EB-2011-0099

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998, S.O. 1998*, c.15 (Schedule B);

AND IN THE MATTER OF a proceeding initiated by the Ontario Energy Board to set distribution rates for E.L.K. Energy Inc.

SUBMISSION OF E.L.K. ENERGY INC. ON MATTERS IDENTIFIED IN PROCEDURAL ORDER NO. 1

DELIVERED MAY 8, 2012

A. INTRODUCTION

1. E.L.K. Energy Inc. ("E.L.K.") is a local distribution company (an "LDC") serving more than 11,300 customers in the Towns of Essex, Lakeshore and Kingsville. Within these towns, which cover a large geographic area in southwestern Ontario, E.L.K. Energy has six non-contiguous service areas, serving the communities of Belle River, Comber, Cottam, Essex, Harrow and Kingsville.

2. On March 1, 2011, the Ontario Energy Board (the "Board") issued a letter identifying a list of distributors that were expected to file a cost of service application in respect of their 2012 rates. E.L.K. was one of the distributors identified on the list.

3. On March 30, 2011, E.L.K. delivered a letter to the Board in which it requested that it be permitted to defer the rebasing of its rates beyond the 2012 rate year. The Board issued a response letter on June 17, 2011 requesting that E.L.K. provide certain information related to the amount by which E.L.K.'s return has exceeded the level of return that underpins E.L.K.'s rates, for 2009 and 2010. The letter also requested that if the return levels for these two years were confirmed to be materially above the level that underpins E.L.K.'s rates, to explain why E.L.K. believed it was nonetheless appropriate for the Board to defer rebasing of E.L.K.'s rates.

4. On June 28, 2011, E.L.K. filed a letter indicating that its return on equity for 2009 and 2010 was approximately 16%. This would place E.L.K.'s returns outside of the Board's 300 basis point dead band. E.L.K. also reiterated its request to defer its rebasing to beyond 2012, and provided reasons in that regard.

5. On July 18, 2011, the Board issued a letter responding to E.L.K.'s letter of June 28, 2011. The

Board denied E.L.K.'s request for a deferral and advised that the Board would commence a proceeding to review E.L.K.'s rates on a cost of service basis in light of the information provided by E.L.K. with respect to its earnings. The Board also noted that it intended to declare E.L.K.'s rates as interim pending the hearing of the application to be filed by E.L.K.

6. Also on July 18, 2011, the Board issued a Notice of Proceeding and Order respecting Interim Rates, in which it advised that it had commenced a proceeding on its own motion to make an order fixing just and reasonable rates for E.L.K., and that it was declaring E.L.K.'s rates as interim, effective July 18, 2011, pending the hearing of the application to be filed by E.L.K.

7. On April 25, 2012, the Board issued Procedural Order No.1 ("PO#1") in this matter. In PO#1, the Board noted that E.L.K. had not yet filed its 2012 cost of service distribution rate application and that the interim rates made effective July 18, 2011 continue to apply. At pages 2 and 3 of PO#1, the Board wrote:

> "In order to mitigate the risk that customers are paying distribution rates that result in earnings that exceed the deemed allowed rate of return set by the Board, the Board is considering the merit of adjusting E.L.K.'s existing interim rates downward effective June 1, 2012. The adjustment would also mitigate concerns of intergenerational inequity. While the appropriate date for such an adjustment should likely be May 1, 2012, the effective date for new rates based on a cost of service application, the Board will afford E.L.K. an opportunity to file submissions on its proposal. The analysis provided in Appendix A indicates that a 14.2 % decrease, (referred to as the "over earnings adjustment factor") to the existing base monthly service charge and base distribution volumetric rate for all customer classes would result in revenues that would permit E.L.K. to earn the deemed rate of return on equity. The proposed adjusted rates are shown in Appendix B.
>
> Subject to its consideration of any submissions from E.L.K. as described below, the Board intends to issue a new interim rate order for rates effective June 1, 2012 which will reflect the adjustments shown in Appendix B. These rates would be declared interim pending the Board's determination of a complete cost of service application filed by E.L.K. for 2012 rates. Since interim rates are and will be in place, the Board would have the ability to retrospectively alter this adjustment (either higher or lower) as the evidence ultimately warrants.
>
> The Board will consider any submissions filed by E.L.K on (i) the appropriateness of and the degree to which the Board intends to adjust E.L.K.'s rates, (ii) the manner in which the over earnings have been calculated in the Revenue Requirement Work Form and the calculation of the over earnings adjustment factor as shown in Appendix A and (iii) the manner in which the rates are proposed to be adjusted as shown in Appendix B."

8. The Board allowed E.L.K. until May 9, 2012 to file any submissions on the matters identified in PO#1. In accordance with PO#1, E.L.K. offers the following submissions in this regard. In short, E.L.K. submits that the Board's proposed 14.2% rate decrease as of

June 1, 2012 is not appropriate, and that the Board should maintain E.L.K.'s distribution rates at their current levels on an interim basis pending the Board's disposition of E.L.K.'s 2012 cost of service distribution rate application, for the reasons discussed below. ELK expects to file its 2012 cost of service application by September 2012.

B. THE BASIS FOR THE "OVER EARNINGS" DETERMINATION:

9. As noted above, in its letter of June 17, 2011, the Board requested that E.L.K. provide certain information related to the amount by which E.L.K.'s return has exceeded the level of return that underpins E.L.K.'s rates, for 2009 and 2010 and, if the return levels for these two years were confirmed to be materially above the level that underpins E.L.K.'s rates, to explain why E.L.K. believed it was nonetheless appropriate for the Board to defer rebasing of E.L.K.'s rates. More particularly, the Board stated in its June 17th letter that:

"The Board has considered the rationale for deferral set out in your letter, as well as the following:

- E.L.K.'s financial position, as shown in its audited financial statements and financial reporting to the Board;
- E.L.K.'s 3-year performance with respect to system reliability indicators and electricity service quality requirements/indicators, as reported to the Board; and
- Credit rating information obtained about E.L.K.

The Board has reviewed E.L.K's financial results since the last time it rebased in 2006 and is concerned about the amount by which E.L.K.'s return has exceeded the level of return that underpins its rates.

In order for the Board to further consider your request for deferral, the Board requires, by June 30, 2011, that you file a calculation of E.L.K.'s return on equity and return on rate base for both 2009 and 2010, together with an explanation of the drivers for the levels of return. These calculations should be provided based on both E.L.K's actual and deemed capital structures. If the return levels for these two years are confirmed to be materially above the level that underpins E.L.K.'s rates, you should also explain why you believe it is nonetheless appropriate for the Board to defer rebasing of E.L.K.'s rates."

10. In its June 28, 2011 response, E.L.K. indicated that the information with respect to returns set out in that response was derived from its audited 2009 and 2010 financial statements. For the Board's reference, copies of those statements accompany this submission as Attachment A.

11. In E.L.K.'s 2010 financial statements, net earnings for 2010 were shown as $1,178,049, and net earnings for 2009 were shown as $983,399. On that basis, the return on equity was 16% in each year. As E.L.K. acknowledged in its June 28, 2011 letter to the Board,

"The return levels are believed to be above the level that underpins E.L.K.'s rates."

C. REVIEW OF 2010 FINANCIAL STATEMENTS

12. E.L.K. has recently finalized its 2011 audited financial statements. A copy of those statements accompanies this submission as Attachment B. In the course of preparing its 2011 financial statements, E.L.K. and its auditors have determined that there was an error in 2010 in E.L.K.'s tracking of the differences between amounts paid to the Independent Electricity System Operator (the "IESO") on account of power and various wholesale market services, and amounts billed to E.L.K.'s customers on account of those items.

13. In the normal course, those differences would have been tracked in applicable variance accounts. Balances in those accounts would have accrued carrying charges, and would have been disposed of, either as a credit to customers or a charge to customers. Had the accounting been performed correctly, a credit in favour of E.L.K.'s customers in the total amount of $926,694 would have been assigned to the variance accounts shown in the following table. The table illustrates adjustments to E.L.K.'s 2010 distribution revenue and corresponding adjustments to the balances in the RSVAs identified therein.

