

Financial Statements of

**KINGSTON ELECTRICITY
DISTRIBUTION LIMITED**

Year ended December 31, 2005



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

AUDITORS' REPORT TO THE SHAREHOLDER

We have audited the balance sheet of Kingston Electricity Distribution Limited as at December 31, 2005 and the statements of earnings, retained earnings (deficit) and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Kingston, Canada

February 24, 2006

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Financial Statements

Year ended December 31, 2005

Financial Statements

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KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Balance Sheet

December 31, 2005, with comparative figures for 2004

	2005	2004 (note 16)
Assets		
Current assets:		
Cash	\$ 24,829	\$ 3,020,830
Due from City of Kingston (note 9(b))	7,063,675	3,338,662
Accounts receivable	1,131,139	808,868
Billed revenue receivable	2,394,586	3,828,227
Unbilled revenue	7,264,433	6,273,767
Recoverable payments in lieu of income taxes (note 13)	-	114,222
Inventory	788,546	912,786
Prepaid expenses	138,593	122,944
	18,805,801	18,420,306
Notes receivable from related party (note 5)	500,000	500,000
Incorporation costs, net	89,099	106,918
Regulatory assets (note 8)	3,580,451	3,779,156
Capital assets (note 4)	22,110,578	20,702,239
	\$ 45,085,929	\$ 43,508,619

Liabilities and Shareholder's Equity

Current liabilities:		
Bank loan (note 7)	\$ 3,000,000	\$ 3,000,000
Accounts payable and accrued liabilities	9,186,323	7,450,661
Due to retailers	932,442	989,561
Deposits payable	434,926	-
Payments in lieu of income taxes payable (note 13)	104,849	-
	13,658,540	11,440,222
Retailer deposits	42,654	50,880
Regulatory liabilities (note 8)	5,360,915	2,838,352
Note payable to City of Kingston (note 6)	10,880,619	12,380,619
Future benefit liabilities (note 10(c))	1,059,462	1,075,407
	31,002,190	27,785,480
Shareholder's equity:		
Share capital:		
Authorized:		
Unlimited Class A common shares		
Issued and outstanding:		
120 Class A common shares	12,380,617	12,380,617
Contributed surplus (note 2)	2,477,763	2,477,763
Retained earnings (deficit)	(774,641)	864,759
	14,083,739	15,723,139
Commitment (note 3)		
Contingent liabilities (notes 11 and 12)		
	\$ 45,085,929	\$ 43,508,619

See accompanying notes to financial statements.

On behalf of the Board:

Director

Director

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Statement of Earnings

Year ended December 31, 2005, with comparative figures for 2004

	2005	2004 (note 16)
Revenue:		
Sales	\$ 55,642,275	\$ 49,048,057
Cost of power	(55,642,275)	(49,048,057)
	-	-
Local distribution revenue	8,064,491	8,264,218
Account set-up charge	64,780	45,746
Pole rentals	96,924	113,539
Interest	52,013	407,590
Miscellaneous	210,856	197,277
	424,573	764,152
	8,489,064	9,028,370
Operating expenses:		
Customer services	314,933	263,152
Administration	1,801,034	1,848,468
Billing and collecting	1,209,730	1,230,573
Distribution	2,022,089	2,108,472
	5,347,786	5,450,665
Earnings before the undernoted	3,141,278	3,577,705
Interest expense	844,321	1,008,729
Depreciation and amortization	1,576,211	1,459,722
Write-off of regulatory assets (note 8)	409,516	-
Earnings before income taxes	311,230	1,109,254
Payments in lieu of corporate income taxes (note 13)	450,630	340,750
Earnings (loss) for the year from continuing operations	(139,400)	768,504
Loss from discontinued operations, net of payments in lieu of corporate income taxes (schedule) (note 2)	-	762,929
Net earnings (loss)	\$ (139,400)	\$ 5,575

See accompanying notes to financial statements.

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Statement of Retained Earnings (Deficit)

Year ended December 31, 2005, with comparative figures for 2004

	2005	2004
Retained earnings, beginning of year:		
As previously reported	\$ 982,998	\$ 1,267,186
Effect of prior period adjustment (note 16)	(118,239)	(408,002)
As restated	864,759	859,184
Net earnings (loss) for the year	(139,400)	5,575
Dividends	(1,500,000)	-
Retained earnings (deficit), end of year	\$ (774,641)	\$ 864,759

See accompanying notes to financial statements.

