

Financial Statements of

**KINGSTON ELECTRICITY  
DISTRIBUTION LIMITED**

Year ended December 31, 2004

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

## Financial Statements

Year ended December 31, 2004

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**KPMG LLP**  
**Chartered Accountants**  
863 Princess Street Suite 400  
PO Box 1600 Stn Main  
Kingston ON K7L 5C8  
Canada

Telephone (613) 549-1550  
Fax (613) 549-6349  
Internet [www.kpmg.ca](http://www.kpmg.ca)

## AUDITORS' REPORT TO THE SHAREHOLDER

We have audited the balance sheet of Kingston Electricity Distribution Limited as at December 31, 2004 and the statements of earnings, 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.

*KPMG LLP*

Chartered Accountants

Kingston, Canada

March 24, 2005

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

## Balance Sheet

December 31, 2004, with comparative figures for 2003

|  | 2004                 | 2003                 |
|--|----------------------|----------------------|
|  |                      | (Restated, note 15)  |
| <b>Assets</b>  |                      |                      |
| Current assets:  |                      |                      |
| Cash   | \$ 3,020,830         | \$ 604,762           |
| Due from City of Kingston (note 9(b))                  | 7,166,889            | 2,923,304            |
| Accounts receivable                                    | 808,868              | 1,724,701            |
| Due from retailers                                     | —                    | 490,641              |
| Recoverable payments in lieu of income taxes           | 114,222              | —                    |
| Unbilled revenue                                       | 6,273,767            | 7,376,811            |
| Inventory  | 912,786              | 863,308              |
| Prepaid expenses                                       | 122,944              | 110,520              |
|  | 18,420,306           | 14,094,047           |
| Due from City of Kingston – future benefits obligation | —                    | 2,009,047            |
| Notes receivable from related party (note 5)           | 500,000              | —                    |
| Incorporation costs, net                               | 106,918              | 124,738              |
| Future recovery of payments in lieu of income taxes    | —                    | 201,682              |
| Regulatory assets (note 8)                             | 3,794,675            | 3,545,625            |
| Capital assets (note 4)                                | 20,702,239           | 25,743,429           |
| <b>Total assets</b>                                    | <b>\$ 43,524,138</b> | <b>\$ 45,718,568</b> |
| <b>Liabilities and Shareholder's Equity</b>            |                      |                      |
| Current liabilities:                                   |                      |                      |
| Bank loan (note 7)                                     | \$ 3,000,000         | \$ 5,700,250         |
| Accounts payable and accrued liabilities               | 7,450,661            | 5,801,330            |
| Due to retailers                                       | 989,561              | —                    |
| Payments in lieu of income taxes payable               | —                    | 268,527              |
| Deferred revenue                                       | —                    | 18,937               |
|  | 11,440,222           | 11,789,044           |
| Deferred revenues, non-current                         | —                    | 346,663              |
| Retailer deposits                                      | 50,880               | 49,381               |
| Regulatory liabilities (note 8)                        | 2,853,871            | 530,781              |
| Note payable to City of Kingston (note 6)              | 12,380,619           | 13,345,629           |
| Future benefits obligations (note 10(c))               | 957,168              | 2,841,909            |
| Redeemable preferred shares (note 2)                   | —                    | 3,465,008            |
|  | 27,682,760           | 32,368,415           |
| Shareholder's equity:                                  |                      |                      |
| Share capital:   |                      |                      |
| Authorized:  |                      |                      |
| Unlimited Class A common shares                        |                      |                      |
| Issued:  |                      |                      |
| 120 Class A common shares (note 2)                     | 12,380,617           | 12,380,619           |
| Retained earnings                                      | 982,998              | 969,534              |
| Contributed surplus (note 2)                           | 2,477,763            | —                    |
| Total shareholder's equity                             | 15,841,378           | 13,350,153           |
| Contingent liabilities (notes 11 and 12)               |                      |                      |
| <b>Total liabilities and shareholder's equity</b>      | <b>\$ 43,524,138</b> | <b>\$ 45,718,568</b> |

See accompanying notes to financial statements.