2010 Distribution Revenue (Original)		$	4,115,198
Adjustments to RSVA			
1580	WMS	$	(9,100)
1584	NW	$	3,557
1586	CN	$	(8,013)
1588	POWER	$	(966,160)
1588-04	GLOB ADJ	$	53,022
2010 Distribution Revenue (Restated)		$	3,188,504

14. E.L.K. has now determined that these differences were not booked to the correct variance accounts. Instead, the amounts billed to customers on account of power (for example) were tracked in an energy sales account, and differences were not moved into Account 1588 – the $RSVA_{Power}$ account. Similar errors were made in respect of other RSVAs, but the most significant error was in respect of Account 1588.

15. The effect of this error was that E.L.K.'s revenues and earnings appeared to be much larger than they in fact were. As can be seen in the 2011 financial statements at

Attachment B, when the differences were properly assigned to variance accounts, the 2010 net earnings, shown as $1,178,049 in the original 2010 financial statements, fell to $536,081, a reduction of $641,969. The calculations underlying the restatement of the 2010 results are set out at Note 18 to the 2011 financial statements ("Prior Period Adjustment").

16. Using the corrected net earnings value reduces E.L.K.'s 2010 return on equity significantly. Instead of approximately 16% based on the incorrect 2010 financial statements, the correct return is approximately 7.95%. The 2011 return on equity, based on net earnings of $316,841, is approximately 4.66%.

17. In light of the corrections discussed above, E.L.K. respectfully submits that it is not earning returns significantly in excess of the Board-approved ROE. On the contrary, when amounts are properly allocated to variance accounts, E.L.K. is earning less than the Board-approved ROE. This suggests that E.L.K. may need a rate increase as part of its 2012 cost of service application in order to be able to earn the Board approved ROE.

18. Accordingly, while E.L.K. understands that the Board has made its current rates interim as of July 18, 2011, E.L.K. submits that there is no basis to reduce those rates. The question of whether it would be appropriate to do so if E.L.K. were earning an ROE of 16% is now moot, as actual returns have been far less than that. To respond directly to the matters raised by the Board in PO#1:

    i. It is not appropriate to adjust E.L.K.'s rates as proposed by the Board;

    ii. In light of the correction of E.L.K.'s error in tracking differences between amounts paid to the IESO, particularly in respect of power, and amounts billed to its customers, it is now apparent that there have been no "over earnings". The calculations of over earnings in the Revenue Requirement Work Form and the calculation of the over earnings adjustment factor as shown in Appendix A to PO#1 are incorrect, as they were based on inputs derived from E.L.K. data that has been shown to be incorrect; and

    iii. The manner in which the rates are proposed to be adjusted as shown in Appendix B to PO#1 is incorrect and inappropriate, again because the adjustment is based on inputs derived from E.L.K. data that has been shown to be incorrect.

19. E.L.K. submits that the Board's proposed rate reduction would lead to significant consumer bill volatility due to a large reduction beginning in June of this year, which would likely be followed by an increase to recover both (a) the revenue forgone during the period between June 2012 and the effective date of E.L.K.'s new rates based on its cost of service application of the reduction; and (b) any incremental revenue requirement arising out of the cost of service application.

D. CONCLUSION:

20. For all of the foregoing reasons, E.L.K. respectfully requests that the Board refrain from any reduction of E.L.K.'s current rates.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 8TH DAY OF MAY, 2012.

E.L.K. Energy Inc.
By its Counsel,
Borden Ladner Gervais LLP
Per:

James C. Sidlofsky

Attachment A

E.L.K. Energy Inc. 2010 Audited Financial Statements

Non-Consolidated Financial Statements of

E.L.K. ENERGY INC.

Year ended December 31, 2010

KPMG

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INDEPENDENT AUDITORS' REPORT

To the Directors

We have audited the accompanying non-consolidated financial statements of E.L.K. Energy Inc. ("the Company"), which comprise the non-consolidated balance sheet as at December 31, 2010 and the non-consolidated statement of earnings, retained earnings and the statement cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information. The non-consolidated financial statements have been prepared by management using the basis of accounting in Note 1 to the non-consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these non-consolidated financial statements in accordance with the basis of accounting in Note 1 to the non-consolidated financial statements; this includes determining that the basis of accounting is an acceptable basis for the preparation of the non-consolidated financial statements in the circumstances, and for such internal control as management determines is necessary to enable the preparation of the non-consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these non-consolidated 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 non-consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the non-consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the non-consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the non-consolidated 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.

KPMG

Opinion

In our opinion, the non-consolidated financial statements present fairly, in all material respects, the non-consolidated financial position of E.L.K. Energy Inc. as at December 31, 2010, and its non-consolidated results of its operations and its non-consolidated cash flows for the year then ended in accordance with the basis of accounting in Note 1 to the non-consolidated financial statements.

Basis of Accounting and Restriction of Use

Without modifying our opinion, we draw attention to Note 1 to the non-consolidated financial statements, which describes the basis of accounting. The non-consolidated financial statements are prepared to assist E.L.K. Energy Inc. to prepare its corporate income tax returns. As a result, the non-consolidated financial statements may not be suitable for another purpose. Our report is intended solely for E.L.K. Energy Inc. and for the federal and provincial income tax authorities and should not be used by parties other than E.L.K Energy Inc. or the federal and provincial tax authorities.

Other Matters

E.L.K. Energy Inc. has prepared a separate set of consolidated financial statements for the year ended December 31, 2010 in accordance with Canadian generally accepted accounting principles on which we issued a separate auditors' report to the shareholders of E.L.K. Energy Inc. dated April 28, 2011.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

April 28, 2011

Windsor, Canada

E.L.K. ENERGY INC.

Non-consolidated Balance Sheet

December 31, 2010, with comparative figures for 2009

	2010	2009
Assets		
Current assets:		
Cash:		
Unrestricted	$ 3,301,234	$ 2,014,573
Restricted (note 2)	1,596,417	3,024,082
Accounts receivable (note 12)	1,699,416	1,650,566
Prepaid expenses	107,502	88,793
Unbilled revenue	3,152,464	3,266,567
Inventories	313,849	342,091
Payment in lieu of income taxes receivable	252,829	147,009
	10,423,711	10,533,681
Property, plant and equipment, at cost (note 3)	22,148,676	22,432,097
Less accumulated amortization	14,031,987	13,904,674
	8,116,689	8,527,423
Regulatory assets (note 4)	2,758,991	293,424
Future payments in lieu of income taxes (note 13)	1,412,000	1,483,000
Investments (note 5)	46,956	47,162
	$ 22,758,347	$ 20,884,690

		2010		2009

Liabilities and Shareholder's Equity

		2010		2009
Current liabilities:				
Accounts payable and accrued liabilities (note 12)	$	4,728,580	$	3,100,852
Current portion of customer deposits		193,019		683,242
Current portion of obligation under capital lease		6,541		-
Shareholder promissory notes (note 6)		1,900,000		1,900,000
		6,828,140		5,684,094
Long-term liabilities:				
Customer deposits		646,148		306,426
Obligation under capital lease		11,447		-
Long-term debt (note 7)		7,200,000		8,000,000
Employee future benefits (note 8)		686,906		686,513
		8,544,501		8,992,939
Shareholder's equity:				
Share capital (note 9)		2,000,100		2,000,100
Retained earnings (deficit)		983,231		(194,818)
Contributed surplus		4,402,375		4,402,375
		7,385,706		6,207,657
Contingencies (note 17)				
	$	22,758,347	$	20,884,690

See accompanying notes to non-consolidated financial statements.

On behalf of the Board:

__________________________ Director

__________________________ Director

E.L.K. ENERGY INC.

Non-consolidated Statement of Earnings

Year ended December 31, 2010, with comparative figures for 2009

		2010		2009
Service revenue	$	19,969,248	$	19,012,054
Service revenue adjustment		(114,103)		(210,145)
		19,855,145		18,801,909
Cost of electricity		15,739,947		14,418,495
Gross margin on service revenue		4,115,198		4,383,414
Other operating revenue:				
Interest and other		739,507		587,143
Late payment charges		99,989		146,753
Unrealized gain (loss) on investments		(206)		2,672
		839,290		736,568
		4,954,488		5,119,982
Expenditures:				
Administration		808,563		822,342
Billing and collecting		726,496		860,852
Amortization		824,357		852,414
Interest		289,953		232,970
Operations and maintenance		546,850		805,899
		3,196,219		3,574,477
Earnings before payments in lieu of income taxes		1,758,269		1,545,505
Payments in lieu of income taxes		580,220		562,106
Net earnings for the year	$	1,178,049	$	983,399

See accompanying notes to non-consolidated financial statements.