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Statement of Cash Flows

Year ended December 31, 2005, with comparative figures for 2004

	2005	2004 (note 16)
Cash provided by (used in):		
Operations:		
Net earnings (loss) for the year from continuing operations	\$ (139,400)	\$ 768,504
Loss from discontinued operations	-	(762,929)
Items not involving cash:		
Depreciation and amortization	1,576,211	2,372,519
Write-off of regulatory assets	409,516	-
Change in non-cash operating working capital (note 14)	1,124,403	2,337,322
	2,970,730	4,715,416
Financing:		
Repayment of note payable to City of Kingston	(1,500,000)	-
Dividends	(1,500,000)	-
Proceeds from share issuance (note 2)	-	3,000,000
Overdraft of subsidiary at time of transfer (note 2)	-	113,275
Repayment of bank loan	-	(2,700,250)
	(3,000,000)	413,025
Investments:		
Purchase of capital assets	(2,966,731)	(2,712,373)
Increase (decrease) in cash and cash equivalents	(2,996,001)	2,416,068
Cash and cash equivalents, beginning of year	3,020,830	604,762
Cash and cash equivalents, end of year	\$ 24,829	\$ 3,020,830
Supplemental cash flow information:		
Interest paid	\$ 974,355	\$ 949,356
Payments in lieu of income taxes	345,751	705,740

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, 2005

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 effective December 31, 2004. 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 were 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, 2005

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, 2005

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 system	4.00%
Meters	4.00%
Tools	10.00%
System supervisory equipment	6.67%
Application software	20.00%
Vehicle	20.00%
Leasehold improvements	Over the term 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% (2004 - 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 transition costs and pre-market opening cost of power variances that have been deferred because it is probable that they will be recovered in rates. These amounts have been accumulated pursuant to the Electricity Act and deferred in anticipation of their future recovery in electricity distribution rates. Regulatory liabilities represent net variances between costs incurred by the Company and related amounts billed to consumers at OEB approved rates as well as net regulatory asset recoveries.

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

1. Significant accounting policies (continued):

(h) Regulatory assets and liabilities (continued):

Management assesses the future uncertainty with respect to the final regulatory disposition of those amounts, and to the extent required, makes accounting provisions to reduce the deferred balances accumulated or to increase the recorded liabilities. Upon rendering of the final regulatory decision adjusting distribution rates, the provisions are adjusted to reflect the final impact of that decision, and such adjustment is reflected in net earnings for the period.

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

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.
- (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.

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

1. Significant accounting policies (continued):

(h) Regulatory assets and liabilities (continued):

- (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 OEB 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, billed revenue 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.

Inventory is recorded net of provisions for obsolescence. Amounts recorded for depreciation and amortization of equipment are based on estimates of useful service life. Future benefit liabilities are based on certain assumptions, including interest (discount) rate, salary escalation, the average retirement age of employees, employee turnover and expected health and dental care costs.

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.

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").

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

1. Significant accounting policies (continued):

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

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 have not been recorded in the accounts as they are expected to be recovered through future revenues.

(k) Future benefit liabilities:

The Company's future benefit liabilities represent its accumulated obligation to Utilities Kingston under a service agreement.

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.

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.

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.

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

2. Sale of shares of subsidiary (continued):

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:

	2005
Current assets	\$ 1,217,002
Employee future benefits recoverable – City of Kingston	1,932,131
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

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

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

3. Electricity industry regulation:

The Ontario Energy Board Act, 1998 (Ontario) ("OEBA") conferred on the Ontario Energy Board ("OEB") increased powers and responsibilities to regulate the electricity industry in Ontario. These powers and responsibilities include approving or fixing rates for the transmission and distribution of electricity, providing continued rate protection for rural and remote electricity consumers, and ensuring that distribution companies fulfill obligations to connect and service customers. The OEB may also prescribe license requirements and conditions of service to electricity distributors which may include, among other things, record keeping, regulatory accounting principles, separation of accounts for distinct businesses, and filing and process requirements for rate setting purposes. In its capacity to approve or set rates, the OEB has the authority to specify regulatory accounting treatments that may differ from Canadian generally accepted accounting principles for enterprises operating in a non-rate regulated environment.