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

## Statement of Earnings

Year ended December 31, 2004, with comparative figures for 2003

|   | 2004          | 2003<br>(Restated,<br>note 15) |
|---|---------------|--------------------------------|
| Sales   | \$ 49,048,057 | \$ 47,227,516                  |
| Cost of power   | 49,048,057    | 47,227,516                     |
|   | —             | —                              |
| Local distribution revenue  | 8,264,218     | 8,276,256                      |
| Other revenue:  |               |                                |
| Account set-up charge   | 45,746        | 31,379                         |
| Pole rentals  | 113,539       | 91,767                         |
| Interest  | 407,589       | 608,253                        |
| Miscellaneous   | 197,277       | 225,806                        |
|   | 764,151       | 957,205                        |
|   | 9,028,369     | 9,233,461                      |
| Operating expenses:   |               |                                |
| Administration  | 1,848,468     | 1,954,996                      |
| Billing and collecting  | 1,230,573     | 1,271,670                      |
| Distribution  | 2,108,472     | 1,927,005                      |
| Customer services   | 263,152       | 245,008                        |
|   | 5,450,665     | 5,398,679                      |
| Earnings before interest, depreciation and income taxes   | 3,577,704     | 3,834,782                      |
| Interest expense  | 1,000,839     | 1,144,594                      |
| Depreciation and amortization   | 1,459,722     | 1,472,142                      |
| Earnings before income taxes  | 1,117,143     | 1,218,046                      |
| Payments in lieu of corporate income taxes (note 13)  | 340,750       | 442,870                        |
| Net earnings for the year from continuing operations  | 776,393       | 775,176                        |
| Loss from discontinued operations, net of payments<br>in lieu of corporate income taxes (Schedule) (note 2) | (762,929)     | (368,890)                      |
| Net earnings  | \$ 13,464     | \$ 406,286                     |

See accompanying notes to financial statements.

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

## Statement of Retained Earnings

Year ended December 31, 2004, with comparative figures for 2003

|                                       | 2004         | 2003<br>(Restated,<br>note 15) |
|---------------------------------------|--------------|--------------------------------|
| Retained earnings, beginning of year: |              |                                |
| As previously reported                | \$ 1,267,186 | \$ 610,782                     |
| Prior period adjustments (note 15)    | (297,652)    | (47,534)                       |
| As restated                           | 969,534      | 563,248                        |
| Net earnings                          | 13,464       | 406,286                        |
| Retained earnings, end of year        | \$ 982,998   | \$ 969,534                     |

See accompanying notes to financial statements.



# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

## Statement of Cash Flows

Year ended December 31, 2004, with comparative figures for 2003

|   | 2004         | 2003<br>(Restated,<br>note 15) |
|---|--------------|--------------------------------|
| Operations:   |              |                                |
| Net earnings  | \$ 13,464    | \$ 406,286                     |
| Depreciation and amortization, which do not involve cash        | 2,372,519    | 2,398,708                      |
| Net change in non-cash operating working capital:               |              |                                |
| Increase in due from City of Kingston                           | (6,049,730)  | (1,303,708)                    |
| Decrease (increase) in accounts receivable                      | 706,347      | (341,509)                      |
| Decrease in due from retailers                                  | 1,480,202    | 1,666,906                      |
| Increase (decrease) in net payments in lieu of income taxes     | (294,095)    | 182,148                        |
| Increase in unbilled revenue                                    | 1,103,044    | 2,185,856                      |
| Increase in inventory   | (49,478)     | (94,693)                       |
| Increase in prepaid expenses                                    | (14,033)     | (4,206)                        |
| Increase in regulatory assets                                   | (249,050)    | (227,183)                      |
| Increase (decrease) in accounts payable and accrued liabilities | 2,014,231    | (3,516,485)                    |
| Increase in deferred revenue, current and non-current           | 181,064      | 2,566                          |
| Increase (decrease) in retailer deposits                        | 1,499        | (17,355)                       |
| Increase in regulatory liabilities                              | 2,323,090    | 418,422                        |
| Increase in future benefits obligation                          | 1,176,342    | 61,351                         |
| Net change in cash from operations                              | 4,715,416    | 1,817,104                      |
| Investments:  |              |                                |
| Purchase of capital assets                                      | (2,712,373)  | (2,410,278)                    |
| Financing:  |              |                                |
| Proceeds (repayment) from bank loan                             | (2,700,250)  | 700,250                        |
| Proceeds from share issuance (note 2)                           | 3,000,000    | —                              |
| Overdraft of subsidiary at time of transfer (note 2)            | 113,275      | —                              |
|   | 413,025      | 700,250                        |
| Increase in cash and cash equivalents                           | 2,416,068    | 107,076                        |
| Cash and cash equivalents, beginning of year                    | 604,762      | 497,686                        |
| Cash and cash equivalents, end of year                          | \$ 3,020,830 | \$ 604,762                     |
| Supplemental cash flow information:                             |              |                                |
| Interest paid   | \$ 949,366   | \$ 1,191,058                   |
| Payments in lieu of income taxes                                | —            | —                              |

The Company considers cash and cash equivalents to be highly liquid investments with original maturities of three months or less.

See accompanying notes to financial statements.

