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**Tay Hydro Electric
Distribution Company Inc.
Financial Statements**
December 31, 2002

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Auditors' Report

To the Directors of
Tay Hydro Electric Distribution Company Inc.

We have audited the balance sheet of Tay Hydro Electric Distribution Company Inc. as at December 31, 2002 and the statements of earnings and deficit and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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

The comparative figures for 2001 are based on financial statements, which were reported on by another firm of accountants.

Orillia, Canada
March 31, 2003

Grant Thornton LLP

Chartered Accountants

Tay Hydro Electric Distribution Company Inc.

Statements of Earnings and Deficit

Year Ended December 31

2002

2001

Revenue		
Distribution and sale of power prior to Open Access	\$ 1,403,241	\$ 3,978,308
Sale of power after Open Access	2,084,596	-
Distribution	<u>835,922</u>	<u>-</u>
	4,323,759	3,978,308 X
Cost of power		
Power purchased prior to Open Access	1,190,129	2,928,059
Power purchased after Open Access	<u>2,084,596</u>	<u>-</u>
	<u>3,274,725</u>	<u>2,928,059</u>
Gross margin	<u>1,049,034</u>	<u>1,050,249</u>
Other revenue	<u>133,743</u>	<u>160,781</u> X
Expenses		
Distribution	172,780	211,258
Administration	275,328	252,707
Depreciation	237,892	238,362
Billing and collecting	<u>172,038</u>	<u>153,255</u>
	<u>858,038</u>	<u>855,582</u>
Earnings from operations	324,739	355,448
Interest income	43,606	49,936 X
Interest on long term debt	<u>(210,086)</u>	<u>(245,063)</u>
Earnings before payments in lieu of income taxes	158,259	160,321
Payments in lieu of income taxes (Note 12)	<u>45,000</u>	<u>-</u>
Net earnings	\$ <u>113,259</u>	\$ <u>160,321</u>
Deficit, beginning of year		
As previously stated	\$ (148,959)	\$ (45,280)
Correction of prior period errors (Note 2)	<u>14,075</u>	<u>14,075</u>
As restated	(134,884)	(31,205)
Net earnings	113,259	160,321
Dividends	<u>(132,000)</u>	<u>(264,000)</u>
Deficit, end of year	\$ <u>(153,625)</u>	\$ <u>(134,884)</u>

See accompanying notes to the financial statements.

Tay Hydro Electric Distribution Company Inc.

Balance Sheet

December 31

2002

2001

Assets

Current

Cash	\$ 806,766	\$ 1,207,668
Receivables	307,581	495,617
Unbilled revenue	535,785	200,614
Inventory	103,393	97,773
Prepays	22,524	12,481
Due from related parties (Note 4)	<u>38,954</u>	<u>11,739</u>
	1,815,003	2,025,892

Property and equipment (Note 5)	3,186,828	3,378,120
Development charges (Note 6)	102,856	100,565
Regulatory assets (Note 7)	<u>379,840</u>	<u>131,674</u>
	\$ 5,484,527	\$ 5,636,251

Liabilities

Current

Payables and accruals	\$ 578,463	\$ 486,640
Payments in lieu of income taxes payable	41,770	-
Due to related party (Note 4)	-	147,413
Current portion of long-term debt	<u>165,000</u>	<u>156,000</u>
	785,233	790,053

Customer and retailer deposits	73,421	38,875
Development charges (Note 6)	102,856	100,565
Long term debt (Note 8)	<u>2,933,821</u>	<u>3,098,821</u>
	3,895,331	4,028,314

Capital and Deficit

Capital stock (Note 9)	1,742,821	1,742,821
Deficit	<u>(153,625)</u>	<u>(134,884)</u>
	1,589,196	1,607,937
	\$ 5,484,527	\$ 5,636,251

Commitment (Note 13)

On Behalf of the Board

Director

Director

See accompanying notes to the financial statements.

Tay Hydro Electric Distribution Company Inc.

Statement of Cash Flows

Year Ended December 31

2002

2001

Cash derived from (applied to)

	2002	2001
Operating		
Net earnings	\$ 113,259	\$ 160,321
Depreciation	237,892	238,362
Loss on disposal of capital assets	-	(2,012)
	<u>351,151</u>	<u>396,671</u>
Change in non-cash operating working capital (Note 10)	<u>(169,287)</u>	<u>190,394</u>
	<u>181,864</u>	<u>587,065</u>
Financing		
Decrease in long term debt	(156,000)	(208,000)
Dividends paid	<u>(132,000)</u>	<u>(264,000)</u>
	<u>(288,000)</u>	<u>(472,000)</u>
Investing		
Net additions to property and equipment	(46,600)	(102,923)
Net additions to regulatory assets	<u>(248,166)</u>	<u>(106,931)</u>
	<u>(294,766)</u>	<u>(209,854)</u>
Net decrease in cash	(400,902)	(94,789)
Cash, beginning of year	<u>1,207,668</u>	<u>1,302,457</u>
Cash, end of year	\$ <u>806,766</u>	\$ <u>1,207,668</u>

See accompanying notes to the financial statements.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2002

1. Nature of operations

The Company distributes electricity under license from the Ontario Energy Board (OEB).

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

The Ontario Energy Board Act, 1998 (Ontario) (OEBA) conferred on the Ontario Energy Board (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 that distribution companies fulfil obligations to connect and service customers. The OEB may also prescribe license requirements and conditions to electricity distributors, which may include among other things, specified accounting records, regulatory accounting principles, separation of accounts for distinct businesses and filing and process requirements for rate setting purposes.

2. Correction of prior period errors

Related party transfer

Pursuant to the Electricity Act, 1998, the Township transferred all of the assets, liabilities and employees of the distribution services division of The Hydro-Electric Commission of the Township to the Company effective November 1, 2000. The transfer was previously recorded at the exchange amount, which was the best estimate of the Township and the Company of fair market value of the net assets transferred as at the transfer date, as follows:

Net assets at net book value	\$ 3,485,642
Goodwill	1,700,000
Long term notes	2,592,821
Common shares	2,592,821

The estimate was based upon a number of assumptions, including that the transfer was at arm's length and expected rate orders by the OEB. The Township transfer by-law that enacted the transfer provided for an adjustment to the purchase price, if the parties mutually determined, subsequently, that it did not reflect the fair market value of the net assets as at the transfer date.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2002

2. Correction of prior period errors (Continued)

The Company has determined the transfer was not at arm's length, and should have been accounted for as a related party transaction in accordance with Canadian generally accepted accounting principles. Accordingly, the transfer should have been recorded at the carrying amount, which was equal to the net book value of the net assets as at the transfer date, as follows:

Net tangible assets	\$ 3,485,642
Long-term notes	1,742,821
Common shares	1,742,821

As a result of this determination and certain adverse rate orders by the OEB, the Township and the Company have mutually determined that the fair market value of the net assets was equal to their net book value as at the transfer date and have adjusted the purchase price accordingly.

Transformers and meters

The Company previously recorded spare transformers and meters on hand as inventory items in error. As recommended by the OEB'S Accounting Procedures Handbook Article 520 these assets are now being recorded as equipment.

The 2001 figures, presented for comparative purposes, have been restated, from those previously reported, in order to properly account for these transactions and balance as follows:

	<u>As previously reported</u>	<u>As restated</u>
Balance sheet		
Inventory	\$ 155,715	\$ 97,773
Property and equipment	3,324,856	3,378,120
Goodwill	1,601,700	-
Total assets	7,242,629	5,636,251
Payables and accruals	486,705	486,640
Due to Township of Tay	219,309	147,413
Long term debt	3,948,821	3,098,821
Total liabilities	4,950,275	4,028,314
Equity		
Share capital	2,592,831	1,742,821
Deficit	(300,477)	(134,884)
	<u>\$ 2,292,354</u>	<u>\$ 1,607,937</u>

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2002

2. Correction of prior period errors (Continued)

Transformers and meters

	<u>As previously reported</u>	<u>As restated</u>
Statements of earnings and deficit		
Depreciation	\$ 317,984	\$ 238,362
Interest	316,959	245,063
Net earnings	\$ 8,803	\$ 160,321

3. Summary of significant accounting policies

Cash and cash equivalents

Cash and cash equivalents include cash on hand, bank balances, money market funds and guaranteed investment certificates.

Inventory

Inventory consists of repair parts, supplies and materials held for future capital expansion and is valued at the lower of cost and net realizable value.

Rate-setting

Rates for the Company for periods preceding Open Access were set by the OEB to provide an annual rate of return on the amount of common equity. Prior to Open Access, the Company purchased power from Ontario Power Generation and charged distribution customers a bundled rate for generation, transmission and distribution of electricity. The bundled rates originally set by the OEB provided for an annual rate of return. Bundled rates remained in place until Open Access.

Commencing with Open Access, the Company purchases power from the Independent Electricity Market Operator (IMO) administered spot market and charges distribution customers' unbundled rates, including the OEB approved distribution rates. These distribution rates were essentially the same as the distribution rates that were incorporated into the bundled rates before Open Access.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2002

3. Summary of significant accounting policies (Continued)

Bill 210 was enacted for the purpose of implementing the Electricity Action Plan announced by the Premier of Ontario on November 11, 2002. The more significant provisions of Bill 210 for the transmission and distribution business are as follows:

- Energy prices for low volume and designated consumers (as defined in Bill 210) are fixed at 4.3 cents per kWh, retroactive to May 1, 2002. Most of the Company's customers qualify for the fixed energy price. In recognition of commodity prices in excess of 4.3 cents per kWh for the period May 1, 2002 to December 1, 2002, Bill 210 requires distributors to issue \$75 refunds to eligible consumers and to credit any remaining refund on future bills. The IMO has and will continue to facilitate this price freeze through funding from Ontario Electricity Financial Corporation (OEFC).
- Transmission and distribution rates are capped until at least April 30, 2006. A rate application can be made to the OEB before this date with written approval of the Minister of Energy.
- Effective December 1, 2002, the price paid by distributors to the IMO for wholesale market charges other than energy is largely fixed at the same price distributors are permitted to charge their customers. For the period May 1, 2002 to December 1, 2002, differences between the rates were accumulated in retail settlement variance accounts under the provisions of Article 490 in the OEB's Accounting Procedures Handbook for disposition through future offsetting variances or through approved rate adjustments.
- Bill 210 provides for the establishment or continuation for certain amounts to be recorded as assets and deferred until disposition is addressed by the OEB. The most significant accounts are retail settlement variances and market ready costs.

