

**PETERBOROUGH DISTRIBUTION INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AT DECEMBER 31, 2004**

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## **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, 2004 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, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*Collins Barrow Kawarthas LLP*

Peterborough, Ontario  
February 25, 2005

Chartered Accountants

**PETERBOROUGH DISTRIBUTION INC.****CONSOLIDATED BALANCE SHEET**  
At December 31, 2004

	2004 \$	2003 \$
<b>ASSETS</b>		
<b>CURRENT</b>		
Due from Peterborough Utilities Services Inc. - Note 2	3,357,612	3,190,492
Accounts receivable	3,988,792	3,844,198
Unbilled revenue on customer accounts	1,186,500	1,224,900
Inventory	767,726	765,960
Incomes taxes receivable	12,753	-
	9,313,383	9,025,550
<b>PROPERTY, PLANT AND EQUIPMENT - Note 3</b>	42,404,811	41,541,033
<b>REGULATORY ASSETS - Note 4</b>	4,730,035	5,205,841
	<b>56,448,229</b>	<b>55,772,424</b>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued charges	7,183,515	6,935,436
Income taxes payable	-	570,829
Customer deposits refundable within one year - Note 5	272,655	259,469
	7,456,170	7,765,734
<b>LONG TERM LIABILITIES - Note 5</b>	23,745,684	23,613,650
<b>SHAREHOLDER'S EQUITY</b>		
Stated capital - Note 6	21,657,680	21,657,680
Retained earnings	3,588,695	2,735,360
	25,246,375	24,393,040
	<b>56,448,229</b>	<b>55,772,424</b>

Approved By The Board,

\_\_\_\_\_, President

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

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

**PETERBOROUGH DISTRIBUTION INC.****CONSOLIDATED STATEMENT OF RETAINED EARNINGS**  
**For The Year Ended December 31, 2004**

	2004 \$	2003 \$
<b>BALANCE</b> , beginning of year	2,735,360	837,996
Net income for the year	2,172,018	2,716,047
Dividend paid on common shares	(1,318,683)	(818,683)
<b>BALANCE</b> , end of year	<b>3,588,695</b>	<b>2,735,360</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, 2004**

	2004 \$	2003 \$
<b>REVENUE - Note 8</b>	12,922,232	13,231,779
<b>EXPENSES</b>		
Operations	4,025,474	3,609,157
Administration	1,580,957	1,560,993
Amortization	2,635,328	2,548,242
	8,241,759	7,718,392
<b>INCOME FROM OPERATIONS</b>	4,680,473	5,513,387
<b>OTHER INCOME (EXPENSE)</b>		
Other income	518,739	500,972
Interest income	543,646	502,295
Interest expense	(1,666,209)	(1,674,800)
Other expense - Note 4	(211,778)	(211,779)
	(815,602)	(883,312)
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>	3,864,871	4,630,075
<b>PROVISION FOR INCOME TAXES</b>	1,692,853	1,914,028
<b>NET INCOME FOR THE YEAR</b>	<b>2,172,018</b>	<b>2,716,047</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, 2004**

	2004 \$	2003 \$
<b>CASH PROVIDED (USED IN)</b>		
<b>OPERATING ACTIVITIES</b>		
Net income for the year	2,172,018	2,716,047
Add: charges in operations not requiring a current cash payment		
Amortization	2,635,328	2,548,242
	4,807,346	5,264,289
Increase (decrease) in customer deposits	145,220	(52,111)
Decrease in regulatory assets	475,806	1,675,773
Net change in non-cash working capital balances related to operations - Note 11	(610,583)	(3,011,934)
	4,817,789	3,876,017
<b>INVESTING ACTIVITY</b>		
Additions to property, plant and equipment	(3,499,106)	(3,069,684)
Proceeds from disposal of equipment	-	11,450
	(3,499,160)	(3,058,234)
<b>FINANCING ACTIVITIES</b>		
Dividend paid on common shares	(1,318,683)	(818,683)
<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>	-	-

**OTHER CASH FLOW INFORMATION**

Income tax paid	2,401,196	1,831,597
Interest paid	1,665,531	1,674,801

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, 2004

### 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

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada.

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 significant inter-company balances and transactions have been eliminated.

#### Electricity Regulation

The company is subject to rate regulation by the Ontario Energy Board (OEB). The following regulatory policies are practiced in a rate regulated environment.

##### (a) Regulatory Assets

Regulatory assets consist of market ready costs and retail settlement variance accounts. These costs are deferred for accounting purposes because it is probable that they will be recovered in future rates. Regulatory assets recognized at December 31, 2004 are disclosed in Note 4.

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

The Minister of Energy has granted approval for distributors to make application to the OEB with regard to rate recovery of certain distribution regulatory assets. These regulatory assets are expected to be recovered over a four-year period, commencing March 1, 2004. The amount to be recovered is subject to OEB review and approval.

##### (b) 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). 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 OEB and recovered from the customers at that time.



# PETERBOROUGH DISTRIBUTION INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2004

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

#### Revenue Recognition

In accordance with the Ontario Energy Board regulations, the company recognizes as revenue the regulated distribution service charges associated with the distribution of energy.

In addition to the distribution services charges, the customer electricity bills include, transmission charges, non-competitive energy charges, debt retirement and electricity commodity charges. These additional charges are flow through amounts and are not considered as revenue to the Company. The Company acts as a billing and collecting agent for other market participants.

Revenue is recorded using the accrual basis of accounting, as energy is consumed by customers. Unbilled revenue is the estimated distribution revenue earned but not invoiced 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.