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

## Notes to Financial Statements

Year ended December 31, 2004

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The principal business of Kingston Electricity Distribution Limited is to distribute electric power to the residents of the City of Kingston and to manage the City's electric power system. The business is primarily regulated by the Ontario Energy Board through the issuance of licenses which require compliance with established market rules and codes. The Company is wholly-owned by the Corporation of the City of Kingston.

### 1. Significant accounting policies:

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

#### (a) Basis of presentation:

The Company's financial statements as at and for the year ended December 31, 2003, were prepared on a consolidated basis and included the assets, liabilities, revenues and expenses of 1425445 Ontario Limited (operating as Utilities Kingston). Pursuant to the transaction more fully described in note 2, the Company disposed of its investment in the subsidiary. Thus, the Company's December 31, 2004 balance sheet does not include the assets or liabilities of 1425445 Ontario Limited. The subsidiary's results from operations are presented as discontinued operations.

#### (b) Rate regulation:

Kingston Electricity Distribution Limited is regulated by the Ontario Energy Board ("OEB") under authority of the Ontario Energy Board Act, 1998. The OEB is charged with the responsibility of approving or setting rates for the transmission and distribution of electricity and the responsibility for ensuring that distribution companies fulfill obligations to connect and service customers.

The OEB has the general power to include or exclude costs, revenues, losses or gains in the rates of a specific period, resulting in a change in the timing of accounting recognition from that, which would apply to enterprises operating in a non-regulated environment. Specifically, the following accounting treatments have been applied:

- (i) Costs incurred in respect of deregulation of the electricity industry in Ontario, have been deferred pursuant to regulations underlying the Electricity Act, 1998, ("EA") and are subject to review and approval for recovery by the OEB.
- (ii) An amount to represent the cost of funds used during construction and development has been applied based on the value of construction-in-progress.



# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

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## 1. Significant accounting policies (continued):

### (b) Rate regulation (continued):

- (iii) The Company provides for amounts in lieu of corporate income taxes using the taxes payable method for its regulated business activities.
- (iv) The Company has deferred recognizing certain pre-market opening cost of power variances and post-market opening retail settlement variances in accordance with Article 490 of the OEB's Accounting Procedures Handbook.

### (c) Revenue recognition:

Revenue is recognized on the accrual basis, which includes an estimate of unbilled revenue, representing customer usage from the date of each customer's last meter reading until the end of the fiscal year. Actual results could differ from estimates made of actual electricity usage.

Services and other revenue are recognized as services are rendered or contract milestones are achieved.

### (d) Inventories:

Inventories are valued at the lower of cost and replacement cost, with cost determined on an average cost basis.

### (e) Capital assets:

Capital assets are recorded at cost and include contracted services, materials, labour, engineering costs, overhead and an allowance for the cost of funds used during construction when applied. Certain assets may be acquired or constructed with financial assistance in the form of contributions from developers or customers. The OEB requires that such contributions, whether in cash or in-kind, be offset against the related asset cost. Contributions in-kind are valued at their fair market value at the date of their contributions.

When identifiable assets, such as buildings, substation equipment, system supervisory equipment, meters, tools and vehicles are retired or otherwise disposed of, their original cost and accumulated amortization are removed from the accounts and the related gain or loss is included in the operating results for the related fiscal period. The cost and related accumulated amortization of grouped assets, such as the transmission system and distribution systems, is removed from the accounts at the end of their estimated service life.

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

## 1. Significant accounting policies (continued):

### (e) Capital assets (continued):

Depreciation is provided on the straight-line basis using the following annual rates:

| Asset                        | Rate                          |
|------------------------------|-------------------------------|
| Buildings                    | 2.00%                         |
| Transmission system          | 4.00%                         |
| Substation equipment         | 3.33%                         |
| Distribution systems         | 4.00%                         |
| Meters                       | 4.00%                         |
| Tools                        | 10.00%                        |
| System supervisory equipment | 6.67%                         |
| Application software         | 20.00%                        |
| Vehicles                     | 20.00%                        |
| Leaseholds                   | Over the term<br>of the lease |

Capital work-in-progress comprises capital assets under construction, assets not yet placed into service and pre-construction activities related to specific projects expected to be constructed. An allowance for the cost of funds used during the construction period has been applied at a rate of 7.25% (2003 – 7.25%).

### (f) Contributed capital:

Amounts recovered from customers on capital projects are recorded as a capital asset contra account and amortized on a straight-line basis at the same rate used for amortization of the related property and equipment.

### (g) Incorporation costs:

Incorporation costs are recorded at cost, net of accumulated amortization. Amortization is provided on a straight-line basis over ten years.

