

**PETERBOROUGH DISTRIBUTION INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AT DECEMBER 31, 2002**

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**TABLE OF CONTENTS**

	<b><u>Page Number</u></b>
<b>AUDITORS' REPORT</b>	1
<b>CONSOLIDATED FINANCIAL STATEMENTS</b>	
Balance Sheet	2
Statement Of Retained Earnings	3
Statement Of Income	4
Statement Of Cash Flows	5
Notes To The Financial Statements	6 to 12

## **AUDITORS' REPORT**

### **TO THE BOARD OF DIRECTORS OF PETERBOROUGH DISTRIBUTION INC.**

We have audited the consolidated balance sheet of the Peterborough Distribution Inc. as at December 31, 2002 and the consolidated statements of retained earnings, income 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Peterborough, Ontario  
March 17, 2003

*Collins Barrow*  
Chartered Accountants

# PETERBOROUGH DISTRIBUTION INC.

## CONSOLIDATED BALANCE SHEET At December 31, 2002

	2002 \$	2001 \$
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash	900	900
Due from Peterborough Utilities Services Inc. - Note 2	-	2,172,394
Accounts receivable	4,038,966	2,871,886
Unbilled revenue on customer accounts	7,762,865	4,390,018
Inventory	890,258	822,817
Income taxes recoverable	-	34,000
	12,692,989	10,292,015
<b>CAPITAL - Note 3</b>	41,031,041	41,289,080
<b>REGULATORY ASSETS - Note 4</b>	1,019,755	688,610
	<b>54,743,785</b>	<b>52,269,705</b>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued charges	7,186,497	6,476,746
Due to Peterborough Utilities Services Inc. - Note 2	830,082	-
Income taxes payable	306,300	-
Customer deposits refundable within one year - Note 5	248,706	273,342
	8,571,585	6,750,088
<b>LONG TERM LIABILITIES - Note 5</b>	23,676,524	23,453,303
<b>SHAREHOLDER'S EQUITY</b>		
Stated capital - Note 6	21,657,680	21,657,680
Retained earnings	837,996	408,634
	22,495,676	22,066,314
	<b>54,743,785</b>	<b>52,269,705</b>

Approved By The Board,

\_\_\_\_\_, Director

\_\_\_\_\_, Director

The accompanying notes are an integral part of this financial statement.

# PETERBOROUGH DISTRIBUTION INC.

## CONSOLIDATED STATEMENT OF RETAINED EARNINGS (DEFICIT) For The Year Ended December 31, 2002

	2002 \$	2001 \$
<b>BALANCE</b> , beginning of year	408,634	(169,853)
Net income for the year	429,362	578,487
<b>BALANCE</b> , end of year	<b>837,996</b>	<b>408,634</b>

The accompanying notes are an integral part of this financial statement.

# PETERBOROUGH DISTRIBUTION INC.

## CONSOLIDATED STATEMENT OF INCOME For The Year Ended December 31, 2002

	2002 \$	2001 \$
<b>REVENUE FROM SALE OF ENERGY</b>	31,139,880	58,654,216
<b>COST OF ENERGY PURCHASED</b>	19,081,154	50,309,786
<b>GROSS MARGIN</b>	12,058,726	8,344,430
<b>EXPENSES</b>		
Operations	1,548,697	1,407,642
Administration	4,097,908	3,643,192
Amortization	2,377,169	2,254,889
	8,023,774	7,305,723
	4,034,952	1,038,707
<b>OTHER INCOME (EXPENSE)</b>		
Other income	519,051	792,960
Interest income	292,008	119,656
Interest expense	(1,699,456)	(1,351,836)
Other expense - Note 7	(2,257,790)	-
	(3,146,187)	(439,220)
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>	888,765	599,487
<b>PROVISION FOR INCOME TAXES - Note 1</b>	459,403	21,000
<b>NET INCOME FOR THE YEAR</b>	<b>429,362</b>	<b>578,487</b>

The accompanying notes are an integral part of this financial statement.