Regulatory assets primarily represent costs that have been deferred because it is probable that they will be recovered in future rates. Regulatory assets recognized at December 31, 2002 are disclosed in Note 7. The rate cap created by Bill 210 limits the opportunity to recover increased costs and capital spending above current rate base levels through rates during the rate cap period, which is currently until at least April 30, 2006. The Minister of Energy has indicated, in a January 23, 2003 letter to distributors, that he will ask the OEB to complete, no later than December 31, 2003, a review of applications by distributors for recovery of the amounts that Bill 210 deems to be regulatory assets. This letter states that once the OEB completes its review and confirms the amounts to be recovered, recovery will commence no later than 2006.

The Company continues to believe that it is probable that the regulatory assets will be recovered through future rates, although there is more uncertainty today about full recovery than existed before Bill 210. The Company continually assesses the likelihood of recovery of regulatory assets. If recovery through future rates is no longer considered probable, the amounts would be charged to the results of operations in the periods that the determination was made.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2002

3. Summary of significant accounting policies (Continued)

The following regulatory treatments have resulted in accounting treatments differing from Canadian GAAP for enterprises operating in a non-regulated environment:

- Market ready costs have been deferred in accordance with the criteria set out in the OEB Electricity Distribution Rate Handbook, the Accounting Procedures Handbook and in subsequent OEB guidelines. In the absence of such regulation, these costs would have been expensed when incurred under Canadian GAAP;
- The Company has deferred certain retail settlement variance amounts under the provisions of Article 490 in the OEB Accounting Procedures Handbook;
- The Company provides for payments in lieu of corporate income taxes relating to its regulated businesses using the taxes payable method as directed by the OEB.

Depreciation

Property and equipment are depreciated by the straight-line method over periods approximating their estimated useful lives as follows:

Land rights	50 years
Buildings	25 years
Distribution system	25 years
Other capital assets	5-10 years

When property and equipment is sold or scrapped, the cost of the asset and the related accumulated depreciation is removed from the accounts with the resulting net gain or loss being included in operations for the year.

Corporate income and capital taxes

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

The Company provides for payments in lieu of corporate income taxes relating to its regulated business using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of the Company at that time.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2002

3. Summary of significant accounting policies (Continued)

Use of estimates

In preparing the Company's financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenditures during the year. Actual results could differ from these estimates.

4. Related party transactions

2002

2001

The Company had the following related party transactions:

Tay Utility Contracting Inc. - related company

Services provided

\$ 34,104 \$ 9,286

Township of Tay - shareholder of parent company

Interest

210,086 245,063

Balances outstanding at December 31:

Due from Tay Utility Contracting Inc.

\$ 34,270 \$ 9,286

Due from Tay Hydro Inc.

4,684 2,453

Due to Township of Tay

(147,413)

5. Property and equipment

2002

2001

	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>	<u>Net Book Value</u>
Land and land rights	\$ 286,104	\$ 83,936	\$ 202,168	\$ 225,603
Buildings	274,658	44,198	230,460	232,745
Distribution system	5,510,451	2,883,049	2,627,402	2,773,144
Other capital assets	<u>523,874</u>	<u>397,076</u>	<u>126,798</u>	<u>146,628</u>
	\$ <u>6,595,087</u>	\$ <u>3,408,259</u>	\$ <u>3,186,828</u>	\$ <u>3,378,120</u>

6. Development charges

In accordance with the Electricity Act 1998, the Company maintains a bank balance and a corresponding liability for development charges, which are to be expended on qualifying growth-related capital assets.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2002

7. Regulatory assets 2002 2001

As described in Note 3, the Company has recorded the following regulatory assets:

Retail services variance	#1580 + 1584 + 1586, 1588	\$ 35,895	\$
Market ready costs	1570 + 1606	<u>343,945</u>	<u>131,674</u>
		\$ <u>379,840</u>	\$ <u>131,674</u>

8. Long term debt 2002 2001

Debenture payable	\$ 1,356,000	\$ 1,512,000
Note payable	<u>1,742,821</u>	<u>1,742,821</u>
	3,098,821	3,254,821
Less: current portion	<u>(165,000)</u>	<u>(156,000)</u>
	\$ <u>2,933,821</u>	\$ <u>3,098,821</u>

The debenture is payable to the Township of Tay, the shareholder of the parent company and bears interest at various rates ranging from 5.05% to 6.10%. Principal payments are due annually May 31 until 2009.

The note is payable to the Township of Tay, the shareholder of the parent company. Payments are interest only at 7.25%. The note is due on demand.

Principal payments due in each of the next five years are as follows:

2003	\$ 165,000
2004	175,000
2005	186,000
2006	197,000
2007	210,000

9. Capital stock 2002 2001

Authorized:

The Company is authorized to issued an unlimited number of common shares and an unlimited number of preference shares.

Issued:

1,000 common shares	\$ <u>1,742,821</u>	\$ <u>1,742,821</u>
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Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2002

10. Supplemental cash flow information

	<u>2002</u>	<u>2001</u>
Change in non-cash operating working capital		
Receivables	\$ 188,036	\$ (104,383)
Unbilled revenue	(335,171)	162,679
Inventory	(5,620)	13,450
Prepays	(10,043)	511
Due from related parties	(27,215)	(9,275)
Payables and accruals	91,823	(14,604)
Payments in lieu of income taxes payable	41,770	-
Due to related party	(147,413)	147,367
Customer and retailer deposits	<u>34,546</u>	<u>(5,351)</u>
	<u>\$ (169,287)</u>	<u>\$ 190,394</u>
Interest received	<u>\$ 43,606</u>	<u>\$ 499,936</u>
Interest paid	<u>\$ (169,285)</u>	<u>\$ 190,394</u>

11. Public liability insurance

The Company is a member of the Municipal Electric Association Reciprocal Insurance Exchange (MEARIE), which was created on January 1, 1987. A reciprocal insurance exchange may be defined as a group of persons formed for the purpose of exchanging reciprocal contracts of indemnity or inter-insurance with each other through the same attorney. MEARIE has provided general liability insurance to the Company of \$20,000,000 per occurrence.

12. Payments in lieu of income taxes

The Company is required to compute and remit to the Ontario Electricity Financial Corporation owned by the Province of Ontario payments in lieu of income taxes (PILS). PILS are computed in accordance with rules for computing income, capital and other taxes provided for in the Income Tax Act (Canada) and the Corporation Tax Act (Ontario) as modified by The Electricity Act, 1998 and related regulations.

Income before provision for PILS	<u>\$ 158,259</u>
Federal and Ontario statutory income tax rates	38.6%

Tay Hydro Electric Distribution Company Inc.
Notes to the Financial Statements

December 31, 2002

12. Payments in lieu of income taxes (Continued).

Provision for PILS at statutory rate	\$ 61,000
Increase (decrease) resulting from:	
Depreciation in excess of capital cost allowance	3,000
Other	<u>(3,000)</u>
Net temporary differences	<u> </u>
Permanent differences	
Loss carry forward	<u>(16,000)</u>
Provision for PILS	\$ <u>45,000</u>
Effective income tax rate	28.4%

Future income taxes relating to the regulated businesses have not been recorded in the accounts as they are expected to be recovered through future revenues.

13. Commitment

Purchasers of electricity in Ontario, through the IMO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. The IMO could draw on these guarantees if the Company fails to make a payment required by default notice issued by the IMO. The maximum potential payment is the face value of the bank letters of credit. As at December 31, 2002, the Company provided prudential support using bank letters of credit of \$ 252,846.

14. Comparative figures

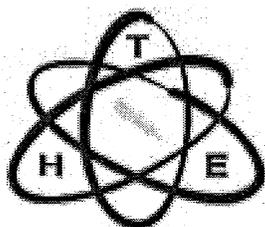
Certain of the 2001 comparative figures have been reclassified to conform to the financial statement presentation adopted for the current year.

Tay Hydro Electric Distribution Company Inc.

Financial Statements

December 31, 2003

Grant Thornton 



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Auditors' Report

To the Directors of
Tay Hydro Electric Distribution Company Inc.

We have audited the balance sheet of Tay Hydro Electric Distribution Company Inc. as at December 31, 2003 and the statements of earnings and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2003 and the results of its operations and cash flows for year then ended in accordance with Canadian generally accepted accounting principles.

Orillia, Canada
March 4, 2004

Chartered Accountants

Tay Hydro Electric Distribution Company Inc.

Statements of Earnings and Retained Earnings

Year Ended December 31 2003 2002

Revenue		
Distribution and sale of power prior to Open Access	\$ -	\$ 1,403,241
Sale of power after Open Access	2,687,803 ✓	2,084,596
Distribution	✓ 1,231,240 ✓	835,922
	<u>3,919,043</u>	<u>4,323,759</u>
Cost of power		
Power purchased prior to Open Access	-	1,190,129
Power purchased after Open Access	2,687,803 ✓	2,084,596
	<u>2,687,803</u>	<u>3,274,725</u>
Gross margin	✓ <u>1,231,240</u>	<u>1,049,034</u>
Other revenue	<u>105,608</u> ✓	<u>133,743</u>
Expenses		
Distribution	169,605 ✓	172,780
Administration	326,306	275,328
Depreciation	253,144 ✓	237,892
Billing and collecting	202,847 ✓	172,038
	<u>951,902</u>	<u>858,038</u>
Earnings from operations	384,946	324,739
Interest income	49,041 ✓	43,606
Interest on long term debt	<u>(201,725)</u> ✓	<u>(210,086)</u>
Earnings before payments in lieu of income taxes	232,262	158,259
Payments in lieu of income taxes (Note 11)	50,000	45,000
Net earnings	\$ <u>182,262</u>	\$ <u>113,259</u>
<hr/>		
Deficit, beginning of year	\$ (153,625)	\$ (134,884)
Net earnings	182,262	113,259
Dividends	<u>-</u>	<u>(132,000)</u>
Retained earnings (deficit), end of year	\$ <u>28,637</u>	\$ <u>(153,625)</u>

opr. m/c less TR. 1,000's DEPRN
5705 9040
9239477.71 + 13646
we have 490,800

See accompanying notes to the financial statements.