### (h) Regulatory assets and liabilities:

Regulatory assets primarily represent costs that have been deferred because it is probable that they will be recovered in rates. Conversely, regulatory liabilities represent variances between amounts billed to consumers in excess of respective costs. Regulatory assets and/or liabilities are comprised principally of the following:

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



# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

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## 1. Significant accounting policies (continued):

### (h) Regulatory assets and liabilities (continued):

- (ii) Pre-market opening cost of power variances – represent accumulated variances between the cost of power purchased by the Company and the amount billed for this power prior to the market opening. The OEB directed utilities to accumulate such variances in the period leading up to market opening.
- (iii) Post-market opening retail settlement variances – represent accumulated variances that have occurred since May 1, 2002 when the competitive electricity market was declared open and that have accumulated pursuant to direction from the OEB. Specifically, these amounts include:
  - variances between the amount charged by the Independent Electricity System Operating (“IESO”) and Hydro One Network Inc. for the operation of the markets and grid, as well as various wholesale market settlement charges, transmission charges as compared to the amount billed to consumers based on the OEB approved wholesale market services rate; and
  - variances between the amounts charged by the IESO to allow for purchases of imported power as compared to the amounts billed to consumers based on the OEB approved rates.
- (iv) Regulatory asset recoveries – represent accumulated recoveries of regulatory assets through increased rates over a four-year period. Amounts recovered will, at some time later, be reconciled to regulatory asset balances in a manner as prescribed by the Ontario Energy Board and following the OEB's final approval of these amounts.

### (i) Measurement uncertainty:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period.

Accounts receivable, unbilled revenue, and regulatory assets are stated after evaluation of amounts expected to be collected or recovered and an appropriate allowance for doubtful accounts.

Measurement uncertainty is elevated due to difficulties the Company has encountered in exchanging information with other market retailer participants. The market rules require the Company to settle transactions daily with each participating retailer. These difficulties are primarily due to application of new business systems by all market participants due to the opening of the retail electricity market.

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

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## 1. Significant accounting policies (continued):

### (i) Measurement uncertainty (continued):

Due to inherent uncertainty involved in making estimates, actual results could differ from those estimates recorded in preparing these financial statements, including changes as a result of future decisions made by the Ontario Energy Board and Minister of Energy. Any adjustments to the estimates made will be recorded in the year they are identified.

### (j) Payments in lieu of corporate income taxes ("PILs"):

The Company is exempt from taxes under the Income Tax Act (Canada) ("ITA") and the Ontario Corporations Tax Act ("OCTA").

Pursuant to the Electricity Act ("EA"), 1998, the Company is required to compute taxes under the ITA and OCTA and remit such amounts thereunder to the Ontario Electricity Financial Corporation ("OEFC"). These amounts, referred to as PILs under the EA, are applied to reduce certain debt obligations of the former Ontario Hydro continuing in OEFC.

The Company provides for PILs using the taxes payable method because the Company's billing rates charged to customers are based on the taxes payable method. Future income taxes are expected to be recovered through future revenues.

### (k) Future benefits obligation:

The Company's future benefits obligation represents its accumulated obligation to Utilities Kingston under a service agreement. Utilities Kingston's employees participate in the Ontario Municipal Employees Retirement Fund (OMERS), a multi-employer public sector pension fund, as a defined contribution plan.

The Company accrues its obligations to Utilities Kingston for employee benefit plans. The cost of non-pension post-retirement and post-employment benefits earned is actuarially determined using the projected benefit method pro-rated on service and management's best estimate of salary escalation, retirement ages of Utility Kingston's employees and expected health care costs.



# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

## 2. Sale of shares of subsidiary:

Effective December 31, 2004, the Company sold 100% of its investment in the common shares of 1425445 Ontario Limited (operating as Utilities Kingston) to 1425447 Ontario Inc., a wholly-owned subsidiary of the City of Kingston. In consideration for this sale, the Company received 1,000 Class E shares issued by 1425447 Ontario Inc ("Holdco"). The fair value assigned to the consideration received was \$2. On December 31, 2004, Holdco redeemed the 1,000 Class E shares that it had issued to the Company for proceeds equal to \$2. Pursuant to the transaction, 1425445 Ontario Limited issued \$3,000,000 in redeemable preferred shares, which brought the total carrying value of these shares to \$6,465,008.

