# London Hydro Inc.

## Financial Statements

For the Year Ended December 31, 2011

*with comparative figures for 2010*

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# INDEPENDENT AUDITORS' REPORT

To the Shareholder of London Hydro Inc.

We have audited the accompanying financial statements of London Hydro Inc. (the "Entity"), which comprise the balance sheet as at December 31, 2011 and the statements of earnings and retained earnings, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

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 comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the financial statements present fairly, in all material respects, the financial position of London Hydro Inc. as at December 31, 2011, and the results of its earnings and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

March 21, 2012

London, Canada

**Management's Report**

**Management's Responsibility for Financial Reporting**

London Hydro's management is responsible for the preparation and presentation of the financial statements, management's discussion and analysis and all other information included in this annual report. Management is also responsible for the selection and use of accounting principles that are appropriate in the circumstances, and for the internal controls over the financial reporting process to reasonably ensure that relevant and reliable information is produced. Financial statements are not precise in nature as they include certain amounts based on estimates and judgement. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control over the financial reporting process. The Board exercises this responsibility through the Audit Committee of the Board. This committee, which is comprised of four directors of the Board, meets with management and the external auditors to ensure that management responsibilities are properly discharged and to review the financial statements and other information included in the annual report before they are presented to the Board of Directors for approval. The financial statements have been signed and approved by the Board of Directors on the recommendation of the Audit Committee.

KPMG LLP, an independent firm of Chartered Accountants, has been appointed by the Company's shareholder, the Corporation of the City of London, and engaged to examine the accompanying financial statements in accordance with generally accepted auditing standards in Canada and provide an independent professional opinion. Their report is presented with the financial statements.

March 21, 2012

V. Sharma

**Vinay Sharma**
Chief Executive Officer

D. Williamson

**Dave Williamson**
Vice-President and Chief Financial Officer

**London Hydro Inc.**
**Balance Sheet**
**December 31, 2011, with comparative figures for 2010**
(in thousands of dollars)

| | Note | 2011 | 2010 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash and equivalents | 4 | $ 313 | $ 7,666 |
| Accounts receivable | 5, 11 | 61,031 | 55,080 |
| Income tax receivable | | 254 | 856 |
| Regulatory assets | 7 | 2,905 | 2,536 |
| Inventories | 6 | 880 | 929 |
| Prepaids | | 821 | 1,464 |
| **Total current assets** | | 66,204 | 68,531 |
| Regulatory assets | 7 | 21,504 | 20,950 |
| Property, plant and equipment | 8 | 205,596 | 199,270 |
| Future income tax assets | 18 | 7,289 | 8,256 |
| **Total non-current assets** | | 234,389 | 228,476 |
| **Total assets** | | $ 300,593 | $ 297,007 |
| **LIABILITIES AND SHAREHOLDER'S EQUITY** | | | |
| **Current liabilities** | | | |
| Accounts payable and accrued liabilities - | | | |
| Due to Independent Electricity System Operator | | $ 22,186 | $ 23,828 |
| Other | | 11,477 | 13,023 |
| Regulatory liabilities | 7 | 2,580 | 2,682 |
| Current portion of long-term debt | 13 | 2,304 | 2,304 |
| Customer and other deposits | 10 | 1,059 | 1,108 |
| Due to shareholder | 11 | 6,548 | 6,987 |
| **Total current liabilities** | | 46,154 | 49,932 |
| **Long-term liabilities** | | | |
| Unrealized loss on interest rate swap | 13 | 548 | 369 |
| Regulatory liabilities | 7 | 19,709 | 15,740 |
| Customer and other deposits | 10 | 14,141 | 11,770 |
| Long-term debt | 13 | 15,346 | 20,650 |
| Due to related party | 11, 13 | 70,000 | 70,000 |
| Employee future benefits | 19 | 10,640 | 9,864 |
| **Total long-term liabilities** | | 130,384 | 128,393 |
| **Total liabilities** | | 176,538 | 178,325 |
| **Shareholder's equity** | | | |
| Share capital | 14 | 96,116 | 96,116 |
| Retained earnings | | 27,939 | 22,566 |
| **Total shareholder's equity** | | 124,055 | 118,682 |
| Commitments | 9,23 | | |
| Subsequent event | 24 | | |
| **Total liabilities and shareholder's equity** | | $ 300,593 | $ 297,007 |

**On behalf of the Board**

Director

Director

**London Hydro Inc.**
**Statement of Operations and Retained Earnings**
**Year ended December 31, 2011, with comparative figures for 2010**
(in thousands of dollars)

