456
Retained earnings	1,657,792	1,653,460

6,342,248 6,337,916

\$ 17,047,439 \$ 17,925,250

On behalf of the Board:

Director

Director

Lakefront Utilities Inc.
Statement of Operations and Retained Earnings

For the year ended December 31	2004	2003
Service revenue	\$ 4,108,278	\$ 3,778,116
Cost of power revenue	<u>18,917,556</u>	<u>17,490,864</u>
	23,025,834	21,268,980
Cost of power purchased	<u>18,917,556</u>	<u>17,490,864</u>
Gross margin on service revenue	4,108,278	3,778,116
Other operating revenue	<u>166,970</u>	<u>236,929</u>
	<u>4,275,248</u>	<u>4,015,045</u>
Operating and maintenance expenses		
Distribution	543,421	429,336
Billing and collection	223,961	273,895
General and administration	<u>618,682</u>	<u>502,075</u>
	<u>1,386,064</u>	<u>1,205,306</u>
Income before amortization, interest and taxes	<u>2,889,184</u>	<u>2,809,739</u>
Amortization	724,056	685,742
Interest on note payable	507,501	507,500
Other interest expense	<u>48,295</u>	<u>64,215</u>
	<u>1,279,852</u>	<u>1,257,457</u>
Income before income taxes	<u>1,609,332</u>	<u>1,552,282</u>
Income taxes		
Payment-in-lieu of income taxes (Note 2)	660,000	641,670
Recovery due to losses carried forward	<u>-</u>	<u>(216,000)</u>
	<u>660,000</u>	<u>425,670</u>
Net income	949,332	1,126,612
Retained earnings, beginning of the year	1,653,460	526,848
Employee future benefits (Note 7)	(145,000)	-
Dividends paid	<u>(800,000)</u>	<u>-</u>
Retained earnings, end of the year	<u>\$ 1,657,792</u>	<u>\$ 1,653,460</u>

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

Lakefront Utilities Inc.
Statement of Cash Flows

For the year ended December 31 **2004** **2003**

Cash provided by (used in)

Operating activities

Net income	\$ 949,332	\$ 1,126,612
Amortization	724,056	685,742
Provision - regulatory assets (Note 4)	112,509	155,076
Changes in non-cash working capital balances		
Accounts receivable	(392,858)	429,200
Unbilled revenue	(245,609)	253,423
Consumable inventory	(39,988)	22,578
Prepaid expenses	(8,020)	(13,836)
Accounts payable and accrued liabilities	195,038	323,877
Payment-in-lieu of income taxes	60,000	373,114
Customer deposits	(34,547)	148,569
	<u>1,319,913</u>	<u>3,504,355</u>

Investing activities

Repayments from (advances to) related party	1,307,367	(1,918,286)
Purchase of capital assets	(572,819)	(762,583)
Increase in regulatory assets	(19,842)	(52,483)
	<u>714,706</u>	<u>(2,733,352)</u>

Financing activities

Repayments to related parties	(1,247,634)	(782,383)
Dividends	(800,000)	-
	<u>(2,047,634)</u>	<u>(782,383)</u>

Net change in cash (13,015) (11,380)

Cash, beginning of year 198,878 210,258

Cash, end of year \$ 185,863 \$ 198,878

Supplemental Cash Flow Information

Cash paid for interest	\$ 555,796	\$ 571,715
Cash paid for payments-in-lieu of income taxes	\$ 600,000	\$ 52,556

Lakefront Utilities Inc.
Summary of Significant Accounting Policies

December 31, 2004

Nature of Business	The Company was incorporated under the Business Corporations Act (Ontario) on April 12, 2000 and is engaged in the distribution of electricity and associated business activities.														
Basis of Preparation	The financial statements have been prepared in accordance with accounting principles for electrical utilities in Ontario as required by the Ontario Energy Board under the authority of Sections 52, 70(2) and (78) of the Ontario Energy Board Act, 1998, and reflect the policies as set forth in the "Accounting Procedures Handbook for Utilities in Ontario". All principles employed are in accordance with Canadian generally accepted accounting principles.														
Use of Estimates	The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's best estimates as additional information becomes available in the future.														
Revenue	Revenue is recognized in the financial statements on the accrual basis when the energy is supplied to the users, whether billed or unbilled.														
Consumable Inventory	Consumable inventory is stated at the lower of cost and net realizable value, where cost is generally determined on the average cost basis.														
Capital Assets	<p>Capital assets are recorded at cost less accumulated amortization. Amortization is provided over the estimated useful life of the assets at rates established by the Ontario Energy Board. Capital assets are amortized on a straight line basis using the following rates:</p> <table><tr><td>Buildings</td><td>5%</td></tr><tr><td>Distribution stations</td><td>3.3%</td></tr><tr><td>Distribution lines - overhead</td><td>4%</td></tr><tr><td>Distribution lines - underground</td><td>4%</td></tr><tr><td>Distribution transformers</td><td>4%</td></tr><tr><td>Distribution meters</td><td>4%</td></tr><tr><td>Other capital assets</td><td>10 - 20%</td></tr></table>	Buildings	5%	Distribution stations	3.3%	Distribution lines - overhead	4%	Distribution lines - underground	4%	Distribution transformers	4%	Distribution meters	4%	Other capital assets	10 - 20%
Buildings	5%														
Distribution stations	3.3%														
Distribution lines - overhead	4%														
Distribution lines - underground	4%														
Distribution transformers	4%														
Distribution meters	4%														
Other capital assets	10 - 20%														

Lakefront Utilities Inc.