Tay Hydro Electric Distribution Company Inc.

Balance Sheet

December 31

2003

2002

Assets

Current

Cash	\$ 972,704 ✓	\$ 806,766
Receivables	261,192 ✓	307,581
Unbilled revenue	478,281 ✓	535,785
Inventory	86,678 ✓	103,393
Prepays	19,080 ✓	22,524
Due from related parties (Note 3)	44,346 ✓	38,954
	<u>1,862,281</u>	<u>1,815,003</u>

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Property and equipment (Note 4)	3,016,031	3,186,828
Development charges (Note 5)	113,340 ✓	102,856
Regulatory assets (Note 6)	<u>481,654 ✓</u>	<u>379,840</u>
	<u>\$ 5,473,306</u>	<u>\$ 5,484,527</u>

Liabilities

Current

Payables and accruals	\$ 529,929 ✓	\$ 578,463
Payments in lieu of income taxes payable	825 ✓	41,770
Current portion of long-term debt	<u>175,000 ✓</u>	<u>165,000</u>
	<u>705,754</u>	<u>785,233</u>

Customer and retailer deposits	123,933 ✓	73,421
Development charges (Note 5)	113,340 ✓	102,856
Long term debt (Note 7)	<u>2,758,821 ✓</u>	<u>2,933,821</u>
	<u>3,701,848</u>	<u>3,895,331</u>

Capital and Deficit

Capital stock (Note 8)	1,742,821 ✓	1,742,821
Retained earnings (deficit)	<u>28,637 ✓</u>	<u>(153,625)</u>
	<u>1,771,458</u>	<u>1,589,196</u>
	<u>\$ 5,473,306</u>	<u>\$ 5,484,527</u>

Commitment (Note 12)

On Behalf of the Board

Director

Director

See accompanying notes to the financial statements.

Tay Hydro Electric Distribution Company Inc.

Statement of Cash Flows

Year Ended December 31

2003

2002

Cash derived from (applied to)

Operating		
Net earnings	\$ 182,262	\$ 113,259
Depreciation	<u>253,144</u>	<u>237,892</u>
	435,406	351,151
Change in non-cash operating working capital (Note 9)	<u>79,693</u>	<u>(169,287)</u>
	<u>515,099</u>	<u>181,864</u>
Financing		
Decrease in long term debt	(165,000)	(156,000)
Dividends paid	<u>-</u>	<u>(132,000)</u>
	<u>(165,000)</u>	<u>(288,000)</u>
Investing		
Net additions to property and equipment	(82,347)	(46,600)
Net additions to regulatory assets	<u>(101,814)</u>	<u>(248,166)</u>
	<u>(184,161)</u>	<u>(294,766)</u>
Net increase (decrease) in cash	165,938	(400,902)
Cash, beginning of year	<u>806,766</u>	<u>1,207,668</u>
Cash, end of year	\$ <u>972,704</u>	\$ <u>806,766</u>

See accompanying notes to the financial statements.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2003

1. Nature of operations

The Company distributes electricity under license from the Ontario Energy Board (OEB). The Electricity Act, 1998 provides for a competitive marketplace in the sale of electricity. Ontario's wholesale and retail electricity markets became open to competition May 1, 2002 (Open Access). The Ontario Energy Board Act, 1998 (Ontario) (OEBA) conferred on the Ontario Energy Board (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 that distribution companies fulfil obligations to connect and service customers. The OEB may also prescribe license requirements and conditions to electricity distributors, which may include among other things, specified accounting records, regulatory accounting principles, separation of accounts for distinct businesses and filing and process requirements for rate setting purposes.

DRAFT

2. Summary of significant accounting policies

Inventory

Inventory consists of repair parts, supplies and materials held for future capital expansion and are valued at the lower of cost and net realizable value.

Rate-setting

The electricity distribution business is subject to rate regulation by the OEB. The OEB has the general power to include or exclude costs, revenues, losses or gains in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have applied in an unregulated company. This change in timing gives rise to the recognition of regulatory assets. These regulatory assets reflect the fact that revenue and expenses are recognized in the financial statements in different periods consistent with their inclusion in rates, as directed by the regulator, than would be the case for an enterprise that is unregulated. Specific regulatory assets recognized at December 31, 2003 are disclosed in Note 6.

In a letter dated December 19, 2003, the Minister of Energy granted approval for distributors to make application to the OEB with regard to rate recovery of certain distribution regulatory assets whose inclusion in rates was delayed by the Electricity Pricing, Conservation and Supply Act, 2002 (Electricity Pricing, Conservation and Supply Act). As a result of the Company's distribution rate application dated February 19, 2004, these distribution regulatory assets are expected to be recovered in distribution rates over four years, commencing April 1, 2004. However, the amount to be recovered will be subject to a yet to be determined OEB review and approval process, expected to occur later in 2004.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2003

2. Summary of significant accounting policies (Continued)

Rate-setting (Continued)

The Company continually assesses the likelihood of recovery of each of its regulatory assets and believes that it is probable that its regulatory assets will be factored into the setting of future rates. If future recovery through rates is no longer considered probable, the appropriate carrying amount will be written off in the period that the assessment is made.

The following regulatory treatments have resulted in accounting treatments differing from Canadian GAAP for enterprises operating in a non-regulated environment:

- Market ready costs have been deferred in accordance with the criteria set out in the OEB Electricity Distribution Rate Handbook, the Accounting Procedures Handbook and in subsequent OEB guidelines. In the absence of such regulation, these costs would have been expensed when incurred under Canadian GAAP;
- The Company has deferred certain retail settlement variance amounts under the provisions of Article 490 in the OEB Accounting Procedures Handbook;

Revenue recognition

Prior to Open Access, revenues attributable to the sale and delivery of electricity were based on OEB approved bundled rates. Since Open Access, revenues are based on OEB approved unbundled rates and are recognized as power is delivered to customers. The Company estimates the monthly revenue for the period based on customer's previous usage because customer meters are not generally read at the end of each month. Unbilled revenue is recognized for customer usage not billed at December 31, 2003.

Depreciation

Property and equipment are depreciated by the straight-line method over periods approximating their estimated useful lives as follows:

Land rights	50 years
Buildings	25-30 years
Distribution system	25 years
Other capital assets	5-10 years

When property and equipment is sold or scrapped, the cost of the asset and the related accumulated depreciation is removed from the accounts with the resulting net gain or loss being included in operations for the year.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2003

2. Summary of significant accounting policies (Continued)

Fixed Assets Retirement Obligations

Canadian generally accepted accounting principles require the Company to determine the fair value of the future expenditures required to settle legal obligations to remove fixed assets on retirement. If reasonably estimable, a liability is recognized equal to the present value of the estimated future removal expenditures. An equivalent amount is capitalized as an inherent cost of the associated fixed assets.

Some of the company's assets may have asset retirement obligations. As the company expects to use the majority of its fixed assets for an indefinite period, no removal date can be determined and, consequently, a reasonable estimate of the fair value of any asset retirement obligations has not been made at this time.

Corporate income and capital taxes

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

The Company provides for payments in lieu of corporate income taxes relating to its regulated business using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of the Company at that time.

Use of estimates

In preparing the Company's financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenditures during the year. Actual results could differ from these estimates.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2003

3. Related party transactions 2003 2002

The Company had the following related party transactions:

Tay Utility Contracting Inc. - related company			
Services provided	\$	29,180	\$ 34,104
Township of Tay - shareholder of parent company			
Interest		201,725	210,086
Sale of power		232,000	231,000

Balances outstanding at December 31:

Due from Tay Utility Contracting Inc.	\$	24,145 ^X	\$ 34,270
Due from Tay Hydro Inc.		20,201 ^X	4,684
Due to Township of Tay		5,600	6,200

4. Property and equipment 2003 2002

	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>	<u>Net Book Value</u>
Land and land rights	\$ 286,219	\$ 88,793	\$ 197,426	\$ 202,168
Buildings	274,658	50,973	223,685	230,460
Distribution system	5,581,586	3,084,406	2,497,180	2,627,402
Other capital assets	<u>534,416</u>	<u>436,676</u>	<u>97,740</u>	<u>126,798</u>
	<u>\$ 6,676,879</u>	<u>\$ 3,660,848</u>	<u>\$ 3,016,031</u>	<u>\$ 3,186,828</u>

5. Development charges

In accordance with the Electricity Act 1998, the Company maintains a bank balance and a corresponding liability for development charges, which are to be expended on qualifying growth-related capital assets.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2003

6. Regulatory assets 2003 2002

As described in Note 2, the Company has recorded the following regulatory assets:

Retail settlement variance	\$ 152,388	\$ 63,637
Market ready costs	<u>329,266</u>	<u>316,203</u>
	<u>\$ 481,654</u>	<u>\$ 379,840</u>

7. Long term debt 2003 2002

Debenture payable	\$ 1,191,000	\$ 1,356,000
Note payable	<u>1,742,821</u>	<u>1,742,821</u>
	2,933,821	3,098,821
Less: current portion	<u>(175,000)</u>	<u>(165,000)</u>
	<u>\$ 2,758,821</u>	<u>\$ 2,933,821</u>

The debenture is payable to the Township of Tay, the shareholder of the parent company and bears interest at various rates ranging from 5.05% to 6.10%. Principal payments are due annually May 31 until 2009.

The note is payable to the Township of Tay, the shareholder of the parent company. Payments are interest only at 7.25%. The note is due on demand.

Principal payments due in each of the next five years are as follows:

2004	\$ 175,000
2005	186,000
2006	197,000
2007	210,000
2008	223,000

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2003

8. Capital stock 2003 2002

Authorized:

The Company is authorized to issued an unlimited number of common shares and an unlimited number of preference shares.