| | Note | 2011 | 2010 |
|---|---|---|---|
| **Revenues** | | | |
| Energy | | $ 297,961 | $ 278,618 |
| Distribution | | 58,760 | 58,748 |
| | | 356,721 | 337,366 |
| Cost of power | | (297,961) | (278,618) |
| **Distribution revenue** | | 58,760 | 58,748 |
| **Operating expenses** | | | |
| Plant operating and maintenance | | 10,859 | 10,246 |
| General and administrative | | 23,207 | 23,163 |
| Amortization of plant and equipment | | 17,669 | 16,504 |
| | | 51,735 | 49,913 |
| Less: Costs recovered | 11 | (3,375) | (3,154) |
| | | 48,360 | 46,759 |
| **Operating income** | | 10,400 | 11,989 |
| **Other Income (expense)** | | | |
| Interest and other revenue | 16 | 4,565 | 4,678 |
| Unrealized loss on interest rate swap | 13 | (179) | (369) |
| Interest expense | 17 | (5,386) | (4,896) |
| | | (1,000) | (587) |
| **Earnings before income taxes** | | 9,400 | 11,402 |
| Income taxes | 18 | 1,527 | 2,353 |
| **Net earnings for the year** | | 7,873 | 9,049 |
| **Retained earnings, beginning of year** | | 22,566 | 16,017 |
| **Dividends** | | (2,500) | (2,500) |
| **Retained earnings, end of year** | | $ 27,939 | $ 22,566 |

The accompanying notes are an integral part of these financial statements.

**London Hydro Inc.**
**Statement of Cashflows**
**Year ended December 31, 2011, with comparative figures for 2010**
(in thousands of dollars)

| | Note | 2011 | 2010 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net earnings for the year | | $ 7,873 | $ 9,049 |
| Adjustments for: | | | |
| Depreciation and amortization | | 17,669 | 16,504 |
| Gain on disposal of property, plant and equipment | | (161) | (209) |
| Unrealized loss on interest rate swap | | 179 | 369 |
| | | 25,560 | 25,713 |
| Net decrease in non-cash working capital related to operations | 15 | (8,284) | (99) |
| Employee future benefits | | 776 | 450 |
| **Net cash provided by operating activities** | | 18,052 | 26,064 |
| **Cash flows from investing activities** | | | |
| Acquisition of property, plant and equipment | | (28,703) | (26,478) |
| Disposition of stranded meters and other plant and equipment | | 650 | 3,188 |
| Regulatory assets and liabilities - future income taxes | 3 g) | 967 | 1,046 |
| Other regulatory assets and liabilities, including smart meters | | 2,944 | (18,253) |
| **Net cash used in investing activities** | | (24,142) | (40,497) |
| **Financing activities** | | | |
| Customer and other deposits | | 2,322 | 4,076 |
| Contributions in aid of construction | | 4,219 | 2,695 |
| Dividends paid | | (2,500) | (12,500) |
| Long-term debt acquired | 13 | - | 23,530 |
| Long-term debt repaid | 13 | (5,304) | (576) |
| **Net cash from (used in) financing activities** | | (1,263) | 17,225 |
| **Net increase (decrease) in cash and equivalents during the year** | | (7,353) | 2,792 |
| **Cash and equivalents, beginning of the year** | | 7,666 | 4,874 |
| **Cash and equivalents, end of the year** | | $ 313 | $ 7,666 |
| **Supplemental cashflow information** | | | |
| Interest paid | | $ 5,125 | $ 4,752 |
| Income taxes paid | | $ 1,833 | $ 2,062 |

The accompanying notes are an integral part of these financial statements

## 1. Regulated Business Operations and Distribution Rates

London Hydro Inc. ("the Company") is a wholly owned subsidiary company of the Corporation of the City of London and provides regulated electrical distribution services to the inhabitants of the City of London.

The Company is regulated by the Ontario Energy Board ("OEB"), under the authority granted by the Ontario Energy Board Act (1998). The OEB has responsibility to set just and reasonable distribution rates and thereby approves all of the Company's distribution and ancillary rates. The Company's distribution revenue is determined by applying those regulated rates to customers and their consumption of electricity in the Company's distribution territory, as established by its distribution license granted by the OEB.

## 2. Financial Effects of Distribution Rate Regulation

The financial results presented are in accordance with Canadian generally accepted accounting principles and within that framework the Company accounts for the impact of regulatory actions in the following manner:

a) Regulatory decisions to adjust distribution rates

In the event that a regulatory decision is rendered, providing regulatory approval and certainty to the recognition of an asset, or creation of a liability, and culminating in an adjustment to the Company's distribution rates, such occurrences are immediately reflected in the Company's accounts.

b) Regulatory direction and practice

In the absence of a regulatory decision impacting rates, and where the Company is required by regulatory accounting practice or direction to accumulate balances for future rate recovery or create liabilities for future discharge, those amounts are recorded in accordance with that regulatory direction. 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.

Amounts currently confirmed by final regulatory decision, and amounts currently accounted for in the absence of final regulatory decision together with related provisions for future uncertainty, are more fully described in Note 7 to the financial statements.

**3. Summary of Significant Accounting Policies**

a) Revenue recognition

The Company is licensed by the OEB to distribute electricity. As a licensed distributor, the Company is responsible for billing customers for electricity generated by third parties and the related costs of providing electricity service, such as transmission services and other services provided by third parties.

The Company is required, pursuant to regulation, to remit such amounts to these third parties, irrespective of whether the Company ultimately collects these amounts from customers. The Company is acting as a principal for the electricity distribution and therefore present electricity revenues on a gross basis.