Summary of Significant Accounting Policies

December 31, 2004

**Impairment of
Long-Lived Assets**

On January 1, 2004, the company adopted CICA Handbook Section 3063, "Impairment of Long-Lived Assets", which requires the Company to test for impairment loss of long-lived assets to be held and used when events or changes in circumstances occur which may cause their carrying value to exceed the total undiscounted cash flows expected from their use and eventual disposition. An impairment loss, if any, is determined as the excess of the carrying value of the asset over its fair value.

Capital Contributions

Capital contributions in aid of construction consist of third party contributions toward the cost of constructing distribution assets and are recorded with capital assets as a contra account. Contributions are amortized at rates corresponding with the useful life of the related capital assets.

Regulatory Assets

The Ontario Government, through the establishment of rules affecting the electricity industry, allows for the establishment or contribution of deferral accounts for certain items until disposition can be addressed by the Ontario Energy Board ("OEB") during its rate setting process. In November 2003, the Province announced its intention to permit electricity distributors to make applications to the OEB for recovery of the regulatory assets (based on year-end balances as at December 31, 2002) to be phased in over a four-year period effective March 1, 2004 (Note 4).

The Company records regulatory assets for amounts that it believes are likely to be collected in the future as a result of the OEB's rate setting process. Regulatory assets that have been accrued for include qualifying transition costs, retail settlement variance accounts, and pre-market opening energy variance account. It is the Company's intention to seek recovery of the regulatory assets, plus accrued interest in the allowable amount in its next rate application.

If as a result of future changes to the regulatory environment, it is unlikely that the Company will recover the regulatory assets, the accounts would be charged to operations in the period in which that determination is made.

Qualifying Transition Costs

These costs reflect amounts incurred to prepare for the opening of the electricity market to competition and the incremental costs to support the market opening.

Lakefront Utilities Inc.

Summary of Significant Accounting Policies

December 31, 2004

Retail Settlement Variance Accounts

These accounts reflect the difference between the cost of electricity and the amounts billed to consumers beginning May 1, 2002, the date the market became open to competition.

Pre-Market Opening Energy Variance Accounts

These accounts reflect the difference between the cost of electricity paid to Ontario Power Generation and the amount billed to customers for electricity usage for the period January 1, 2001 to April 30, 2002.

Payment-in-lieu of Income Taxes

Under the Electricity Act, 1998, the Company is required to make payments-in-lieu of corporate taxes to the Ontario Electricity Financial Corporation (OEFC). These payments are recorded 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) and modified by the Electricity Act, 1998 and related regulations.

The Company provides for payments-in-lieu of corporate income taxes using the taxes payable method. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. Future income taxes are expected to be reflected in future rates and accordingly, are not recognized in the financial statements.

Customer Deposits

Customer deposits are cash collections from customers to guarantee the payment of energy bills. Customer deposits includes interest credited to customers' deposit accounts, with interest expense recorded to offset this amount. Deposits expected to be refunded to customers within the next fiscal year are classified as a current liability.

Financial Instruments

Unless otherwise noted, it is management's opinion that the company is not exposed to significant interest, currency or credit risks arising from its financial instruments, and the fair values of the financial instruments approximate their carrying values.

Lakefront Utilities Inc. Notes to Financial Statements

December 31, 2004

1. Due from Related Party

The balance is due from Lakefront Utilities Services Inc. (LUSI), a company under common control, and represents cash held by LUSI that will be transferred to the Company to meet future financial obligations. The amount is due on demand, unsecured and bears interest at a floating rate based on the current bank rate. The company received \$34,758 (2003 - \$86,400) in interest during the year.

2. Payment-in-lieu of income Taxes

The provision for income taxes under the taxes payable method for the year is \$660,000 (2003 - \$425,670) which represents payments-in-lieu of corporate taxes.

Future income tax benefits of \$ \$281,000 (2003 - \$158,000) have not been recorded in the accounts. Significant components of the Company's future taxes as at December 31 are as follows:

	2004	2003
Capital assets	\$ 281,000	\$ 158,000

3. Capital Assets

	2004		2003	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Land	\$ 219,284	\$ -	\$ 219,284	\$ -
Buildings	565,550	432,213	541,053	401,287
Distribution stations	2,517,601	1,079,547	2,517,601	997,593
Distribution lines - overhead	7,301,490	3,724,443	7,048,828	3,436,901
Distribution lines - underground	3,675,816	1,433,246	3,562,745	1,299,145
Distribution transformers	3,384,275	1,251,750	3,201,620	1,121,333
Distribution meters	792,029	357,179	736,711	324,876
Other capital assets	614,085	406,306	550,509	354,155
	19,070,130	8,684,684	18,378,351	7,935,290
Less: Contributions in aid of construction	(633,456)	(78,880)	(514,495)	(53,541)
	\$ 18,436,674	\$ 8,605,804	\$ 17,863,856	\$ 7,881,749
Net book value		\$ 9,830,870		\$ 9,982,107