Issued:

1,000 common shares	\$ <u>1,742,821</u>	\$ <u>1,742,821</u>
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9. Supplemental cash flow information 2003 2002

Change in non-cash operating working capital

Receivables	\$ 46,389	\$ 188,036
Unbilled revenue	57,504	(335,171)
Inventory	16,715	(5,620)
Prepays	3,444	(10,043)
Due from related parties	(5,392)	(27,215)
Payables and accruals	(48,534)	91,823
Payments in lieu of income taxes payable	(40,945)	41,770
Due to related party	-	(147,413)
Customer and retailer deposits	<u>50,512</u>	<u>34,546</u>
	\$ <u>79,693</u>	\$ <u>(169,287)</u>
Interest received	\$ <u>51,961</u>	\$ <u>43,606</u>
Interest paid	\$ <u>(201,725)</u>	\$ <u>(169,285)</u>
Payments in lieu of income taxes and capital taxes paid	\$ <u>91,832</u>	\$ <u>10,079</u>

10. Public liability insurance

The Company is a member of the Municipal Electric Association Reciprocal Insurance Exchange (MEARIE), which was created on January 1, 1987. A reciprocal insurance exchange may be defined as a group of persons formed for the purpose of exchanging reciprocal contracts of indemnity or inter-insurance with each other through the same attorney. MEARIE has provided general liability insurance to the Company of \$20,000,000 per occurrence.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2003

11. Payments in lieu of income taxes

The Company is required to compute and remit to the Ontario Electricity Financial Corporation owned by the Province of Ontario payments in lieu of income taxes (PILS). PILS are computed in accordance with rules for computing income, capital and other taxes provided for in the Income Tax Act (Canada) and the Corporation Tax Act (Ontario) as modified by The Electricity Act, 1998 and related regulations.

	<u>2003</u>	<u>2002</u>
Income before provision for PILS	\$ <u>232,262</u>	\$ <u>158,259</u>
Federal and Ontario statutory income tax rates	36.6%	38.6%
Provision for PILS at statutory rate	\$ 85,000	\$ 61,000
Increase (decrease) resulting from:		
Depreciation in excess of capital cost allowance	13,000	3,000
Other	<u>-</u>	<u>(3,000)</u>
Net temporary differences	<u>13,000</u>	<u>-</u>
Permanent differences		
Loss carry forward	-	(16,000)
Other	<u>(48,000)</u>	<u>-</u>
	<u>(48,000)</u>	<u>(16,000)</u>
Provision for PILS	\$ <u>50,000</u>	\$ <u>45,000</u>
Effective income tax rate	21.5%	28.4%

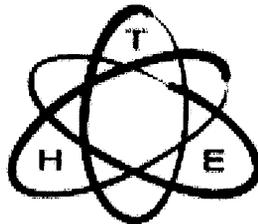
Future income taxes relating to the regulated businesses have not been recorded in the accounts as they are expected to be recovered through future revenues.

12. Commitment

Purchasers of electricity in Ontario, through the IMO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. The IMO could draw on these guarantees if the Company fails to make a payment required by default notice issued by the IMO. The maximum potential payment is the face value of the bank letters of credit. As at December 31, 2003, the Company provided prudential support using bank letters of credit of \$ 272,469.

Tay Hydro Electric Distribution Company Inc.
Financial Statements
December 31, 2004

Grant Thornton 



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Auditors' Report

To the Directors of
Tay Hydro Electric Distribution Company Inc.

We have audited the balance sheet of Tay Hydro Electric Distribution Company Inc. as at December 31, 2004 and the statements of earnings and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2004 and the results of its operations and cash flows for year then ended in accordance with Canadian generally accepted accounting principles.

Grant Thornton LLP

Orillia, Canada
March 23, 2005

Chartered Accountants

Tay Hydro Electric Distribution Company Inc.

Statements of Earnings and Retained Earnings

Year Ended December 31

2004

2003

Revenue		
Sale of power	\$ 2,863,192	\$ 2,687,803
Distribution	<u>1,208,087</u>	<u>1,231,240</u>
	4,071,279	3,919,043
Cost of power		
Power purchased	<u>2,863,192</u>	<u>2,687,803</u>
Gross margin	<u>1,208,087</u>	<u>1,231,240</u>
Other revenue	<u>91,259</u>	<u>105,605</u>
Expenses		
Distribution	182,885	169,601
Administration	384,692	326,308
Depreciation	262,255	253,144
Billing and collecting	<u>208,451</u>	<u>202,846</u>
	<u>1,038,283</u>	<u>951,899</u>
Earnings from operations	261,063	384,946
Interest income	51,075	49,041
Interest on long term debt	<u>(191,920)</u>	<u>(201,725)</u>
Earnings before payments in lieu of income taxes	120,218	232,262
Payments in lieu of income taxes (Note 11)	<u>13,198</u>	<u>50,000</u>
Net earnings	\$ <u>107,020</u>	\$ <u>182,262</u>
Retained earnings (deficit), beginning of year	\$ 28,637	\$ (153,625)
Net earnings	<u>107,020</u>	<u>182,262</u>
Retained earnings, end of year	\$ <u>135,657</u>	\$ <u>28,637</u>

See accompanying notes to the financial statements.

Tay Hydro Electric Distribution Company Inc.

Balance Sheet

December 31

2004

2003

Assets

Current

Cash	\$ 901,774	\$ 972,704
Receivables	180,085	261,193
Unbilled revenue	656,552	478,281
Inventory	99,821	86,678
Prepays	16,188	19,081
Payments in lieu of income taxes recoverable	28,186	-
Due from related parties (Note 3)	<u>47,423</u>	<u>44,346</u>
	<u>1,930,029</u>	<u>1,862,283</u>

Property and equipment (Note 4)	2,899,933	3,016,030
Development charges (Note 5)	115,755	113,340
Regulatory assets (Note 6)	<u>595,090</u>	<u>481,653</u>
	<u>\$ 5,540,807</u>	<u>\$ 5,473,306</u>

Liabilities

Current

Payables and accruals	\$ 624,340	\$ 529,929
Payments in lieu of income taxes payable	-	825
Current portion of long term debt	<u>186,000</u>	<u>175,000</u>
	<u>810,340</u>	<u>705,754</u>

Customer and retailer deposits	118,399	123,933
Development charges (Note 5)	115,755	113,340
Regulatory liabilities (Note 6)	45,014	-
Long term debt (Note 7)	<u>2,572,821</u>	<u>2,758,821</u>
	<u>3,662,329</u>	<u>3,701,848</u>

Shareholder's Equity

Capital stock (Note 8)	1,742,821	1,742,821
Retained earnings	<u>135,657</u>	<u>28,637</u>
	<u>1,878,478</u>	<u>1,771,458</u>
	<u>\$ 5,540,807</u>	<u>\$ 5,473,306</u>

Commitment and Contingent liability (Notes 13 and 14)

On Behalf of the Board

Director

Director

See accompanying notes to the financial statements.

Tay Hydro Electric Distribution Company Inc.

Statement of Cash Flows

Year Ended December 31

2004

2003

Cash derived from (applied to)

Operating		
Net earnings	\$ 107,020	\$ 182,262
Depreciation	<u>262,255</u>	<u>253,144</u>
	369,275	435,406
Change in non-cash operating working capital (Note 9)	<u>(50,624)</u>	<u>79,691</u>
	<u>318,651</u>	<u>515,097</u>
Financing		
Decrease in long term debt	<u>(175,000)</u>	<u>(165,000)</u>
Investing		
Net additions to property and equipment	(146,158)	(82,347)
Net additions to regulatory assets	<u>(68,423)</u>	<u>(101,812)</u>
	<u>(214,581)</u>	<u>(184,159)</u>
Net (decrease) increase in cash	(70,930)	165,938
Cash, beginning of year	<u>972,704</u>	<u>806,766</u>
Cash, end of year	\$ <u>901,774</u>	\$ <u>972,704</u>

See accompanying notes to the financial statements.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2004

1. Nature of operations

The company distributes electricity under license from the Ontario Energy Board (OEB). The Electricity Act, 1998 provides for a competitive marketplace in the sale of electricity. Ontario's wholesale and retail electricity markets became open to competition May 1, 2002. The Ontario Energy Board Act, 1998 (Ontario) (OEBA) conferred on the Ontario Energy Board (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 that distribution companies fulfil obligations to connect and service customers. The OEB may also prescribe license requirements and conditions to electricity distributors, which may include among other things, specified accounting records, regulatory accounting principles, separation of accounts for distinct businesses and filing and process requirements for rate setting purposes.

2. Summary of significant accounting policies

Inventory

Inventory consists of repair parts, supplies and materials held for future capital expansion and are valued at the lower of cost and net realizable value.

Rate-setting

The electricity distribution business is subject to rate regulation by the OEB. The OEB has the general power to include or exclude costs, revenues, losses or gains in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have applied in an unregulated company. This change in timing gives rise to the recognition of regulatory assets. These regulatory assets reflect the fact that revenue and expenses are recognized in the financial statements in different periods consistent with their inclusion in rates, as directed by the regulator, than would be the case for an enterprise that is unregulated. Specific regulatory assets and liabilities recognized at December 31, 2004 are disclosed in Note 6.

In a letter dated December 19, 2003, the Minister of Energy granted approval for distributors to make application to the OEB with regard to rate recovery of certain distribution regulatory assets whose inclusion in rates was delayed by the Electricity Pricing, Conservation and Supply Act, 2002. These distribution regulatory assets are expected to be recovered in distribution rates over four years, commencing April 1, 2004. The amount to be recovered will be subject to OEB review and approval process.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2004

2. Summary of significant accounting policies (Continued)

Rate-setting (Continued)

The company continually assesses the likelihood of recovery of each of its regulatory assets and believes that it is probable that its regulatory assets will be factored into the setting of future rates. If future recovery through rates is no longer considered probable, the appropriate carrying amount will be written off in the period that the assessment is made.

The following regulatory treatments have resulted in accounting treatments differing from Canadian generally accepted accounting principles (GAAP) for enterprises operating in a non-regulated environment.

- Market ready costs have been deferred in accordance with the criteria set out in the OEB Electricity Distribution Rate Handbook, the Accounting Procedures Handbook and in subsequent OEB guidelines. In the absence of such regulation, these costs would have been expensed when incurred under Canadian GAAP.
- The company has deferred certain retail settlement variance amounts under the provisions of Article 490 in the OEB Accounting Procedures Handbook.