Revenue attributable to the delivery and consumption of electricity is based upon rates approved by the OEB and the Independent Electricity Systems Operator ("IESO") and includes the cost of electricity supplied, distribution charges and any regulatory charges. Revenue recognized as electricity is delivered and consumed by customers. Revenue is recorded on the basis of regular monthly meter readings and estimates of customer usage since the last meter reading date to the end of the period. Revenue is measured at the value of the consideration received or receivable, net of sales tax.

Amounts billed for Debt Retirement Charges are excluded from revenues, as the Company is acting as an agent for the collection of these amounts. The Company may file to recover uncollected debt retirement charges from the Ontario Electricity Financial Corporation ("OEFC").

b) Financial assets and liabilities

The standards require that as financial assets and liabilities are initially recognized that they be measured at fair value, except for certain related party transactions. After initial recognition, financial assets are categorized as assets held-for-trading, held-to-maturity investments, loans and receivables or, available-for-sale assets, and financial liabilities must be classified as held-for-trading, or other financial liabilities. All financial instruments are measured on the balance sheet at fair value except for loans and receivables, held-to-maturity investments, and other liabilities, which are measured at amortized cost.

Subsequent measurement and changes in fair value depend on their initial classification as follows: held-for-trading is measured at fair value and changes in fair value are recognized in the statement of operations and retained earnings.

**3. Summary of Significant Accounting Policies, continued**

b) Financial assets and liabilities, continued

The Company has classified its financial instruments as follows:

| | |
|---|---|
| Cash and equivalents | Held-for-trading |
| Accounts receivable | Loans and Receivables |
| Income tax receivable | Loans and Receivables |
| Accounts payable and accrued liabilities | Other Liabilities |
| Customer and other deposits | Other Liabilities |
| Due to shareholder | Other Liabilities |
| Long-term debt | Other Liabilities |
| Due to related party | Other Liabilities |

c) Inventories

Inventories are required to be measured at the lower of average cost and net realizable value. Items considered to be major future components of property, plant and equipment are recorded as such in the financial statements.

d) Property, plant and equipment

Property, plant and equipment are amortized over their estimated useful lives using the straight-line method over the following periods:

| | |
|---|---|
| Land rights and buildings | 25 to 60 years |
| Distribution substation equipment | 30 years |
| Other distribution equipment | 15 to 40 years |
| Other fixed assets | 5 to 15 years |

When an item of property, plant and equipment is sold or otherwise disposed of, the related cost and accumulated amortization are removed from the respective accounts and any gain or loss on disposition is recognized in earnings.

Assets under construction are not subject to depreciation until they are put into service.

Plant and equipment, that by their nature are not readily identifiable as individual assets, are grouped together. Under this method, the related cost and accumulated amortization are removed from their respective grouping account at the end of the asset's estimated useful life, regardless of actual service life. Any proceeds on disposition are recognized in earnings in the year of disposition.

**3. Summary of Significant Accounting Policies, continued**

e) Contributions to capital costs

Contributions are received from developers and contractors for capital costs incurred by the Company. These contributions are included as a reduction to the cost of the related plant and equipment when those assets are placed in service.

f) Cash and equivalents

Cash on hand and on deposit with banks, and short-term investments with maturity of three months or less, are considered cash and equivalents.

g) Future income taxes

CICA Handbook Section 3465 states that where future income taxes may be expected to be included in approved rates charged to customers in the future and to be recovered or returned to future customers, the recognition of a regulatory asset or liability for the increase or reduction in future revenue is required. Furthermore, the regulatory asset or liability established by this requirement is a temporary difference for which an additional future income tax asset or liability is recognized.

h) Employee future benefits

The Company has adopted the following policies for future benefits provided to both active and retired employees:

*Pension benefits*

The Company has a pension agreement with the Ontario Municipal Employees Retirement System (OMERS), which is a multi-employer contributory defined benefit plan. Company contributions to the plan are recognized as pension expense in the period that they are incurred. As this is a multi-employer plan, no pension liability for this type of plan is recorded in the Company's financial statements.

*Other post-retirement and post-employment benefits*

The Company provides other benefits to active and retired employees including group life insurance and health-care benefits. Recognition of these benefits are actuarially determined using the projected benefit method pro-rated on service using management's best estimate of salary escalation, retirement ages of employees and expected health care costs.

*(tabular amounts in thousands of dollars)*

### 3. Summary of Significant Accounting Policies, continued

i) Measurement uncertainty

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

Certain estimates are also required as regulations, which will ultimately determine the actual results, have yet to be finalized and are dependent on the completion of regulatory proceedings or decisions. Due to these uncertainties, actual results might differ from those estimates and the impact will be recorded in the current period when the actual results are known.

### 4. Cash and Cash Equivalents

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Bank balances | $ | 313 | $ | 7,666 |

### 5. Accounts Receivable

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Trade receivables | $ | 25,469 | $ | 26,440 |
| Allowance for doubtful accounts | | (2,259) | | (3,712) |
| Unbilled revenue | | 31,693 | | 27,399 |
| Other | | 6,128 | | 4,953 |
| | $ | 61,031 | $ | 55,080 |

Included in accounts receivable is approximately $5.1 million (2010 - $5.4 million) of customer receivables for water consumption that the Company bills and collects on behalf of the Corporation of the City of London. As the Company does not assume liability for collection of these amounts, any amount relating to water consumption that is determined to be uncollectible is charged to the Corporation of the City of London.

