

Financial statements of

HYDRO OTTAWA LIMITED

December 31, 2005



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Auditors' Report

To the Shareholder of
Hydro Ottawa Limited

We have audited the balance sheet of Hydro Ottawa Limited as at December 31, 2005 and the statements of income and retained earnings and of 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 its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants

March 23, 2006

Report of Management

Management is responsible for the integrity of the financial data reported by the Company. Fulfilling this responsibility requires the preparation and presentation of non-consolidated financial statements and other data using management's best judgment, estimates and Canadian generally accepted accounting principles, applied on a basis consistent with the preceding year.

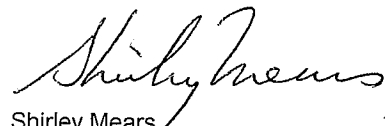
Management maintains appropriate systems of internal control and corporate-wide policies and procedures which provide reasonable assurance that the Company's assets are safeguarded and that financial records are relevant and reliable.

The Board of Directors, through the Audit Committee, ensures that management fulfills its responsibility for financial reporting and internal control. The Audit Committee consists of outside directors and at regular meetings reviews audit, internal control and financial reporting matters with management and external auditors. The Audit Committee has reviewed the financial statements and submitted its report to the Board of Directors.

On behalf of Management,



Rosemarie Leclair
President and
Chief Executive Officer



Shirley Mears
Senior Vice President and
Chief Financial Officer

HYDRO OTTAWA LIMITED

Financial Statements

year ended December 31, 2005

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HYDRO OTTAWA LIMITED
Statement of Income and Retained Earnings
year ended December 31, 2005
(tabular amounts are in thousands of dollars)

	<u>2005</u>	<u>2004</u>
REVENUES		
Power recovery	\$ 592,231	\$ 507,838
Distribution sales	90,884	85,689
Other revenue	10,783	11,687
	693,898	605,214
EXPENSES		
Purchased power	592,231	507,838
Operations	42,576	44,720
Amortization of capital assets	29,674	25,890
Recovery of provision for regulatory assets (Note 4)	(5,820)	(7,928)
Recovery of transition costs (Note 4)	(1,798)	-
Restructuring costs	-	851
	656,863	571,371
Earnings before other expenses and payments in lieu of corporate income taxes	37,035	33,843
Other expenses		
Interest expense (Note 12)	12,366	14,916
Payments in lieu of provincial capital tax	1,500	1,550
	13,866	16,466
Earnings before payments in lieu of corporate income taxes	23,169	17,377
Payments in lieu of corporate income taxes (Note 13)	2,427	761
NET EARNINGS	20,742	16,616
DEFICIT, BEGINNING OF YEAR	(8,205)	(24,821)
RETAINED EARNINGS (DEFICIT), END OF YEAR	\$ 12,537	\$ (8,205)

See accompanying notes to the financial statements

HYDRO OTTAWA LIMITED

Balance Sheet

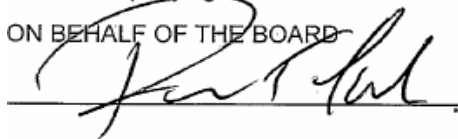
as at December 31, 2005

(tabular amounts are in thousands of dollars)

	<u>2005</u>	<u>2004</u>
CURRENT ASSETS		
Cash	\$ 3,874	\$ 1,728
Accounts receivable (Note 3)	46,048	49,624
Unbilled revenue	96,024	80,960
Inventory	6,440	8,224
Prepays	1,482	719
	153,868	141,255
NET REGULATORY ASSETS (Note 4)	6,610	5,469
CAPITAL ASSETS (Note 5)	410,389	383,162
OTHER ASSETS (Note 6)	391	391
Total assets	\$ 571,258	\$ 530,277
CURRENT LIABILITIES		
Accounts payable and accrued liabilities (Note 8)	\$ 131,665	\$ 124,033
Note payable (Note 10)	-	232,185
	131,665	356,218
DEFERRED REVENUE	1,635	-
NET REGULATORY LIABILITIES (Note 4)	16,300	9,623
EMPLOYEE FUTURE BENEFITS (Note 9)	3,596	3,351
CUSTOMER DEPOSITS	6,259	2,209
NOTES PAYABLE (Note 10)	232,185	-
	391,640	371,401
CONTINGENT LIABILITIES & COMMITMENTS (Note 7, 15, 16)		
SHAREHOLDER'S EQUITY		
Share Capital (Note 11)	167,081	167,081
Retained Earnings (Deficit)	12,537	(8,205)
	179,618	158,876
Total liabilities and shareholder's equity	\$ 571,258	\$ 530,277