(118,966)

697,179

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2004

4. Regulatory Assets

	2004	2003
Qualifying transition costs	\$ 1,714,435	\$ 1,435,995
Retail settlement variance accounts	3,414	432,715
Pre-market opening energy variance accounts	1,053,649	882,946
	<u>2,771,498</u>	<u>2,751,656</u>
Provision	<u>(2,721,569)</u>	<u>(2,609,060)</u>
	<u>\$ 49,929</u>	<u>\$ 142,596</u>

In a letter dated December 19, 2003, the Ministry of Energy granted approval for distributors to make application to the OEB with regard to rate recovery of certain distribution regulatory assets whose inclusion in rates was delayed by the *Electricity Pricing, Conservation and Supply Act, 2002* (*Electric Pricing, Conservation and Supply Act*). As a result of the Company's distribution rate application dated January 22, 2004, these distribution regulatory assets are expected to be recovered over a four-year period, effective March 1, 2004 with an implementation date for consumption of April 1, 2004. However, the amount to be recovered will be subject to a yet to be determined OEB review and approval process, expected to occur later in 2005.

The Company has made a provision to mitigate the risk of non-recovery of the full amount of regulatory assets recorded.

5. Accounts Payable and Accrued Liabilities

	2004	2003
Accounts payable - energy purchased	\$ 1,957,736	\$ 1,735,448
Other accounts payable and accrued liabilities	681,628	708,878
	<u>\$ 2,639,364</u>	<u>\$ 2,444,326</u>

Lakefront Utilities Inc. Notes to Financial Statements

December 31, 2004

6. Due to Related Parties

In addition to the promissory note payable described in Note 8, as at year end, the Company had the following amounts due to related parties:

	2004	2003
Cobourg Networks Inc.	\$ -	\$ 1,253,309
The Corporation of the Town of Cobourg	8,353	2,678
	<u>\$ 8,353</u>	<u>\$ 1,255,987</u>

The amount due to the Corporation of the Town of Cobourg, the ultimate parent entity, is non-interest bearing, unsecured and due on demand. The remaining balances due to entities under common control are due on demand, unsecured and bear interest at a floating rate based on the current bank rate.

The company was charged \$nil (2003 - \$34,000) in interest on the above loans during the year.

7. Employee Future Benefits

The Company pays certain health, hospital and life insurance benefits on behalf of its retired employees. The Company measures its accrued benefit obligation for accounting purposes as at December 31 each year. The cost of retirement benefits earned by employees is determined using the projected benefit method and management's best estimate of expected salary escalation and retirement ages of employees. This has been applied retroactively without restatement of comparative figures, as a decrease in opening retained earnings. The company determined during the year that the liability for employee future benefits is \$145,000. Since the company is unable to determine which periods the expenses relate to, the full amount has been adjusted for through retained earnings.

8. Note Payable

	2004	2003
Promissory note payable, Town of Cobourg interest at 7.25% per annum, interest payable monthly, principal due on demand	<u>\$ 7,000,000</u>	<u>\$ 7,000,000</u>

During the year, the Company was charged \$507,501 (2003 - \$507,500) in interest. The Town of Cobourg does not intend to demand repayment until replacement term financing is in place.

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2004

9. Share Capital

Authorized
Unlimited Common shares

Issued

10,000,000 Common shares

	2004	2003
\$ 4,684,456	\$ 4,684,456	

10. Public Liability Insurance

The Company is a member of the Municipal Electrical Association Reciprocal Insurance Exchange.

The Municipal Electrical Association Reciprocal Insurance Exchange is a pooling of the public liability insurance risks of the municipal utilities in Ontario. All members of the pool are subject to assessment for losses experienced by the pool for the years in which they were members on a pro-rata basis, based on the total of their respective service revenues. It is anticipated that should such an assessment occur, it would be funded over a period of up to five years. No assessments have been made with respect to 2004.

11. Contingency

A class action lawsuit claiming \$500 million in restitution 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 electrical utilities in Ontario which have charged late payment charges on overdue 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 defence of this action. The Company assumed all of the liabilities of the former utilities on the transfer of electrical distribution assets on May 1, 2000. At this time it is not possible to quantify the effect, if any, on the financial statements. As such, no accrual of any potential liability has been recognized.

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2004

12. Pension Agreements

The Town makes contributions to the Ontario Municipal Employees Retirement Fund (OMERS), which is a multi-employer plan, on behalf of its staff. The plan is a defined benefit plan which specifies the amount of the retirement benefit to be received by the employees based on the length of service and rates of pay.

For the year ended December 31, 2004, the current pension costs charged to expenses were \$48,383 (2003 - \$15,210).

13. Comparative Figures

Certain comparative figures presented in the financial statements have been restated to conform to the current year's presentation.

Appendix 39

2005 Financial Statements

Lakefront Utilities Inc.
Financial Statements
For the year ended December 31, 2005

	Contents
Auditors' Report	2
Financial Statements	
Balance Sheet	3
Statement of Operations and Retained Earnings	4
Statement of Cash Flows	5
Summary of Significant Accounting Policies	6-10
Notes to Financial Statements	9-17



Driving growth

BDO Dunwoody LLP
Chartered Accountants
and Advisors

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Auditors' Report

To the Shareholder of Lakefront Utilities Inc.