At the year-end, approximately $0.4 million (2010 - $0.7 million) is included in the allowance for doubtful accounts for uncollectible amounts relating to water consumption.

*(tabular amounts in thousands of dollars)*

**6. Inventories**

Inventory, which consists of parts and supplies acquired for internal construction, consumption, or recoverable work, is valued at the lower of cost and net realizable value. Cost is determined on a weighted average basis. Net realizable value is determined by replacement cost.

The amount of inventories consumed by the Company and recognized as an expense during 2011 was $0.8 million (2010 - $0.9 million).

**7. Regulatory Assets and Liabilities**

Regulatory assets

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Amounts approved for recovery in distribution rates | $ | 194 | $ | 480 |
| Smart meter expenditures in excess of recoveries | | 23,237 | | 21,776 |
| Amounts submitted for future rate approval: | | | | |
| Transitional cost recoveries | | 458 | | 458 |
| Other | | 520 | | 772 |
| | | 24,409 | | 23,486 |
| Less: Current portion | | 2,905 | | 2,536 |
| | $ | 21,504 | $ | 20,950 |

Regulatory liabilities

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Amounts approved for disposition in distribution rates | $ | 287 | $ | 2,222 |
| Purchase power cost variances (non-commodity) | | 7,889 | | 4,461 |
| Purchase power cost variances (commodity) | | 6,676 | | 3,057 |
| Future income tax liability | | 7,152 | | 8,164 |
| Other | | 285 | | 518 |
| | | 22,289 | | 18,422 |
| Less: Current portion | | 2,580 | | 2,682 |
| | $ | 19,709 | $ | 15,740 |

**7. Regulatory Assets and Liabilities, continued**

Regulatory Assets

a) Smart meter expenditures in excess of recoveries

The Corporation has been authorized under Ontario Regulation 427/06 to undertake metering activities under the Provincial Smart Meter Program, and to recover through rates, the funding required for the implementation of this program. These balances represent the extent to which program costs to date have exceeded recoveries to date.

Variances between costs and recoveries will be submitted to the OEB for approval and the current portion of regulatory assets recoverable, reflect the estimated amounts to be recovered during 2012.

b) Transitional and other cost recoveries

*Transitional costs*

The regulatory decision of December 9, 2004 affirmed the recovery of transitional costs in rates over a three-year period ending April 30, 2008. The remaining unrecovered balances will be submitted for recovery in future rate proceedings when amounts recoverable exceed the threshold amounts established by the OEB for rate submission.

*Other cost recoveries*

Other costs consist of $0.5 million (2010 - $0.3 million) incurred to transition to International Financial Reporting Standards (IFRS). The OEB has authorized the establishment of a deferral account for expenditures to transition to IFRS, which may be submitted for future approval for rate recovery.

Regulatory Liabilities

a) Amounts approved for disposition in distribution rates

During 2008, the Company filed a cost of service rate application for the 2009 rate year. On August 21, 2009 the Ontario Energy Board ("OEB") issued its Decision with respect to this application which included a request for OEB approval for the disposition of certain authorized regulatory deferral accounts and purchased power variance account balances. The regulatory decision of August 21, 2009 approved the disposition of these balances over a 19 month period ending April 30, 2011. As at December 31, 2011 these balances were fully disposed of.

**7. Regulatory Assets and Liabilities, continued**

Regulatory Liabilities, continued

b) Purchased power cost variances

As a regulated distributor of electricity, the Company is obligated to provide default energy supply to those consumers who elect not to purchase their energy from an energy retailer. The regulatory framework requires that all default energy commodity and non-commodity costs be billed to the consumer at regulated rates.

Variances between purchase costs and amounts billed are required to be captured in Retail Settlement Variance Accounts for disposition in future rates. The variance accounts have been further defined by the regulator into commodity related and non-commodity accounts. Those accounts defined as commodity accounts are eligible for regulatory review on a quarterly basis. All other accounts are defined as non-commodity and are currently eligible for review on an annual basis.

For all variance accounts, the review period does not in itself determine whether any adjustment will be permitted as the regulator will determine when the balances are material enough to warrant an adjustment to rates.

Currently, the variances accumulated are for the period commencing January 1, 2009 to December 31, 2011. Variances accumulated prior to January 1, 2009 in the amount of $9.6 million plus allowed interest were included in the regulatory amounts that were approved for rate recovery/disposition in August 2009.

The Corporation currently has an application submitted to the OEB for review and disposition of certain variances accumulated to December 31, 2011. Pending review and approval by the OEB of that application, the current portion of regulatory liabilities, reflect the estimated amounts to be disposed of during 2012.

c) Other

As at December 31, 2011, a balance of $0.3 million (2010 - $2.2 million) of purchased power variance amounts and $0.1 million over recovery (2010 - $0.5 million recoverable) of special purpose charge assessment, previously approved for disposition, remains to be dispersed to ratepayers through future Decisions to be issued by the Ontario Energy Board. Additionally, and in accordance with accounting directives received from the Ontario Energy Board, the Corporation has recorded $0.2 million (2010 - $0.1 million) for future rate disposition, due to savings as a result of the implementation of the Harmonized Sales Tax.

