

*Financial Statements of*

**NEWMARKET HYDRO LTD.**

*December 31, 2002*

Deloitte & Touche LLP  
5140 Yonge Street, Suite 1700  
Toronto, ON M2N 6L7  
Canada

Tel: (416) 601 6150  
Fax: (416) 229 2524  
www.deloitte.ca

**Deloitte  
& Touche**

## **Auditors' Report**

To the Shareholder of  
Newmarket Hydro Ltd.

We have audited the balance sheet of Newmarket Hydro Ltd. as at December 31, 2002 and the statements of earnings and retained earnings and of cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2002 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*Deloitte & Touche LLP*

Chartered Accountants

Toronto, Ontario  
March 21, 2003

**Deloitte  
Touche  
Tohmatsu**

# **NEWMARKET HYDRO LTD.**

## **Table of Contents**

**December 31, 2002**

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	<u>Page</u>
Balance Sheet	1
Statement of Earnings and Retained Earnings	2
Statement of Cash Flows	3
Notes to the Financial Statements	4-12

**NEWMARKET HYDRO LTD.****Balance Sheet**

December 31, 2002

ASSETS	2002	2001
<b>CURRENT</b>		
Cash and cash equivalents	\$ 11,755,220	\$ 11,864,149
Accounts receivable	3,802,732	3,450,464
Due from IMO	1,692,576	-
Unbilled revenue	4,678,320	4,605,381
Inventory	692,021	725,289
Prepaid expenses	163,291	66,082
	<b>22,784,160</b>	<b>20,711,365</b>
<b>OTHER ASSETS</b>		
Deferred charges	31,449	21,849
Deferred qualifying transition costs	413,690	531,241
Intangibles	112,132	67,422
Other assets	16,048	25,705
	<b>573,319</b>	<b>646,217</b>
<b>CAPITAL ASSETS (Note 3)</b>	<b>36,534,746</b>	<b>37,526,753</b>
	<b>\$ 59,892,225</b>	<b>\$ 58,884,335</b>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities (Note 5)	\$ 5,309,323	\$ 5,356,641
Current portion of customers' deposits	250,000	173,000
Current portion of subdividers' lot levies	17,862	17,860
Due to related parties (Note 15)	3,970,550	3,970,550
	<b>9,547,735</b>	<b>9,518,051</b>
<b>OTHER</b>		
Customers' deposits	2,152,912	1,626,459
Employee future benefits (Note 4)	279,170	177,537
	<b>2,432,082</b>	<b>1,803,996</b>
<b>LONG-TERM DEBT (Note 7)</b>	<b>22,000,000</b>	<b>22,000,000</b>
	<b>33,979,817</b>	<b>33,322,047</b>
<b>EQUITY</b>		
Share capital (Note 8)	25,806,563	25,806,563
Retained earnings (deficit)	105,845	(244,275)
	<b>25,912,408</b>	<b>25,562,288</b>
	<b>\$ 59,892,225</b>	<b>\$ 58,884,335</b>