Revenue recognition

Revenues are based on OEB approved unbundled rates and are recognized as power is delivered to customers. The company estimates the monthly revenue for the period based on customer's previous usage because customer meters are not generally read at the end of each month. Unbilled revenue is recognized for customer usage not billed at December 31, 2004.

Depreciation

Property and equipment are depreciated by the straight-line method over periods approximating their estimated useful lives as follows:

Land rights	50 years
Buildings	25-30 years
Distribution system	25 years
Other capital assets	5-10 years

When property and equipment is sold or scrapped, the cost of the asset and the related accumulated depreciation is removed from the accounts with the resulting net gain or loss being included in operations for the year.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2004

2. Summary of significant accounting policies (Continued)

Fixed assets retirement obligations

Canadian generally accepted accounting principles require the company to determine the fair value of the future expenditures required to settle legal obligations to remove fixed assets on retirement. If reasonably estimable, a liability is recognized equal to the present value of the estimated future removal expenditures. An equivalent amount is capitalized as an inherent cost of the associated fixed assets.

Some of the company's assets may have asset retirement obligations. As the company expects to use the majority of its fixed assets for an indefinite period, no removal date can be determined and, consequently, a reasonable estimate of the fair value of any asset retirement obligations has not been made at this time.

Corporate income and capital taxes

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

The company provides for payments in lieu of corporate income taxes relating to its regulated business using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of the company at that time.

Use of estimates

In preparing the company's financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenditures during the year. Actual results could differ from these estimates.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2004

3. Related party transactions 2004 2003

The company had the following related party transactions:

Tay Utility Contracting Inc. - related company			
Services provided	\$	33,424	\$ 29,180
Township of Tay - shareholder of parent company			
Interest		191,920	201,725
Sale of power		236,000	232,000
Property taxes		12,888	14,696

Balances outstanding at December 31:

Due from Tay Utility Contracting Inc.	\$	38,188	\$ 24,145
Due from Tay Hydro Inc.		23,912	20,201
Due to Township of Tay		4,900	5,600

4. Property and equipment 2004 2003

	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>	<u>Net Book Value</u>
Land and land rights	\$ 299,804	\$ 93,577	\$ 206,227	\$ 197,426
Buildings	274,675	57,748	216,927	223,702
Distribution system	5,670,989	3,289,351	2,381,638	2,497,165
Other capital assets	577,582	482,441	95,141	97,737
	<u>\$ 6,823,050</u>	<u>\$ 3,923,117</u>	<u>\$ 2,899,933</u>	<u>\$ 3,016,030</u>

5. Development charges

In accordance with the Electricity Act 1998, the company maintains a bank balance and a corresponding liability for development charges, which are to be expended on qualifying growth-related capital assets.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2004

6. Regulatory assets and liabilities 2004 2003

As described in Note 2, the company has recorded the following regulatory assets and liabilities:

Regulatory assets

Retail settlement variance	\$ 199,590	\$ 152,387
Pre-market opening energy variance	45,014 ✓	-
Market ready costs	<u>350,486</u>	<u>329,266</u>
	<i>550 076</i> \$ <u>595,090</u>	\$ <u>481,653</u>

Regulatory liabilities

Pre-market opening energy variance	\$ <u>45,014</u>	\$ <u>-</u>
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The pre-market opening energy variance account has been established for the purpose of recording the estimated difference between the company's purchased cost of power based on time-of-use and the amounts billed to non-time-of-use customers charged at an average rate for the same period starting January 1, 2001 and ending May 1, 2002. The company has recorded an asset and a corresponding allowance of \$45,014 at December 31, 2004. This amount is being amortized to future income and is subject to review and approval by the OEB.

7. Long term debt 2004 2003

Debenture payable	\$ 1,016,000	\$ 1,191,000
Note payable	<u>1,742,821</u>	<u>1,742,821</u>
	2,758,821	2,933,821
Less: current portion	<u>186,000</u>	<u>175,000</u>
	\$ <u>2,572,821</u>	\$ <u>2,758,821</u>

The debenture is payable to the Township of Tay, the shareholder of the parent company and bears interest at various rates ranging from 5.05% to 6.10%. Principal payments are due annually May 31 until 2009.

The note is payable to the Township of Tay, the shareholder of the parent company. Payments are interest only at 7.25%. The note is due on demand.

Principal payments due in each of the next five years are as follows:

2005	\$ 186,000
2006	197,000
2007	210,000
2008	223,000
2009	200,000

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2004

8. Capital stock 2004 2003

Authorized:

The company is authorized to issue an unlimited number of common shares and an unlimited number of preference shares.

Issued:

1,000 common shares	\$ <u>1,742,821</u>	\$ <u>1,742,821</u>
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9. Supplemental cash flow information 2004 2003

Change in non-cash operating working capital

Receivables	\$ 81,108	\$ 46,388
Unbilled revenue	(178,271)	57,504
Inventory	(13,143)	16,715
Prepays	2,893	3,443
Due from related parties	(3,077)	(5,392)
Payables and accruals	94,411	(48,534)
Payments in lieu of income taxes payable	(29,011)	(40,945)
Customer and retailer deposits	(5,534)	50,512
	<u>\$ (50,624)</u>	<u>\$ 79,691</u>
 Interest received	 \$ <u>51,198</u>	 \$ <u>49,041</u>
 Interest paid	 \$ <u>192,620</u>	 \$ <u>201,725</u>
 Payments in lieu of income taxes and capital taxes paid	 \$ <u>41,266</u>	 \$ <u>91,832</u>

10. Public liability insurance

The company is a member of the Municipal Electric Association Reciprocal Insurance Exchange (MEARIE), which was created on January 1, 1987. A reciprocal insurance exchange may be defined as a group of persons formed for the purpose of exchanging reciprocal contracts of indemnity or inter-insurance with each other through the same attorney. MEARIE has provided general liability insurance to the company of \$20,000,000 per occurrence.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2004

11. Payments in lieu of income taxes

The company is required to compute and remit to the Ontario Electricity Financial Corporation owned by the Province of Ontario payments in lieu of income taxes (PILS). PILS are computed in accordance with rules for computing income, capital and other taxes provided for in the Income Tax Act (Canada) and the Corporation Tax Act (Ontario) as modified by The Electricity Act, 1998 and related regulations.

	<u>2004</u>	<u>2003</u>
Income before provision for PILS	\$ <u>120,219</u>	\$ <u>232,262</u>
Federal and Ontario statutory income tax rates	36.12%	36.6%
Provision for PILS at statutory rate	\$ <u>43,423</u>	\$ 85,008
Increase (decrease) resulting from:		
Temporary differences		
Depreciation in excess of capital cost allowance	37,912	35,414
Other	<u>(13,609)</u>	<u>(8,234)</u>
Net temporary differences	<u>24,303</u>	<u>27,180</u>
Permanent differences		
Capital cost allowance on appraisal increment	(22,118)	(23,346)
Small business deduction	(32,410)	(39,254)
Other	-	412
Net permanent differences	<u>(54,528)</u>	<u>(62,188)</u>
Provision for PILS	\$ <u>13,198</u>	\$ <u>50,000</u>
Effective income tax rate	11.0%	21.5%

Future income taxes relating to the regulated businesses have not been recorded in the accounts as they are expected to be recovered through future revenues.

12. Pension Plan

The Municipality makes contributions to the Ontario Municipal Employees Retirement Fund (OMERS), which is a multi-employer plan, on behalf of 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.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2004

12. Pension Plan (Continued)

Effective January 1, 2004, full contributions were made at rates ranging from 6% to 8.8% depending on the proposed retirement age and the level of earnings. As a result \$23,693 (2003 - \$5,385) was contributed to OMERS for current service.

13. Commitment

Purchasers of electricity in Ontario, through the IMO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. The IMO could draw on these guarantees if the company fails to make a payment required by default notice issued by the IMO. The maximum potential payment is the face value of the bank letters of credit. As at December 31, 2004, the company provided prudential support using bank letters of credit of \$ 272,469.

14. Contingent liability

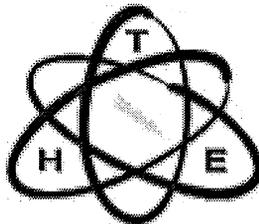
A class action lawsuit claiming \$500 million in restitution payments plus interest was served on Toronto Hydro on November 18, 1999. The action was initiated against Toronto Hydro Electric Commission as the representative of the defendant class consisting of all municipal electric utilities in Ontario, which have charged late payment charges on overdue utility bills at any time after April 1, 1981.

The claim is that late payment penalties result in the municipal electric utilities receiving interest at effective rates in excess of 60% per year, which is illegal under Section 347(1)(b) of the Criminal Code.

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

Tay Hydro Electric Distribution Company Inc.
Financial Statements
December 31, 2005

Grant Thornton 



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Auditors' Report

To the Directors of
Tay Hydro Electric Distribution Company Inc.

We have audited the balance sheet of Tay Hydro Electric Distribution Company Inc. as at December 31, 2005 and the statements of earnings and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2005 and the results of its operations and cash flows for year then ended in accordance with Canadian generally accepted accounting principles.

Grant Thornton LLP

Orillia, Canada
April 7, 2006

Chartered Accountants

Tay Hydro Electric Distribution Company Inc.

Statements of Earnings and Retained Earnings

Year Ended December 31 2005 2004

Revenue		
Sale of power	\$ 3,218,878	\$ 2,863,192
Distribution	<u>1,323,182</u>	<u>1,208,087</u>
	4,542,060	4,071,279
Cost of power		
Power purchased	<u>3,218,878</u>	<u>2,863,192</u>
Gross margin	<u>1,323,182</u>	<u>1,208,087</u>
Other revenue	<u>132,258</u>	<u>91,259</u>
Expenses		
Distribution	210,836	182,885
Administration	505,750	384,692
Amortization	278,586	262,255
Pre-market energy variance	45,014	-
Billing and collecting	<u>221,416</u>	<u>208,451</u>
	1,261,602	1,038,283
Earnings from operations	193,838	261,063
Interest income	35,226	51,075
Interest on long term debt	<u>(181,158)</u>	<u>(191,920)</u>
Earnings before payments in lieu of income taxes	47,906	120,218
Payments in lieu of income taxes, (recoverable) (Note 12)	<u>(80,700)</u>	<u>13,198</u>
Net earnings	<u>\$ 128,606</u>	<u>\$ 107,020</u>
<hr/>		
Retained earnings, beginning of year	\$ 135,657	\$ 28,637
Net earnings	<u>128,606</u>	<u>107,020</u>
Retained earnings, end of year	<u>\$ 264,263</u>	<u>\$ 135,657</u>

See accompanying notes to the financial statements.