See accompanying notes to the financial statements

ON BEHALF OF THE BOARD



Director

HYDRO OTTAWA LIMITED

Statement of Cash Flows

year ended December 31, 2005

(tabular amounts are in thousands of dollars)

	<u>2005</u>	<u>2004</u>
NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net earnings	\$ 20,742	\$ 16,616
Adjustments for non-cash items		
Amortization of capital assets	29,674	25,890
Gain on disposal of capital assets	(30)	(95)
Allowance for funds used during construction (Note 5)	(467)	(1,225)
	<u>49,919</u>	<u>41,186</u>
Net change in non-cash operating working capital items and regulatory assets and liabilities (Note 14)	<u>25,662</u>	<u>(3,893)</u>
	<u>75,581</u>	<u>37,293</u>
FINANCING		
Contributions in aid of construction	21,433	7,536
Advances from parent company	(15,000)	8,682
Customer deposits repaid	(2,031)	(271)
	<u>4,402</u>	<u>15,947</u>
INVESTING		
Acquisition of capital assets	(77,925)	(62,770)
Proceeds from sale of capital assets	88	203
	<u>(77,837)</u>	<u>(62,567)</u>
NET CASH INFLOW (OUTFLOW)	<u>2,146</u>	<u>(9,327)</u>
CASH, BEGINNING OF YEAR	<u>1,728</u>	<u>11,055</u>
CASH, END OF YEAR	<u>\$ 3,874</u>	<u>\$ 1,728</u>
Other information		
Interest paid	\$ 12,945	\$ 20,115
Payments in lieu of taxes paid	\$ 2,275	\$ 2,337

See accompanying notes to the financial statements

HYDRO OTTAWA LIMITED

Notes to the Financial Statements

year ended December 31, 2005
(tabular amounts are in thousands of dollars)

1. DESCRIPTION OF BUSINESS

Hydro Ottawa Limited (Hydro Ottawa or the Company) was incorporated on October 3, 2000 pursuant to the *Business Corporations Act* (Ontario). The incorporation was required by the Ontario government's *Electricity Act, 1998*. The Company is a wholly owned subsidiary of Hydro Ottawa Holding Inc., which in turn is owned by the City of Ottawa.

The Company is a regulated electricity distribution company that owns and operates electricity infrastructure in the City of Ottawa and the Village of Casselman and is responsible for the safe, reliable delivery of electricity to homes and businesses in its licensed service area. In addition to billing for distribution services, it also invoices customers for amounts it is required to pay to other organizations in Ontario's electricity system for providing wholesale generation and transmission services and for debt retirement.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) for commercial entities, including principles prescribed by the Ontario Energy Board (OEB) in the Accounting Procedures Handbook (AP Handbook). In the opinion of management, all adjustments necessary for fair presentation are reflected in the financial statements. The financial statements reflect the significant accounting policies summarized below.

1) REGULATION

Hydro Ottawa is regulated by the OEB under the authority of the *Ontario Energy Board Act, 1998*. The OEB is charged with the responsibility of approving or setting rates for the transmission and distribution of electricity and the responsibility for ensuring that distribution companies fulfill obligations to connect and service customers.

The OEB has the general power to include or exclude costs and revenues 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.

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

a) Regulatory assets and liabilities

Regulatory assets primarily represent costs that have been deferred because it is probable that they will be recovered in future rates. Similarly, regulatory liabilities can arise from differences in amounts billed to customers for electricity services and the costs that the Company incurs to purchase these services. The Company began recovering its regulatory assets (net of liabilities) on an interim basis starting April 1, 2004. This recovery continued throughout 2005. In June 2005, the OEB provided distributors with filing guidelines for final approval of these regulatory assets. Accordingly, the Company filed an application with the OEB for the final recovery of regulatory assets (net of liabilities) accumulated to December 31, 2004, on August 2, 2005, which if approved would result in an increase in rates for the period May 1, 2006 to April 30, 2008.