Management has measured the transaction using the carrying value method, pursuant to generally accepted accounting principles. In reaching this decision, management has concluded that the transaction is not in the normal course of operations and that the transfer does not result in a substantial change in ownership of the subsidiary. In accordance with CICA recommendations, the excess of the consideration received for the shares over the carrying value of the net assets of the subsidiary was recorded as contributed surplus. The following table summarizes the carrying value of the net assets given up at the time of the transaction:

|  |              |
|--|--------------|
| Current assets   | \$ 1,217,003 |
| Employee future benefits recoverable – City of Kingston                          | 1,932,130    |
| Employee future benefits recoverable – Kingston Electricity Distribution Limited | 890,190      |
| Future recovery of payments in lieu of taxes                                     | 99,991       |
| Property and equipment   | 5,398,865    |
| Total assets   | 9,538,179    |
| Bank loan  | 113,275      |
| Other current liabilities  | 662,600      |
| Deferred revenue, non-current  | 487,727      |
| Employee future benefits payable   | 2,822,320    |
| Notes payable to Kingston Electricity Distribution Limited                       | 500,000      |
| Note payable to City of Kingston   | 965,010      |
| Redeemable preferred shares  | 6,465,008    |
| Total liabilities  | 12,015,940   |
| Carrying amount of net liabilities transferred                                   | (2,477,761)  |
| Consideration received   | 2            |
| Excess of consideration received over carrying value                             | \$ 2,477,763 |

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

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## 2. Sale of shares of subsidiary (continued):

The results from operations of Utilities Kingston for both the 2004 and 2003 fiscal years are presented as discontinued operations on the "Statement of Earnings".

## 3. Electricity industry restructuring and regulation:

In December 2003, the Government of Ontario passed legislation, the Ontario Energy Board Amendment Act (Electricity Pricing), 2003 (the "Amendment Act"), which is based on the principle that the price of electricity should better reflect its true cost. The Amendment Act effectively increased the cap on the commodity price of electricity imposed by the Electricity Pricing, Conservation and Supply Act, 2002 in favour of an interim two tiered and fixed commodity price structure for low volume and designated consumers. Effective April 1, 2004, the fixed commodity price is 4.7¢/kWh for the first 750 kilowatt hours consumed in any month and consumption above that level is priced at a higher rate of 5.5¢/kWh. This current two-tiered pricing regime will remain in place until April 1, 2005 when the OEB will institute a regulated price plan.

Effective March 1, 2004, the Company received approval for rate increases to permit the recovery of regulatory assets over a four-year period. The Corporation anticipates recovery of these assets over a four-year period, commencing April 2004 with such recovery subject to the OEB's approval following its review of these amounts.

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 commences in 2005, will determine the final recovery amount of their regulatory assets to be included in future distribution rates.

Commencing March 1, 2005, electricity distribution companies will be permitted to adjust rates to achieve the full theoretical regulatory rate of return of 9.88%. A condition of this rate adjustment is that electricity distribution companies must invest the equivalent of one year of the amount of the adjustment in conservation and demand side management initiatives, to be prescribed by future regulation.



# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

## 4. Capital assets:

|                               |              |                          | 2004           |              | 2003                     |                |
|-------------------------------|--------------|--------------------------|----------------|--------------|--------------------------|----------------|
|                               | Cost         | Accumulated depreciation | Net book value | Cost         | Accumulated depreciation | Net book value |
| Land                          | \$ 197,343   | \$ —                     | \$ 197,343     | \$ 197,343   | \$ —                     | \$ 197,343     |
| Buildings                     | 440,637      | 80,680                   | 359,957        | 440,637      | 65,546                   | 375,091        |
| Transmission system           | 1,562,991    | 521,768                  | 1,041,223      | 1,562,991    | 427,798                  | 1,135,193      |
| Substation equipment          | 2,424,875    | 636,431                  | 1,788,444      | 2,352,090    | 508,748                  | 1,843,342      |
| Distribution system:          |              |                          |                |              |                          |                |
| Overhead                      | 8,491,527    | 1,544,449                | 6,947,078      | 7,170,037    | 1,145,241                | 6,024,796      |
| Underground                   | 5,418,262    | 1,588,743                | 3,829,519      | 5,158,534    | 1,318,011                | 3,840,523      |
| Transformers                  | 2,762,751    | 753,998                  | 2,008,753      | 2,728,991    | 595,692                  | 2,133,299      |
| Meters                        | 2,774,366    | 680,279                  | 2,094,087      | 2,568,147    | 525,625                  | 2,042,522      |
| Tools                         | 476,632      | 212,507                  | 264,125        | 401,676      | 165,495                  | 236,181        |
| System supervisory equipment  | 1,892,229    | 657,378                  | 1,234,851      | 1,889,400    | 509,982                  | 1,379,418      |
| Application software          | 102,762      | 72,012                   | 30,750         | 102,762      | 51,460                   | 51,302         |
| Vehicle                       | 25,886       | 10,171                   | 15,715         | 24,885       | 4,976                    | 19,909         |
| Leaseholds                    | 20,602       | 2,060                    | 18,542         | —            | —                        | —              |
| Capital work in progress      | 871,852      | —                        | 871,852        | 1,241,839    | —                        | 1,241,839      |
| Computer and office equipment | —            | —                        | —              | 123,125      | 49,250                   | 73,875         |
| GIS software                  | —            | —                        | —              | 356,570      | 285,256                  | 71,314         |
| Broadband Network             | —            | —                        | —              | 6,965,874    | 2,051,213                | 4,914,661      |
| Communication equipment       | —            | —                        | —              | 76,424       | 61,140                   | 15,284         |
| Major tools                   | —            | —                        | —              | 122,435      | 48,972                   | 73,463         |
| Transportation equipment      | —            | —                        | —              | 344,224      | 270,150                  | 74,074         |
| Total                         | \$27,462,715 | \$ 6,760,476             | \$20,702,239   | \$33,827,984 | \$ 8,084,555             | \$25,743,429   |