We have audited the balance sheet of Lakefront Utilities Inc. as at December 31, 2005 and the statements of operations and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the 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.

BDO Dunwoody LLP

Chartered Accountants

Markham, Ontario

April 7, 2006, except as to Note 9 which is as of April 13, 2006

Lakefront Utilities Inc.
Balance Sheet

December 31 **2005** **2004**

Assets

Current

Cash	\$ 173,137	\$ 185,863
Due from related party (Note 3)	2,461,986	2,410,154
Accounts receivable	1,236,268	1,701,137
Unbilled revenue	3,085,212	2,603,363
Consumable inventory	198,275	226,516
Prepaid expenses	60,656	39,607

7,215,534 **7,166,640**

Capital assets (Note 4)

9,920,441 **9,830,870**

Regulatory assets (Note 5)

779,921 **49,929**

\$ 17,915,896 **\$ 17,047,439**

Liabilities and Shareholder's Equity

Current

Accounts payable and accrued liabilities (Note 6)	\$ 3,780,033	\$ 2,639,364
Payment-in-lieu of income taxes payable (Note 7)	4,450	385,114
Due to related party (Note 8)	-	8,353
Current portion of customer deposits	130,000	230,000

3,914,483 **3,262,831**

Customer deposits

156,171 **297,360**

Employee future benefits (Note 9)

244,494 **237,912**

Note payable (Note 10)

7,000,000 **7,000,000**

11,315,148 **10,798,103**

Shareholder's equity

4,684,456 **4,684,456**

1,916,292 **1,564,880**

6,600,748 **6,249,336**

\$ 17,915,896 **\$ 17,047,439**

On behalf of the Board:

Director

Director

Lakefront Utilities Inc.
Statement of Operations and Retained Earnings

<u>For the year ended December 31</u>	<u>2005</u>	<u>2004</u>
Service revenue	\$ 3,590,145	\$ 3,731,958
Service revenue adjustments (Note 5)	<u>781,570</u>	<u>579,814</u>
	4,371,715	4,311,772
Cost of power revenue	<u>22,623,872</u>	<u>18,917,556</u>
	26,995,587	23,229,328
Cost of power purchased	<u>22,623,872</u>	<u>18,917,556</u>
Gross margin on service revenue	4,371,715	4,311,772
Other operating revenue	<u>207,582</u>	<u>166,970</u>
	<u>4,579,297</u>	<u>4,478,742</u>
Operating and maintenance expenses		
Distribution	587,817	543,421
Billing and collection	336,819	347,971
General and administration	<u>729,097</u>	<u>698,166</u>
	1,653,733	1,589,558
Income before amortization, interest and taxes	<u>2,925,564</u>	<u>2,889,184</u>
Amortization	749,415	724,056
Interest on note payable	507,500	507,501
Other interest expense	<u>50,237</u>	<u>48,295</u>
	1,307,152	1,279,852
Income before income taxes	1,618,412	1,609,332
Income taxes		
Payment-in-lieu of income taxes (Note 7)	<u>667,000</u>	<u>660,000</u>
Net income	<u>951,412</u>	<u>949,332</u>
Retained earnings, beginning of the year, as previously stated	1,657,792	1,653,460
Prior period adjustment (Note 9)	(92,912)	(92,912)
Employee future benefits (Note 9)	<u>-</u>	<u>(145,000)</u>
Retained earnings, beginning of the year, as restated	1,564,880	1,415,548
Dividends paid	<u>(600,000)</u>	<u>(800,000)</u>
Retained earnings, end of the year	<u>\$ 1,916,292</u>	<u>\$ 1,564,880</u>

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

Lakefront Utilities Inc.
Statement of Cash Flows

For the year ended December 31 **2005** **2004**

Cash provided by (used in)

Operating activities

Net income	\$ 951,412	\$ 949,332
Amortization	749,415	724,056
Provision - regulatory assets (Note 5)	(884,032)	112,509
Changes in non-cash working capital balances		
Accounts receivable	464,869	(392,858)
Unbilled revenue	(481,849)	(245,609)
Consumable inventory	28,241	(39,988)
Prepaid expenses	(21,049)	(8,020)
Accounts payable and accrued liabilities	1,140,669	195,038
Payment-in-lieu of income taxes	(380,664)	60,000
Customer deposits	(241,189)	(34,547)
Employee future benefits	6,582	-
	<u>1,332,405</u>	<u>1,319,913</u>

Investing activities

Repayments from (advances to) related party	(51,832)	1,307,367
Purchase of capital assets	(838,986)	(572,819)
Decrease (increase) in regulatory assets	154,040	(19,842)
	<u>(736,778)</u>	<u>714,706</u>

Financing activities

Repayments to related party	(8,353)	(1,247,634)
Dividends	(600,000)	(800,000)
	<u>(608,353)</u>	<u>(2,047,634)</u>

Net change in cash

(12,726) (13,015)