Regulatory balances are comprised principally as follows:

(i) Transition costs:

Hydro Ottawa incurred transition costs in preparing the Company for requirements of the competitive electricity market in Ontario. Criteria set out in the OEB's Distribution Rate Handbook and AP Handbook allow certain costs to be deferred that would be expensed when incurred under GAAP for an unregulated business. Hydro Ottawa has not recorded additional transition costs since 2002; however, interest on the recorded transition costs has been accrued as a regulatory asset.

HYDRO OTTAWA LIMITED

Notes to the Financial Statements

year ended December 31, 2005
(tabular amounts are in thousands of dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

a) Regulatory assets and liabilities (Continued)

(ii) Pre-market opening electricity variance:

At December 31, 2002, Hydro Ottawa recognized the pre-market opening electricity variance for the period January 1, 2001 to April 30, 2002, the date of market opening, in accordance with the AP Handbook. The pre-market opening variance represents the difference between the utility's cost of power purchased based upon time-of-use (TOU) rates and amounts billed for the cost of power to non-TOU customers at an average rate for the same period. Simple interest has been accrued as a regulatory asset as per the AP Handbook.

(iii) Post-market opening variances:

Retail services and settlement variances - The retail settlement variances relate to the charges Hydro Ottawa incurred for transmission services, generation (the commodity) and wholesale market operations from the Independent Electricity System Operator (IESO) and Hydro One Networks that were not recovered from customers during the period. The nature of the settlement variances is such that the balance can fluctuate between an asset and a liability over time and are reported at period-end dates in accordance with rules prescribed by the OEB. Hydro Ottawa has also recognized the net cost of providing retailer billing services and service transaction request services as a variance amount. On January 1, 2005, the IESO implemented, pursuant to Bill 100, a new price adjustment applicable to customers who are not eligible for the regulated price plans and therefore pay spot market price. To facilitate this, electricity distributors are given a price adjustment on their invoice from the IESO, called the Global Adjustment, which they pass on to this class of customer via a Provincial Benefit on the customer's bill.

The Global Adjustment represents the difference between market prices and the combined regulated and contract prices paid to electricity generators for electricity. This adjustment may be either positive or negative depending on the prevailing electricity market conditions. The electricity distributor adjusts the customer's invoice for the Provincial Benefit based on rates set monthly by the IESO. The difference between the Global Adjustment provided to electricity distributors, and the Provincial Benefit passed on to this particular class of customer, is tracked in a retail settlement variance account.

Miscellaneous deferred debits – The deferred debits represent one-time expenses incurred to issue the 2002 customer rebates arising from Bill 210 which established a price cap of 4.3 cents per kilowatt-hour (kWh) for the electricity commodity for low-volume and designated customers (Eligible Customers) retroactive to May 1, 2002.

Deferred OEB annual cost assessments – The OEB has allowed electricity distributors to record their OEB cost assessments for the OEB's 2004 fiscal and subsequent years in order that these costs may be given consideration for rate recovery in the future. The Company has deferred these expenditures in accordance with the directions set out in the AP Handbook.

Deferred cash pension contributions - The OEB has allowed electricity distributors to apply for the recovery of incremental Ontario Municipal Employees Retirement System (OMERS) pension expenditures for fiscal years starting after December 31, 2004. Accordingly, the Company has deferred these expenditures in accordance with the directions set out in the AP Handbook.

Deferred payments in lieu of taxes (PILs) - Variances that result from the difference between OEB approved PILs recoverable in electricity distribution services charges and the actual amount collected from customers that relates to the recovery of PILs are deferred in accordance with the AP Handbook.

Interest on all recorded post-market opening variances has been accrued as a regulatory asset as per the AP Handbook.

HYDRO OTTAWA LIMITED

Notes to the Financial Statements

year ended December 31, 2005
(tabular amounts are in thousands of dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

b) *Contributions in aid of construction*

Capital contributions are required contributions received from outside sources used to finance additions to capital assets. Capital contributions received are treated as a contra account and are included in capital assets. The amount is amortized by a charge to accumulated amortization and a credit to amortization expense at an equivalent rate to that used to depreciate the related capital asset.

c) *Allowance for funds used during construction (AFUDC)*

Commencing January 1, 2000, an allowance for the cost of funds used during the construction period of major capital and development projects has been applied to the related capital assets. The rate applied during the current fiscal period as prescribed in the 2006 Electricity Distribution Rate (EDR) Handbook is equal to the weighted average cost of capital, being 6.6%. In 2004, the rate applied was equal to the rate allowed by the OEB in respect of long-term borrowings, being 6.9%.