APPROVED BY THE BOARD

..... Director

..... Director

**NEWMARKET HYDRO LTD.****Statement of Earnings and Retained Earnings**

Year ended December 31, 2002

	2002	2001
SERVICE REVENUE		
General	\$ 35,201,768	\$ 29,401,132
Residential	23,369,117	18,918,534
Street lighting	162,066	150,368
	58,732,951	48,470,034
Unbilled revenue adjustment	422,481	834,250
	59,155,432	49,304,284
COST OF POWER		
Purchased power	47,979,491	42,736,393
Variance account write-off (Note 10)	2,713,020	-
	50,692,511	42,736,393
GROSS MARGIN	8,462,921	6,567,891
OTHER INCOME		
Standard supply service administration charge	49,532	-
Retailer charges	17,708	-
Interest	433,727	393,717
Occupancy, connection and collection fees	183,981	143,085
Rentals	61,226	38,985
Power bill aggregation	228,723	528,929
Miscellaneous	(28,241)	279,664
Net gain on disposal of capital assets	11,647	26,551
	958,303	1,410,931
OPERATING EXPENSES		
Amortization of capital assets, net of \$170,371 (2001 - \$207,068) charged to other accounts	2,763,019	2,627,035
Amortization of contributions for capital construction	(211,939)	(152,498)
System operations and maintenance	1,612,021	1,277,504
Customer billing and collecting	1,043,769	1,198,985
Community relations and advertising	66,374	45,779
Administration	1,550,489	1,314,603
Write-down of intangibles	-	279,042
Write-off of transition costs	268,920	-
Interest	1,644,230	446,377
Property and capital tax	219,527	117,896
	8,956,410	7,154,723
INCOME BEFORE INCOME TAX	464,814	824,099
INCOME TAX (Note 9)	114,694	24,500
NET INCOME	350,120	799,599
DEFICIT, BEGINNING OF YEAR	(244,275)	(821,034)
LOT LEVY CONTRIBUTIONS (Note 2(h))	-	35,160
DIVIDENDS (Note 15)	-	(258,000)
RETAINED EARNINGS (DEFICIT), END OF YEAR	\$ 105,845	\$ (244,275)

**NEWMARKET HYDRO LTD.****Statement of Cash Flows**

Year ended December 31, 2002

	2002	2001
<b>NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES</b>		
<b>OPERATING</b>		
Net income	\$ 350,120	\$ 799,599
Items not affecting cash		
Amortization of capital assets	2,933,390	2,834,103
Amortization of contributions for capital construction	(211,939)	(152,498)
Amortization of deferred charges	-	-
Employee future benefits	101,633	95,341
Write-down of intangibles	-	279,042
Write-off of transition costs	268,920	
Gain on disposal of capital assets	(11,647)	(26,551)
	3,430,477	3,829,036
Net change in non-cash working capital balances related to operations		
Accounts receivable	(352,268)	1,287,977
Due from IMO	(1,692,576)	-
Unbilled revenue	(72,939)	(834,250)
Inventory	33,268	(21,193)
Prepaid expenses	(97,209)	(15,672)
Accounts payable and accrued liabilities	(47,318)	572,228
	1,201,435	4,818,126
<b>INVESTING</b>		
Additions to capital assets (net of capital contributions)	(1,729,444)	(1,212,708)
Increase in intangibles	(44,710)	(115,114)
Increase in deferred qualifying transition costs	(151,369)	(220,301)
Proceeds from sale of capital assets	11,647	26,551
Decrease in other assets	9,657	4,200
Increase in deferred charges	(9,600)	(10,500)
Dividend paid	-	(258,000)
	(1,913,819)	(1,785,872)
<b>FINANCING</b>		
Increase in customers' deposits	603,455	254,823
Advance from related party	-	170,550
	603,455	425,373
<b>NET CASH (OUTFLOW) INFLOW</b>	<b>(108,929)</b>	<b>3,457,627</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>11,864,149</b>	<b>8,406,522</b>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ 11,755,220</b>	<b>\$ 11,864,149</b>
<b>SUPPLEMENTARY CASH FLOW INFORMATION</b>		
Interest paid	\$ 2,070,270	\$ 3,784
Income taxes paid	\$ 253,931	\$ 24,500

**NEWMARKET HYDRO LTD.**  
**Notes to the Financial Statements**  
**December 31, 2002**

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**1. NATURE OF OPERATIONS**

Newmarket Hydro Ltd. (the Corporation) is a wholly-owned subsidiary of Newmarket Hydro Holdings Inc. and was incorporated April 10, 2000 under the laws of the Province of Ontario. The Company commenced operations on November 1, 2000. Newmarket Hydro Holdings Inc. is wholly-owned by the Town of Newmarket.