Under the OEBA and the decisions of the OEB, distribution charges for the electricity distribution business were to be increased annually over three years (2001, 2002 and 2003) to achieve an annual rate of return of 9.88% on the amount of common equity deemed to be allocated to this business.

Distribution charges were also to be increased to permit the recovery of costs incurred by the Company to prepare for the opening of the competitive electricity market in Ontario ("Market Opening"). The Company has capitalized some of these costs as regulatory assets (note 8).

In January 2004, the Company filed applications to adjust its distribution charges to provide for the recovery of its regulatory assets over a four year period. The applications were approved by the OEB effective March 1, 2004.

In January 2005, the Company filed rate applications to adjust its distribution charges to provide for the full theoretical regulatory rate of return of 9.88% and continued recovery of its regulatory assets. As mandated by the OEB, the rate increase is subject to a financial commitment by the Company to invest \$175,000 in conservation and demand management activities over the period September 1, 2005 to September 30, 2007. The rate applications and applications for the approval of its conservation and demand management programs have since been approved by the OEB. At December 31, 2005, \$48,000 with respect to these programs has been spent.

On July 29, 2005, the Company filed its Electricity Distribution Rate Application for 2006 distribution rates, for rates to be effective May 1, 2006. The 2006 distribution rate, in accordance with the OEB filing requirements, provides for a revised rate of return of 9.0%, as compared to 9.88% in previous years. The application was approved by the OEB April 12, 2006.

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

4. Capital assets:

			2005	2004
	Cost	Accumulated amortization	Net book value	Net book value
Land	\$ 197,343	\$ -	\$ 197,343	\$ 197,343
Buildings	440,638	95,814	344,824	359,957
Transmission system	1,564,190	614,964	949,226	1,041,223
Substation equipment	2,407,769	755,625	1,652,144	1,788,444
Distribution system:				
Overhead	9,547,222	1,983,699	7,563,523	6,947,079
Underground	5,940,387	1,880,875	4,059,512	3,829,518
Transformers	2,769,250	913,344	1,855,906	2,008,753
Meters	3,009,519	844,325	2,165,194	2,094,086
Tools	586,819	265,698	321,121	264,125
System supervisory equipment	2,150,679	822,004	1,328,675	1,234,851
Vehicle	25,887	15,331	10,556	15,715
Application software	102,762	92,564	10,198	30,749
Leasehold improvements	51,108	34,626	16,482	18,542
Capital work-in-progress	1,635,874	-	1,635,874	871,854
	\$ 30,429,447	\$ 8,318,869	\$ 22,110,578	\$ 20,702,239

The cost and accumulated amortization of capital assets at December 31, 2004 amounted to \$27,462,715 and \$6,760,476 respectively.

5. Note 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 (2004 - \$500,000) bears interest at prime plus 0.5% and it is the intent of the Company not to demand repayment before January 1, 2007. At December 31, 2005, the prime rate was 5%.

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 \$10,880,619 (2004 - \$12,380,619), 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, 2007.

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

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 (2004 - \$Nil) was drawn at December 31, 2005. 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 rate on bankers' acceptances plus a 0.75% stamping fee resulting in an effective rate of 4%. An amount of \$3,000,000 (2004 - \$3,000,000) was drawn as of December 31, 2005, interest payable only, with principal due September 8, 2006.

Bank indebtedness is secured by a general security agreement.

On April 12, 2002, to comply with requirements of the Independent Electricity System Operator, as a 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, 2005 (2004 - \$8,005,832).

8. Regulatory assets and liabilities:

Regulatory assets are comprised of:

	2005	2004
Transition costs	\$ 3,296,939	\$ 3,576,121
Pre-market opening cost of power variances	283,512	203,035
Total regulatory assets	\$ 3,580,451	\$ 3,779,156

Regulatory liabilities are comprised of:

	2005	2004
Post-market opening retail customer and retail settlement variances (net)	\$ 3,279,916	\$ 2,071,657
Net regulatory asset recoveries	2,080,999	766,695
	\$ 5,360,915	\$ 2,838,352

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

8. Regulatory assets and liabilities (continued):

In December 2005, the Company attended a hearing of the OEB relating to the approval of the Company's net regulatory assets accumulated up to December 31, 2004. In this hearing, the OEB approved the net regulatory assets submitted by the Company, on the condition that the Company consent to a voluntary reduction in the amounts submitted. This reduction, amounting to \$409,516 (2004 - \$Nil) has been recorded as an expense in the current year on the statement of earnings.

