

NIAGARA-ON-THE-LAKE HYDRO INC.

Financial Statements

December 31, 2001

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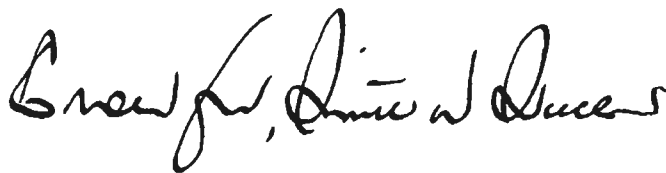
AUDITORS' REPORT

To the Board Members and Shareholder
of Niagara-on-the-Lake Hydro Inc.

We have audited the balance sheet of Niagara-on-the-Lake Hydro Inc. as at December 31, 2001 and the statements of operations, 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, 2001 and the results of its operations and its cash flows for the year then ended in accordance with the accounting principles disclosed in note 1 to the financial statements.



Niagara Falls, Ontario
April 12, 2002

CRAWFORD, SMITH AND SWALLOW
CHARTERED ACCOUNTANTS LLP

NIAGARA-ON-THE-LAKE HYDRO INC.

BALANCE SHEET

December 31, 2001

	2001	note 18 2000
Assets - note 16	\$	\$
Current Assets		
Cash and cash equivalents		138,647
Marketable securities		30,730
Accounts receivable	1,010,811	1,072,118
Unbilled revenue	772,408	1,017,169
Payments in lieu of corporate income taxes refundable	22,842	
Due from affiliated company - note 2		2,579
Inventories	196,432	326,501
Prepaid expenses	38,360	46,312
	2,040,853	2,634,056
Capital Assets		
Land	55,986	55,986
Buildings	818,675	816,925
Distribution stations	447,673	447,673
Distribution overhead lines	7,627,751	7,428,442
Distribution underground lines	7,426,266	7,136,266
Distribution transformers	4,276,002	4,259,143
Distribution meters	847,844	805,902
Equipment	1,576,328	1,504,800
Other	25,038	25,038
	23,101,563	22,480,175
Less accumulated amortization	10,034,659	9,148,281
	13,066,904	13,331,894
Other Assets		
Regulatory assets - note 4	222,844	75,765
Extraordinary event costs - note 5	91,968	85,751
Special deposits	43,313	49,021
Long-term investments- note 6	36,000	36,000
	394,125	246,537
	15,501,882	16,212,487

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.

BALANCE SHEET

December 31, 2001

		note 18
Liabilities and Shareholder's Equity	2001	2000
	\$	\$
Current Liabilities		
Bank indebtedness	196,716	
Accounts payable	1,152,902	1,176,444
Due to affiliated companies - note 2	15,302	
Note payable - note 7	70,000	238,000
Current portion of customer deposits	42,000	50,000
Other current liabilities	91,461	298,714
	1,568,381	1,763,158
Other Liabilities		
Employee future benefits - note 8	358,785	334,301
Long-term customer deposits	43,313	49,021
Accumulated vested sick leave credits	19,361	19,361
Other deposits	92,900	450,690
	514,359	853,373
Long-Term Note Payable - note 9	6,901,333	6,901,333
Contingent Liability - note 14		
Shareholder's Equity		
Share capital - note 10	2,632,307	2,632,307
Paid-up capital	4,269,026	4,269,026
Deficit	(383,524)	(206,710)
	6,517,809	6,694,623
	15,501,882	16,212,487

Signed on behalf of the Board:

_____ Director

_____ Director

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.

STATEMENT OF DEFICIT

for the year ended December 31, 2001

	2001	note 18 2000
	\$	\$
Deficit, Beginning of Year	(206,710)	
Net Loss for the Year	(176,814)	(206,710)
Deficit, End of Year	(383,524)	(206,710)

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.