Cash, beginning of year

185,863 198,878

Cash, end of year

\$ 173,137 \$ 185,863

Supplemental Cash Flow Information

Cash paid for interest	\$ 557,737	\$ 555,796
Cash paid for payments-in-lieu of income taxes	\$ 1,075,000	\$ 600,000

Lakefront Utilities Inc.
Summary of Significant Accounting Policies

December 31, 2005

Nature of Business	The Company was incorporated under the Business Corporations Act (Ontario) on April 12, 2000 and is engaged in the distribution of electricity and associated business activities.
Basis of Preparation	The financial statements have been prepared in accordance with accounting principles for electrical utilities in Ontario as required by the Ontario Energy Board under the authority of Sections 52, 70(2) and (78) of the Ontario Energy Board Act, 1998, and reflect the policies as set forth in the "Accounting Procedures Handbook for Utilities in Ontario". All principles employed are in accordance with Canadian generally accepted accounting principles.
Rate Setting	<p>The Company is regulated by the OEB under authority of the Ontario Energy Board Act, 1988. The OEB is charged with the responsibility of approving or setting rates for the transmission and distribution of electricity and for ensuring that distribution companies fulfil obligations to connect and service customers.</p> <p>In order to achieve a proper matching of revenue and expenses, the timing of recognition of certain revenues and expenses for the distribution of electricity may differ from that otherwise expected under Canadian generally accepted accounting principles (GAAP) for non-rate regulated enterprises, specifically:</p> <p>(a) Lakefront Utilities Inc. has deferred as regulatory assets, certain retail settlement variance amounts under the provisions of Article 490 in the OEB's Accounting Procedures Handbook (Note 5).</p> <p>(b) The Company provides for payments in lieu of corporate income taxes relating to its regulated business using the taxes payable method as directed by the OEB.</p>
Revenue	Revenue is recognized in the financial statements on the accrual basis when the energy is supplied to the users, whether billed or unbilled.
Consumable Inventory	Consumable inventory is stated at the lower of cost and net realizable value, where cost is generally determined on the average cost basis.

Lakefront Utilities Inc. Summary of Significant Accounting Policies

December 31, 2005

Capital Assets

Capital assets are recorded at cost less accumulated amortization. Amortization is provided over the estimated useful life of the assets at rates established by the Ontario Energy Board. Capital assets are amortized on a straight line basis using the following rates:

Buildings	5%
Distribution stations	3.3%
Distribution lines - overhead	4%
Distribution lines - underground	4%
Distribution transformers	4%
Distribution meters	4%
Other capital assets	10 - 20%

Assets Impairment

The Company monitors events and changes in circumstances which may require an assessment of the recoverability of its long lived assets. If required, the Company would assess recoverability using estimated undiscounted future operating cash flows. If the carrying amount of an asset is not recoverable, an impairment loss is recognized in operations, measured by comparing the carrying amount of the asset to its fair value.

Capital Contributions

Capital contributions in aid of construction consist of third party contributions toward the cost of constructing distribution assets and are recorded with capital assets as a contra account. Contributions are amortized at rates corresponding with the useful life of the related capital assets.

Regulatory Assets

The Ontario Government, through the establishment of rules affecting the electricity industry, allows for the establishment or contribution of deferral accounts for certain items until disposition can be addressed by the Ontario Energy Board ("OEB") during its rate setting process. In November 2003, the Province announced its intention to permit electricity distributors to make applications to the OEB for recovery of the regulatory assets (based on year-end balances as at December 31, 2002) to be phased in over a four-year period effective March 1, 2004 (Note 5).

The Company records regulatory assets for amounts that it believes are likely to be collected in the future as a result of the OEB's rate setting process. Regulatory assets that have been accrued for include qualifying transition costs, retail settlement variance accounts, and pre-market opening energy variance account. It is the Company's intention to seek recovery of the regulatory assets, plus accrued interest in the allowable amount in its next rate application.

Lakefront Utilities Inc.
Summary of Significant Accounting Policies

December 31, 2005

Regulatory Assets (continued) If as a result of future changes to the regulatory environment, it is unlikely that the Company will recover the regulatory assets, the accounts would be charged to operations in the period in which that determination is made.

Qualifying Transition Costs

These costs reflect amounts incurred to prepare for the opening of the electricity market to competition and the incremental costs to support the market opening.

Pre-Market Opening Energy Variance Accounts

These accounts reflect the difference between the cost of electricity purchased from Ontario Power Generation and the amount the utility was permitted to bill to customers for electricity usage for the period January 1, 2001 to April 30, 2002.

Retail Settlement Variance Accounts

These accounts reflect the difference between the cost of electricity purchased and the amounts the utility billed to consumers (based on regulated rates) beginning May 1, 2002, the date the market became open to competition.

Specifically, these amounts include:

(a) variances between the amount charged by the Independent Electricity System Operator ("IESO") and Hydro One for the operation of the markets and grid, the purchase of imported power by the IESO to augment Ontario's power supply and charged by the IESO as an uplift charge that is part of the wholesale market service charges, as well as various other wholesale market service charges, transmission charges as compared to the amount billed to customers based on the OEB approved rates and;

(b) the differences between the amount charged by the IESO and the amount billed to customers for energy costs due to losses.