d) *Payment in lieu of corporate income taxes*

Hydro Ottawa is considered to be a municipal electric utility (MEU) for purposes of the payments in lieu of taxes (PILs) regime contained in the *Electricity Act, 1998*. The *Electricity Act, 1998* provides that a MEU that is exempt from tax under the *Income Tax Act (Canada) (ITA)* and the *Corporations Tax Act (Ontario) (CTA)* is required to make, for each taxation year, a PILs amount to the Ontario Electricity Financial Corporation (OEF) in an amount approximating the tax that it would be liable to pay under the ITA and the CTA if it were not exempt from tax.

The AP Handbook provides for the recovery of PILs by Hydro Ottawa through annual distribution rate adjustments as approved by the OEB.

The Company has adopted the taxes payable method to account for PILs as outlined in the AP Handbook. Under the taxes payable method, no provision is made for future income taxes as a result of unused tax losses or 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 by the regulated business at that time.

The Company is exempt from tax under the ITA, as not less than 90% of its capital is directly owned by the City of Ottawa and not more than 10% of its income is derived from activities carried on outside the municipal boundaries of the City of Ottawa. A corporation exempt under the ITA is also exempt from tax under the CTA.

2) MEASUREMENT UNCERTAINTY

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of revenue, expenses, assets, liabilities and the disclosure of contingent assets and liabilities at the financial statement date. Accounts receivable, unbilled revenue and regulatory assets and liabilities are reported net of an appropriate allowance for unrecoverable amounts.

Due to the inherent uncertainty involved in making such estimates, actual results could differ from estimates recorded in preparing these financial statements, including changes as a result of future decisions made by the OEB or the provincial government. The financial statements have, in management's opinion, been properly prepared using careful judgment within reasonable limits of materiality and within the framework of the accounting policies.

HYDRO OTTAWA LIMITED

Notes to the Financial Statements

year ended December 31, 2005
(tabular amounts are in thousands of dollars)

2. *SIGNIFICANT ACCOUNTING POLICIES (Continued)*

3) *FINANCIAL INSTRUMENTS*

The Company's financial instruments consist of cash, accounts receivable, unbilled revenue, accounts payable and accrued liabilities, customer deposits, notes payable and standby letters of credit. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant currency, commodity or credit risks arising from these financial instruments. The carrying values of the Company's financial instruments approximate their fair values unless otherwise noted.

Concentration of credit risk in accounts receivable and unbilled revenue is limited, due to the large number of customers the Company services. The Company performs ongoing credit evaluations on its customers and requires collateral to support customer accounts receivable on specific accounts to mitigate significant losses. The Company establishes an allowance for doubtful accounts based on the credit risk applicable to particular customers, and historical and other information.

The Company is exposed to interest rate risk on its short-term borrowings. Under Hydro Ottawa Holding Inc.'s credit facilities (Note 7), any advances on its operating credit line would expose the Company to fluctuations in short-term interest rates related to prime-rate loans and banker's acceptances.

4) *INVENTORY*

Inventory consists primarily of parts and supplies acquired for internal construction or consumption and are stated at the lower of cost and replacement cost, with cost determined on a weighted moving average basis.

A comprehensive review of the utilization of inventory is conducted each year to identify items with an impaired value as stock items that have become obsolete.

5) *SPARE TRANSFORMERS AND METERS*

Spare transformers and meters are items that are expected to be substituted for original distribution plant transformers and meters when these original plant assets are being repaired and are held and dedicated for the specific purpose of backing up plant-in-service as opposed to assets available for other uses. Spare transformers and meters are treated as capital assets.

6) *CAPITAL ASSETS*

Capital assets include distribution equipment, facilities and buildings, as well as construction and operating equipment.

Capital assets are recorded at cost and include contracted services, materials, labour, engineering costs, overheads and an allowance for the cost of funds used during construction. Certain assets may be acquired or constructed with financial assistance in the form of contributions from customers.

Significant renewals and enhancements to existing assets are capitalized only if the service life of the asset is increased, reliability is improved above original design standards or if operating costs are reduced by a substantial and quantifiable amount.

Maintenance and repair costs are expensed as incurred.

Amortization is recorded on a straight-line basis over the estimated service life of the related asset.