9. Related party transactions:

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

During the year, the Company paid \$8,209,001 (2004 - \$7,019,000) 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. There was no balance owing at December 31, 2005 with respect to these transactions.

(b) City of Kingston:

During the year, the Company contracted for certain financial services from the City of Kingston. As at December 31, 2005, 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 \$7,063,675 (2004 - \$3,338,662).

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

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

10. Future benefit liabilities:

(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 of the accrued pension liability indicates that the present value of the accrued pension benefits as at December 31, 2005 is \$181,678 (2004 - \$185,217).

Information with respect to the accrued pension liability is as follows:

	2005	2004
		(note 16(a))
Accrued pension liability, January 1	\$ 185,217	\$ 187,432
Expenses recognized for the period	7,865	7,889
Pension payments	(11,404)	(10,104)
Accrued pension liability, December 31	\$ 181,678	\$ 185,217

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

The Company provides extended health care, dental and life insurance benefits to employees of 1425445 Ontario Limited (operating as Utilities Kingston) through support services contracted to them. 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:

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, decreasing to 5.0% over 15 years

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

10. Future benefit liabilities (continued):

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

Information with respect to these accrued benefit liabilities is as follows:

	2005	2004
Accrued benefit liabilities, January 1	\$ 890,190	\$ 2,763,148
Expenses recognized for the period	31,545	249,041
Amortization of actuarial loss	43,202	-
Benefits paid for the period	(87,153)	(189,868)
	877,784	2,822,321
Effect of sale of subsidiary (note 2)	-	(1,932,131)
Accrued benefit liabilities, December 31	\$ 877,784	\$ 890,190

These accrued benefit liabilities at December 31 include the following components:

	2005	2004
Accrued benefit obligation	\$ 1,138,902	\$ 1,194,510
Unamortized actuarial losses	(261,118)	(304,320)
Accrued benefit liabilities, December 31	\$ 877,784	\$ 890,190

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 liabilities:

	2005	2004
Future benefit liabilities are comprised of:		(note 16(a))
Pension plan	\$ 181,678	\$ 185,217
Health, dental and life insurance	877,784	890,190
	\$ 1,059,462	\$ 1,075,407

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

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, 2005, 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 \$500,000 in restitutionary payments plus interest was served on the former Toronto Hydro-Electric Commission, continuing as Toronto Hydro Corporation, on November 18, 1998. The action was initiated against the former 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 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. This action is at a preliminary stage. Pleadings have closed but examinations for discovery have not been conducted and the classes have not been certified. The Electricity Distributors Association is undertaking the defense of this class action on behalf of the Defendant Class.

On April 22, 2004, in a decision in a class action commenced against The Consumers' Gas Company Limited (now Enbridge Gas Distribution Inc.), the Supreme Court of Canada ruled that Consumers' Gas was required to repay that portion of certain late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the Criminal Code. Although the claim related to charges collected by Consumers' Gas after the enactment of section 347 of the Criminal Code in 1981, the Supreme Court limited recovery to charges collected after the action was initiated in 1994.

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

12. Contingent liabilities (continued):

The Company is not a party to the Consumers' Gas class action, however, it is anticipated that the above noted class action will now proceed for determination in light of the reasons of the Supreme Court in the Consumers' Gas class action.

The Defendant Class may have defences available to it in this action that were not disposed of by the Supreme Court in the Consumers' Gas class action. Also, the determination of whether the late payment charges collected by the Corporation from its customers were in excess of the interest limit stipulated in section 347 of the Criminal Code is fact specific in each circumstance.

At this time, given the preliminary status of this action, it is not possible to quantify the effect, if any, on the financial statements of the Company. Consequently, no provision has been made in these financial statements with respect to any possible losses that may arise as a result of this matter.

- (c) The Company provides a guarantee in favour of an affiliated company, 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, 2005, this guarantee remained in place.