E.L.K. ENERGY INC.

Non-consolidated Statement of Retained Earnings (Deficit)

Year ended December 31, 2010, with comparative figures for 2009

	2010	2009
Balance, beginning of year	$ (194,818)	$ 9,421,683
Net earnings for the year	1,178,049	983,399
Dividends paid	-	(10,599,900)
Balance, end of year	$ 983,231	$ (194,818)

See accompanying notes to non-consolidated financial statements.

E.L.K. ENERGY INC.

Non-consolidated Statement of Cash Flows

Year ended December 31, 2010, with comparative figures for 2009

	2010	2009
Cash provided by (used in):		
Operations:		
Net earnings for the year	$ 1,178,049	$ 983,399
Items not involving cash:		
Amortization of property, plant and equipment	824,357	852,414
Future payments in lieu of income taxes	71,000	(491,000)
Increase in employee future benefits	393	333
Gain on sale of property, plant and equipment	(58,654)	-
Unrealized loss (gain) on investments	206	(2,672)
Changes in non-cash operating working capital	1,106,471	445,704
	3,121,822	1,788,178
Financing:		
Increase (decrease) in long-term customer deposits	339,722	(15,968)
Increase in capital lease obligation	17,988	-
Decrease in shareholders' promissory notes	-	(2,000,000)
Increase (decrease) in long-term debt	(800,000)	8,000,000
Share capital issued	-	2,000,000
Dividends paid	-	(10,599,900)
	(442,290)	(2,615,868)
Investing:		
Property, plant and equipment additions	(810,311)	(569,360)
Proceeds on sale of property and equipment	183,566	-
Decrease (increase) in regulatory assets	(2,193,791)	747,428
	(2,820,536)	178,068
Decrease in cash	(141,004)	(649,622)
Change in accounting policy for the recognition of future tax assets and liabilities	-	(992,000)
Cash, beginning of year	5,038,655	6,680,277
Cash, end of year	$ 4,897,651	$ 5,038,655
Cash consists of:		
Unrestricted	$ 3,301,234	$ 2,014,573
Restricted	1,596,417	3,024,082
	$ 4,897,651	$ 5,038,655

See accompanying notes to non-consolidated financial statements.

E.L.K. Energy Inc. supplies and distributes electric power and maintains electrical distribution systems in the following communities: Essex, Harrow, Belle River, Comber, Kingsville, and Cottam.

E.L.K. Energy Inc. also performs the billing function for the Municipality of the Town of Essex Water Department.

1. Basis of presentation:

The non-consolidated financial statements have been prepared in accordance with the significant accounting policies set out below. These non-consolidated financial statements materially differ from Canadian generally accepted accounting principles because they are non-consolidated. The Company's investment in its wholly-owned subsidiary, E.L.K. Solutions Inc., is accounted for using the cost method. Earnings from this investment are recognized only to the extent dividends are received or receivable. Consolidated financial statements are available for distribution.

2. Significant accounting policies:

(a) Restricted cash:

Restricted cash of $nil (2009 - $732,850) consists of an irrevocable standby letter of credit issued in favour of the Independent Electricity System Operator ("IESO") as collateral in support of the Company's purchase of electricity. Restricted cash of $1,596,417 (2009 - $2,291,232) relates to contractor security deposits.

(b) Inventories:

Inventories are valued at the lower of cost, determined on a first-in, first-out basis, and net realizable value.

(c) Property, plant and equipment:

Property, plant and equipment are stated at cost. Buildings, plant and equipment and the transmission and distribution system are amortized on the straight-line basis at rates suggested by the Ontario Energy Board. These rates of amortization range from 2% to 25%.

(d) Revenue recognition:

Revenue from the sale of electrical energy is recognized when power is delivered to customers. Billings from the last meter reading date prior to December 31 are adjusted based on a number of factors to reflect estimated usage to the year end date. These estimates are reflected on the balance sheet as unbilled revenue. Unbilled revenue is the amount of electricity that has been shipped to customers but not billed by the end of the year.

2. Significant accounting policies (continued):

(e) Investments:

The Company has designated its investment in the common shares of Sun Life Financial and its investment in the preferred shares of Utilismart Corporation as held for trading investments and these instruments are recorded at market value as determined by quoted market prices. Realized and unrealized gains and losses as a result of disposition of shares and changes in fair value are recorded in the statement of earnings as an unrealized gain on investments.

The investment in ELK Solutions Inc. and Gosfield North Communications are measured at cost.

(f) Employee future benefits:

The Company provides post retirement benefits for employees who retire from active employment. The Company measures the costs of its obligation based on its best estimate.

The Company accrues its obligations under employee benefit plans as the employees render the services necessary to earn employee future benefits.

The cost of retirement benefits earned by employees is actuarially determined using the projected cost method pro rated on service and the actuary's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs. The excess of the net actuarial gain or loss over 10% of the benefit obligation is amortized over the average remaining service period of active employees of the plan, which is 12.3 years at December 31, 2010.

Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment.

(g) Payments in lieu of taxes ("PILs"):

The Company is currently exempt from taxes under the Income Tax Act (Canada) ("ITA") and the Ontario Corporations Tax Act ("OCTA").

Pursuant to the Electricity Act, the Company is required to compute taxes under the ITA and OCTA and remit such amounts thereunder computed to the Ministry of Finance (Ontario). These amounts, referred to as PILs under the Electricity Act, are applied to reduce certain debt obligations of the former Ontario Hydro continuing as Ontario Electricity Financial Corporation.

2. Significant accounting policies (continued):

(g) Payments in lieu of taxes ("PILs") (continued):

The Company provides for amounts in lieu of corporate income taxes using the asset and liability method. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the Ontario Energy Board ("OEB") and recovered from the customers of the Company at the time.

(h) Pension plan:

The Company provides a pension plan for its employees through the Ontario Municipal Employees Retirement System ("OMERS"). OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund ("the Fund"), and provides pensions for employees of Ontario municipalities, local boards, public utilities and school boards. The Fund is a contributory defined benefit pension plan.

(i) Customer deposits:

Customer deposits comprise cash collections from electricity customers which are applied against any unpaid portion of individual customer accounts. Customer deposits in excess of unpaid account balances are refundable to individuals upon termination of their electricity service.

(j) Use of estimates:

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. Significant items subject to such estimates and assumptions include valuation allowances for accounts receivable, regulatory assets, future payments in lieu of income taxes and employee future benefits, and the carrying value of property, plant and equipment. Actual results could differ from those estimates.

2. Significant accounting policies (continued):

(k) Rate regulation:

Smart Meter Initiative:

The Province of Ontario has committed to have "Smart Meter" electricity meters installed in all homes and small businesses throughout Ontario by the end of 2010. Smart Meters permit consumption to be recorded within specific time intervals and specific tariffs to be levied within such intervals.

On October 21, 2010, the Company submitted an application to the OEB for the consideration and approval of a Utility-Specific Smart Meter Funding Adder in accordance with the Smart Meter Funding and Cost Recovery Guideline of the OEB. The application was approved March 28, 2011. The Application provided for a new rate adder of $1.45 per metered customer per month, representing an increase of $0.45 per customer per month. Such new rate adder contributes approximately $193,523 annually towards the Company's investment in Smart Meters and operating costs.

Green Energy and Green Economy Act:

In early 2009, the government tabled the Green Energy and Green Economy Act ("GEGEA"). This new legislation makes fundamental changes to the roles and responsibilities of LDCs in the areas of renewable power generation, conservation and demand management delivery, and the development of smart distribution grids.