STATEMENT OF OPERATIONS

for the year ended December 31, 2001

	2001 \$	note 18 2000 \$
Service Revenue		
Residential energy	5,560,436	762,073
General energy	8,349,384	1,187,824
Street lighting energy	77,353	11,435
Sentinel lights energy	11,949	2,047
Pole rentals	35,994	6,692
Unbilled revenue	(156,894)	150,659
	13,878,222	2,120,730
Cost of Power		
Power purchased	11,366,747	2,020,019
Gross Margin	2,511,475	100,711
Other Income		
Administration expense recovery	43,058	65,949
Other revenue	2,930	15,745
Interest income	34,291	4,625
Management fees	7,025	2,735
	87,304	89,054
	2,598,779	189,765
Other Expenditure		
Distribution operations	550,037	64,776
Billing and collection	368,708	26,544
General administration	527,382	165,483
Financial expense	490,936	4,072
Amortization - note 15(a)	838,530	135,600
	2,775,593	396,475
Net Loss for the Year	(176,814)	(206,710)

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.

STATEMENT OF CASH FLOWS

for the year ended December 31, 2001

	2001 \$	note 18 2000 \$
Operating Activities		
Net loss for the year	(176,814)	(206,710)
Amortization - note 15(a)	904,483	146,449
Working capital provided (used) by operations	727,669	(60,261)
Changes in non-cash working capital components - note 11 (a)	71,063	(24,265)
Funds provided (used) by operating activities	798,732	(84,526)
Investing Activities		
Transfer from Niagara-on-the-Lake Hydro- Electric Commission		325,550
Additions to capital assets - note 11(b)	(639,493)	(102,786)
Increase in regulatory assets - note 4	(147,079)	(24,892)
Increase in extraordinary event costs	(6,217)	
Decrease (increase) in special deposits	5,708	(1,424)
Funds provided (used) by investing activities	(787,081)	196,448
Other Activities		
Increase in future employee benefits	24,484	3,301
Increase (decrease) in customer deposits	(13,708)	6,424
Increase (decrease) in other deposits	(357,790)	17,000
Funds provided (used) by other activities	(347,014)	26,725
Increase (Decrease) in Cash and Cash Equivalents	(335,363)	138,647
Cash and Cash Equivalents, Beginning of Year	138,647	
Cash and Cash Equivalents, End of Year	(196,716)	138,647

See accompanying notes

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2001

Incorporation

On July 1, 2000, Niagara-on-the-Lake Hydro Inc. was incorporated under the Business Corporations Act (Ontario) along with its affiliate companies, Niagara-on-the-Lake Energy Inc. and Energy Services Niagara Inc. The incorporation was pursuant to the provisions of the Energy Competition Act, 1998.

1. Accounting Policies

These financial statements of Niagara-on-the-Lake Hydro Inc. have been prepared in accordance with accounting principles prescribed for electric distribution utilities by the Ontario Energy Board. The company is a wholly-owned subsidiary of Niagara-on-the-Lake Energy Inc.

Cash and cash equivalents

Cash equivalents are readily convertible investments with maturities of three months or less. Investments are recorded at the lower of cost and market.

Inventories

Inventory is valued at average cost with allowances for obsolete stock.

Capital assets

Capital assets are stated at cost and removed from the accounts when disposed or retired. Costs of assets which are pooled are removed from the accounts at the end of their estimated average service lives. Gains or losses at retirement or disposition of such assets are credited or charged to other income.

Amortization is provided for capital assets using the straight-line method based on the following estimated service lives:

Buildings	25 to 50 years
Distribution stations	30 years
Distribution lines	25 years
Distribution transformers and meters	25 years
Other capital assets	3 to 15 years
Intangible assets	Nil

Other assets

Expenditures made which may benefit future periods are recorded as other assets. See Regulatory Assets, note 4.

Paid-up capital

Paid-up capital reflects the balance of capital contributions received by the former Niagara-on-the-Lake Hydro-Electric Commission prior to January 1, 2000.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2001

1. Accounting Policies - continued

Revenue recognition

Service revenue is recorded as revenue in the period to which it relates. Service revenue from the sale of electrical energy includes an estimated accrual for power supplied but not billed to customers from the last meter reading date to the year end. The impact of the year end change in this estimated accrual is included in service revenue in the Statement of Operations.

Customer deposits

Customer deposits are cash collections from customers to guarantee the payment of electricity bills. Deposits expected to be refunded to customers within the next fiscal period are classified as a current liability.