**PETERBOROUGH DISTRIBUTION INC.****CONSOLIDATED STATEMENT OF CASH FLOWS**  
**For The Year Ended December 31, 2002**

	2002 \$	2001 \$
<b>CASH PROVIDED (USED IN)</b>		
<b>OPERATING ACTIVITIES</b>		
Net income for the year	429,362	578,487
Add: charges in operations not requiring a current cash payment		
Amortization	2,377,169	2,254,889
	2,806,531	2,833,376
Increase in customer deposits	198,585	53,764
Net change in non-cash working capital balances related to operations (as summarized below)	(554,841)	87,947
	2,450,275	2,975,087
<b>INVESTING ACTIVITY</b>		
Net additions to capital assets	(2,119,130)	(4,033,821)
Regulatory assets	(331,145)	(440,366)
	(2,450,275)	(4,474,187)
<b>FINANCING ACTIVITIES</b>		
Issuance of note payable	-	1,500,000
<b>NET INCREASE IN CASH DURING THE YEAR</b>	-	900
<b>CASH POSITION - BEGINNING OF YEAR</b>	900	-
<b>CASH POSITION - END OF YEAR</b>	<b>900</b>	<b>900</b>
Net change in non-cash working capital balances related to operations		
Due from Peterborough Utilities Services Inc.	3,002,476	1,520,593
Accounts receivable	(1,167,080)	(1,445,801)
Unbilled revenue	(3,372,847)	(778,159)
Inventories	(67,441)	(3,951)
Deposits paid	-	257,500
Income taxes payable (recoverable)	340,300	(34,000)
Accounts payable and accrued charges	709,751	571,765
	<b>(554,841)</b>	<b>87,947</b>
<b>OTHER CASH FLOW INFORMATION</b>		
Interest paid	1,699,456	1,351,836
Income tax paid	153,991	34,000

The accompanying notes are an integral part of this financial statement.

# **PETERBOROUGH DISTRIBUTION INC.**

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2002**

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### **NATURE OF ORGANIZATION**

Peterborough Distribution Inc. is a regulated electricity distribution company. The Company was formed in 1999 in response to various reorganizational requirements under the provincial government's Electricity Competition Act (Bill 35). The affiliated companies of Peterborough Distribution Inc. are:

The Peterborough Call Centre Inc.,  
Peterborough Utilities Services Inc.,  
Peterborough Utilities Inc., and  
Campbellford/Seymour Electric Generation Inc.

All of the above companies and Peterborough Distribution Inc. are wholly owned by the City of Peterborough Holdings Inc. which, in turn, is wholly owned by the Corporation of the City of Peterborough.

### **1. SIGNIFICANT ACCOUNTING POLICIES**

#### **a) Principles of Consolidation**

The consolidated financial statements include the accounts of Peterborough Distribution Inc. and its wholly owned subsidiaries Asphodel-Norwood Distribution Inc. and Lakefield Distribution Inc. All inter-company accounts and transactions have been eliminated.

#### **b) Basis of Presentation**

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada for rate-regulated entities.

#### **Regulation**

Ontario's wholesale and retail electricity markets became open to competition on May 1, 2002 (Open-market). On December 9, 2002, the Province enacted the Electricity Pricing, Conservation and Supply Act, 2002 (Bill 210), which amended the Electricity Act, 1998 and other statutes for the purpose of implementing the Electricity Action Plan announced by the Premier of Ontario on November 11, 2002.

Prior to the Open-market, rates for the transmission and distribution of electricity were set by the Ontario Energy Board (OEB). In its capacity to approve or set rates, the OEB has the authority to specify regulatory treatments that differ from Canadian generally accepted accounting principles (GAAP) for enterprises operating in a non-regulated environment.

With the Open-market, the Company purchases power from the Independent Electricity Market Operator (IMO) administered spot market, and charges distribution customers unbundled rates, including the OEB-approved distribution rates. These distribution rates were essentially the same as the distribution rates that were incorporated into bundled rates before the Open-market. Bill 210 was enacted for the purpose of implementing the Electricity Action Plan announced by the Premier of Ontario on November 11, 2002.

The following regulatory treatments have resulted in accounting treatments differing from Canadian GAAP from enterprises operating in a non-rate-regulated environment. Market ready costs and retail settlement variance amounts have been deferred in accordance with the criteria set out in the OEB's Electricity Distribution Rate Handbook, The Accounting Procedures Handbook and in subsequent OEB guidelines. In the absence of such regulation, these costs would have been expensed when incurred under Canadian GAAP. The company provides for payments in lieu of corporate income taxes relating to its regulated business using the taxes payable method as directed by the OEB.