*(tabular amounts in thousands of dollars)*

**8. Property, Plant and Equipment**

Cost:

| | Land and Buildings | Distribution Substation Equipment | Other Distribution Equipment | Other Fixed Assets | Construction in Progress | Total |
|---|---|---|---|---|---|---|
| Balance at January 1, 2010 | $ 23,056 | $ 12,428 | $ 292,155 | $ 30,727 | $ 5,198 | $ 363,564 |
| Additions | 569 | 84 | $ 12,635 | $ 6,658 | 3,838 | 23,784 |
| Transfers | - | - | - | - | - | - |
| Disposals / Retirements | (368) | - | $ (10,253) | $ (3,078) | - | (13,699) |
| Balance at December 31, 2010 | $ 23,257 | $ 12,512 | $ 294,537 | $ 34,307 | $ 9,036 | $ 373,649 |
| Balance at January 1, 2011 | $ 23,257 | $ 12,512 | $ 294,537 | $ 34,307 | $ 9,036 | $ 373,649 |
| Additions | 1,162 | 3,867 | 16,541 | 4,744 | (1,830) | 24,484 |
| Transfers | - | - | - | - | - | - |
| Disposals / Retirements | (104) | - | (9,068) | (2,414) | - | (11,586) |
| Balance at Dec 31, 2011 | $ 24,315 | $ 16,379 | $ 302,010 | $ 36,637 | $ 7,206 | $ 386,547 |

Accumulated depreciation:

| | Land and Buildings | Distribution Substation Equipment | Other Distribution Equipment | Other Fixed Assets | Construction in Progress | Total |
|---|---|---|---|---|---|---|
| Balance at January 1, 2010 | $ 9,892 | $ 5,427 | $ 137,194 | $ 16,082 | $ - | $ 168,595 |
| Depreciation | 602 | 326 | 11,464 | 3,920 | - | 16,312 |
| Disposals / Retirements | (368) | - | (7,084) | (3,076) | - | (10,528) |
| Balance at December 31, 2010 | $ 10,126 | $ 5,753 | $ 141,574 | $ 16,926 | $ - | $ 174,379 |
| Balance at January 1, 2011 | $ 10,126 | $ 5,753 | $ 141,574 | $ 16,926 | $ - | $ 174,379 |
| Depreciation | 649 | 380 | 11,734 | 4,533 | - | 17,296 |
| Disposals / Retirements | (104) | - | (8,206) | (2,414) | - | (10,724) |
| Balance at Dec 31, 2011 | $ 10,671 | $ 6,133 | $ 145,102 | $ 19,045 | $ - | $ 180,951 |

Net book value:

| Balance at | Land and Buildings | Distribution Substation Equipment | Other Distribution Equipment | Other Fixed Assets | Construction in Progress | Total |
|---|---|---|---|---|---|---|
| December 31, 2010 | $ 13,131 | $ 6,759 | $ 152,963 | $ 17,381 | $ 9,036 | $ 199,270 |
| December 31, 2011 | $ 13,644 | $ 10,246 | $ 156,908 | $ 17,592 | $ 7,206 | $ 205,596 |

*(tabular amounts in thousands of dollars)*

## 9. Letters of Credit

At December 31, 2011, the Company had provided $6.6 million (2010 – $6.6 million) in bank standby letters of credit to the Independent Electricity System Operator.

## 10. Customer and Other Deposits

Customer and other deposits include security deposits for energy consumption bearing interest at a rate of prime less 2% per annum and developer deposits held in accordance with regulation.

Deposits from electricity distribution customers are refundable to customers demonstrating an acceptable level of credit risk as determined by the Company in accordance with policies set out by the OEB or upon termination of their electricity distribution service.

Construction deposits represent cash prepayments for the estimated cost of capital projects recoverable from customers and developers. Upon completion of the capital project, and dependent upon the final determination of the required capital contribution, these deposits are either refunded to the developer or transferred to contributions in aid of construction.

Customer deposits are comprised of:

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Customer deposits | $ | 7,120 | $ | 6,773 |
| Construction deposits | | 8,080 | | 6,105 |
| | | 15,200 | | 12,878 |
| Less: Current Portion | | 1,059 | | 1,108 |
| | $ | 14,141 | $ | 11,770 |

*(tabular amounts in thousands of dollars)*

**11. Related Party Balances and Transactions**

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Non-interest bearing trade balance due to shareholder, without stated repayment terms | $ | 6,548 | $ | 6,987 |
| Unsecured promissiory note, due to related party, bearing interest at 6% per annum, payable on demand with 367 days notice, maturing October 31, 2015 | | 70,000 | | 70,000 |
| | | 76,548 | | 76,987 |
| Less: Current portion | | 6,548 | | 6,987 |
| | $ | 70,000 | $ | 70,000 |

Included in the accounts receivable is $1.1 million (2010 - $0.6 million) of energy, water, and sundry receivables due from the Corporation of the City of London.