Employee future benefits

The company pays certain medical, dental and life insurance benefits on behalf of its retired employees. The company recognizes these post-retirement costs in the period in which the employees rendered the services. See note 8.

Capitalized interest

The company capitalizes an amount of interest which represents an allowance for the use of funds expended during the construction period of capital assets. Interest is also capitalized on all funds expended and deferred as regulatory assets. See note 15(b).

Payments in lieu of corporate income taxes and capital taxes

Under the Electricity Act, 1998, the company is required to make payments in lieu of corporate taxes to Ontario Electricity Financial Corporation (OEFEC), commencing October 1, 2001. These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) as modified by the Electricity Act, 1998, and related regulations.

The company provides for payments in lieu of corporate income taxes using the taxes payable method. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the Ontario Energy Board and recovered from the customers of Niagara-on-the-Lake Hydro Inc.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2001

2. Due To (From) Affiliated Companies

	2001	note 18 2000
	\$	\$
Niagara-on-the-Lake Energy Inc.	(3,585)	
Energy Services Niagara Inc.	18,887	(2,579)
	15,302	(2,579)

Balances are non-interest bearing with no fixed terms of repayment.

3. Related Party Transactions

During the period, Niagara-on-the-Lake Hydro Inc. provided operation and administration services to its affiliates in the normal course of business in the following amounts:

	2001	note 18 2000
	\$	\$
Niagara-on-the-Lake Energy Inc.	85	
Energy Services Niagara Inc.	35,018	4,323
	35,103	4,323

The company has recorded a management fee due from Energy Services Niagara Inc. in the amount of \$ 6,685.

As at December 31, 2001, Niagara-on-the-Lake Hydro Inc. has an accounts receivable due from the Town of Niagara-on-the-Lake (The "Town") in the amount of \$ 2,000 (\$ 65,949 - 2000). The Town is the sole shareholder of Niagara-on-the-Lake Energy Inc. who in turn, is the sole shareholder of Niagara-on-the-Lake Hydro Inc.

In the ordinary course of business, the company enters into transactions with the Town including its boards and agencies. The company derives revenues from the sale of electricity and recovers costs of supplying electrical equipment and distribution system from these related parties. Purchases from related parties take place at fair market value. Account balances resulting from these transactions which are included in the balance sheet are settled in accordance with normal trade terms.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2001

4. Regulatory Assets

The Ontario Energy Board (the "Board") has established in its Electricity Distribution Handbook four criteria, which if met, authorizes a distribution utility to defer certain costs. A portion of these costs have been incurred for the implementation of the planned competitive electricity market in Ontario and are termed "Qualifying Transition Costs". The Board has authorized another grouping of costs, "Settlement Variances", to track the differences between certain costs incurred and the amounts recovered through the utility's rate orders. All such costs will be deferred until the Board requests submissions on how the utility plans to recover these costs from electricity distribution ratepayers. The recovery of these costs will be subject to the review and approval of the Board.

Upon review of the company's submission, the Board may conclude that certain costs are not eligible for recovery from distribution utility ratepayers. The Board may then prescribe the accounting treatment of any costs deemed to be ineligible. Failing this, any ineligible costs related to capital expenditures would be transferred to capital assets and be amortized in accordance with the appropriate rate for the capital asset class. Any ineligible costs of an operational nature would be recorded as an expense on the statement of operations in the year they become ineligible.

As at December 31, 2001, the company has accumulated \$ 222,844 (\$ 75,765 - 2000) in regulatory assets on the balance sheet as other assets. It is management's belief that these assets are consistent with the Board's deferral criteria.