Estimated service lives for capital asset classes are as follows:

Distribution system	25 to 40 years
General plant	4 to 50 years

Assets under construction are not subject to amortization.

HYDRO OTTAWA LIMITED

Notes to the Financial Statements

year ended December 31, 2005
(tabular amounts are in thousands of dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

6) CAPITAL ASSETS (Continued)

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable, the Company will estimate the future cash flows expected to result from the use of the asset group and their eventual disposition, and record an impairment loss if required.

7) EMPLOYEE FUTURE BENEFITS

a) Pension plan

The Company provides pension benefits for its employees through the Ontario Municipal Employees Retirement System ("OMERS"). OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund (the Fund), and provides pensions for employees of Ontario municipalities, local boards, public utilities and school boards. The Fund is a contributory defined benefit pension plan, which is financed by equal contributions from participating employers and employees and by the investment earnings of the Fund. The Company recognizes the expense related to this plan as contributions are made.

b) Employee future benefits other than pension plan

Employee future benefits other than pensions provided by the Company include medical and life insurance benefits, supplemental pensions and accumulated sick leave credits. These plans provide benefits to certain employees when they are no longer providing active service.

Employee future benefit expense is recognized in the period in which the employees render services.

Employee future benefits are recorded on an accrual basis. The accrued benefit obligation and current service costs are calculated using the projected benefit method pro-rated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value of benefits attributed to employees' services rendered in the period. Actuarial gains and losses resulting from experience different from that assumed or from changes in actuarial assumptions are amortized based on the excess of unamortized net actuarial gains and losses over the 10% corridor calculated in the aggregate for all groups. The expected average remaining service life as at December 31, 2005 is 16 years.

8) CUSTOMER DEPOSITS

Customer deposits are cash collections from customers to guarantee the payment of energy bills and fulfillment of construction obligations. Deposits estimated to be refundable to customers within the next fiscal year are classified as a current liability.

On February 3, 2004, the OEB released amendments to the Distribution System Code (DSC) with respect to customer security deposits. The DSC now sets out the maximum customer security deposits permitted, the length of time that deposits can be held, how customers can seek exemption for part or all of the deposit and the interest that distributors must pay on these deposits. The new DSC requirements came into effect on August 3, 2004; however as permitted by the OEB, the Company did not return customer security deposits under the new rules until 2005.

9) REVENUE RECOGNITION

a) Power recovery

Power recovery revenue is the pass through of the Company's purchased power costs to the consumer.

b) Distribution sales

Electricity distribution sales are recorded on the basis of regular meter readings and estimates of current usage from the last meter reading to the end of the fiscal period.

HYDRO OTTAWA LIMITED
Notes to the Financial Statements
year ended December 31, 2005
(tabular amounts are in thousands of dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

9) REVENUE RECOGNITION (Continued)

c) *Other revenue*

Other revenue related to sales of other services is recognized as services are rendered. Contract revenue is accounted for using the percentage of completion method, whereby revenue is recognized proportionately with the degree of completion of the services under contract. Losses on contracts are fully recognized when they become evident.

d) *Unbilled revenue*

Unbilled revenue represents distribution sales, along with accrued revenue from electricity consumed by customers since the date of each customer's last meter reading that has not yet been billed.

e) *Deferred revenue*

In 2005, Hydro Ottawa began collecting the third instalment (third tranche) of its regulated rate of return, on the condition that an equivalent amount would be invested in conservation and demand management (CDM) activities by September 2007. The CDM recoveries in 2005 exceeded the cumulative amount spent on CDM activities. The excess recoveries are treated as deferred revenue as the Company has billed the customer but has yet to discharge its obligation relating to the investment of these funds. The CDM required capital expenditures and operating expenses are recorded from July 1, 2004 to September 30, 2007 while the recovery is received over the twelve-month period from March 1, 2005 to February 28, 2006.

3. ACCOUNTS RECEIVABLE

	<u>2005</u>	<u>2004</u>
Electricity receivables net of allowance for doubtful accounts of \$2,267,000 (2004 - \$2,900,000)	\$ 38,621	\$ 38,700
Other receivables	7,427	8,088
Amounts due from related parties (Note 17)	-	2,836
	<u>\$ 46,048</u>	<u>\$ 49,624</u>

4. REGULATORY ASSETS AND LIABILITIES

In accordance with the AP Handbook, the Company has accounted for regulatory variances during the year. All pre-market opening electricity variances and post-market opening variances have been recorded as regulatory assets, with the exception of the variances related to the transmission connection costs and global adjustment that have been recorded as regulatory liabilities. Interest has been accrued on the regulatory assets and regulatory liabilities as per the AP Handbook. Transition costs have been recorded as capital assets, but the related accrued interest has been treated as a regulatory asset.