The principal activity of the Corporation is to distribute electricity to the residents and businesses in the Town of Newmarket under the license issued by the Ontario Energy Board ("OEB"). The Corporation is regulated by the OEB and adjustments to the Corporation's distribution and power rates require OEB approval.

**2. SIGNIFICANT ACCOUNTING POLICIES**

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and policies set forth in the Accounting Procedures Handbook issued by the OEB under the authority of the Ontario Energy Board Act, 1998:

*(a) Cash and Cash Equivalents*

Cash equivalents include short-term investments with maturities of three months or less when purchased.

*(b) Inventory*

Inventory consisting of repair parts, supplies and materials for maintenance and capital expansions is valued at the lower of cost (determined on a first-in, and first-out basis) and net realizable value.

*(c) Capital Assets*

Capital assets are stated at cost which is comprised of material, labour, charges for truck time plus overheads. Amortization is provided on the straight-line basis over the estimated service lives of the assets as summarized below:

Distribution systems	25 to 30 years
Other equipment	3 to 15 years

*(d) Deferred Qualifying Transition Costs*

Deferred qualifying transition costs consist of qualifying capital costs and related expenditures incurred in the preparation for electricity market opening, May 1, 2002. Recovery of the deferred costs is regulated by the OEB.

**NEWMARKET HYDRO LTD.**  
**Notes to the Financial Statements**  
**December 31, 2002**

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**2. SIGNIFICANT ACCOUNTING POLICIES (continued)**

*(e) Deferred Charges*

Deferred charges represent prepaid vehicle lease payments which are amortized over the life of the lease.

*(f) Intangibles*

Intangibles include corporate restructuring costs that are comprised principally of professional fees. Intangibles are stated at cost and amortized over five years.

*(g) Contributions for Capital Construction*

Contributions for capital construction consist of third party contributions toward the cost of constructing distribution assets and a portion will be refunded by the Corporation based on future economic evaluations, in accordance with the OEB Distribution System Code. They are accounted for as reductions to the cost of related capital assets and are amortized at rates corresponding with the useful lives of the related capital assets.

*(h) Subdivider Lot Levies*

Subdivider lot levies received prior to January 1, 2000 are recorded by the Corporation as liabilities until the funds are expended, at which time they are transferred to equity of the Corporation. Lot levies received on or after January 1, 2000 are transferred to contributions for capital construction upon being expended.

*(i) Revenue Recognition and Cost of Power*

Service revenue is recorded on the basis of regular meter readings and estimated customer usage since the last meter reading date to the end of the period. The related cost of power is recorded on the basis of power consumed by the customer.

*(j) Payments in Lieu of Income Taxes*

Under the Electricity Act, 1998, the Corporation is required to make payments-in-lieu of corporate taxes to the Ontario Electricity Financial Corporation (OEFC), commencing October 1, 2001. These payments are calculated in accordance with the rules for computing taxable income and taxable capital and other relevant amounts contained in the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) as modified by the Electricity Act, 1998, and related regulations. Prior to October 1, 2001, the Corporation was not subject to income or capital taxes.

The Corporation uses the taxes payable method of accounting for income taxes. 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. Rate-regulated enterprises need not recognize future income taxes to the extent that future income taxes are expected to be included in the rates charged to and recovered from future customers.

Payments-in-lieu of income taxes are henceforth referred to as income taxes.



**NEWMARKET HYDRO LTD.**  
**Notes to the Financial Statements**  
December 31, 2002

**2. SIGNIFICANT ACCOUNTING POLICIES (continued)**

*(k) Post-employment Benefits other than Pensions*

Newmarket Hydro Ltd. pays certain health, dental and life insurance benefits on behalf of its retired employees. The Corporation recognizes these post-retirement costs in the period in which the employees rendered the services.

The transitional obligation resulting from the implementation of this policy in 2000 (applied on a prospective basis) is being amortized over the average remaining service period of employees (11 years).

*(l) Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Due to the inherent uncertainty in making estimates, actual results could differ from those estimates.