The Green Energy and Green Economy Act provides LDCs with the freedom to own and operate a portfolio of renewable power generation and will permit them to provide district heating services in their communities through co-generation. LDCs will also bear added responsibilities to assist and enable consumers to reduce their peak demand and conserve energy in an effort to meet provincial conservation targets. LDCs will also gain new responsibilities in transforming their local distribution networks into smart grids harnessing advanced technologies to facilitate the connection of small-scale generators and the two-way flow of information.

New LDC License requirements – Conservation and Demand Management Targets ("CDM Targets"):

2. **Significant accounting policies (continued):**

On November 12, 2010, the OEB amended LDC requirements for achieving certain CDM targets over a four year period commencing January 1, 2011. The Company's CDM targets include a demand reduction target of 2.960 MW and a consumption reduction target of 8.260 GWh. LDCs must also comply with a new CDM Code of the OEB, which provides LDC requirements for the development and delivery of CDM strategy to the OEB for the achievement of LDC-specific CDM targets, annual accounting and reporting to the OEB, and eligibility criteria for performance and incentive payments. The Company has filed its CDM strategy with the OEB on October 28, 2010.

(l) Long-lived assets:

The Company periodically reviews the useful lives and the carrying values of its long-lived assets for continued appropriateness. The Company reviews for impairment long-lived assets (or asset groups) to be held and used whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If the sum of the undiscounted expected future cash flows expected to result from the use and eventual disposition of an asset is less than its carrying amount, it is considered to be impaired. An impairment loss is measured at the amount by which the carrying amount of the asset exceeds its fair value. When quoted market prices are not available, the Company uses the expected future cash flows discounted at a rate commensurate with the risks associated with the recovery of the asset as an estimate of fair value.

(m) Financial Instruments:

All financial instruments are carried 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.

The Company has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Accounts receivable	Loans and receivables
Accounts payable and accruals	Other liabilities
Shareholder promissory notes	Other liabilities
Long-term debt	Other liabilities

3. Property, plant and equipment:

			2010	2009
	Cost	Accumulated amortization	Net book value	Net book value
Land	$ 173,887	$ -	$ 173,887	$ 173,877
Buildings, plant and equipment	3,739,733	2,779,561	960,172	1,220,998
Transmission and distribution system	18,235,056	11,252,426	6,982,640	7,132,548
	$ 22,148,676	$ 14,031,987	$ 8,116,689	$ 8,527,423

4. Regulatory assets (liabilities):

Regulatory assets and liabilities arise as a result of the rate regulating process. The Company has recorded the following regulatory assets and liabilities:

	2010	2009
Regulatory assets (liabilities):		
Future payments in lieu of income taxes	$ (977,111)	$ (955,111)
Other regulatory assets	2,327,611	113,018
Miscellaneous deferred debits	3,240	3,240
Amount approved for recovery of regulatory assets	(269,413)	614,401
Retail settlement variances	292,158	634,691
Smart meter capital and recovery	1,382,506	(116,815)
	$ 2,758,991	$ 293,424

(a) Future payments in lieu of income taxes:

Future payments in lieu of income taxes represent the OEB approved PILs methodology for determining the deferral account allowance.

4. **Regulatory assets (continued):**

(b) Retail settlement variances:

E.L.K. has deferred certain retail settlement variances amounts under the provisions of Article 490 of the OEB's Accounting Procedures Handbook.

These variances represent amounts that have accumulated since Market Opening and comprise:

(i) variances between amounts charged by the Independent Electricity System Operator ("IESO") for the operation of the wholesale electricity market and grid, various wholesale market settlement charges, amounts charged to allow for the purchase of imported electricity and transmission charges, and the amounts billed to customers by the Company based on the OEB approved market service rate; and

(ii) amounts allocated to the Company and approved by the OEB for the recovery of regulatory assets incurred by Hydro One including low voltage tariffs. The Hydro One recovery of these charges commenced on April 1, 2005 and these costs will be passed through to customers during the rate making process.

(c) Other regulatory assets:

On December 20, 2004, the OEB issued a letter on the accounting treatment of OEB assessments. The OEB clearly identifies that it is their intent to allow electricity LDC's to record their OEB cost assessments for the Board's fiscal year 2005 and subsequent years in order that these costs may be given consideration for rate recovery in the future.

On February 15, 2005, the OEB issued a letter instructing the deferral of cash pension contributions made to the Ontario Municipal Employees Retirement System ("OMERS") for 2005 and subsequent years. As of May 1, 2006, the deferral of OMERS contributions has been discontinued and OMERS has been included in the rates.

(d) Miscellaneous deferred debits:

On December 13, 2005, the OEB issued a letter on the accounting treatment of costs related to Ontario Price Credit ("OPC"). Costs related to the payment of OPC are being deferred. No additional amounts will be approved by the OEB until the next cost of services application.

4. Regulatory assets (continued):

(e) Amounts approved for recovery of regulatory assets:

The Ontario Energy Board Act, 1998 (Ontario) ("OEBA"), approved, as part of the 2006 rates application process, a reallocation for each regulatory asset or liability to a separate account, amounts approved for recovery of regulatory assets . The associated recoveries collected through rates over May 1, 2006 to April 30, 2008 are to be recorded as a reduction of amounts approved for recovery of regulatory assets. Any residual balance at the end of the collection period will be reviewed in future proceedings of the OEB.

(f) Smart Meter deferral account:

Represents the deferral of operating expenditures, capital expenditures and revenues related to Smart Meters in accordance with the direction set out by the OEB. In 2010, 11,099 meters were replaced by smart meters. The book value of $271,776 (2009 - $nil) for the replaced meters was transferred to regulatory assets.

(g) Electricity industry in Ontario:

The Ontario Energy Board Act, 1998 (Ontario) ("OEBA"), conferred on the OEB increased powers and responsibilities to regulate the electricity industry. These powers and responsibilities include the power to approve or fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity consumers, and the responsibility for ensuring the distribution companies fulfill obligations to connect and service customers. The

OEB may also prescribe license requirements and records, regulatory accounting principles, separation of accounts for distinct business and filing and processing requirements for rate setting purposes. In its capacity to approve or set rates, the OEB has the authority to specify regulatory treatments that may result in accounting treatments that differ from Canadian generally accepted accounting principles for enterprises operating in a non-rate regulated environment.

5. Investments:

	2010	2009
Investment in the Class A common shares of E.L.K. Solutions Inc., at cost	$ 100	$ 100
Investment in Gosfield North Communications at cost	1	–
Investment in the preferred shares of Utilismart Corporation, at market	2,413	2,413
Investment in the common shares of Sun Life Financial, at market	44,442	44,649
	$ 46,956	$ 47,162

6. Shareholder promissory notes:

The shareholder promissory notes are payable on demand, accrue interest at 7.25% payable annually, and are secured by a general security agreement. These notes are subordinate to the bank term loan.

7. Long-term debt:

	2010	2009
Three year term loan with interest rate of 1.343%, repayable in full on or before maturity of June 2012, secured by a general security agreement	$ 7,200,000	$ 8,000,000

During the year, the Company paid $147,028 of interest on long-term debt (2009 – $56,516).

8. Employee future benefits:

E.L.K. Energy Inc. pays certain benefits on behalf of its retired employees.

The Company measures its accrued benefit obligation for accounting purposes as at December 31 each year. A valuation date of December 31, 2010 has been used.

Information about E.L.K. Energy Inc.'s defined benefit plans, which are unfunded, is as follows:

	2010	2009
Accrued benefit obligation, beginning of year	$ 686,513	$ 686,180
Service cost	7,867	5,655
Interest cost	28,353	35,247
Amortization of actuarial gain	(8,858)	(8,408)
Benefits paid	(26,969)	(32,161)
Projected accrued benefit obligation, end of year, as determined by actuarial valuation	$ 686,906	$ 686,513

	2010	2009
Funded status:		
Funded status, deficit	$ (524,597)	$ (525,052)
Unamortized net actuarial gain	(162,309)	(161,461)
	$ (686,906)	$ (686,513)

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

	2010	2009
Discount rate	5.00%	5.50%
Rate of compensation increase	3%	3%
Medical trend rate:		
Initial	10%	10%
Ultimate	4%	4%

The approximate impact of a 1% change in health insurance trend rates is as follows:

	2010	2009
Change in obligation for 1% increase in trend rates	$ 48,000	$ 33,000
Change in obligation for 1% decrease in trend rates	(42,000)	(29,000)

9. Share capital:

The authorized and issued share capital is as follows:

	2010	2009
Authorized:		
Unlimited common shares		
Issued:		
30,000 common shares (2009 – 30,000)	$ 2,000,100	$ 2,000,100

10. Pension costs:

The Company makes contributions to the Ontario Municipal Employees Retirement Fund ("OMERS") which is a multi-employer plan, on behalf of 21 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. The OMERS plan is in a deficit position.