Information about the Company's net regulatory assets and liabilities is as follows:

	<u>2005</u>	<u>2004</u>
Transition costs:		
Capital assets net of recovery of \$1,798,000 (2004 - \$nil)	\$ 2,268	\$ 6,431
Interest on transition costs net of recovery of \$1,122,000 (2004 - \$611,000)	71	421
Provision for doubtful recovery	<u>(71)</u>	<u>(421)</u>
Total transition costs	<u>2,268</u>	<u>6,431</u>

HYDRO OTTAWA LIMITED
Notes to the Financial Statements
year ended December 31, 2005
(tabular amounts are in thousands of dollars)

4. REGULATORY ASSETS AND LIABILITIES (Continued)

Pre-market opening electricity variance:		
Regulatory assets net of recovery of \$10,123,000 (2004 - \$2,293,000)	17,257	23,633
Provision for doubtful recovery	<u>(17,257)</u>	<u>(23,633)</u>
Total pre-market opening electricity variance	-	-
Post-market opening variances:		
Retail settlement variance account assets net of recovery of \$10,338,000 (2004 - \$5,995,000)	7,931	5,920
Provision for doubtful recovery	<u>(5,099)</u>	<u>(3,496)</u>
	<u>2,832</u>	<u>2,424</u>
Other regulatory assets net of recovery of \$456,000 (2004 - \$498,000)	4,747	4,889
Provision for doubtful recovery	<u>(969)</u>	<u>(1,844)</u>
	<u>3,778</u>	<u>3,045</u>
Retail settlement variance account liabilities net of disposition of \$6,261,000 (2004 - \$2,277,000)	<u>(16,300)</u>	<u>(9,623)</u>
Total post-market opening variances	<u>(9,690)</u>	<u>(4,154)</u>
Total regulatory assets and liabilities	<u>\$ (7,422)</u>	<u>\$ 2,277</u>
Regulatory assets and liabilities are recorded as:		
Net regulatory assets	\$ 6,610	\$ 5,469
Net regulatory liabilities	(16,300)	(9,623)
Capital assets	<u>2,268</u>	<u>6,431</u>
	<u>\$ (7,422)</u>	<u>\$ 2,277</u>

The Company expects to recover or dispose of these regulatory assets and liabilities by April 30, 2008.

Information about the Company's recovery of provision for regulatory assets is as follows:

	2005 (Recapture) of Provision for Doubtful Recovery	2004 (Recapture) of Provision for Doubtful Recovery
Recovery of regulatory assets through rate approval	\$ (11,384)	\$ (8,388)
Disposition of regulatory liabilities through rate approval	1,797	1
Regulatory assets provision	<u>3,767</u>	<u>459</u>
Total recovery of provision for regulatory assets	<u>\$ (5,820)</u>	<u>\$ (7,928)</u>

HYDRO OTTAWA LIMITED

Notes to the Financial Statements

year ended December 31, 2005
(tabular amounts are in thousands of dollars)

4. REGULATORY ASSETS AND LIABILITIES (Continued)

The impact of accounting for regulatory assets and liabilities in the absence of rate regulation considerations under GAAP in the current period are:

1) The opening of the restructured electricity market on May 1, 2002 separated the purchase of power into several components such as the cost of the commodity or power, and non-competitive charges being transmission connection and network costs, and wholesale market service costs. These costs are to be passed on to the customer. The difference between actual costs incurred and the amounts recovered through rates are held as regulatory assets or liabilities, with final disposition subject to OEB approval.

a) Retail settlement variances of \$2,832,000 (2004 - \$2,424,000) for non-competitive electricity charges and power charges such as the cost of imported power, excluding the transmission connection costs variance and global adjustment variance, are recorded as regulatory assets. In the absence of rate regulation considerations, actual non-competitive electricity charges and power costs could be expensed as incurred. Consequently, operating results for 2005 would be \$408,000 lower.

b) Retail settlement transmission connection costs and global adjustment variances of \$16,300,000 (2004 - \$9,623,000) are regulatory liabilities. They represent the over recovery of transmission connection charges and the difference between the Provincial Benefit provided to customers and the Global Adjustment received from the IESO. In the absence of rate regulation considerations, actual transmission connection costs and global adjustment variances would be recognized as revenue when billed to the customer and as an expense when charged by the IESO. Consequently, operating results for 2005 would be \$6,677,000 higher.