# PETERBOROUGH DISTRIBUTION INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2002

.....2

### 1. SIGNIFICANT ACCOUNTING POLICIES - (Continued)

#### Regulatory Assets

Regulatory assets represent costs that have been deferred because it is probable that they will be recovered in future rates. Bill 210 provides for the establishment or continuation of deferral accounts for certain amounts until disposition is addressed by the OEB. Regulatory assets recognized at December 31, 2002 are disclosed in Note 4. In recognition of the uncertainty related to these assets, the Company has not reflected Pre-market opening energy variance in the amount of \$1,369,813, in the results of operations or balance sheet for external financial reporting purposes. In addition, an amount of \$1,429,969 has been provided as an allowance against the deferred transition costs during the year. The Company intends to recover these items and all other regulatory assets through future rate applications.

The Company continually assesses the likelihood of recovery of regulatory assets. If recovery through future rates was no longer considered probable, the amounts would be charged to the results of operations in the period that the assessment was made.

#### c) Other Accounting Policies

##### Revenue Recognition

Revenue is recorded using the accrual basis of accounting, as energy is consumed by customers. Unbilled revenue at the balance sheet date is for the estimated power supplied but not billed to customers between the date the meters were last read and the end of the year.

##### Use of Estimates

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 as well as the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the year. Actual results could differ from these estimates.

##### Inventory

Inventories consist of distribution system maintenance and construction materials and are valued at the lower of moving average cost and replacement cost.

# PETERBOROUGH DISTRIBUTION INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2002

.....3

### 1. SIGNIFICANT ACCOUNTING POLICIES - (Continued)

#### Capital Assets

Capital assets are recorded at cost and include labour, materials, engineering and contracted services.

The cost and related accumulated amortization for identifiable capital assets, such as substations, remain in the accounts until the assets are retired or disposed of at which time any gain or loss is reflected in operations. Capital assets which are recorded on a group basis, such as meters, are removed from the accounts only at the end of their estimated service lives.

In circumstances where external customers are required to make specific contributions to fund the construction and installation of specific fixed assets, the Company nets the customer contributions against the acquisition cost. Customer contributions in aid of construction received by the Company were \$555,285 (2001 - \$821,075).

Amortization is provided annually on a basis designed to amortize the assets over their estimated useful lives as follows:

Substations	25 - 40 years straight-line
Overhead lines	20 - 25 years straight-line
Underground lines	20 - 25 years straight-line
Transformers	17 - 25 years straight-line
Meters	17 - 25 years straight-line
Plant equipment	4 - 5 years straight-line
Water heater controllers	10 years straight-line

#### Customer Deposits

Customers may be required to post security to obtain electricity or other services. Where the security posted is in the form of cash or cash equivalents, these amounts are recorded in the accounts as customer deposits. Interest is paid on customer balances at rates established from time to time by the Company.

#### Risk Management

The estimated fair value of the company's financial assets and liabilities approximates carrying value. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks. See note 5 for information pertaining to long term liabilities.

# PETERBOROUGH DISTRIBUTION INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2002

.....4

### 1. SIGNIFICANT ACCOUNTING POLICIES - (Continued)

#### Corporate Income Taxes

Under the Electricity Act, 1998, the Company is required to make payments in lieu of corporate taxes to Ontario Electricity Financial Corporation (OEFC). 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 relating to its regulated businesses using the taxes payable method as directed by the OEB. 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 OEB and recovered from the customers at that time.

### 2. RELATED PARTY TRANSACTIONS

Included in these financial statements are transactions between related parties. The Company provides electricity and services to the principle shareholder of its parent company, the City of Peterborough. Electrical energy is sold to the City at the same prices and terms as other electricity customers. During the year, the Company also engaged in transactions in the normal course of operations with affiliate companies. Professional services were provided to Peterborough Utilities Services Inc. for an amount of \$104,569. Energy purchases in the amount of \$1,424,979 were provided by Peterborough Utilities Inc. Building rent, software and equipment rental, professional services and other charges were paid to Peterborough Utilities Services Inc. A summary of these charges is as follows:

Administrative services	\$2,765,414
Capital expenditures	1,065,750
Operating costs	1,069,873
Building rent	440,584
Software and equipment rental	554,467

In addition, Peterborough Utilities Services Inc. maintains a bank account on behalf of the related group. Amounts due to each company are maintained in the accounting records. Interest is accrued as earned. The amount due to Peterborough Utilities Services Inc. at December 31, 2002 consisted of an operating loan of \$830,082 (2001 - \$2,172,394 receivable).