The amount contributed to OMERS for 2010 was $95,857 (2009 – $97,894) for current service and is included as an expenditure on the statement of earnings.

In 2010 the contribution rates were 6.4% for employees earnings below the year's maximum pensionable earnings and 9.7% thereafter.

11. Supplemental cash flow information:

	2010	2009
Cash paid during the year for:		
Interest	$ 478,970	$ 70,611
Payments in lieu of income taxes	836,872	713,599
Cash received during the year for:		
Interest	55,154	47,400

12. Related party transactions:

The amounts due to/from shareholder and subsidiary are as follows:

	2010	2009
Due to shareholder, included in accounts payable	$ 464,808	$ 463,394
Due from shareholder, included in accounts receivable	23,061	24,286
Due from subsidiary, included in accounts receivable	185,602	133,763

Transactions with shareholder are as follows:

	2010	2009
Provision of services to shareholder	$ 442,958	$ 463,394
Interest incurred on shareholder promissory notes	142,925	176,454

These amounts are measured at the exchange amount, which is the amount of consideration paid or received as established and agreed to by the related parties.

13. Future payments in lieu of income taxes:

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future tax liabilities and assets are as follows:

	2010	2009
Future tax liabilities:		
Investments	$ 8,750	$ 10,000
Total future tax liabilities	$ 8,750	$ 10,000
Future tax assets:		
Property, plant and equipment	$ 964,800	$ 972,000
Employee future benefits	232,150	280,000
Intangible assets	148,750	184,000
Smart meter revenue	71,350	51,000
Financing fees	3,700	6,000
Total future tax assets	1,420,750	1,493,000
Net future tax assets	$ 1,412,000	$ 1,483,000

14. Fair value of financial assets and liabilities:

The fair value of the Company's cash, accounts receivable, accounts payable and accrued liabilities, customer deposits and shareholder promissory notes approximate their carrying values due to the relative short-term maturity of these financial instruments.

It is not practical to determine the fair value of the investment in subsidiary as it is not publicly traded.

The fair value of the Company's long-term debt approximates its carrying value as the terms and conditions of the borrowing agreement is similar to current market terms and conditions.

Risk Factors:

The Company's activities provide for a variety of financial risks, particularly credit risk, market risk and liquidity risk.

i) Credit risk:

Financial assets carry credit risk that a counter-party will fail to discharge and 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 earns its revenue from a broad base of customers located in the towns of Essex, Lakeshore, and Kingsville. No single customer in either year would account for revenue in excess of 1% of the respective reported balances.

The carrying amount of accounts receivable is reduced through the use of an allowance for doubtful accounts and the amount of the related impairment loss is recognized in the statement of earnings. Subsequent recoveries of receivables previously provisioned are credited to the statements of earnings. The balance of the allowance for doubtful accounts at December 31, 2010 is $370,780 (2009 - $504,864). No single customer accounts for more than 1% of accounts receivable at year-end.

The Company's credit risk associated with accounts receivable is primarily related to payments from distribution customers. The Company has approximately 11,120 customers, the majority of which are residential. At December 31, 2010, approximately $926,623 is considered 60 days past due. Credit risk is managed through collection of security deposits from customers in accordance with directions provided by the OEB. As at December 31, 2010, the Company holds security deposits in the amount of $839,167 (2009 - $989,688).

14. Fair value of financial assets and liabilities (continued):

ii) Market risk:

Market risks primarily refer to the risk of loss that results from changes in commodity prices, foreign exchange rates, and interest rates. The Company currently does not have commodity or foreign exchange risk. E.L.K. Energy Inc. is exposed to fluctuations in interest rates as the regulated rate of return for the Company's distribution business is derived using a complex formulaic approach which is in part based on the forecast for long-term Government of Canada bond yields. This rate of return is approved by the OEB as part of the approval of distribution rates.

iii) 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 expense. The Company has access to a line of credit and monitors cash balances to ensure that sufficient levels of liquidity are on hand to meet financial commitments ad they come due.

15. Directors' remuneration:

The remuneration of directors amounted to $22,291 (2009 – $17,261).

16. Capital management:

In managing capital, the Company focuses on liquid resources available for operations. The organization's objective is to have sufficient liquid resources to continue operating despite adverse financial events and to provide it with the flexibility to take advantage of opportunities that will advance its purposes. The need for sufficient liquid resources is considered in the monitoring of cashflows and actual operating results. As at December 31, 2010, the Company has met its objective of having sufficient liquid resources to meet its current obligations.

17. Contingencies:

Late payment charges class action:

Pursuant to its order dated July 22, 2010 (the "Order"), the Ontario Superior Court of Justice approved the settlement of a class action lawsuit, which was served on the former Toronto Hydro-Electric Commission, continuing as Toronto Hydro Corporation, on November 18, 1998. The original class action was for the amount of $500,000 and was initiated against the former Toronto Hydro-Electric Commission as the representative of the Defendant Class consisting of all municipal electric utilities ("MEU") in Ontario, of which the Company is a successor MEU, which have charged late payment charges on overdue utility bills at any time after April 1, 1981.

The order formalized a settlement pursuant to which the defendant MEUs will pay the amount of $17,000,000 plus costs and taxes in settlement of all claims. The amount allocated for payment by each MEU is its proportionate share of the settlement amount based on its percentage of distribution service revenue over the period for which it has exposure for repayment of late payment penalties exceeding the interest rate limit in the Criminal Code. The Company's share of the settlement amount is $28,388 payable on June 30, 2011. Under the settlement, all the MEUs involved in the settlement, including the Company, will request an order from the OEB allowing for the future recovery from customers of all costs related to the settlement. The Company has accrued a liability in the amount of $28,388 and the request for recovery has been filed with the OEB.

On October 29, 2010, the OEB issued a notice of proceeding involving all of the defendant MEUs including the Company, to determine whether the costs and damages incurred by MEUs are recoverable from electricity ratepayers, and if so, the form and timing of such recovery. On February 22, 2011, the OEB issued its decision on this matter and indicated their intent to allow the recovery of all costs and damages arising from the settlement of the class action over a one year period commencing May 1, 2011, through a fixed rate rider. On March 28, 2011, the recovery was approved.

18. Future 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.

18. Future accounting changes (continued):

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.

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 period beginning on or after January 1, 2011 to disclose that fact.

The Company has decided to implement IFRS commencing on January 1, 2012.

Attachment B

E.L.K. Energy Inc. 2011 Audited Financial Statements Including Restatement of 2010 Results

Non-Consolidated Financial Statements of

E.L.K. ENERGY INC.

Year ended December 31, 2011

KPMG LLP
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INDEPENDENT AUDITORS' REPORT

To the Directors of E.L.K. Energy Inc.

We have audited the accompanying non-consolidated financial statements of E.L.K. Energy Inc., which comprise the non-consolidated balance sheet as at December 31, 2011, the non-consolidated statement of earnings, retained earnings and the cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information. The non-consolidated financial statements have been prepared by management in accordance with the basis of accounting in Note 1 to the non-consolidated financial statements.

Management's Responsibility for the Non-consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these non-consolidated financial statements in accordance with the basis of accounting in Note 1 to the non-consolidated financial statements; this includes determining that the basis of accounting is an acceptable basis for the preparation of the non-consolidated financial statements in the circumstances, and for such internal control as management determines is necessary to enable the preparation of the non-consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these non-consolidated 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 non-consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the non-consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the non-consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the non-consolidated 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.

KPMG

Opinion

In our opinion, the non-consolidated financial statements present fairly, in all material respects, the non-consolidated financial position of E.L.K. Energy Inc. as at December 31, 2011, and its non-consolidated results of operations and its non-consolidated cash flows for the year then ended in accordance with the basis of accounting in Note 1 to the non-consolidated financial statements.