**3. CAPITAL ASSETS**

	2002			2001
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Land	\$ 46,315	\$ -	\$ 46,315	\$ 44,815
Transmission and distribution systems	66,110,981	(25,705,097)	40,405,884	40,067,612
Plant and equipment	2,883,587	(2,216,849)	666,738	797,063
Office equipment	453,137	(258,598)	194,539	185,245
Leasehold improvements	106,438	(29,213)	77,225	13,887
	69,600,458	28,209,757	41,390,701	41,108,622
Contributions for capital construction	(5,284,900)	428,945	(4,855,955)	(3,581,869)
	\$ 64,315,558	\$ 27,780,812	\$ 36,534,746	\$ 37,526,753

**4. EMPLOYEE FUTURE BENEFITS**

The accrued benefit obligation at January 1, 2002 and the net periodic expense for the year ended December 31, 2002 were determined by actuarial valuation. The actuarial valuation at January 1, 2002 determined the accrued benefit obligation to be \$548,460 (2001 - \$507,148).

**NEWMARKET HYDRO LTD.**  
**Notes to the Financial Statements**  
December 31, 2002

**4. EMPLOYEE FUTURE BENEFITS (continued)**

Information about the employee future benefits is as follows:

	2002	2001
Accrued benefit obligation, beginning of year	\$ 548,460	\$ 507,148
Unamortized transitional obligation, end of year	\$ 398,880	\$ 414,939
	2002	2001
Estimated accrued benefit liability, beginning of year	\$ 177,537	\$ 82,196
Expense for the year	57,024	53,185
Amortization of transitional obligation	57,372	54,029
Benefits paid during the year	(12,763)	(11,873)
Estimated accrued benefit liability, end of year	\$ 279,170	\$ 177,537

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

*General inflation*

Future general inflation levels, as measured by changes in the Consumer Price Index ("CPI"), were assumed to be 3.5% in 2000 and thereafter.

*Interest (discount) rate*

The present value as at December 31, 2002 of the future benefits, and the expense for the twelve months ended December 31, 2002, were determined using a discount rate of 6.0%. This corresponds to the assumed CPI rate plus an assumed rate of return of 2.5%.

*Salary levels*

Future general salary and wage levels were assumed to increase at 2% per annum.

*Health costs*

Health costs were assumed to increase at the CPI rate plus a further increase of 4% annually, graded down to 1% in 2004 and thereafter.

*Dental costs*

Dental costs were assumed to increase at the CPI rate plus a further increase of 1.0% in 2000 and thereafter.

**NEWMARKET HYDRO LTD.**  
**Notes to the Financial Statements**  
**December 31, 2002**

**5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

	<u>2002</u>	<u>2001</u>
Accounts payable - purchased power	\$ 4,240,014	\$ 4,559,459
Other accounts payable and accrued liabilities	921,948	499,612
Deferred revenues	142,606	289,765
Upper Canada Energy Alliance	4,755	7,805
	<u>\$ 5,309,323</u>	<u>\$ 5,356,641</u>

**6. SHORT TERM CREDIT FACILITIES**

(a) 364 Day Revolving Operating Loan

The Corporation has a \$1,500,000 operating loan available from a major chartered bank. The purpose is to finance timing differences between deposit maturities, and existing debt and capital requirements, as necessary. This facility is a 364 day revolving operating loan, bearing interest at prime, to be repaid within one year from date of acceptance, unless extended by the bank. A standby fee of 10 basis points, payable quarterly in arrears applies to any unused portion of the facility. As at the balance sheet date, the Corporation has no balance outstanding on this facility (2001 - n/a). The operating loan includes restrictive clauses with respect to debt repayment.

(b) Prudential Requirements

Part 5.4 of the Independent Market Operator (IMO) Settlements Manual obligated the Corporation to secure prudential support in the amount of \$5,406,833 before electricity market opening (May 1, 2002). The Corporation secured the necessary prudential support by means of a \$8,505,000 Letter of Credit with a major chartered bank. The Letter of Credit includes restrictive clauses with respect to debt repayment.