2) Other regulatory assets of \$2,200,000 (2004 - \$760,000) include costs that the OEB has allowed electricity distributors to record, such as OEB cost assessments, incremental OMERS pension expenditures, retail service costs and miscellaneous deferred debits, in order that these costs may be given consideration for rate recovery in the future. Also included in other regulatory assets are deferred payments in lieu of taxes of \$1,578,000 (2004 - \$2,285,000) that represent variances that result from the difference between OEB approved PILs recoverable in electricity distribution services charges and the actual amount collected from customers relating to the recovery of PILs. In the absence of rate regulation considerations, the operating results for 2005 would be \$733,000 lower.

Final approval of regulatory assets and liabilities:

The Company reviews all regulatory assets for likelihood of recovery. The absence of final approval is a consideration in this evaluation. The Company has recorded a net provision of \$23,396,000 (2004 - \$29,394,000) against regulatory assets. The Company continues to assess the likelihood of full recovery of regulatory assets. If future recovery becomes assured, the Company would recognize the recovery in the results of operations in the period such a decision is made.

In 2005 the Company filed an application with the OEB to obtain final approval to recover \$4,066,000 in transition costs included in general plant capital assets. The Company has received interim approval to begin recovering these costs. The Company has recovered \$2,920,000 (2004 - \$611,000) in regulatory assets through rates of which \$1,798,000 (2004 - \$nil) represented transition costs and \$1,122,000 (2004 - \$611,000) represented interest accrued on these costs. Included in the cost of general plant is \$2,268,000 (2004 - \$6,431,000) of transition costs still recoverable.

HYDRO OTTAWA LIMITED
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5. CAPITAL ASSETS

	2005			2004
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Distribution system	\$ 727,204	\$ 351,928	\$ 375,2	\$ 337,846
General plant	138,846	57,078	81,7	71,418
Assets under construction	16,473	-	16,473	18,797
	882,523	409,006	473,5	428,061
Contributions in aid of construction	(74,710)	(11,582)	(63,1	(44,899)
	\$ 807,813	\$ 397,424	\$ 410,3	\$ 383,162

During the year, the company capitalized an allowance for funds used during construction of \$467,000 (2004 - \$1,225,000).

The OEB permits an AFUDC, based on Hydro Ottawa's weighted average cost of capital, to be included in the rate base. AFUDC is also included in the cost of capital assets for financial reporting purposes, and is depreciated over future periods as part of the total cost of the related asset, based on the expectation that depreciation expense, including the AFUDC component, will be approved for inclusion in future rates. Since AFUDC includes an interest component, and a cost-of-equity component, it exceeds the Company's actual weighted average cost of debt. In the absence of rate regulation considerations under GAAP, the operating results for 2005 would be \$113,000 lower.

6. OTHER ASSETS

In 2004, the Company sold a server valued at \$541,000. The sale of the server did not result in any gain or loss on disposal. Consideration for the server consisted of credits to be applied against fees payable under the maintenance agreement with \$150,000 applied in 2004 and the remaining to be applied as follows:

2008	\$130,000
2009	130,000
2010	131,000
	<u>\$391,000</u>

7. CREDIT FACILITIES

Hydro Ottawa Holding Inc. on behalf of itself and its subsidiaries arranged a new credit facility in the amount of \$350,000,000 with a syndicate of Canadian banks. The new facility consisted of two elements: a \$150,000,000 three-year, extendible, revolving term credit facility which expires January 6, 2008, and a \$200,000,000 364-day bridge facility.

Amounts drawn under the revolving term credit facility as bankers' acceptances are calculated using a discount rate that is 0.1% below the average posted rate for Bankers' Acceptances (3.33% at December 31, 2005). Prime rate advances under this facility bear interest at the bank's prime rate (5% at December 31, 2005). The fee payable for bankers' acceptances and standby letters of credit is based on a margin determined by reference to the Hydro Ottawa Holding Inc.'s credit rating. This facility contains a requirement to maintain the consolidated debt to capitalization ratio at or below 75% and to use no more than \$75,000,000 of the facility to fund capital expenditures, customary covenants and events of default. At December 31, 2005, the Company had drawn \$22,000,000 in standby letters of credit against this facility.