Basis of Accounting and Restriction of Use

Without modifying our opinion, we draw attention to Note 1 to the non-consolidated financial statements, which describes the basis of accounting. The non-consolidated financial statements are prepared to assist E.L.K. Energy Inc. to prepare its corporate income tax returns. As a result, the non-consolidated financial statements may not be suitable for another purpose. Our report is intended solely for E.L.K. Energy Inc. and for the federal and provincial income tax authorities and should not be used by parties other than E.L.K Energy Inc. or the federal and provincial tax authorities.

Other Matters

E.L.K. Energy Inc. has prepared a separate set of consolidated financial statements for the year ended December 31, 2011 in accordance with Canadian generally accepted accounting principles on which we issued a separate auditors' report.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

April 26, 2012

Windsor, Canada

E.L.K. ENERGY INC.

Non-consolidated Balance Sheet

December 31, 2011, with comparative figures for 2010

	2011	2010 (restated - see note 18)
Assets		
Current assets:		
Cash:		
Unrestricted	$ 3,547,395	$ 3,301,234
Restricted (note 2)	1,019,175	1,596,417
Accounts receivable (note 12)	1,716,945	1,699,416
Prepaid expenses	124,924	107,502
Unbilled revenue	3,266,194	3,152,464
Inventories	287,076	313,849
Payment in lieu of income taxes receivable	632,483	537,555
	10,594,192	10,708,437
Property, plant and equipment, at cost (note 3)	22,628,508	22,148,676
Less accumulated amortization	14,871,786	14,031,987
	7,756,722	8,116,689
Regulatory assets (note 4)	707,022	1,832,297
Future payments in lieu of income taxes (note 13)	1,448,000	1,412,000
Investments (note 5)	36,042	46,956
	$ 20,541,978	$ 22,116,379

		2011		2010 (restated - see note 18)

Liabilities and Shareholder's Equity

Current liabilities:				
Accounts payable and accrued liabilities (note 12)	$	3,792,580	$	4,728,580
Current portion of customer deposits		193,019		193,019
Current portion of obligation under capital lease		6,541		6,541
Current year portion of long-term debt (note 7)		6,400,000		-
Shareholder promissory notes (note 6)		1,900,000		1,900,000
		12,292,140		6,828,140
Long-term liabilities:				
Customer deposits		763,601		646,148
Obligation under capital lease		3,271		11,447
Long-term debt (note 7)		-		7,200,000
Employee future benefits (note 8)		688,187		686,906
		1,455,059		8,544,501
Shareholder's equity:				
Share capital (note 9)		2,000,100		2,000,100
Retained earnings		392,304		341,263
Contributed surplus		4,402,375		4,402,375
		6,794,779		6,743,738
Contingencies (note 17)				
	$	20,541,978	$	22,116,379

See accompanying notes to non-consolidated financial statements.

On behalf of the Board:

______________________________ Director

______________________________ Director

E.L.K. ENERGY INC.

Non-consolidated Statement of Earnings

Year ended December 31, 2011, with comparative figures for 2010

	2011	2010 (restated see note 18)
Service revenue	$ 22,758,157	$ 23,254,511
Service revenue adjustment	289,273	(114,103)
	23,047,430	23,140,408
Cost of electricity	20,088,089	19,951,904
Gross margin on service revenue	2,959,341	3,188,504
Other operating revenue:		
Interest and other	1,010,474	739,507
Late payment charges	127,881	99,989
Unrealized loss on investments	(10,914)	(206)
	1,127,441	839,290
	4,086,782	4,027,794
Expenditures:		
Administration	835,771	808,563
Billing and collecting	799,175	726,496
Amortization	839,799	824,357
Interest	307,318	289,953
Operations and maintenance	771,091	546,850
	3,553,154	3,196,219
Earnings before payments in lieu of income taxes	533,628	831,575
Payments in lieu of income taxes	216,787	295,494
Net earnings	$ 316,841	$ 536,081

See accompanying notes to non-consolidated financial statements.

E.L.K. ENERGY INC.

Non-consolidated Statement of Retained Earnings

Year ended December 31, 2011, with comparative figures for 2010

		2011		2010 (restated see note 18)
Balance, beginning of year	$	341,263	$	(194,818)
Net earnings		316,841		536,081
Dividends paid		(265,800)		-
Balance, end of year	$	392,304	$	341,263

See accompanying notes to non-consolidated financial statements.

E.L.K. ENERGY INC.

Non-consolidated Statement of Cash Flows

Year ended December 31, 2011, with comparative figures for 2010

	2011	2010 (restated see note 18)
Cash provided by (used in):		
Operations:		
Net earnings	$ 316,841	$ 536,081
Items not involving cash:		
Amortization of property, plant and equipment	839,799	824,357
Future payments in lieu of income taxes	(36,000)	71,000
Increase in employee future benefits	1,281	393
Gain on sale of property, plant and equipment	-	(58,654)
Unrealized loss on investments	10,914	206
Changes in non-cash operating working capital	(1,152,836)	821,745
	(20,001)	2,195,128
Financing:		
Increase in long-term customer deposits	117,453	339,722
Increase (decrease) in capital lease obligation	(8,176)	17,988
Decrease in long-term debt	(800,000)	(800,000)
Dividends paid	(265,800)	-
	(956,523)	(442,290)
Investing:		
Property, plant and equipment additions	(480,332)	(810,311)
Proceeds on sale of property and equipment	500	183,566
Decrease (increase) in regulatory assets	1,125,275	(1,267,097)
	645,443	(1,893,842)
Decrease in cash	(331,081)	(141,004)
Cash, beginning of year	4,897,651	5,038,655
Cash, end of year	$ 4,566,570	$ 4,897,651
Cash consists of:		
Unrestricted	$ 3,547,395	$ 3,301,234
Restricted	1,019,175	1,596,417
	$ 4,566,570	$ 4,897,651

See accompanying notes to non-consolidated financial statements.

E.L.K. Energy Inc. supplies and distributes electric power and maintains electrical distribution systems in the following communities: Essex, Harrow, Belle River, Comber, Kingsville, and Cottam.

E.L.K. Energy Inc. also performs the billing function for the Municipality of the Town of Essex Water Department.

1. Basis of accounting:

These non-consolidated financial statements have been prepared in accordance with Part V of the CICA Handbook – Accounting except for E.L.K. Energy Inc.'s investment in its wholly-owned subsidiary, E.L.K. Solutions Inc., which is accounted for using the cost method. These non-consolidated financial statements have been prepared in accordance with the significant accounting policies set out below.

2. Significant accounting policies:

(a) Restricted cash:

Restricted cash of $1,019,175 (2010 - $1,596,417) relates to contractor security deposits.

(b) Inventories:

Inventories are valued at the lower of cost, determined on a first-in, first-out basis, and net realizable value.

(c) Property, plant and equipment:

Property, plant and equipment are stated at cost. Buildings, plant and equipment and the transmission and distribution system are amortized on the straight-line basis at rates suggested by the Ontario Energy Board. These rates of amortization range from 2% to 25%.

(d) Revenue recognition:

Electricity distribution service charges comprises customer billings for electricity and distribution service charges less the cost of electricity purchases by the Corporation. Customer billings for electricity and distribution service charges are recorded on the basis of time of use customer usage from the last billing until the end of the fiscal year. The latter component is recorded as unbilled revenue.

2. Significant accounting policies (continued):

(e) Investments:

The Company has designated its investment in the common shares of Sun Life Financial and its investment in the preferred shares of Utilismart Corporation as held for trading investments and these instruments are recorded at market value as determined by quoted market prices. Realized and unrealized gains and losses as a result of disposition of shares and changes in fair value are recorded in the statement of earnings as an unrealized gain or loss on investments.

The investment in ELK Solutions Inc. and Gosfield North Communications are measured at cost.

(f) Employee future benefits:

The Company provides post retirement benefits for employees who retire from active employment. The Company measures the costs of its obligation based on its best estimate.

The Company accrues its obligations under employee benefit plans as the employees render the services necessary to earn employee future benefits.