Tay Hydro Electric Distribution Company Inc.

Balance Sheet

December 31

2005

2004

Assets

Current

Cash	\$ 1,474,591	\$ 901,774
Receivables	294,146	165,408
Unbilled revenue	580,530	656,552
Inventory	104,857	99,821
Prepays	25,638	16,188
Payments in lieu of income taxes recoverable	139,696	28,186
Due from related parties (Note 3)	<u>61,012</u>	<u>62,100</u>
	2,680,470	1,930,029

Property and equipment (Note 4)	2,732,653	2,899,933
Other assets (Note 5)	47,569	27,611
Restricted cash (Note 6)	118,678	115,755
Regulatory assets (Note 7)	<u>581,195</u>	<u>567,479</u>
	\$ 6,160,565	\$ 5,540,807

Liabilities

Current

Payables and accruals	\$ 1,064,985	\$ 624,340
Current portion of long term debt	<u>1,939,821</u>	<u>1,928,821</u>
	3,004,806	2,553,161

Customer and retailer deposits	116,367	118,399
Development charges (Note 6)	118,678	115,755
Regulatory liabilities (Note 7)	280,630	45,014
Long term debt (Note 8)	<u>633,000</u>	<u>830,000</u>
	4,153,481	3,662,329

Shareholder's Equity

Capital stock (Note 9)	1,742,821	1,742,821
Retained earnings	<u>264,263</u>	<u>135,657</u>
	2,007,084	1,878,478
	\$ 6,160,565	\$ 5,540,807

Commitment and Contingent liability (Notes 14 and 15)

On Behalf of the Board

Director

Director

See accompanying notes to the financial statements.

working capital
1,268,047.00
< 1,064,985 >

< 1,971,000 >

1,418,485

Tay Hydro Electric Distribution Company Inc.

Statement of Cash Flows

Year Ended December 31

2005

2004

Increase (decrease) in cash and cash equivalents

Operating		
Net earnings	\$ 128,606	\$ 107,020
Amortization	<u>278,586</u>	<u>262,255</u>
	407,192	369,275
Change in non-cash operating working capital (Note 10)	<u>260,989</u>	<u>(50,624)</u>
	<u>668,181</u>	<u>318,651</u>
Financing		
Decrease in long term debt	<u>(186,000)</u>	<u>(175,000)</u>
Investing		
Net additions to property and equipment	(105,352)	(146,158)
Net additions to other assets	(25,912)	-
Net additions to regulatory liabilities	235,616	45,014
Net reduction to regulatory assets	<u>(13,716)</u>	<u>(113,437)</u>
	<u>90,636</u>	<u>(214,581)</u>
Net increase (decrease) in cash	572,817	(70,930)
Cash, beginning of year	<u>901,774</u>	<u>972,704</u>
Cash, end of year	\$ <u>1,474,591</u>	\$ <u>901,774</u>

See accompanying notes to the financial statements.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2005

1. Nature of operations

The company distributes electricity under license from the Ontario Energy Board (OEB). The Electricity Act, 1998 provides for a competitive marketplace in the sale of electricity. Ontario's wholesale and retail electricity markets became open to competition May 1, 2002. The Ontario Energy Board Act, 1998 (Ontario) (OEBA) conferred on the Ontario Energy Board (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 that distribution companies fulfil obligations to connect and service customers. The OEB may also prescribe license requirements and conditions to electricity distributors, which may include among other things, specified accounting records, regulatory accounting principles, separation of accounts for distinct businesses and filing and process requirements for rate setting purposes.

2. Summary of significant accounting policies

Cash and cash equivalents

Cash and cash equivalents include cash and bank balances

Inventory

Inventory consists of repair parts, supplies and materials held for future capital expansion and are valued at the lower of cost and net realizable value.

Rate-setting

The electricity distribution business is subject to rate regulation by the OEB. The OEB has the general power to include or exclude costs, revenues, losses or gains in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have applied in an unregulated company. This change in timing gives rise to the recognition of regulatory assets and liabilities. These regulatory assets and liabilities reflect the fact that revenue and expenses are recognized in the financial statements in different periods consistent with their inclusion in rates, as directed by the regulator, than would be the case for an enterprise that is unregulated. Specific regulatory assets and liabilities recognized at December 31, 2005 are disclosed in Note 7.

In a letter dated December 19, 2003, the Minister of Energy granted approval for distributors to make application to the OEB with regard to rate recovery of certain distribution regulatory assets whose inclusion in rates was delayed by the Electricity Pricing, Conservation and Supply Act, 2002. These distribution regulatory assets are being recovered in distribution rates over four years, commencing April 1, 2004.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2005

2. Summary of significant accounting policies (Continued)

Rate-setting (Continued)

In 2005, the OEB initiated a process to establish approved rates for electricity distributors based on updated revenue requirements, with the intent that these new rates would be effective May 1, 2006. As part of this process, the company submitted evidence to the OEB for final review.

The company continually assesses the likelihood of recovery of each of its regulatory assets and liabilities and believes that it is probable that its regulatory assets and liability will be factored into the setting of future rates. If future recovery through rates is no longer considered probable, the appropriate carrying amount will be written off in the period that the assessment is made.

Market transition costs have been deferred in accordance with the criteria set out in the OEB Electricity Distribution Rate Handbook, the Accounting Procedures Handbook (APH) and in subsequent OEB guidelines. In the absence of such regulation, these costs would have been expensed when incurred under Canadian GAAP.

Revenue recognition

Revenues are based on OEB approved unbundled rates and are recognized as power is delivered to customers. The company estimates the monthly revenue for the period based on customer's usage because customer meters are not generally read at the end of each month. Unbilled revenue is recognized for customer usage not billed at December 31, 2005.

Amortization

Property and equipment are amortized using the straight-line method over periods approximating their estimated useful lives as follows:

Land rights	50 years
Buildings	25-30 years
Distribution system	25 years
Other capital assets	2-10 years

When property and equipment is sold or scrapped, the cost of the asset and the related accumulated depreciation is removed from the accounts with the resulting net gain or loss being included in operations for the year.

Other assets are comprised of organization costs and costs for an optimization study which are amortized using the straight-line method over 5 years.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2005

2. Summary of significant accounting policies (Continued)

Fixed assets retirement obligations

Canadian generally accepted accounting principles require the company to determine the fair value of the future expenditures required to settle legal obligations to remove fixed assets on retirement. If reasonably estimable, a liability is recognized equal to the present value of the estimated future removal expenditures. An equivalent amount is capitalized as an inherent cost of the associated fixed assets.

Some of the company's assets may have asset retirement obligations. As the company expects to use the majority of its fixed assets for an indefinite period, no removal date can be determined and, consequently, a reasonable estimate of the fair value of any asset retirement obligations has not been made at this time.

Corporate income and capital taxes

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

The company provides for payments in lieu of corporate income taxes relating to its regulated business using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of the company at that time. This regulation accounting treatment differs from Canadian generally accepted accounting principles for enterprises operating in a non-regulated environment.

Use of estimates

In preparing the company's financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenditures during the year. Actual results could differ from these estimates.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2005

3. Related party transactions 2005 2004

The company had the following related party transactions:

Tay Utility Contracting Inc. - related company			
Services provided	\$	9,104	\$ 33,424
Township of Tay - shareholder of parent company			
Interest		182,058	191,920
Sale of power		277,087	236,000
Property taxes		13,418	12,888

Balances outstanding at December 31:

Due from Tay Utility Contracting Inc.	\$	30,410	\$ 38,188
Due from Tay Hydro Inc.		30,602	23,912
Due from (to) Township of Tay		1,750	(8,948)
Note payable to Township of Tay		1,742,821	1,742,821
Debenture payable to Township of Tay		830,000	1,016,000

The note payable, debenture and interest thereon have been recorded in these financial statements at the carrying amounts, which were equal to historical cost or fair value. The interest rate represents fair value as was determined at the time the debt was issued.

During the year, the company provided services to Tay Contracting Inc. in the amount of \$9,104 (2004 - \$33,424). These transactions have been recorded in these financial statements at the carrying amounts, which were equal to historical cost or fair value. Fair value represents fees for equivalent services provided to third parties in the normal course of operations as prescribed by regulation.

The company provides electricity to the Township. These transactions are in the normal course of operations and are measured at the exchange amount, which is equal to fair value as prescribed by regulation. During the year, the company billed electricity and services to the Town in the amount of \$277,087 (2004 - \$236,000). During the year, the company paid municipal taxes as prescribed by the province in the amount of \$13,418 (2004 - \$12,888)

4. Property and equipment 2005 2004

	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>	<u>Net Book Value</u>
Land and land rights	\$ 299,804	\$ 98,361	\$ 201,443	\$ 206,227
Buildings	274,675	64,523	210,152	216,927
Distribution system	5,741,577	3,494,756	2,246,821	2,381,638
Other capital assets	611,632	537,395	74,237	95,141
	<u>\$ 6,927,688</u>	<u>\$ 4,195,035</u>	<u>\$ 2,732,653</u>	<u>\$ 2,899,933</u>

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2005

5. Other assets			<u>2005</u>	<u>2004</u>
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>	<u>Net Book Value</u>
Optimization study	\$ 25,912	\$ 432	\$ 25,480	\$ -
Organization costs	<u>27,611</u>	<u>5,522</u>	<u>22,089</u>	<u>27,611</u>
	<u>\$ 53,523</u>	<u>\$ 5,954</u>	<u>\$ 47,569</u>	<u>\$ 27,611</u>

6. Development charges

In accordance with the Electricity Act 1998, the company maintains a bank balance and a corresponding liability for development charges collected, which are to be expended on qualifying growth-related capital assets.