#### Property, Plant And Equipment

Property, plant and equipment are recorded at cost and include labour, materials, engineering and contracted services.

The cost and related accumulated amortization for identifiable property, plant and equipment, 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. Property, plant and equipment 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 \$1,496,017 (2003 - \$1,237,740).

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

# PETERBOROUGH DISTRIBUTION INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2004

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

#### 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.

### 2. RELATED PARTY TRANSACTIONS

The Company provides electricity and services to the shareholder of its parent, the City of Peterborough. Electrical energy is sold to the City at the same prices and terms as other electricity customers. The Company also engaged in transactions in the normal course of operations with affiliated companies at market rates. 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:

Professional services	\$3,035,277
Capital expenditures	1,433,151
Operating costs	1,117,790
Building rent	451,595
Software and equipment rental	366,360

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 from Peterborough Utilities Services Inc. at December 31, 2004 consisted of cash of \$3,357,612 (2003 - \$3,190,492).

### 3. PROPERTY, PLANT AND EQUIPMENT

	Cost \$	Accumulated Amortization \$	Net Book Value	
			2004 \$	2003 \$
Land	134,522	-	134,522	134,522
Buildings	207,629	19,545	188,084	193,275
Substations	1,667,383	281,328	1,386,055	1,385,891
Overhead lines	19,885,823	4,011,365	15,874,458	15,390,117
Underground lines	15,939,832	3,574,869	12,364,963	12,450,153
Transformers	10,638,801	2,726,906	7,911,895	8,082,194
Meters	3,260,370	694,931	2,565,439	2,010,977
Other	1,545,224	760,306	784,918	941,663
Construction in progress	1,194,477	-	1,194,477	952,241
	54,474,061	12,069,250	42,404,811	41,541,033

# PETERBOROUGH DISTRIBUTION INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For The Year Ended December 31, 2004

### 4. REGULATORY ASSETS

The Company has recorded the following regulatory assets.

	2004 \$	2003 \$
Retail settlement variance accounts	5,074,721	4,989,340
Deferred transition costs	212,767	212,766
Other	108,470	3,735
Regulatory assets recovered	(665,923)	-
	4,730,035	5,205,841

Regulatory assets arise as a result of the rate-setting process as described in Note 1. The Company has also incurred pre-market opening variances of \$1,369,813 which are not reflected in the regulatory assets due to uncertainty of recovery. In addition, an amount of \$1,311,532 (2003 - \$1,099,754) has been provided as an allowance against deferred transition costs. The Company intends to recover these items and all other regulatory assets through future rate applications.

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.

### 5. LONG TERM LIABILITIES

	2004 \$	2003 \$
Demand loan from City of Peterborough Holdings Inc. bearing interest at 7.25% (2003 - 7.25%)	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	860,659	715,439
	24,018,339	23,873,119
Less: customer deposits due within one year	272,655	259,469
	23,745,684	23,613,650

Interest expense on the demand loans for the year ended December 31, 2004 was \$1,611,853 (2003 - \$1,621,757). There are no specific terms for repayment of the demand loans.

# PETERBOROUGH DISTRIBUTION INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2004

### 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. FINANCIAL INSTRUMENTS

The estimated fair value of the Company's financial assets and liabilities approximates carrying value. Financial assets held by the Company expose it to credit risk. As at December 31, 2004, there are no significant concentrations of credit risk with respect to any class of financial assets. The Company earns its revenue from a broad base of customers. As at December 31, 2004, there were no significant balances of accounts receivable due from any single customer.

### 8. ELECTRICITY DISTRIBUTION SERVICE CHARGES

	2004 \$	2003 \$
Customer billing for electricity and distribution service charges	68,599,100	63,681,544
Energy	38,558,507	32,888,091
Transmission	7,547,824	7,247,298
Non-competitive energy charges	4,457,583	5,158,450
Debt retirement charge	5,112,954	5,155,926
	55,676,868	50,449,765
Total electricity distribution service charges	12,922,232	13,231,779

# **PETERBOROUGH DISTRIBUTION INC.**

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2004**

### **9. FUTURE INCOME TAXES**

The Company has a future income tax asset of \$818,400. 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.

### **10. COMPARATIVE FIGURES**

Certain comparative figures have been reclassified to conform to the current year's presentation.

### **11. NON-CASH WORKING CAPITAL**

Net change in non-cash working capital balances related to operations is comprised of the following:

	2004 \$	2003 \$
Due from Peterborough Utilities Services Inc.	(167,120)	(4,020,574)
Accounts receivable	(144,594)	194,768
Unbilled revenue	38,400	112,941
Inventories	(1,766)	124,298
Accounts payable and accrued charges	248,079	405,206
Income taxes payable (recoverable)	(583,582)	171,427
	(610,583)	(3,011,934)

## PETERBOROUGH DISTRIBUTION INC.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS For The Year Ended December 31, 2004

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#### 12. 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 2002, the company and its subsidiaries secured an operating line in the amount of approximately \$9 million which consists of an operating line up to \$3.7 million and \$5.3 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.

#### 13. AMALGAMATION

Asphodel-Norwood Distribution Inc. and Lakefield Distribution Inc., wholly owned subsidiaries of Peterborough Distribution Inc., were amalgamated with Peterborough Distribution Inc. on December 31, 2004 pursuant to subsection 177(1) of the Business Corporations Act. The issued and outstanding shares of the capital of Asphodel-Norwood Distribution Inc. and Lakefield Distribution Inc. at the date of amalgamation were cancelled without any repayment of capital.