The cost of retirement benefits earned by employees is actuarially determined using the projected cost method pro rated on service and the actuary's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs. The excess of the net actuarial gain or loss over 10% of the benefit obligation is amortized over the average remaining service period of active employees of the plan, which is 11.3 years at December 31, 2011.

Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment.

(g) Payments in lieu of taxes ("PILs"):

The Company is currently exempt from taxes under the Income Tax Act (Canada) ("ITA") and the Ontario Corporations Tax Act ("OCTA").

Pursuant to the Electricity Act, the Company is required to compute taxes under the ITA and OCTA and remit such amounts thereunder computed to the Ministry of Finance (Ontario). These amounts, referred to as PILs under the Electricity Act, are applied to reduce certain debt obligations of the former Ontario Hydro continuing as Ontario Electricity Financial Corporation.

2. Significant accounting policies (continued):

(g) Payments in lieu of taxes ("PILs") (continued):

The Company provides for amounts in lieu of corporate income taxes using the asset and liability method. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the Ontario Energy Board ("OEB") and recovered from the customers of the Company at the time.

(h) Pension plan:

The Company provides a pension plan for its employees through the Ontario Municipal Employees Retirement System ("OMERS"). OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund ("the Fund"), and provides pensions for employees of Ontario municipalities, local boards, public utilities and school boards. The Fund is a contributory defined benefit pension plan.

(i) Customer deposits:

Customer deposits comprise cash collections from electricity customers which are applied against any unpaid portion of individual customer accounts. Customer deposits in excess of unpaid account balances are refundable to individuals upon termination of their electricity service.

(j) Use of estimates:

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. Significant items subject to such estimates and assumptions include valuation allowances for accounts receivable, regulatory assets, future payments in lieu of income taxes and employee future

2. Significant accounting policies (continued):

(j) Use of estimates (continued):

benefits, and the carrying value of property, plant and equipment. Actual results could differ from those estimates.

(k) Rate regulation:

Smart Meter Initiative:

The Province of Ontario has committed to have “Smart Meter” electricity meters installed in all homes and small businesses throughout Ontario by the end of 2010. Smart Meters permit consumption to be recorded within specific time intervals and specific tariffs to be levied within such intervals.

In support of this initiative, the Company completed its deployment of Smart Meters throughout 2010 and early 2011, with approximately 10,859 Smart Meters deployed. Time of use billing for customers began with the September 2011 billing period.

In accordance with the Smart Meter Funding and Cost Recovery – Final Disposition, December 15, 2011 the Smart Meter funding adder of $1.45 per metered customer per month will cease April 30, 2012. The Corporation will be filing its smart meter rate application in 2012 along with its cost of service application.

(l) Long-lived assets:

The Company periodically reviews the useful lives and the carrying values of its long-lived assets for continued appropriateness. The Company reviews for impairment long-lived assets (or asset groups) to be held and used whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If the sum of the undiscounted expected future cash flows expected to result from the use and eventual disposition of an asset is less than its carrying amount, it is considered to be impaired. An impairment loss is measured at the amount by which the carrying amount of the asset exceeds its fair value. When quoted market prices are not available, the Company uses the expected future cash flows discounted at a rate commensurate with the risks associated with the recovery of the asset as an estimate of fair value.

2. Significant accounting policies (continued):

(m) Financial Instruments:

All financial instruments are carried 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.

The Company has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Accounts receivable	Loans and receivables
Accounts payable and accruals	Other liabilities
Shareholder promissory notes	Other liabilities
Long-term debt	Other liabilities

(n) Related party transactions:

Transactions with related parties represent the culmination of the earnings process and are measured at the exchange amount.

3. Property, plant and equipment:

	Cost	Accumulated amortization	2011 Net book value	2010 Net book value
Land	$ 173,877	$ -	$ 173,877	$ 173,877
Buildings, plant and equipment	3,760,272	1,885,577	1,874,695	960,172
Transmission and distribution system	18,694,359	12,986,209	5,708,150	6,982,640
	$ 22,628,508	$ 14,871,786	$ 7,756,722	$ 8,116,689

4. Regulatory assets (liabilities):

Regulatory assets and liabilities arise as a result of the rate regulating process. The Company has recorded the following regulatory assets and liabilities:

	2011	2010 (restated – See note 18)
Regulatory assets (liabilities):		
Future payments in lieu of income taxes	$ (920,111)	$ (884,111)
Other regulatory assets	3,718,330	3,051,199
Miscellaneous deferred debits	3,240	3,240
Amount approved for recovery of regulatory assets	495,437	(448,663)
Retail settlement variances	(3,974,796)	(1,271,874)
Smart meter capital and recovery	1,384,922	1,382,506
	$ 707,022	$ 1,832,297

(a) Future payments in lieu of income taxes:

Future payments in lieu of income taxes represent the OEB approved PILs methodology for determining the deferral account allowance.

(b) Retail settlement variances:

E.L.K. has deferred certain retail settlement variances amounts under the provisions of Article 490 of the OEB's Accounting Procedures Handbook.

These variances represent amounts that have accumulated since Market Opening and comprise:

(i) variances between amounts charged by the Independent Electricity System Operator ("IESO") for the operation of the wholesale electricity market and grid, various wholesale market settlement charges, amounts charged to allow for the purchase of imported electricity and transmission charges, and the amounts billed to customers by the Company based on the OEB approved market service rate; and

4. Regulatory assets (continued):

(b) Retail settlement variances (continued):

(ii) amounts allocated to the Company and approved by the OEB for the recovery of regulatory assets incurred by Hydro One including low voltage tariffs. The Hydro One recovery of these charges commenced on April 1, 2005 and these costs will be passed through to customers during the rate making process.

(c) Other regulatory assets:

On December 20, 2004, the OEB issued a letter on the accounting treatment of OEB assessments. The OEB clearly identifies that it is their intent to allow electricity LDC's to record their OEB cost assessments for the Board's fiscal year 2005 and subsequent years in order that these costs may be given consideration for rate recovery in the future.

(d) Miscellaneous deferred debits:

On December 13, 2005, the OEB issued a letter on the accounting treatment of costs related to Ontario Price Credit ("OPC"). Costs related to the payment of OPC are being deferred. No additional amounts will be approved by the OEB until the next cost of services application.

(e) Amounts approved for recovery of regulatory assets:

The Ontario Energy Board Act, 1998 (Ontario) ("OEBA"), approved, as part of the 2006 rates application process, a reallocation for each regulatory asset or liability to a separate account, amounts approved for recovery of regulatory assets . The associated recoveries collected through rates over May 1, 2006 to April 30, 2008 are to be recorded as a reduction of amounts approved for recovery of regulatory assets. Any residual balance at the end of the collection period will be reviewed in future proceedings of the OEB.

(f) Smart Meter deferral account:

This account represents the deferral of operating expenditures, capital expenditures and revenues related to Smart Meters in accordance with the direction set out by the OEB. In total, 11,099 meters were "stranded" and transferred to the regulatory account. The book value of $271,776 for the replaced meters was transferred to regulatory assets in 2010.

4. Regulatory assets (continued):

(g) Electricity industry in Ontario:

The Ontario Energy Board Act, 1998 (Ontario) (“OEBA”), conferred on the OEB increased powers and responsibilities to regulate the electricity industry. These powers and responsibilities include the power to approve or fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity consumers, and the responsibility for ensuring the distribution companies fulfill obligations to connect and service customers.

The OEB may also prescribe license requirements and records, regulatory accounting principles, separation of accounts for distinct business and filing and processing requirements for rate setting purposes. In its capacity to approve or set rates, the OEB has the authority to specify regulatory treatments that may result in accounting treatments that differ from Canadian generally accepted accounting principles for enterprises operating in a non-rate regulated environment.

5. Investments:

	2011	2010
Investment in the Class A common shares of E.L.K. Solutions Inc., at cost	$ 100	$ 100
Investment in Gosfield North Communications, at cost	1	1
Investment in the preferred shares of Utilismart Corporation, at market	8,045	2,413
Investment in the common shares of Sun Life Financial, at market	27,896	44,442
	$ 36,042	$ 46,956

6. Shareholder promissory notes:

The shareholder promissory notes are payable on demand, accrue interest at 7.25% payable annually, and are secured by a general security agreement. These notes are subordinate to the bank term loan. In 2011, the Company paid $154,045 (2010 - $142,925) of interest on these notes.