	2001	note 18 2000
	\$	\$
Qualifying Transition Costs		
Billing activities	133,970	44,520
Wholesale market requirement	70,563	
Regulatory/customer requirements	38,132	31,245
Payments in lieu of corporate income taxes	10,250	
	252,915	75,765
Settlement Variances	(30,071)	
	222,844	75,765

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2001

5. Extraordinary Event Costs

In May, 2000, the certain properties within the municipal boundaries of the Town of Niagara-on-the-Lake were subject to a type of storm known as a "downburst". The damage throughout the Town was extensive and therefore required resources of the company previously unbudgeted. The Ontario Energy Board (the "Board") has established in its Electricity Distribution Handbook criteria, which if met, authorizes a distribution utility to defer certain costs incurred which relate to an extraordinary event. Such costs will be deferred until the Board requests submissions on how the utility plans to recover these costs from electricity distribution ratepayers. The recovery of these costs will be subject to the review and approval of the Board.

6. Long-Term Investments

The company has committed \$ 36,000 to a partnership known as the ENERconnect Limited Partnership as a limited partner. This partnership will carry on the business of procuring power on behalf of, and providing services relating to power procurement to limited partners and other third parties who are not.

7. Note Payable

The company has a short-term note payable with the Energy Services Niagara Inc. Principal payments of \$ 10,000 and interest at 7.25% are due monthly until July, 2002. Interest paid for the period amounted to \$ 5,105.

8. Employee Future Benefits

Defined Benefit Plan Information

	2001	2000
	\$	\$
Employee benefit plan assets		
Employee benefit plan liabilities	358,785	334,301
Employee benefit plan deficit	358,785	334,301

	2001	2000
	\$	\$
Accrued benefit obligation, beginning of year	334,301	331,000
Expense for the year	33,924	4,384
Benefits paid during the year	(9,440)	(1,083)
Accrued benefit obligation, end of year	358,785	334,301

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2001

8. Employee Future Benefits - continued

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

General Inflation - Future general inflation levels, as measured by changes in the Consumer Price Index (CPI), were assumed at 3.5% in 2000 and thereafter.

Interest (Discount) Rate - The present value of future liabilities and the expense were determined using a discount rate of 6.0%. This corresponds to the assumed CPI rate plus an assumed real rate of return of 2.5%.

Salary Levels - Future general salary and wage levels were assumed to increase at 2.0% per annum.

Medical Costs - Medical costs were assumed to increase at the CPI rate plus a further increase of 11.5% in 2000 graded down to 6.5% in 2009 and thereafter.

Dental Costs - Dental costs were assumed to increase at the CPI rate plus a further increase of 3.5% in 2000 and graded down to the CPI rate in 2009 and thereafter.

9. Long-Term Note Payable

On November 1, 2000, Niagara-on-the-Lake Hydro Inc. incurred a long-term note payable to the Town of Niagara-on-the-Lake in the amount of \$ 6,901,333. Pursuant to the transfer by-law, the long-term note payable was issued as a non-interest bearing instrument pending the establishment of permanent terms. There is no intent to redeem the long-term note payable.

Effective March 1, 2001, interest is payable at 7.25% and payments during the year amounted to \$ 458,651.

10. Share Capital

Authorized

Unlimited number of common shares

	2001	note 18 2000
	\$	\$
Issued		
1,001 common shares	2,632,307	2,632,307

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2001

11. Statement of Cash Flows

(a) Changes in working capital components include:

	2001	note 18 2000
	\$	\$
Marketable securities	30,730	(183)
Accounts receivable	61,307	(178,955)
Unbilled revenue	244,761	(150,659)
Payments in lieu of corporate income taxes refundable	(22,842)	
Inventories	130,069	(63,048)
Prepaid expenses	7,952	(10,275)
Accounts payable	(23,542)	272,037
Due to affiliated companies	17,881	(2,579)
Note payable	(168,000)	
Other current liabilities	(207,253)	109,397
	71,063	(24,265)

(b) Acquisition of capital assets

During the period, capital assets were acquired in the amount of \$ 1,370,820. Capital contributions received from third parties amounted to \$ 731,327. Cash payments of \$ 639,493 were made to purchase capital assets.

(c) Interest and payments in lieu of corporate income taxes

	2001	note 18 2000
	\$	\$
Interest received	19,816	5,762
Interest paid	480,945	
Payments in lieu of corporate income taxes paid	33,092	

12. Pension Agreement

The company makes contributions to the Ontario Municipal Employees Retirement Systems (OMERS), which is a multi-employer plan, on behalf of approximately 13 members of its staff. The plan is a defined benefit plan which specifies the amount of the retirement benefit to be received by the employees based on the length of service and rates of pay.