7. Regulatory assets and liabilities

As described in Note 2, the company has recorded the following regulatory assets and liabilities:

Regulatory assets		
Retail settlement variance	\$ 499,698	\$ 190,818
Pre-market opening energy variance	-	45,014
Qualifying market transition costs	228,071	350,486
Other regulatory assets	<u>63,252</u>	<u>42,041</u>
	791,021	628,359
Amounts recovered through rates	<u>(209,826)</u>	<u>(60,880)</u>
	\$ 581,195	\$ 567,479
Regulatory liabilities		
Pre-market opening energy variance	\$ 45,014	\$ 45,014
Other regulatory liabilities	<u>273,366</u>	-
	318,380	45,014
Repayments to customers through rates	<u>(37,750)</u>	-
	\$ 280,630	\$ 45,014

The pre-market opening energy variance account has been established for the purpose of recording the estimated difference between the company's purchased cost of power based on time-of-use and amounts billed to non-time-of-use customers charged at an average rate for the same period starting January 1, 2001 and ending May 1, 2002. The company has recorded this amount as an expense and liability in 2005.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2005

8. Long term debt	<u>2005</u>	<u>2004</u>
Debenture payable	\$ 830,000	\$ 1,016,000
Note payable	<u>1,742,821</u>	<u>1,742,821</u>
	2,572,821	2,758,821
Less: current portion	<u>1,939,821</u>	<u>1,928,821</u>
	\$ <u>633,000</u>	\$ <u>830,000</u>

The debenture is payable to the Township of Tay, the shareholder of the parent company and bears interest at various rates ranging from 5.05% to 6.10%. Principal payments are due annually May 31 until 2009.

The note is payable to the Township of Tay, the shareholder of the parent company. Payments are interest only at 7.25%. The note is due on demand.

Scheduled principal payments due in each of the next four years are as follows:

2006	\$ 197,000
2007	210,000
2008	223,000
2009	200,000

9. Capital stock	<u>2005</u>	<u>2004</u>
-------------------------	--------------------	--------------------

Authorized:

The company is authorized to issue an unlimited number of common shares and an unlimited number of preference shares.

Issued:

1,000 common shares	\$ <u>1,742,821</u>	\$ <u>1,742,821</u>
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Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2005

10. Supplemental cash flow information	<u>2005</u>	<u>2004</u>
Change in non-cash operating working capital		
Receivables	\$ (128,738)	\$ 95,785
Unbilled revenue	76,022	(178,271)
Inventory	(5,036)	(13,143)
Prepays	(9,450)	2,893
Due from related parties	1,088	(17,754)
Payables and accruals	440,645	94,411
Payments in lieu of income taxes payable	(111,510)	(29,011)
Customer and retailer deposits	<u>(2,032)</u>	<u>(5,534)</u>
	\$ <u>260,989</u>	\$ <u>(50,624)</u>
Interest received	\$ <u>33,729</u>	\$ <u>51,198</u>
Interest paid	\$ <u>182,958</u>	\$ <u>192,620</u>
Payments in lieu of income taxes and capital taxes paid	\$ <u>30,810</u>	\$ <u>41,266</u>

11. Public liability insurance

The company is a member of the Municipal Electric Association Reciprocal Insurance Exchange (MEARIE), which was created on January 1, 1987. A reciprocal insurance exchange may be defined as a group of persons formed for the purpose of exchanging reciprocal contracts of indemnity or inter-insurance with each other through the same attorney. MEARIE has provided general liability insurance to the company of \$20,000,000 per occurrence.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2005

12. Payments in lieu of income taxes

The company is required to compute and remit to the OEFC payments in lieu of income taxes (PILS). PILS are computed in accordance with rules for computing income, capital and other taxes provided for in the Income Tax Act (Canada) and the Corporation Tax Act (Ontario) as modified by The Electricity Act, 1998 and related regulations.

	<u>2005</u>	<u>2004</u>
Income before provision for PILS	\$ 53,429	\$ 120,219
Federal and Ontario statutory income tax rates	36.12%	36.12%
Provision for PILS at statutory rate	\$ 19,299	\$ 43,423
Increase (decrease) resulting from:		
Temporary differences		
Amortization in excess of capital cost allowance	40,442	37,912
Net regulatory assets not deducted for accounting purposes	(209,928)	-
Other	(346)	(13,609)
Net temporary differences	<u>(169,832)</u>	<u>24,303</u>
Permanent differences		
Capital cost allowance on appraisal increment	(21,234)	(22,118)
Small business deduction	91,023	(32,410)
Other	44	-
Net permanent differences	<u>69,833</u>	<u>(54,528)</u>
Provision for PILS	\$ <u>(80,700)</u>	\$ <u>13,198</u>
Effective income tax rate	<u>(151.0)%</u>	<u>11.0%</u>

Future income taxes relating to the regulated businesses have not been recorded in the accounts as they are expected to be recovered through future revenues.

13. Pension Plan

The Municipality makes contributions to the Ontario Municipal Employees Retirement Fund (OMERS), which is a multi-employer plan, on behalf of 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.

Tay Hydro Electric Distribution Company Inc.

Notes to the Financial Statements

December 31, 2005

13. Pension Plan (Continued)

Effective January 2004, full contributions were made at rates ranging from 6% to 8.8% depending on the proposed retirement age and the level of earnings. As a result \$25,827 (2004 - \$23,693) was contributed to OMERS for current service.

14. Commitment

The company pays life insurance premiums on behalf of one retired employee. The company records the expense as payments are incurred. As a result, no accrued benefit liability has been recorded.

15. Contingent liability

A class action lawsuit claiming \$500 million in restitution payments plus interest was served on Toronto Hydro on November 18, 1999. The action was initiated against Toronto Hydro Electric Commission as the representative of the defendant class consisting of all municipal electric utilities in Ontario, which have charged late payment charges on overdue utility bills at any time after April 1, 1981.

The claim is that late payment penalties result in the municipal electric utilities receiving interest at effective rates in excess of 60% per year, which is illegal under Section 347(1)(b) of the Criminal Code.

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

16. Financial instruments

The company's financial instruments consist of receivables, unbilled revenue, due to (from) related party, payables and accruals, customer and retailer deposits and long-term debt. Unless otherwise noted, it is management's opinion that the company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximate their carrying values, unless otherwise noted.

17. Comparative figures

Certain of the comparative figures have been reclassified to conform to the financial statement presentation adopted for the current year.

FINANCIAL STATEMENTS OF

**TAY HYDRO ELECTRIC
DISTRIBUTION COMPANY INC.**

December 31, 2006

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AUDITORS' REPORT

To the Shareholders of
Tay Hydro Electric Distribution Company Inc.

We have audited the balance sheet of Tay Hydro Electric Distribution Company Inc. as at December 31, 2006 and the statements of retained earnings, income and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at December 31, 2005 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated April 7, 2006.

Collins Barrow Kawarthas

Chartered Accountants
Licensed Public Accountants

Peterborough, Ontario
June 15, 2007

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.
BALANCE SHEET

As at December 31, 2006

	2006	2005
	\$	\$
ASSETS		
Current assets		
Cash	1,131,051	1,474,591
Accounts receivable	378,867	294,146
Income taxes receivable	-	139,696
Inventory	119,042	104,857
Prepaid expenses	46,109	25,638
Due from related parties (note 3)	84,878	61,012
Unbilled revenue	622,622	580,530
	<u>2,382,569</u>	<u>2,680,470</u>
Other assets		
Property, plant and equipment (note 4)	2,814,651	2,732,653
Regulatory assets (note 5)	97,789	386,323
Other assets (note 6)	16,567	166,247
	<u>2,929,007</u>	<u>3,285,223</u>
	<u>5,311,576</u>	<u>5,965,693</u>

The accompanying notes are an integral part of these financial statements

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.
BALANCE SHEET

As at December 31, 2006

	2006 \$	2005 \$
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	855,346	1,091,346
Income taxes payable	141,010	-
Current portion of long-term debt (note 7)	1,952,821	1,939,821
	<u>2,949,177</u>	<u>3,031,167</u>
Long-term liabilities		
Long-term debt (note 7)	422,200	633,000
Customer and retailer deposits	139,132	116,367
Development charges (note 10)	-	118,678
Regulatory liabilities (note 6)	30,021	59,397
	<u>591,353</u>	<u>927,442</u>
Shareholders' equity		
Share capital (note 9)	1,742,821	1,742,821
Retained earnings	28,225	264,263
	<u>1,771,046</u>	<u>2,007,084</u>
	<u>5,311,576</u>	<u>5,965,693</u>

Approved on behalf of the Board

_____ Director

_____ Director

The accompanying notes are an integral part of these financial statements

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.
STATEMENT OF RETAINED EARNINGS

For the year ended December 31, 2006

	2006	2005
	\$	\$
Retained earnings - beginning of year		
As previously stated	264,263	135,657
Equity adjustment (note 10)	118,678	-
As restated	382,941	135,657
Net income (loss) for the year	(33,716)	128,606
Dividends paid	(321,000)	-
Retained earnings - end of year	28,225	264,263

The accompanying notes are an integral part of these financial statements

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.
STATEMENT OF INCOME

For the year ended December 31, 2006

	2006 \$	2005 \$
Revenue		
Sale of power	3,314,322	3,218,878
Distribution	1,203,145	1,323,182
	4,517,467	4,542,060
Cost of sales		
Power purchased	3,314,322	3,218,878
Gross profit	1,203,145	1,323,182
Expenses		
Distribution	198,184	210,836
Amortization	282,724	278,586
Operations and administration	309,680	528,017
Billing and collecting	222,770	221,416
	1,013,358	1,238,855
Income before undernoted items and income taxes	189,787	84,327
Other income (expense)		
Interest income	70,013	35,225
Other income	101,842	109,512
Interest on long term debt	(169,861)	(181,158)
	1,994	(36,421)
Income before income taxes	191,781	47,906
Provision for (recovery of) income taxes (note 8)	225,497	(80,700)
Net income (loss) for the year	(33,716)	128,606

The accompanying notes are an integral part of these financial statements

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.
STATEMENT OF CASH FLOWS

For the year ended December 31, 2006

	2006	2005
	\$	\$
CASH PROVIDED FROM (USED FOR)		
Operating activities		
Net income (loss) for the year	(33,716)	128,606
Items not affecting cash		
Amortization	282,724	278,586
	249,008	407,192
Change in non-cash working capital items (note 11)	(117,864)	287,350
	131,144	694,542
Investing activities		
Purchase of property, plant and equipment	(359,200)	(105,352)
Decrease (increase) in regulatory liabilities	(29,376)	14,383
Decrease (increase) in other assets	144,158	(25,912)
Decrease (increase) in regulatory assets	288,534	181,156
	44,116	64,275
Financing activities		
Dividends paid	(321,000)	-
Repayment of long-term debt	(197,800)	(186,000)
	(518,800)	(186,000)
Increase (decrease) in cash	(343,540)	572,817
Cash - beginning of year	1,474,591	901,774
Cash - end of year	1,131,051	1,474,591

The accompanying notes are an integral part of these financial statements

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

1. NATURE OF OPERATIONS

Tay Hydro Electric Distribution Company Inc. is incorporated under the Business Corporations Act of the Province of Ontario.