# PETERBOROUGH DISTRIBUTION INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2002

.....5

### 3. CAPITAL ASSETS

	Cost \$	Accumulated Amortization \$	Net Book Value	
			2002 \$	2001 \$
Land	134,522	-	134,522	134,522
Buildings	207,629	9,163	198,466	203,657
Substations	1,419,130	157,446	1,261,684	1,316,821
Overhead lines	17,013,977	2,217,676	14,796,301	14,754,130
Underground lines	14,649,453	2,073,514	12,575,939	13,021,403
Transformers	9,597,703	1,597,705	7,999,998	8,190,416
Meters	2,351,970	389,683	1,962,287	1,996,845
Other	1,492,333	444,655	1,047,678	1,210,852
Construction in progress	1,054,166	-	1,054,166	460,434
	47,920,883	6,889,842	41,031,041	41,289,080

### 4. REGULATORY ASSETS

Regulatory assets arise as a result of the rate-setting process. As described in Note 1, the Company has recorded the following regulatory assets.

	2002 \$	2001 \$
Retail settlement variance accounts	803,254	-
Deferred transition costs	212,766	688,610
Other	3,735	-
	1,019,755	688,610

## PETERBOROUGH DISTRIBUTION INC.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2002

..... 6

#### 5. LONG TERM LIABILITIES

	2002 \$	2001 \$
Demand loan from City of Peterborough Holdings Inc. bearing interest at 6.175% (2000 - 6%)	21,657,680	21,657,680
Demand loan from the Corporation of the City of Peterborough bearing interest at bank prime less 1¼%	1,500,000	1,500,000
Customer deposits	767,550	568,965
	23,925,230	23,726,645
Less: customer deposits due within one year	248,706	273,342
	23,676,524	23,453,303

Interest expense on the demand loans for the year ended December 31, 2002 was \$1,570,182 (2001 - \$1,350,180). There are no specific terms for repayment of the demand loans.

#### 6. STATED CAPITAL

##### Authorized

- unlimited number of common shares
- unlimited number of preferred shares

##### Issued

- 1000 common shares for consideration of \$21,657,680

#### 7. OTHER OPERATING EXPENSE

Other operating expenses consist of an allowance for specific transition costs and variance accounts for which there is uncertainty related to their recovery from future rate submissions. These costs, if recovered will be recorded in the period in which they are received.

## PETERBOROUGH DISTRIBUTION INC.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2002

.....7

#### 8. FUTURE INCOME TAXES

During the year, the Company and its subsidiary, Lakefield Distribution Inc., utilized \$401,000 of loss carryforwards to reduce income for tax purposes. Asphodel-Norwood Distribution Inc., a subsidiary, has available \$12,915 (2001 - \$6,600) of losses for income tax purposes that can be used to reduce taxable income of future years. The future benefit of these losses has not been recognized in the financial statements. If not used to reduce taxable income, these losses will expire in 2008 and 2009.

The Company has a future income tax asset of \$349,915. This asset is determined by calculating the temporary differences arising from the difference between the tax basis of an asset and its carrying amount on the balance sheet. Future income tax assets are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to be recovered or settled. This asset has not been recognized in these financial statements.

#### 9. CONTINGENCIES

(a) The Company participates with other municipal utilities in Ontario in an agreement to exchange reciprocal contracts of indemnity through the Municipal Electric Association Reciprocal Insurance Exchange. Under this agreement, the Company is contingently liable for additional assessments to the extent that premiums collected are not sufficient to cover actual losses, claims and costs experienced.

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

The claim is that late payment penalties result in the municipal electrical 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 defense of this class action. At this time it is not possible to quantify the effect, if any, on these financial statements.

(c) As a condition of the restructuring of the Peterborough Utilities Commission in 2000, the Corporation of the City of Peterborough advanced funds to the parent of the Company, Peterborough Holdings Inc. All of the Company's assets have been pledged as security provided for the borrowing. The Company has also provided an unlimited guarantee related to the indebtedness of the City of Peterborough Holdings Inc., its subsidiaries and affiliate companies.

During the year, the company and its subsidiaries secured an operating line in the amount of approximately \$9 million which consists of an operating line up to \$2 million and \$7 million letters of guarantee issued to the Independent Electricity Market Operator. As security, the company and its subsidiaries have provided a general security agreement over the assets of the company and its subsidiaries. As a condition of the financing arrangement, the shareholder has provided a subordination agreement to the bank which postpones and subordinates its Creditor Security in favour of the bank.