Lakefront Utilities Inc.

Summary of Significant Accounting Policies

December 31, 2005

**Payment-in-lieu of
Income Taxes**

Under the Electricity Act, 1998, the Company is required to make payments-in-lieu of corporate taxes to the Ontario Electricity Financial Corporation (OEFEC). These payments are recorded 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) and modified by the Electricity Act, 1998 and related regulations.

The Company provides for payments-in-lieu of corporate income taxes using the taxes payable method. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. Future income taxes are expected to be reflected in future rates and accordingly, are not recognized in the financial statements.

Customer Deposits

Customer deposits are cash collections from customers to guarantee the payment of energy bills. Customer deposits includes interest credited to customers' deposit accounts, with interest expense recorded to offset this amount. Deposits expected to be refunded to customers within the next fiscal year are classified as a current liability.

Pension Plan

The Corporation accounts for its participation in the Ontario Municipal Employee Retirement System ("OMERS"), a multi-employer public sector pension fund, as a defined benefit plan. Both participating employers and employees are required to make plan contributions based on participating employees' contributory earnings. The corporation recognizes the expense related to this plan as contributions are made.

Lakefront Utilities Inc.
Summary of Significant Accounting Policies

December 31, 2005

Post-employment Benefits

Employee future benefits other than pension provided by the Company include medical and insurance benefits. These benefit plans provide benefits to certain employees when they are no longer providing active service.

Standards issued by The Canadian Institute of Chartered Accountants with respect to accounting for employee future benefits require the corporation to accrue for its obligations under other employee benefit plans and related costs, net of plan assets.

The cost of post-employment benefits offered to employees are actuarially determined using the projected benefit method, prorated on service and based on assumptions that reflect management's best estimate. Under this method, the projected post-retirement benefit is deemed to be earned on a pro-rata basis over the years of service in the attribution period commencing at date of hire, and ending at the earliest age the employee could retire and qualify for benefits.

The excess of the net actuarial gains (losses) over 10% of the accrued benefit obligation are amortized into expense on a straight-line basis over the average remaining service period of active employees to full eligibility.

Financial Instruments

Unless otherwise noted, it is management's opinion that the company is not exposed to significant interest, currency or credit risks arising from its financial instruments, and the fair values of the financial instruments approximate their carrying values.

Use of Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's best estimates as additional information becomes available in the future.

Lakefront Utilities Inc. Notes to Financial Statements

December 31, 2005

1. Electricity Industry Restructuring and Regulation

On October 30, 1998, the provincial government passed the Electricity Act and the Ontario Energy Board ("OEB") Act, collectively known as Bill 35, the Energy Competition Act, 1998. The Electricity Act established the framework for a competitive market for the sale of electricity in the Province of Ontario. The Ontario Energy Board Act gave the OEB the power to licence and regulate all market participants, and set transmission and distribution rates.

The electricity marketplace was deregulated on May 1, 2002 and electricity generators, electricity wholesalers and retailers began competing for customers. As mandated by the Energy Competition Act (Bill 35), a three-year phase-in (2001 to 2003) of the electricity distributors' commercial rate of return and provincial tax increases was implemented to smooth the impact on consumers of the transition of distributors from municipal electric utilities. However, in response to volatile and rising electricity prices in 2002, the Province of Ontario enacted The Electricity Pricing, Conservation and Supply Act, 2002 (Bill 210). This new legislation was given Royal Assent on December 9, 2002, effectively froze distribution rates until 2006, and fixed the commodity price paid by low volume and designated customers at 4.3 cents per kilowatt-hour (kWh) retroactive to May 1, 2002.

On December 18, 2003, Bill 210 was superseded and modified by Bill 4 when a newly elected provincial government passed the Ontario Energy Board Amendment Act (Electricity Pricing), 2003 which enabled further changes to the pricing of electricity in Ontario. In June 2004, the provincial government introduced legislation to further restructure the electricity industry. On December 9, 2004, this new legislation, the Electricity Restructuring Act, 2004 (Bill 100) received Royal Assent. Bill 100 makes amendments to the Electricity Act, and the OEB Act, 1998. The legislation deals primarily with supply and conservation, reassigns responsibilities to different entities, and lays out the roles and responsibilities for the new Ontario Power Authority ("OPA"). Additionally, the Independent Market Operation ("IMO") will be renamed the Independent Electricity System Operator ("IESO") to better reflect its new role.

(a) Electricity commodity pricing:

On April 1, 2004, Bill 4 removed the 4.3 cents commodity price freeze, and a two-tiered pricing regime was implemented for all customers who were eligible for the 4.3 cents commodity rate. The commodity price was fixed at 4.7 cents per kWh for the first 750 kWh of consumption per month and 5.5 cents per kWh for any incremental monthly consumption thereafter. This current two-tiered pricing regime remained in place until April 1, 2005 when the OEB instituted a regulated price plan ("RPP").

The RPP retains the two-tiered pricing regime. The new prices which took effect on April 1, 2005 are based on an OEB forecast of the cost of electricity over the next 12 months. These prices will remain in effect until April 30, 2006 and will be adjusted then and every six months after that, at a price determined by the OEB. Since April 1, 2005, consumers on the RPP have the commodity price fixed at 5.0 cents per kWh for the first 750 kWh of consumption per month and 5.8 cents per kWh for consumption over that threshold.