During the year and within the course of normal operations, the Company provided services to the City of London on an estimated cost recovery basis at an amount of $3.4 million (2010 - $3.2 million), and paid interest to a related party in the amount of $4.2 million (2010 - $4.2 million).

During the year the Company billed customers for water service on behalf of the shareholder and remitted funds to the shareholder in the amount of $117.6 million (2010 - $119.3 million).

**12. Short-term Credit Facilities**

The Company has an uncommitted operating revolving line of credit facility of $25.0 million with the Toronto Dominion Bank. As at December 31, 2011, the amount drawn by the Company under this line of credit was $ nil (2010 - $nil). The line of credit is unsecured and interest is at bank prime rate on prime based borrowings, or at Bankers Acceptances (B/A) rates plus a 1.0% stamping fee on B/A based borrowings.

*(tabular amounts in thousands of dollars)*

**13. Long-term Debt**

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Revolving extendable loans bearing interest at prime, payable interest only, due February 18, 2013 | $ | - | $ | 3,000 |
| Non-revolving term instalment loan bearing interest at the 4 year Banker's Acceptance rate of 2.73% plus a stamping fee of 0.9% payable in monthly instalments of $192,000 principal plus interest due on March 31, 2014 | | 17,650 | | 19,954 |
| | | 17,650 | | 22,954 |
| Less: Current portion | | 2,304 | | 2,304 |
| | $ | 15,346 | $ | 20,650 |

The Company has a committed 364 day extendable operating revolving loan facility of $10.0 million with the Toronto Dominion Bank. Under the terms of this agreement, the lender has extended the maturity date of this loan to February 18, 2013. The company has a one year period from the loan maturity date to repay any outstanding balances in the event the lender elects not to extend the loan for an additional 364 day period. As at December 31, 2011, the amount drawn by the Company under this loan facility was $nil (2010 - $3.0 million). Interest is at bank prime rate on prime based borrowings, or at Bankers Acceptances ("B/A") rates plus a 1.0% stamping on B/A based borrowings.

In addition to the long-term loan facility with the Toronto Dominion Bank, the Company has entered into an interest rate swap agreement with the Royal Bank of Canada for an unsecured loan of $20.5 million to fund its Smart Meter capital expenditure program. Principal repayments on this loan commenced in October 2010 and are being amortized over a 10 year period ending March 31, 2020. The swap agreement is a fixed rate swap maturing on March 31, 2014, which effectively converts variable interest rates on unsecured Bankers Acceptances to an effective interest rate of 2.73% plus a stamping fee of 0.9% for an all-in rate of 3.63%.

The swap agreement entered into with Royal Bank of Canada does not meet the standard to apply hedge accounting. Accordingly, the interest rate swap contract is marked to market at year end with the unrealized gain or loss recorded in the income statement. The unrealized loss recorded in 2011 was $0.2 million (2010 - $0.4 million).

Additionally, and as described in Note 11 to these financial statements, the Company has issued a promissory note to the Public Utility Commission of the City of London in the amount of $70.0 million bearing interest at 6% per annum. Interest is paid at the end of each quarter. The note is unsecured and payable on demand with 367 days notice, and matures on October 31, 2015.

*(tabular amounts in thousands of dollars)*

## 14. Share Capital

Authorized:

An unlimited number of common shares

An unlimited number of non-voting, non-cumulative preference shares, redeemable at the paid-up amount

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Issued: | | | | |
| 1,001 common shares | $ | 96,116 | $ | 96,116 |

## 15. Change in Non-Cash Working Capital Related to Operations

The net change in non-cash working capital related to operations is comprised of:

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Receivables | $ | (5,349) | $ | (13) |
| Inventories | | 49 | | (154) |
| Prepaid expenses | | 643 | | (407) |
| Accounts payable and accrued liabilities | | (3,188) | | 625 |
| Due to shareholder | | (439) | | (150) |
| | $ | (8,284) | $ | (99) |

## 16. Interest and Other Revenue

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Interest (Note 17) | $ | 392 | $ | 221 |
| Late payment charges | | 1,073 | | 1,198 |
| Sundry | | 1,650 | | 1,695 |
| Customer billing service fees | | 632 | | 657 |
| Pole and other rental income | | 379 | | 380 |
| Scrap and other income | | 311 | | 171 |
| Ontario Power Authority incentives | | 39 | | 356 |
| Renewable generation revenue | | 89 | | - |
| | $ | 4,565 | $ | 4,678 |

*(tabular amounts in thousands of dollars)*

**17. Interest Income and Expense**

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Interest income from: | | | | |
| Bank deposits | $ | 100 | $ | 93 |
| Regulatory assets | | 292 | | 128 |
| Interest income | | 392 | | 221 |
| Interest expense on: | | | | |
| Due to related party | | 4,200 | | 4,200 |
| Long- term debt | | 809 | | 528 |
| Short-term debt | | 57 | | 3 |
| Regulatory liabilities | | 207 | | 112 |
| Other | | 113 | | 53 |
| Interest expense | | 5,386 | | 4,896 |
| | $ | 4,994 | $ | 4,675 |

**18. Income Taxes**

a) Income tax status

As a wholly owned subsidiary company of the Corporation of the City of London, the Company is exempt from income taxes under the Income Tax Act (Canada). Pursuant to the Electricity Act (1998) (Ontario) the Company is required to make payments in lieu of tax to the Ontario Electricity Financial Corporation. The amount of payments in lieu of tax will be approximately equivalent to corporate taxes that would have to be paid if the Company was a taxable corporation under the Income Tax Act (Canada).