The principal activity of the company is to distribute electricity to the residents and businesses in the Township of Tay under license issued by the Ontario Energy Board (OEB). The company is regulated by the OEB and adjustments to its distribution rates require OEB approval.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements are prepared in accordance with Canadian generally accepted accounting principles. The significant policies are detailed as follows:

(a) *Electricity Regulation*

The company is subject to rate regulation by the Ontario Energy Board (OEB). The OEB is charged with the responsibility of approving rates for the transmission and distribution of electricity. The following regulatory policies are practiced in a rate regulated environment.

(i) Regulatory Assets

Regulatory assets consist of deferred qualifying transition costs and various rate and retail variance accounts. The costs related to these accounts are deferred for accounting purposes because it is probable that they will be recovered in future rates. Regulatory assets recognized at December 31, 2006 are disclosed in Note 6. The company continually assesses to the likelihood of the recovery of these assets. If recovery is no longer considered probable, the amount are charged to operations in the year the assessment is made. The recovery of regulatory assets commenced April 1, 2004.

(ii) Corporate Taxes

Under the Electricity Act, 1998, the company is required to make payments in lieu of income taxes (PILS) to the Ontario Electricity Financial Corporation (OEFC). As directed by the OEB, the company provides for PILS payments using the taxes payable method. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts.

(b) *Inventory*

Inventory is valued at the lower of cost and net realizable value with costs being determined on a weighted average basis. Inventory consists primarily of repair parts, supplies and materials held for future capital expansion.

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

2. SIGNIFICANT ACCOUNTING POLICIES, continued

(c) Revenue recognition

Revenues are 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 the power billed by Hydro One.

(d) Property, plant and equipment

Property, plant and equipment are recorded at cost. The company provides for amortization using the straight-line method at rates designed to amortize the cost of the property, plant and equipment over their estimated useful lives. The annual amortization rates are as follows:

Buildings	25-30 years
Distribution system	25 years
Land rights	50 years
Other capital assets	2-10 years

(e) Asset retirement obligations

Canadian generally accepted accounting principles require the company to determine the fair value of the future expenditures required to settle legal obligations to remove fixed assets on retirement. If reasonably estimable, a liability is recognized equal to the present value of the estimated future removal expenditures.

Some of the company's assets may have asset retirement obligations. As the company expects to use the majority of its fixed assets for an indefinite period, no removal costs can be determined and, consequently, a reasonable estimate of the fair value of any asset retirement obligations has not been made at this time.

(f) Financial instruments

The company's financial instruments consist of cash, accounts receivable, unbilled revenue, due from related parties, accounts payable and accrued liabilities and long-term debt. Unless otherwise noted it is management's opinion that the company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

(g) Management estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

2. **SIGNIFICANT ACCOUNTING POLICIES, continued**

(h) *Prior year's figures*

Prior year's figures have been restated, where applicable, to conform to current year's presentation.

3. **RELATED PARTY TRANSACTIONS**

(a) During the year, the company entered into transactions with the following related parties:

Tay Utility Contracting Inc., related company
 Township of Tay, shareholder of parent company

(b) Transactions

	2006	2005
	\$	\$
Revenue		
Services - Tay Utility Contracting Inc.	18,825	9,104
Sale of Power - Township of Tay	305,064	277,087
	<u>323,889</u>	<u>286,191</u>
Expenses		
Interest expense - Township of Tay	169,861	182,058
Property taxes - Township of Tay	14,435	13,418
	<u>184,296</u>	<u>195,476</u>

These transactions are in the normal course of operations and have been valued in these financial statements at the exchange amount which is the amount of consideration established and agreed to by the related parties.

The advances are non-interest bearing with no set terms of repayment.

(c) The amounts due from related companies consists of:

	2006	2005
	\$	\$
Due from Tay Utility Contracting Inc.	36,593	30,410
Due from Tay Hydro Inc.	48,285	30,602
	<u>84,878</u>	<u>61,012</u>

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

3. **RELATED PARTY TRANSACTIONS, continued**

(d) Balances due to the Township of Tay included in long term debt consists of:

	2006	2005
	\$	\$
Due from (to) Township of Tay	-	1,750
Note payable to Township of Tay	1,742,821	1,742,821
Debenture payable to Township of Tay	633,000	830,000
	<u>2,375,821</u>	<u>2,574,571</u>

The note payable, debenture and interest thereon have been recorded in these financial statements at the carrying amounts, which were equal to historical cost or fair value. The interest rate represents fair value as was determined at the time the debt was issued.

4. **PROPERTY, PLANT AND EQUIPMENT**

	Cost	Accumulated amortization	2006 Net book value	2005 Net book value
	\$	\$	\$	\$
Buildings	276,277	71,332 ✓	204,945 ^x	210,152 ✓
Distribution system	6,030,128	3,711,623	2,318,505	2,246,821
Land rights	299,804	103,087 ✓	196,717 ^x	201,443 ✓
Other capital assets	637,560	543,076	94,484	74,237
	<u>7,243,769</u>	<u>4,429,118</u>	<u>2,814,651</u>	<u>2,732,653</u>

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

5. REGULATORY ASSETS

As described in note 2, the company has recorded the following regulatory assets and liabilities.

	\$
Retail settlement variances	(230,871)
Qualifying market transition costs	4,809
Other regulatory assets	48,337
Approved regulatory assets	716,661
Regulatory assets recovered	(441,147)
Regulatory assets	97,789
	\$
Regulatory liability	59,397
Current portion included in accounts payable	(29,376)
Regulatory liability	30,021

6. OTHER ASSETS

	2006	2005
	\$	\$
Organization costs	16,567	22,089
Optimization study	-	25,480
Restricted cash	-	118,678
	16,567	166,247

Organization costs consist of \$ 27,611 original cost, less accumulated amortization of \$ 11,044. During the year the company charged \$ 5,522 of amortization to operations.

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

7. LONG-TERM DEBT

	2006	2005
	\$	\$
Debenture payable	633,000	830,000
Note payable	1,742,821	1,742,821
Promissory notes payable	19,820	19,820
	2,395,641	2,592,641
Less: current portion	(1,952,821)	(1,959,641)
	442,820	633,000

The debenture is payable to the Township of Tay, the shareholder of the company and bears interest at rates of 5.05% to 6%. Principal payments are due annually May 31 until 2009.

The note payable is to the Township of Tay, the shareholder of the parent company. Payments are interest only at 7.25%. The note is due on demand.

The promissory notes are non-interest bearing with no specific terms of repayment. Scheduled principal re-payments are as follows:

	\$
2007	210,000
2008	223,000
2009	200,000

8. PROVISION FOR INCOME TAXES

The income tax provision differs from that computed using the statutory rates for the following reasons:

	000's
	\$
Income taxes at statutory rates	69
Amortization in excess of capital cost allowance	25
Regulatory assets not deductible for tax purposes	176
Small business deduction	(40)
Other	(5)
Provision for income taxes	225

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

9. **SHARE CAPITAL**

Authorized
 Unlimited number of common shares
 Unlimited number of preference shares

Issued

	2006	2005
	\$	\$
1,000 common shares	1,742,821	1,742,821

10. **EQUITY ADJUSTMENT**

The company has established that the development charges included in the financial statements in prior years should have been recorded as equity and accordingly has made an adjustment to the prior year opening equity to reflect this reclassification.

11. **STATEMENT OF CASH FLOWS**

Change in non-cash working capital items

	2006	2005
	\$	\$
Increase in accounts receivable	(84,721)	(128,738)
Increase in inventory	(14,185)	(5,036)
Due from related parties	(23,866)	1,088
Increase in prepaid expenses	(20,471)	(9,450)
Decrease (increase) in customer and retailer deposits	22,765	(2,032)
Decrease (increase) in unbilled revenue	(42,092)	76,022
Increase in income taxes payable	141,010	-
Decrease (increase) in income taxes receivable	139,696	(111,510)
Increase (decrease) in accounts payable and accrued liabilities	(236,000)	467,006
	(117,864)	287,350
Other information		
Interest paid	190,078	182,958
Interest received	61,691	33,729
Income taxes paid (recovered)	(29,141)	30,810

TAY HYDRO ELECTRIC DISTRIBUTION COMPANY INC.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

12. SUBSEQUENT EVENTS

Effective April 30, 2007, Tay Hydro Electric Distribution Company Inc. and Newmarket Hydro Ltd. were amalgamated to form Newmarket-Tay Power Distribution Ltd.

13. PENSION PLAN

The company makes contributions to the Ontario Municipal Employees Retirement Fund (OMERS), which is a multi-employer plan, on behalf of 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. OMERS contributions totaled \$ 53,380 - (2005 - \$ 25,827).

14. CONTINGENT LIABILITY

A class action claiming \$500 million in restitutionary payments plus interest was served on Toronto Hydro on November 18, 1999. The action was initiated against Toronto Hydro Electric Commission as the representative of the Defendant Class consisting of all municipal electric Ontario, which have charged late payment charged 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 rate in excess of 60% per year, which is illegal under Section 347(1)(b) of the Criminal Code.

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