For residential customers only, the threshold has changed from 750 kWh to 1000 kWh per month, for the winter season (November 1 – April 30). The threshold will then drop to 600 kWh per month, for the summer season (May 1 – October 31). For non-residential consumers, the 750 kWh threshold will remain the same throughout the year. The RPP also proposes time-of-use pricing for consumers installed with smart meters.

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2005

1. Electricity Industry Restructuring and Regulation (continued)

(b) Recovery of regulatory assets and measurement uncertainty:

Bill 210 eliminated the ability of electricity distributors to recover a variety of costs incurred since their preparations for market opening. These costs were deemed to be "regulatory assets", and are reflected in the balance sheet until the manner and timing of disposition is determined by the OEB.

On June 30, 2004 the OEB, at the request of the Corporation, adjourned the Corporation's application in respect of its Phase 2 Regulatory Asset proceeding. This proceeding dealt with, amongst other matters, the recovery of transition costs incurred by the Corporation in preparing for market opening in May 2002. The Corporation proceeded with its application in August 2005.

On December 9, 2004, the OEB released its process for OEB review of the prudence of the total regulatory asset amounts claimed by electricity distributors. This process, which commenced in 2005 ended in late April 2006, when the OEB determined the final recovery amount of their regulatory assets to be included in future distribution rates.

With the introduction of Bill 4, the Company was allowed to recover some of its regulatory assets under the supervision of the OEB, on an interim basis, over a four-year period starting April 1, 2004 (Note 5). In light of the four-year time span coupled with uncertainty and associated other risks, and the nature of the regulatory asset recovery application process, management has recorded a reserve for regulatory asset impairment in the amount of \$623,586 (2004 - \$1,507,618). This estimate is subject to some uncertainty based on the results of the Regulatory Asset proceedings.

2. Credit Facilities

The Company has a line of credit with TD Bank with a maximum credit limit of \$500,000, which bears interest at prime plus 0.5% per annum; and a standby letter of credit with a maximum limit of \$1,960,000, which bears interest at 0.75% per annum. The balance for the two facilities at December 31, 2005 was \$nil.

3. Due from Related Party

The balance is due from Lakefront Utilities Services Inc. (LUSI), a company under common control, and represents cash held by LUSI that will be transferred to the Company to meet future financial obligations. The amount is due on demand, unsecured and bears interest at a floating rate based on the current bank rate. The company received \$53,444 (2004 - \$34,758) in interest during the year.

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2005

4. Capital Assets

	2005		2004	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Land	\$ 219,284	\$ -	\$ 219,284	\$ -
Buildings	851,759	463,816	565,550	432,213
Distribution stations	2,539,002	1,162,356	2,517,601	1,079,547
Distribution lines - overhead	7,631,947	4,014,081	7,301,490	3,724,443
Distribution lines - underground	3,758,008	1,568,265	3,675,816	1,433,246
Distribution transformers	3,471,471	1,385,654	3,384,275	1,251,750
Distribution meters	829,473	390,979	792,029	357,179
Other capital assets	726,405	479,014	614,085	406,306
	20,027,349	9,464,165	19,070,130	8,684,684
Less: Contributions in aid of construction	(751,689)	(108,946)	(633,456)	(78,880)
	\$ 19,275,660	\$ 9,355,219	\$ 18,436,674	\$ 8,605,804
Net book value		\$ 9,920,441		\$ 9,830,870

5. Regulatory Assets

	2005	2004
Qualifying transition costs and Pre-market opening energy variance accounts	\$ 623,586	\$ 1,507,618
Retail settlement variance accounts	779,921	49,929
	1,403,507	1,557,547
Provision	(623,586)	(1,507,618)
	\$ 779,921	\$ 49,929

The variances arise as a result of the differing rates on amounts paid to the IESO (Independent Electricity System Operator) and Hydro One Networks as compared to the average rates charged to the customers.

In a letter dated December 19, 2003, the Ministry of Energy granted approval for distributors to make application to the OEB with regard to rate recovery of certain distribution regulatory assets whose inclusion in rates was delayed by the *Electricity Pricing, Conservation and Supply Act, 2002* (*Electric Pricing, Conservation and Supply Act*). As a result of the Company's distribution rate application dated January 22, 2004, these distribution regulatory assets are expected to be recovered over a four-year period, effective March 1, 2004 with an implementation date for consumption of April 1, 2004, however, the amount to be recovered will be subject to a yet to be determined OEB review and approval process. A final decision was made by the OEB in the late April 2006.

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2005

5. Regulatory Assets (continued)

Management continually assesses the likelihood of recovery of regulatory assets. If recovery through future rates is no longer considered probable, the amounts would be charged to the results of operations in the period that the assessment is made. If a future regulatory decision is made by the OEB or the Minister of Energy to allow recovery of the transitional costs, the corporation will recognize a reduction in the regulatory asset balance in the period such a decision is made.

During the year, the Company recovered \$781,570 (2004 - \$579,814) related to recovery of these regulatory assets.