**7. LONG-TERM DEBT**

The Corporation has an unsecured promissory note outstanding in the amount of \$22,000,000 to the Town of Newmarket. The note bears interest at a simple annual rate equal to the rate of interest that the Corporation is, from time to time, permitted by the OEB to recover in its rates (currently 7.25% per annum). Interest is due on the last day of each fiscal year and on terms and at such time as may be further determined by the Director of Finance/Town Treasurer in consultation with senior corporate officers of the Corporation. Beginning in 2003, interest will be paid quarterly in arrears. Determination of, and changes to, maturity and repayment terms require 13 months notice. The Promissory Note has been subordinated to the IMO Letter of Credit referred to in Note 6.

**NEWMARKET HYDRO LTD.**  
**Notes to the Financial Statements**  
**December 31, 2002**

**8. SHARE CAPITAL**

	<u>2002</u>	<u>2001</u>
Authorized		
Unlimited number of common shares		
Issued		
1,001 Common shares	<b>\$ 25,806,563</b>	<b>\$ 25,806,563</b>

**9. INCOME TAXES**

The Corporation became obligated to make payments-in-lieu of taxes on October 1, 2001. There were no income or capital taxes in the periods prior to October 1, 2001.

The provision for income taxes under the taxes payable method (see Note 2(j)) for the year is \$114,694 (2001 - \$24,500) representing large corporations tax and corporate minimum tax.

Future income taxes have not been recorded in the accounts as they are expected to be recovered reflected through future distribution rates. As at December 31, 2002 future income tax assets of \$3,060,692 (2001 - \$3,211,266) have not been recorded on the balance sheet. Future income tax expenses of \$150,574 (2001 - benefit of \$260,772) have not been reflected in the income tax provision for the year ended December 31, 2002.

The Corporation has income tax losses carried forward of \$442,380 (2001 - \$594,490) which expire in 2008.

A reconciliation between income recorded on the financial statements and the income (loss) for income tax purposes is provided as follows:

	<u>2002</u>	<u>2001</u>
Income before provision for income taxes	<b>\$ 464,814</b>	<b>\$ 824,099</b>
Less: Income prior to October 1, 2001 not subject to tax	-	(1,099,999)
Capital cost allowance in excess of amortization	<b>(407,574)</b>	<b>(192,379)</b>
Other net amounts deducted for accounting over tax amounts	<b>94,870</b>	<b>(126,211)</b>
Income (loss) for tax purposes	<b>\$ 152,110</b>	<b>\$ (594,490)</b>

**NEWMARKET HYDRO LTD.**  
**Notes to the Financial Statements**  
**December 31, 2002**

**9. INCOME TAXES (continued)**

Significant components of the Corporation's future tax assets as at December 31 are as follows:

	2002	2001
Recoverable corporate minimum tax	\$ 10,865	\$ -
Loss carry forwards	133,245	179,060
Capital assets	2,832,496	2,978,732
Employee future benefits	84,086	53,474
Net future income tax asset	\$ 3,060,692	\$ 3,211,266

The prior year future income tax asset figures have been restated for comparative purposes due to an amendment of the capital cost allowance claimed on capital assets in the fiscal year 2001.

**10. VARIANCE ACCOUNT WRITE-OFF**

	2002			2001
	Paid to OPG or IMO	Revenue from Customers	Variance Account	
<i>Pre-market opening variances</i>				
Cost of power variance	\$ 15,890,354	\$ (14,555,542)	\$ 1,334,812	\$ -
<i>Post-market opening variances</i>				
Energy variance	26,072,651	(26,072,651)	-	-
Wholesale market service variance	3,830,478	(2,831,784)	998,694	-
Transmission variance	4,899,028	(4,519,514)	379,514	-
	\$ 50,692,511	(47,979,491)	\$ 2,713,020	\$ -

During the year the Corporation accumulated certain variance accounts representing purchase of power costs in excess of revenue billed to customers. The OEB regulates both the rates that can be charged to the Corporation and the rates that the Corporation can charge its customers.