As a result of OMERS waiving pension funding requirements, the amount contributed to OMERS for the year ending December 31, 2001 was nil for current service.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2001

13. General Liability Insurance

The company is a member of the Municipal Electric Association Reciprocal Insurance Exchange (MEARIE) which is a pooling of general liability insurance risks. Members of MEARIE would be assessed, on a pro-rata basis, based on the total of their respective deposit premiums should losses be experienced by MEARIE, in excess of reserves and supplementary insurance, for the years in which the company or the former Niagara-on-the-Lake Hydro-Electric Commission was a member. To December 31, 2001, the company has not been made aware of any additional assessments. Participation in MEARIE covers a three year underwriting period which expires January 1, 2004.

14. Contingent Liability

Class Action

A class action claiming \$ 500 million in restitutionary payments plus interest was served on the former Toronto Hydro-Electric Commission 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 based on the premise that late payment penalties result in the municipal electric utilities receiving interest at effective rates in excess of 60% per year, which is illegal under section 347(1)(b) of the Criminal Code.

The Municipal Electric Association is undertaking the defence of this class action. At this time, it is not possible to quantify the effect, if any, on the financial statements of the company.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2001

15. Other Information

(a) Amortization

	2001	note 18 2000
	\$	\$
Amortization of capital assets charged to operations	838,530	135,600
Amortization of capital assets charged to operating assets	65,953	10,849
	904,483	146,449

(b) Capitalized Interest

	2001	note 18 2000
	\$	\$
Capitalized interest	15,280	

16. Financial Instruments

Credit Risk

The company in the normal course of business monitors the financial condition of its customers and reviews the credit history of new customers. The company is currently holding customer deposits on hand in the amount of \$ 85,313 (\$ 99,021 - 2000) and is reflected on the balance sheet. Allowances are also maintained for potential credit losses. Management believes that it has adequately provided for any exposure to normal customer credit risk.

Operating Line of Credit

As at December 31, 2001, the company had a line of credit of \$ 2,250,000 of which \$ 56,931 had been drawn down. The line of credit is revolving operating and term facilities that bear interest at prime rate minus 0.25% and are secured by all assets of the company. There are unlimited guarantees provided by Niagara-on-the-Lake Energy Inc. and Energy Services Niagara Inc. The company is to maintain a current ratio not less than 1.2:1.

NIAGARA-ON-THE-LAKE HYDRO INC.

NOTES TO FINANCIAL STATEMENTS

for the year ended December 31, 2001

17. Payments in Lieu of Corporate Income Taxes

Future income taxes relating to this regulated business have not been recorded in the accounts as they are expected to be recovered through future revenues. As at December 31, 2001, future income tax assets of \$ 1,389,319, based on substantively enacted income tax rates, have not been recorded. The company was not subject to payments in lieu of corporate income taxes prior to October 1, 2001.

Temporary differences and carryforwards which give rise to future income tax assets and liabilities are as follows:

	2001	2000
	\$	\$
Future income tax assets		
Capital assets	1,252,883	
Employee future benefits	108,066	
Tax loss carryforwards	28,370	
	1,389,319	

As at December 31, 2001, the company is liable for payments in lieu of corporate income taxes in the amount of \$ 10,250. This balance is currently reflected under Regulatory Assets since it will be recovered with future rates. See note 4.

An independent valuation was completed effective October 1, 2001 in order to determine the fair market value of the company for the purpose of calculating payments in lieu of corporate income taxes under s. 93 of the Electricity Act. The valuation resulted in a fair market value of approximately \$ 17,219,000 of tangible capital assets, an increase of approximately \$ 4,116,022 over net book value as at October 1, 2001. This valuation was performed for the purposes of calculating payments in lieu of corporate income taxes only and has not been reflected as an adjustment to net book value for accounting purposes.

At December 31, 2001 the company had a net operating loss carryforward of \$ 73,457 which expire in 2008.

18. Comparative Figures

The comparative figures are for the two months ended December 31, 2000.