*(tabular amounts in thousands of dollars)*

**18. Income Taxes, continued**

b) Income tax expense

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Earnings before income taxes | $ | 9,400 | $ | 11,402 |
| Income tax expense based on combined federal and provincial statutory income tax rate of 28.25% (2010 - 31.0%) | $ | 2,656 | $ | 3,535 |
| Tax effect of temporary differences | | (1,147) | | (1,190) |
| Other items | | 18 | | 8 |
| Income tax expense recognized | $ | 1,527 | $ | 2,353 |
| Income tax expense is comprised of the following: | | | | |
| Current income tax | $ | 1,572 | $ | 2,445 |
| Future income tax | | (45) | | (92) |
| | $ | 1,527 | $ | 2,353 |

c) Future income tax balances

CICA 3465.103 recognizes that, as a rate regulated entity, future income tax assets paid on behalf of customers will be returned to customers as they are recovered. As a result, these increases or decreases in future income tax assets are offset by a regulatory liability.

The benefit of certain future income tax assets will be realized by customers by way of a reduction in future distribution rates charged by the Company. The components of future income tax assets are as follows:

Future income tax assets:

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Capital assets | $ | 1,349 | $ | 3,062 |
| Employee future benefits | | 2,676 | | 2,398 |
| Smart Meter net recoveries | | 1,328 | | 720 |
| Other regulatory liabilities | | 1,799 | | 1,984 |
| Benefit of future income taxes to be realized by customers | | 7,152 | | 8,164 |
| Loss on interest rate swap | | 137 | | 92 |
| | $ | 7,289 | $ | 8,256 |

*(tabular amounts in thousands of dollars)*

## 19. Employee Future Benefits

a) Pension plan

The Company has a pension agreement with OMERS, on behalf of its employees. The plan is a contributory defined benefit plan which specifies the amount of retirement benefit to be received by the employees based on the length of service and rates of pay. During the year, the Company contributed $1.7 million (2010 - $1.5 million).

b) Medical and life insurance benefits plan

The Company provides medical and life insurance benefit coverage to certain retirees of the Company. Based on a recent actuarial valuation, the following information has been determined:

Accrued benefit obligation:

| | | **2011** | | **2010** |
|---|---|---|---|---|
| Balance, beginning of year | $ | 11,951 | $ | 10,045 |
| Current service costs | | 346 | | 210 |
| Interest cost | | 784 | | 646 |
| Benefits paid | | (477) | | (448) |
| Actuarial loss (gain) | | (1,125) | | 1,498 |
| Balance, end of year | $ | 11,479 | $ | 11,951 |

Accrued benefit liability:

| | | **2011** | | **2010** |
|---|---|---|---|---|
| Accrued benefit obligation | $ | 11,479 | $ | 11,951 |
| Benefits paid between measurement dates of September 30 and December 31 | | - | | (110) |
| Unamortized net actuarial loss | | (839) | | (1,977) |
| Accrued benefit liability, end of year | $ | 10,640 | $ | 9,864 |

The Company's net periodic benefit cost is comprised of the following:

| | | **2011** | | **2010** |
|---|---|---|---|---|
| Current service cost | $ | 346 | $ | 210 |
| Interest cost | | 784 | | 646 |
| | $ | 1,130 | $ | 856 |

*(tabular amounts in thousands of dollars)*

## 19. Employee Future Benefits, continued

The excess of the net actuarial loss in excess of ten percent of the accrued benefit obligation is amortized over the average remaining service life of employees, which is estimated to be 13 years.

| | **2011** | **2010** |
|---|---|---|
| Discount rate | 5.0% | 5.2% |
| Initial medical cost rate | 6.7% | 6.8% |
| Ultimate medical cost rate | 4.5% | 4.6% |
| Year ultimate rate reached | 2028 | 2028 |
| Dental cost rate | 4.5% | 4.5% |

The estimated impact on fiscal 2011 reported pension amounts of a one percent increase or decrease in the health care cost assumptions is as follows:

| | **Reported** | **+1.0%** | **-1.0%** |
|---|---|---|---|
| Current service cost | 346 | 423 | 287 |
| Interest cost | 784 | 868 | 716 |
| Accrued benefit obligation | 11,479 | 12,506 | 10,645 |

## 20. Financial Instruments and Risk Management

a) Financial instruments

As a rate-regulated entity, the nature of the Company's operations are defined and restricted by regulation. Financial operations and risks are also substantially influenced by regulation, limiting the necessity to engage in risk mitigation strategies involving the use of derivatives or hedges. As further defined in Note 13 to these financial statements the Company uses derivative financial instruments, primarily interest rate swaps, to manage its interest rate exposure.