The balance of the variance accounts at December 31, 2002 of \$2,713,020 has been written off as management believes the likelihood of future recovery to be low. This is in light of the undesirable impact on customer rates the recovery of these costs would have, as well as the fact that any recovery could not begin until 2006, as a result of the current distribution rate freeze established by Bill 210. No commitment has been made by the Ontario government or the OEB to allow recovery of these variance accounts.

**NEWMARKET HYDRO LTD.**  
**Notes to the Financial Statements**  
**December 31, 2002**

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**11. PENSION AGREEMENT**

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

Currently, due to a surplus of investment earnings in the fund, the Corporation and its employees are in a "contribution holiday". Therefore, in the twelve months ended December 31, 2002, there were no current service pension costs charged to income.

**12. LEGAL PROCEEDINGS**

A class action claiming \$500 million in restitutionary payments plus interest was served on Toronto Hydro Electric Commission on November 18, 1998. The action was initiated against Toronto Hydro as the representative of the Defendant Class consisting of all municipal electric utilities in Ontario that 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 electric utilities receiving interest at effective rates in excess of 60% per year, which are illegal under Section 347(1)(b) of the Criminal Code.

The Electricity Distributors Association is undertaking the defense of this class action. At this time it is not possible to quantify the effect, if any, on the financial statements of the Corporation, and as such no accrual of any potential liability has been recognized.

**13. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The fair values of the financial instruments included in the financial statements approximate their carrying amounts due to the short-term maturity of those instruments. The fair value of the long-term debt has not been calculated on the basis that the future terms of the promissory notes (Note 7) are indefinite.

**14. COMMITMENTS**

- (a) The Corporation has a five-year lease agreement with the Town of Newmarket for rental of the 590 Steven Court building. Annual payments of \$180,500 are due on December 31 of each year subsequent to the commencement date of October 1, 2001.
- (b) In accordance with the OEB Distribution System Code, the Corporation will be required to make payments to developers relating to third party contributions for capital construction. The obligation to make payments will result in a reduction to "Contributions for Capital Construction" once the amount is determinable.

**NEWMARKET HYDRO LTD.**  
**Notes to the Financial Statements**  
December 31, 2002

**15. RELATED PARTY TRANSACTIONS**

The following summarizes the Corporation's related party transactions and balances with the Town of Newmarket:

Transactions	2002	2001
Revenues		
Energy sales (at commercial rates)	\$ 1,478,980	\$ 1,366,071
Services		
Street light capital	133,089	155,615
Street lamp maintenance	253,197	347,514
Costs		
Interest	1,595,000	398,750
Rent	180,000	45,000
Water bill	1,135	1,203
Municipal taxes	71,642	82,795
Balances		
Accounts receivable	\$ 360,673	\$ 127,758
Long term debt	22,000,000	22,000,000
Accrued interest payable	-	414,395

The following summarizes the Corporation's related party transactions with its parent company:

Transactions	2002	2001
Dividends paid	\$ -	\$ 258,000
Balances		
Amounts due to Newmarket Hydro Holdings Inc.	\$ 3,970,550	\$ 3,970,550

**16. BILL 210 – ENERGY REBATES**

Bill 210 received Royal Assent on November 25, 2002. One of the major premises of the Bill was to retroactively freeze the costs of electricity for designated users at 4.3 cents per kwh. As required by Bill 210, the Corporation issued rebates by way of a \$75 cheque to customers prior to December 31, 2002 and a credit to customer accounts as at that date. In turn, the amounts rebated or credited to customers were received from the IMO by way of a credit on the Corporation's power bill.

The amounts received or receivable from the IMO for rebates and customer credits totalled \$3,357,000. As the cost of power is intended to be a pass-through to the end customer, there is no net income affect arising from the rebates and credits.