Comparative figures for 2003 contain the cost and accumulated depreciation amounts relating to the former subsidiary (note 2).

## 5. Notes receivable from related party:

The Company has a note receivable from 1425445 Ontario Limited, operating as Utilities Kingston. The total note receivable of \$500,000 (2003 - \$3,000,000) bears interest at prime plus 0.5% and it is the intent of the Company not to demand repayment before January 1, 2006. With respect to the comparative figures for 2003, the prior year's note receivable from 1425445 Ontario Limited, in the amount of \$3,000,000, was eliminated upon consolidation.

## 6. Note payable to City of Kingston:

In consideration for transfer of the City of Kingston's electricity distribution business, the City of Kingston took back a note payable on January 1, 2000, for an amount equivalent to 50% of the value of net assets transferred. The note payable, in the amount of \$12,380,619 (2003 - \$13,345,629), bears interest at 7.25% per annum and has no fixed terms of repayment. It is not the intent of the City of Kingston to demand repayment before January 1, 2006. Comparative figures for 2003 contain both the note payable by the Company and that of its subsidiary.

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

## 7. Bank loan and letter of credit:

The Company has an operating loan available for use in the amount of \$5,000,000 of which \$Nil (2003 - \$4,000,000) was drawn at December 31, 2004. Interest on this facility has been set at the bank's prime rate.

In addition, a revolving term loan of \$3,000,000 was negotiated with interest at the bank's prime rate, which at December 31, 2004 was 4.25%. An amount of \$3,000,000 (2003 - \$1,700,000) was drawn as of December 31, 2004, interest payable only with principal due September 9, 2005.

Bank indebtedness is secured by a general security agreement.

On April 12, 2002, to comply with requirements of the Independent Electricity System Operator, as the new supplier of energy to the wholesale electricity market, Kingston Electricity Distribution Limited was required to post security prudentials determined in relation to the Company's credit rating. A Letter of Credit has been provided in the amount of \$8,005,832 as of December 31, 2004 (2003 - \$8,005,832).

## 8. Regulatory assets and liabilities:

Regulatory assets are comprised of:

|  | 2004                | 2003                |
|--|---------------------|---------------------|
| Transition costs                           | \$ 3,591,640        | \$ 3,354,980        |
| Pre-market opening cost of power variances | 203,035             | 190,645             |
| <b>Total regulatory assets</b>             | <b>\$ 3,794,675</b> | <b>\$ 3,545,625</b> |

Regulatory liabilities are comprised of:

|  | 2004                | 2003                  |
|--|---------------------|-----------------------|
|  |                     | (Restated<br>note 15) |
| Post-market opening retail customer and retail<br>settlement variances | \$ 2,087,176        | \$ 530,781            |
| Regulatory asset recoveries  | 766,695             | -                     |
|  | <b>\$ 2,853,871</b> | <b>\$ 530,781</b>     |



# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

## 9. Related party transactions:

### (a) 1425445 Ontario Limited (operating as Utilities Kingston):

During the year, the Company paid \$8,382,458 (2003 - \$8,783,981) to 1425445 Ontario Limited (operating as Utilities Kingston) for support services and capital works. 1425445 Ontario Limited is a shared-services business incorporated to provide support services to both the Company and to various infrastructure businesses of the City of Kingston.

### (b) City of Kingston:

During the year, the Company contracted for certain financial services from the City of Kingston. As at December 31, 2004, the Company had an amount due from the City of Kingston representing the cumulative net balance of cash receipts and disbursements processed on behalf of the Company in the amount of \$7,166,889 (2003 - \$2,923,304).

Charges for the above services are recorded at exchange amounts established and agreed to by the related parties.