The Company has adopted CICA Handbook Sections 3855 and 3861, Financial Instruments for disclosure purposes as the Company's financial instruments are not subject to the disclosure requirements under Sections 3862 or 3863 of the CICA Handbook.

**20. Financial Instruments and Risk Management, continued**

b) Credit risk

Financial assets carry credit risk that a counter-party will fail to discharge an obligation which would result in a financial loss. Financial assets held by the Company, such as accounts receivable, expose it to credit risk. The Company primarily assesses credit risk exposure by customer segment. Concentrations of consumption by segment or individual customer, may impact risk due to varying energy consumption patterns and allowable security deposit requirements associated with each segment. The Company is not exposed to a significant concentration of credit risk within any customer segment or individual customer. No single customer accounts for revenue in excess of 10% of total revenue.

The carrying amount of accounts receivable is reduced through the use of an allowance for doubtful accounts and the amount of the related provision for doubtful accounts is recognized in the income statement. Subsequent recoveries of receivables previously provisioned are credited to the income statement. The balance of the allowance for doubtful accounts at December 31, 2011 is $2.3 million (2010 - $3.7 million). Bad debt expense was $0.8 million for the year. The Company's credit risk associated with accounts receivable is primarily related to payments from distribution customers.

Credit risk is managed through collection of security deposits from customers in accordance with directions provided by the OEB. As at December 31, 2011, the Company held security deposits in the amount of $7.1 million (2010 - $6.8 million). Additionally, if presented with substantial credit losses, the Company would make application to the regulator for recovery of those losses through distribution rate adjustments in future years.

By regulation, the Company is responsible for collecting both the distribution and energy portions of the electricity bill. On average, the Company earns 15% of amounts billed to customers with the remaining 85% being collected for other parties. The Company is therefore exposed to a credit risk substantially greater than the income that it regularly earns.

c) Liquidity risk

The Company monitors its liquidity risk to ensure access to sufficient funds to meet operational and investing requirements. The Company's objective is to ensure that sufficient liquidity is on hand to meet obligations as they fall due while minimizing interest exposure. The Company has access to a $25.0 million line of credit as well as a committed 364 day extendable operating revolving loan of $10.0 million and monitors cash balances to ensure that sufficient levels of liquidity are on hand to meet financial commitments as they come due.

The majority of accounts payable, as reported on the balance sheet, are due within 30 days.

*(tabular amounts in thousands of dollars)*

## 21. Capital Disclosures

The main objectives of the Company when managing capital are to ensure ongoing access to funding to maintain and improve the electricity distribution system, compliance with covenants related to its credit facilities, prudent management of its capital structure with regard for recoveries of financing charges permitted by the OEB on its regulated electricity distribution business, and to deliver the appropriate financial returns.

The Company's definition of capital includes shareholder's equity and long-term debt. As at December 31, 2011 capital amounts are as follows:

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Long-term debt | $ | 85,346 | $ | 90,650 |
| Shareholder's equity | | 124,055 | | 118,682 |
| | $ | 209,401 | $ | 209,332 |

The OEB regulates the amount of interest on debt and rate of return that may be earned by the Company, through its electricity distribution rates, in respect of its regulated electricity distribution business. The OEB permits such recoveries on the basis of a deemed capital structure represented by 60% debt and 40% equity. The actual capital structure for the Company may differ from the OEB deemed structure.

The Company has customary covenants typically associated with long-term debt. The Company is in compliance with all credit agreement covenants and limitations associated with its long-term debt.

## 22. Emerging Accounting Changes

International Financial Reporting Standards ("IFRS")

The Canadian Accounting Standards Board ("AcSB") has adopted a strategic plan that will have Canadian GAAP converge with IFRS, effective January 1, 2011 which will require entities to restate, for comparative purposes, their interim and annual financial statements and their opening financial position.

In October 2010, the AcSB approved the incorporation of IFRS 1 into Part 1 of the Canadian Institute of Chartered Accountants ("CICA") Handbook for qualifying entities with activities subject to rate regulation. Part 1 of the CICA Handbook specifies that first-time adoption is mandatory for interim and annual financial statements relating to annual periods beginning on or after January 1, 2012.

**22. Emerging Accounting Changes, continued**

The amendment also requires entities that do not prepare its interim and annual financial statements in accordance with Part 1 of the Handbook during the annual periods beginning on or after January 1, 2011 to disclose that fact.

The Corporation has elected to implement IFRS commencing on January 1, 2012.

The Corporation has completed the financial systems and related process changes that are required to transition to IFRS on January 1,2012 and is currently in the process of restating its 2011 financial results under IFRS for comparative reporting purposes during 2012 and thereafter.

The impact of the adoption to IFRS on the Corporation's financial position and results of operations is not yet fully determined.

**23. Commitment**

The Company has commitments of approximately $1.1 million to complete their new Outage Management and Geographic Information Systems.

**24. Subsequent Event**

On March 21, 2012 the Board of Directors declared a $3.0 million dividend payable to the sole shareholder, the Corporation of the City of London.

**25. Comparative Figures**

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