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:

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

13. Payments in lieu of corporate income taxes (continued):

	2005	2004
Federal and Ontario statutory income tax rate	36.1%	36.1%
Income before provision for PILs	\$ 311,230	\$ 1,109,254
Provision for PILs at statutory rate	\$ 112,354	\$ 400,441
Increase (decrease) resulting from:		
Capital cost allowance less than (in excess of) depreciation and amortization	158,571	84,212
Ontario Capital Tax	50,113	53,398
Tax effect of transition costs deducted for tax purposes	-	(198,866)
Tax effect of regulatory asset recoveries in current year	35,226	-
Tax effect of regulatory asset write-down in current year	102,371	-
Tax effect of other miscellaneous adjustments	(8,005)	1,565
Provision for PILs	\$ 450,630	\$ 340,750
Effective income tax rate	144.8%	30.7%

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 \$1,358,000 (2004 - \$1,004,000). This would result in a 2005 total future tax recovery of \$354,000 (2004 - \$100,000). However, future income taxes have not been recorded in the accounts as they are expected to be recovered through future revenues.

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

14. Change in non-cash operating working capital:

	2005	2004
Increase in due from City of Kingston	\$ (3,725,013)	\$ (6,049,730)
Decrease (increase) in accounts receivable	(322,271)	706,347
Decrease in billed revenue receivable	1,433,641	-
Decrease (increase) in recoverable payments in lieu of income taxes	219,071	(294,095)
Decrease (increase) in unbilled revenue	(990,666)	1,103,044
Decrease (increase) in inventory	124,240	(49,478)
Increase in prepaid expenses	(15,649)	(14,033)
Increase in regulatory assets	(210,811)	(249,050)
Increase (decrease) in retailer deposits	(8,226)	1,499
Increase in deferred revenue	-	181,064
Increase (decrease) in due to retailers	(57,119)	1,480,202
Increase in accounts payable and accrued liabilities	1,735,662	2,014,231
Increase in deposits payable	434,926	-
Increase in regulatory liabilities	2,522,563	2,323,090
Increase (decrease) in future benefits obligations	(15,945)	1,184,231
	\$ 1,124,403	\$ 2,337,322

15. Financial instruments:

(a) Fair value of financial instruments:

The carrying values of the amount due from City of Kingston, accounts receivable, billed revenue receivable, payments in lieu of income taxes, unbilled revenue, bank loan, accounts payable and accrued liabilities, due to retailers, deposits payable, retailer deposits and regulatory assets and liabilities approximate their fair value due to the expected short term maturity of these instruments.

The carrying value of the note payable to City of Kingston and notes receivable from related party 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, 2005

15. Financial instruments (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.

16. Prior period adjustments:

(a) Adjustments recorded in fiscal 2005:

An adjustment has been recorded in 2005 to reflect an actuarial valuation performed on the Company's pension plan. The Company has applied the effects of this adjustment retroactively. The net effect of this adjustment has been to decrease the retained earnings (deficit) at December 31, 2003 by \$110,350 and at December 31, 2004 by \$118,239, and to increase the future benefit liabilities at December 31, 2003 by \$110,350 and at December 31, 2004 by \$118,239. In addition, the adjustment results in a decrease in net earnings of \$7,889 for the year ended December 31, 2004.

(b) Adjustments recorded in fiscal 2004:

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, 2003 by \$99,401 and to increase the regulatory liabilities balance at December 31, 2003 by \$99,401.

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Notes to Financial Statements (continued)

Year ended December 31, 2005

16. Prior period adjustments (continued):

(b) Adjustments recorded in fiscal 2004 (continued):

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 retained 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:

	2005	2004
Future benefits obligation	\$ (118,239)	\$ (110,350)
Adjustments related to the cost of power	-	(275,071)
Interest on regulatory liabilities, excluding power variances	-	(99,401)
Interest on regulatory liabilities – power variances	-	76,820
Total	\$ (118,239)	\$ (408,002)

17. Comparative figures:

Certain 2004 comparative figures have been reclassified to conform with the financial statement presentation adopted per the current year.

KINGSTON ELECTRICITY DISTRIBUTION LIMITED

Schedule of Discontinued Operations

Year ended December 31, 2005, with comparative figures for 2004

	2005	2004
Fibre revenues	\$ -	\$ 1,619,547
Contracted services revenue	-	38,933,589
Other revenue	-	1,747,861
	-	42,300,997
Contracted service expenditures	-	40,489,746
Operating expenses	-	1,306,291
Depreciation	-	912,797
Interest expense	-	224,288
Capital taxes	-	29,113
Payments in lieu of income tax	-	101,691
	-	43,063,926
	\$ -	\$ (762,929)