## 10. Future benefits obligation:

### (a) Pension plan:

The former Hydro-Electric Commission of the Corporation of the City of Kingston entered into agreements in 1995 with a number of former employees on non-contributory defined benefit pension plans. An actuarial report based upon the pension agreements indicates that the present value of the accrued pension benefits as at December 31, 2004 is \$66,978 (2003 - \$78,762).

### (b) Extended health care, dental and life insurance benefits:

The Company provides extended health care, dental and life insurance benefits to employees through support services contracted to 1425445 Ontario Limited (operating as Utilities Kingston). An independent actuarial study of the post-retirement and post-employment benefits has been undertaken. The most recent actuarial valuation of the future benefits was completed as at December 31, 2004. This resulted in an actuarial loss to be amortized, beginning in 2005, on a straight-line basis over the expected average remaining service life of the related employee groups, which is estimated to be 11 years.

The significant actuarial assumptions adopted in estimating the Company's accrued benefit obligation are as follows:

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|                            |  |
|----------------------------|--|
| Discount rate              | 6.0% per annum   |
| Salary escalation          | 4.0% per annum   |
| Dental benefits escalation | 5.0% per annum   |
| Health benefits escalation | 10.0% per annum in 2005,<br>decreasing to 5.0% over 15 years |

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# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

## 10. Future benefits obligation (continued):

### (b) Extended health care, dental and life insurance benefits (continued):

Information with respect to the Company's post-retirement and post-employment benefit obligations is as follows:

|  | 2004         | 2003         |
|--|--------------|--------------|
| Accrued benefit liability, January 1   | \$ 2,763,147 | \$ 2,701,796 |
| Expenses recognized for the period     | 249,041      | 240,682      |
| Benefits paid for the period           | (189,868)    | (179,331)    |
|  | 2,822,320    | 2,763,147    |
| Effect of sale of subsidiary (note 2)  | (1,932,130)  | —            |
| Accrued benefit liability, December 31 | \$ 890,190   | \$ 2,763,147 |

The accrued benefit liability at December 31 includes the following components:

|  | 2004         | 2003         |
|--|--------------|--------------|
| Accrued benefit obligation             | \$ 1,194,510 | \$ 2,763,147 |
| Unamortized actuarial losses           | (304,320)    | —            |
| Accrued benefit liability, December 31 | \$ 890,190   | \$ 2,763,147 |

These benefits will be paid to 1425445 Ontario Limited (operating as Utilities Kingston) as future benefit obligations are paid by Utilities Kingston to its employees as part of the support services contract with the Company.

### (c) Future benefit obligations:

|   | 2004       | 2003         |
|---|------------|--------------|
| Future benefits obligation is comprised of: |            |              |
| Pension plan                                | \$ 66,978  | \$ 78,762    |
| Health, dental and life insurance           | 890,190    | 2,763,147    |
|   | \$ 957,168 | \$ 2,841,909 |



# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

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## 11. General liability insurance:

The Company is a member of the Municipal Electric Association Reciprocal Insurance Exchange (MEARIE) which is a pooling of general liability risks. Members of MEARIE would be assessed, on a pro-rata basis, based on the total of their respective deposit premiums should losses be experienced by MEARIE that are in excess of their reserves and supplemental insurance, for the years in which the Company, and the former Hydro-Electric Commission, has been a member. The Company has not been made aware of any additional assessments.

## 12. Contingent liabilities:

(a) The nature of the Company's activities is such that there may be litigation pending or is prospect at any time. With respect to claims at December 31, 2004, management believes there are valid defenses and appropriate insurance coverages in place. In the event any claims are successful, management believes that such claims are not expected to have a material effect on the financial position.

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

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

Subsequent to year end, the Supreme Court of Canada unanimously ruled on a similar lawsuit against a private gas distribution company. The court ruled that the late payment penalties the utility had charged its customers from 1994 to 2002 exceeded legal limits and amounted to criminal misconduct. The Court stated that once the action was commenced in 1994, that utility should have known that the rate of interest charged might have resulted in a criminal rate of interest.

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 Company. Losses, if any, arising from this matter, will be accounted for in the year in which the case is resolved.

(c) Previous to the transaction more fully described in note 2, the Company had provided a guarantee in favour of its former subsidiary, 1425445 Ontario Limited, with a value no greater than 25% of the Company's equity less the outstanding note receivable from 1425445 Ontario Limited. At December 31, 2004, this guarantee remained in place.