6. Accounts Payable and Accrued Liabilities

	<u>2005</u>	<u>2004</u>
Accounts payable - energy purchased	\$ 2,285,618	\$ 1,957,736
Other accounts payable and accrued liabilities	1,494,415	681,628
	<u>\$ 3,780,033</u>	<u>\$ 2,639,364</u>

7. Payment-in-lieu of Income Taxes

The provision for income taxes under the taxes payable method for the year is \$667,000 (2004 - \$660,000) which represents payments-in-lieu of corporate taxes.

Future income tax benefits of \$491,000 (2004 - \$281,000) have not been recorded in the accounts. Significant components of the Company's future taxes as at December 31 are as follows:

	<u>2005</u>	<u>2004</u>
Capital assets	\$ 491,000	\$ 281,000

8. Due to Related Party

In addition to the promissory note payable described in Note 10, as at year end, the Company had the following amount due to a related party:

	<u>2005</u>	<u>2004</u>
The Corporation of the Town of Cobourg	\$ -	\$ 8,353

The amount due to the Corporation of the Town of Cobourg, the ultimate parent entity, is non-interest bearing, unsecured and due on demand.

The fair value of the amount due to related party could not be reasonably determined as there is no comparable market data for this amount.

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2005

9. Employee Future Benefits

The Company pays certain health, dental and life insurance benefits on behalf of its retired employees.

The Company measures its accrued benefit obligation for accounting purposes as at December 31 each year. The date of the actuarial valuation was as at December 31, 2005.

Information about the Corporation's defined benefit plan is as follows:

	2005	2004
Accrued benefit obligation liability, beginning of year	\$ 237,912	\$ -
Adjustment to opening balance	-	237,912
Current service cost	5,653	4,384
Interests on accrued benefit obligation	11,904	9,964
Benefits paid	(10,975)	(14,348)
Accrued benefit obligation liability, end of year	\$ 244,494	\$ 237,912

A prior period adjustment of \$92,912 has been made to reduce opening retained earnings in 2004 and 2005 to correct an understatement of the opening balance of the accrued benefit liability for employee future benefits. A corresponding increase has been made to the employee future benefits liability for \$92,912.

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

- (a) General inflation:
Future general inflation levels, as measured by changes in the Consumer Price Index ("CPI"), were assumed at 2.0% in 2005 and thereafter.
- (b) Interest (discount) rate:
The obligation as at December 31, 2005, representing the present value of future liabilities was determined using a discount rate of 5.0%. This corresponds to the assumed CPI rate plus an assumed real rate of 3.0%.
- (c) Salary levels:
Future general salary and wage levels were assumed to increase at 3.1% per annum.
- (d) Medical costs:
Medical costs were assumed to be at 11% for 2006, with a reduction of 1% per annum thereafter. Actual 2006 premiums were used for the 2005 valuations.
- (e) Dental costs:
Dental costs were assumed to be fixed at 5% in 2006 and thereafter. Actual 2006 premiums were used for the 2005 valuations.

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2005

10. Note Payable

	<u>2005</u>	<u>2004</u>
Promissory note payable, Town of Cobourg interest at 7.25% per annum, interest payable monthly, principal due on demand	<u>\$ 7,000,000</u>	<u>\$ 7,000,000</u>

During the year, the Company was charged \$507,500 (2004 - \$507,501) in interest. The Town of Cobourg does not intend to demand repayment until replacement term financing is in place.

11. Share Capital

Authorized Unlimited	Common shares		
Issued		<u>2005</u>	<u>2004</u>
10,000,000	Common shares	<u>\$ 4,684,456</u>	<u>\$ 4,684,456</u>

12. Public Liability Insurance

The Company is a member of the Municipal Electrical Association Reciprocal Insurance Exchange.

The Municipal Electrical Association Reciprocal Insurance Exchange is a pooling of the public liability insurance risks of the municipal utilities in Ontario. All members of the pool are subject to assessment for losses experienced by the pool for the years in which they were members on a pro-rata basis, based on the total of their respective service revenues. It is anticipated that should such an assessment occur, it would be funded over a period of up to five years. No assessments have been made with respect to 2005.

Lakefront Utilities Inc.
Notes to Financial Statements

December 31, 2005

13. Contingency

A class action lawsuit claiming \$500 million in restitution payments plus interest was served on Toronto Hydro on November 18, 1998. The action was initiated against the Toronto Hydro Electric Commission as the representative of the Defendant Class consisting of all municipal electrical utilities in Ontario which have charged late payment charges on overdue 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 defence of this action. The Company assumed all of the liabilities of the former utilities on the transfer of electrical distribution assets on May 1, 2000. At this time it is not possible to quantify the effect, if any, on the financial statements. As such, no accrual of any potential liability has been recognized.

14. Pension Agreements

The Town makes contributions to the Ontario Municipal Employees Retirement Fund (OMERS), which is a multi-employer plan, on behalf of its staff. The plan is a defined benefit plan which specifies the amount of the retirement benefit to be received by the employees based on the length of service and rates of pay.

For the year ended December 31, 2005, the current pension costs charged to recoverable assets were \$50,222 (2004 - \$48,383).

15. Comparative Figures

Certain comparative figures presented in the financial statements have been restated to conform to the current year's presentation.