7. Long-term debt:

	2011	2010
Three year term loan with interest rate of 2.35% 2010 - 1.343%) repayable in full on or before maturity of June 2012, secured by a general security agreement	$ 6,400,000	$ 7,200,000
Less: current portion	6,400,000	-
	$ -	$ 7,200,000

During the year, the Company paid $153,273 of interest on long-term debt (2010 – $147,028).

8. Employee future benefits:

E.L.K. Energy Inc. pays certain benefits on behalf of its retired employees.

The Company measures its accrued benefit obligation for accounting purposes as at December 31 each year. A valuation date of December 31, 2010 was used, with results extrapolated to December 31, 2011.

Information about E.L.K. Energy Inc.'s defined benefit plans, which are unfunded, is as follows:

	2011	2010
Accrued benefit obligation, beginning of year	$ 686,906	$ 686,513
Service cost	11,420	7,867
Interest cost	25,858	28,353
Amortization of actuarial gain	(9,721)	(8,858)
Benefits paid	(26,276)	(26,969)
Projected accrued benefit obligation, end of year, as determined by actuarial valuation	$ 688,187	$ 686,906

	2011	2010
Funded status:		
Funded status, deficit	$ (546,879)	$ (524,597)
Unamortized net actuarial gain	(141,308)	(162,309)
	$ (688,187)	$ (686,906)

8. Employee future benefits (continued):

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

	2011	2010
Discount rate	4.25%	5.00%
Rate of compensation increase	3%	3%
Medical trend rate:		
Initial	8.2%	10%
Ultimate	4%	4%

The approximate impact of a 1% change in health insurance trend rates is as follows:

	2011	2010
Change in obligation for 1% increase in trend rates	$ 50,000	$ 48,000
Change in obligation for 1% decrease in trend rates	(44,000)	(42,000)

9. Share capital:

The authorized and issued share capital is as follows:

	2011	2010
Authorized:		
Unlimited common shares		
Issued:		
30,000 common shares	$ 2,000,100	$ 2,000,100

10. Pension costs:

The Company makes contributions to the Ontario Municipal Employees Retirement Fund ("OMERS") which is a multi-employer plan, on behalf of 21 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. The OMERS plan is in a deficit position.

The amount contributed to OMERS for 2011 was $124,860 (2010 – $95,857) for current service and is included as an expenditure on the statement of earnings.

In 2011 the contribution rates were 7.4% (2010 - 6.4%) for employees earnings below the year's maximum pensionable earnings and 10.7% (2010 - 9.7%) thereafter.

11. Supplemental cash flow information:

	2011	2010
Cash paid during the year for:		
Interest	$ 307,659	$ 478,970
Payments in lieu of income taxes	564,544	836,872
Cash received during the year for:		
Interest	77,844	55,154

12. Related party transactions:

The amounts due to/from shareholder and subsidiary are as follows:

	2011	2010
Due to shareholder, included in accounts payable	$ 472,170	$ 464,808
Due from shareholder, included in accounts receivable	22,169	23,061
Due from subsidiary, included in accounts receivable	93,006	185,602

12. Related party transactions:

Transactions with shareholder are as follows:

	2011	2010
Provision of services to shareholder	$ 464,738	$ 442,958
Interest incurred on shareholder promissory notes	154,045	142,925

These amounts are measured at the exchange amount, which is the amount of consideration paid or received as established and agreed to by the related parties.

13. Future payments in lieu of income taxes:

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future tax liabilities and assets are as follows:

	2011	2010
Future tax liabilities:		
Investments	$ 6,000	$ 8,750
Total future tax liabilities	$ 6,000	$ 8,750
Future tax assets:		
Property, plant and equipment	$ 967,000	$ 964,800
Employee future benefits	229,000	232,150
Intangible assets	130,000	148,750
Smart meter revenue	126,000	71,350
Financing fees	2,000	3,700
Total future tax assets	1,454,000	1,420,750
Net future tax assets	$ 1,448,000	$ 1,412,000

14. Fair value of financial assets and liabilities:

The fair value of the Company's cash, accounts receivable, accounts payable and accrued liabilities, customer deposits and shareholder promissory notes approximate their carrying values due to the relative short-term maturity of these financial instruments.

It is not practical to determine the fair value of the investment in subsidiary as it is not publicly traded.

The fair value of the Company's long-term debt approximates its carrying value as the terms and conditions of the borrowing agreement is similar to current market terms and conditions.

Risk Factors:

The Company's activities provide for a variety of financial risks, particularly credit risk, market risk and liquidity risk.

i) Credit risk:

Financial assets carry credit risk that a counter-party will fail to discharge and 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 earns its revenue from a broad base of customers located in the towns of Essex, Lakeshore, and Kingsville. No single customer in either year would account for revenue in excess of 1% of the respective reported balances.

The carrying amount of accounts receivable is reduced through the use of an allowance for doubtful accounts and the amount of the related impairment loss is recognized in the statement of earnings. Subsequent recoveries of receivables previously provisioned are credited to the statements of earnings. The balance of the allowance for doubtful accounts at December 31, 2011 is $639,297 (2010 - $359,988). No single customer accounts for more than 1% of accounts receivable at year-end.

The Company's credit risk associated with accounts receivable is primarily related to payments from distribution customers. The Company has approximately 11,120 customers, the majority of which are residential. At December 31, 2011, approximately $1,090,135 (2010 -$926,623) is considered 60 days past due. 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 holds security deposits in the amount of $956,619 (2010 - $839,167).

14. Fair value of financial assets and liabilities (continued):

ii) Market risk:

Market risks primarily refer to the risk of loss that results from changes in commodity prices, foreign exchange rates, and interest rates. The Company currently does not have material commodity or foreign exchange risk. E.L.K. Energy Inc. is exposed to fluctuations in interest rates as the regulated rate of return for the Company's distribution business is derived using a complex formulaic approach which is in part based on the forecast for long-term Government of Canada bond yields. This rate of return is approved by the OEB as part of the approval of distribution rates.

iii) 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 expense. The Company has access to a line of credit and monitors cash balances to ensure that sufficient levels of liquidity are on hand to meet financial commitments as they come due.

15. Directors' remuneration:

The remuneration of directors amounted to $21,709 (2010 – $22,291).

16. Capital management:

In managing capital, the Company focuses on liquid resources available for operations. The organization's objective is to have sufficient liquid resources to continue operating despite adverse financial events and to provide it with the flexibility to take advantage of opportunities that will advance its purposes. The need for sufficient liquid resources is considered in the monitoring of cashflows and actual operating results. As at December 31, 2011, the Company has met its objective of having sufficient liquid resources to meet its current obligations.

17. Contingencies:

From time to time, the Company is involved in various litigation matters arising in the ordinary course of its business. The Company has no reason to believe that the disposition of any such current matter could reasonably be expected to have a materially adverse impact on the Company's financial position, results of operations or its ability to carry on any of its business activities.

18. Prior period adjustment:

During the year ended December 31, 2011, the Company became aware that the 2010 retail settlement variance component of regulatory assets was overstated as a result of an error in the calculation.

The Company has corrected this error retroactively and accordingly the 2010 comparative figures have been restated as follows:

	2010 Increase (decrease)
Balance sheet:	
Payment in lieu of income taxes receivable	$ 284,726
Regulatory assets	(926,694)
Retained earnings	(641,968)
Statement of earnings:	
Service revenue	3,285,266
Cost of electricity	4,211,956
Payments in lieu of income taxes	(284,726)
Net earnings	(641,968)

19. Future 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.

19. Future accounting changes (continued):

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.

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 period beginning on or after January 1, 2011 to disclose that fact.

In March 2012, the AcSB extended the deferral of adoption of Part 1 of the CICA Handbook for qualifying entities with activities subject to rate regulation for an additional year to January 1, 2013. The Company had decided to implement IFRS commencing January 1, 2012 and is now assessing whether the extended deferral option will be taken.