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

## 13. Payments in lieu of corporate income taxes:

The provision for amounts in lieu of corporate income taxes ("PIL's") differs from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rates. A reconciliation between the statutory and effective tax rates is provided as follows:

|   | 2004       | 2003         |
|---|------------|--------------|
| Federal and Ontario statutory income tax rate                                 | 36.1%      | 36.6%        |
| Income before provision for PIL's   | 1,117,143  | \$ 1,218,046 |
| Provision for PIL's at statutory rate   | \$ 403,512 | \$ 446,048   |
| Increase (decrease) resulting from:   |            |              |
| Capital cost allowance less than (in excess of) depreciation and amortization | 84,212     | 13,214       |
| Large Corporations Tax  | —          | 36,800       |
| Ontario Capital Tax   | 53,398     | 48,845       |
| Tax effect of transition costs deducted for tax purposes                      | (198,866)  | (122,749)    |
| Tax effect of other miscellaneous adjustments                                 | (1,506)    | 20,712       |
| Provision for PIL's   | \$ 340,750 | \$ 442,870   |
| Effective income tax rate   | 30.5%      | 36.4%        |

Based on substantively enacted income tax rates, the potential benefit of unrecorded future income tax assets arising substantially from differences between accounting and tax values for capital assets is \$1,004,000 (2003 - \$1,104,000). This would result in a 2004 total future tax expense of \$100,000 (2003 - \$94,400). However, future income taxes have not been recorded in the accounts as they are expected to be recovered through future revenues.

## 14. Financial instruments and credit risks:

### (a) Fair value of financial instruments:

The carrying values of the amount due from City of Kingston, accounts receivable, due to retailers, recoverable payments in lieu of income taxes, unbilled revenue, the notes receivable from related party, accounts payable and accrued liabilities, retailer deposits, regulatory liabilities and the note payable to the City of Kingston approximate their fair value due to the expected short term maturity of these instruments. The carrying value of the notes receivable from subsidiary and the note payable to City of Kingston approximates fair value primarily due to the market rate of returns attached to the instruments.



# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

## 14. Financial instruments and credit risks (continued):

### (b) Credit risks:

Credit risk is the risk that a counterparty will fail to discharge its obligation to the Corporation reducing the expected cash inflow from Corporation assets recorded at the balance sheet date. Credit risk can be concentrated in debtors that are similarly affected by economic or other conditions.

The Corporation has assessed that there are no significant concentrations of credit risk other than the present uncertainty relating to the recovery of regulatory assets. The final regulatory amount recoverable will be assessed in future years by the regulator after the audit of those costs.

## 15. Prior period adjustments:

Prior year comparative figures have been adjusted to properly reflect certain components of the Company's cost of power. The net effect of this adjustment has been to increase the accounts payable balance at December 31, 2003 by \$575,889, to decrease the regulatory liabilities by \$300,818 and to decrease the net earnings and retained earnings at December 31, 2003 by \$275,071.

In addition, an adjustment has been recorded to reflect changes in the methodology that management used to calculate interest on regulatory liabilities. The net effect of this adjustment has been to decrease the retained earnings balance at December 31, 2002 by \$47,535, to decrease net earnings for 2003 by \$51,866 and to increase the regulatory liabilities balance at December 31, 2003 by \$99,401.

Finally, an adjustment has been recorded to reflect changes in the methodology that management used to calculate interest on power variances. The net effect of this adjustment has been to increase the net earnings for 2003 by \$76,820 and to increase the regulatory liabilities balance at December 31, 2003 by \$76,820.

The effects of the prior period adjustments are summarized in the following table:

|   | 2003         | 2002        |
|---|--------------|-------------|
| Adjustments related to the cost of power                      | \$ (275,071) | \$ –        |
| Interest on regulatory liabilities, excluding power variances | (51,867)     | (47,534)    |
| Interest on regulatory liabilities – power variances          | 76,820       | –           |
| Total   | \$ (250,118) | \$ (47,534) |

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2004

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## **16. Comparative figures:**

Certain 2003 comparative figures have been reclassified to conform with the financial statement presentation adopted for 2004.

# KINGSTON ELECTRICITY DISTRIBUTION LIMITED

## Schedule of Discontinued Operations

Year ended December 31, 2004, with comparative figures for 2003

|   | 2004         | 2003         |
|---|--------------|--------------|
| Fibre revenues                            | \$ 1,619,547 | \$ 1,504,983 |
| Contracted services revenue               | 38,933,589   | 33,274,586   |
| Other revenue                             | 1,747,861    | 1,763,242    |
|   | 42,300,997   | 36,542,811   |
| Contracted service expenditures           | 40,489,746   | 34,839,895   |
| Operating expenses                        | 1,306,291    | 1,026,468    |
| Depreciation                              | 912,797      | 926,566      |
| Interest expense                          | 224,288      | 240,598      |
| Capital taxes                             | 29,113       | 42,182       |
| Payments in lieu of income tax (recovery) | 101,691      | (164,008)    |
|   | 43,063,926   | 36,911,701   |
| Net loss                                  | \$ (762,929) | \$ (368,890) |