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7. CREDIT FACILITIES (Continued)

On January 5, 2005, Hydro Ottawa Holding Inc. on behalf of itself and its subsidiaries terminated the existing unsecured \$152,000,000 credit facility with a Canadian chartered bank, and replaced it with a \$47,285,000 credit facility that expires May 18, 2006. It is Hydro Ottawa Holding Inc.'s intention to renew this facility, amended for a reduction in the amount of standby letters of credit, for another year. This facility consists of a \$24,850,000, 364-day revolving term operating credit line, \$22,285,000 in standby letter of credits and a \$150,000 corporate Visa facility. Direct advances under the 364-day operating credit line bear interest at prime less 0.35% per annum. This facility contains customary covenants and events of default including a covenant to maintain the consolidated tangible net worth in excess of \$55,000,000 at all times. At December 31, 2005 the Company had drawn no amount on the operating credit line (2004 - \$nil) and \$211,000 (2004 - \$22,285,000) in standby letter of credits.

8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	<u>2005</u>	<u>2004</u>
Purchased power payable	\$ 57,9	\$ 49,083
Rebates payable to eligible customers	4,518	2,433
Customer credit balances	28,636	11,115
Collateral funds held	14,068	20,149
Other accounts payable and accrued liabilities	16,731	20,994
Deferred revenue	4,321	-
Payments in lieu of corporate income taxes payable	1,622	-
Advances from parent company (Note 17)	2,000	17,000
Due to related parties (Note 17)	1,816	3,259
	<u>\$ 131,665</u>	<u>\$ 124,033</u>

9. EMPLOYEE FUTURE BENEFITS

i. Pension Plan

The Company's participating employer contributions for the year was \$2,257,000 (2004 - \$2,060,000).

ii. Employee future benefits other than pension plan

Employee future benefits are calculated using an annual compensation rate increase of 3.0% (2004 - 2.5% to 3%), an inflation rate of 2.0% (2004 - 1.75%), and a discount rate of 5.25% (2004 - 6.0%) to calculate the liabilities.

Information about the Company's defined benefit plans is as follows:

	<u>2005</u>		
	<u>Accumulated Liability</u>	<u>Expense for the period</u>	<u>Benefits Paid</u>
Life insurance	\$ 3,877	\$ 582	\$ 325
Supplemental pensions	28	3	3
Sick leave	16	-	-
	<u>\$ 3,921</u>	<u>\$ 585</u>	<u>\$ 328</u>
Projected benefit obligation	<u>\$ 7,522</u>		
Actuarial deficit	<u>\$ (3,601)</u>		

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9. EMPLOYEE FUTURE BENEFITS (Continued)

	2004		
	Accumulated Liability	Expense (recovery) for the period	Benefits Paid
Life insurance	\$ 3,620	\$ 487	\$ 331
Supplemental pensions	28	3	3
Sick leave	16	(42)	-
	<u>\$ 3,664</u>	<u>\$ 448</u>	<u>\$ 334</u>
Projected benefit obligation	<u>\$ 6,562</u>		
Actuarial deficit	<u>\$ (2,89</u>		

The last actuarial valuation was performed January 1, 2004. The actuary has updated the assumptions and estimates at December 31, 2005. As a result of this exercise, the Company increased the projected benefit obligation by \$960,000 (2004 - \$487,000). This amount is reflected in the projected benefit obligation and the excess over the 10% corridor will be charged to earnings over the average remaining service life of current employees of 16 years, beginning January 1, 2006.

The current liability portion of the accrued employee future benefits included in other accounts payable is \$325,000 (2004 - \$313,000) and the non-current portion of \$3,596,000 (2004 - \$3,351,000) is included in long term liabilities.

10. NOTES PAYABLE

Effective July 1, 2005, the Company issued promissory notes, payable to Hydro Ottawa Holding Inc., in the amounts of \$200,000,000 bearing interest at 5.14% per annum and \$32,185,000 bearing interest at 5.9% per annum, to replace the promissory note due on demand issued December 31, 2004, payable to Hydro Ottawa Holding Inc. in the amount of \$232,185,000. The note bore interest commencing at 7% per annum declining to the rate of interest charged to Hydro Ottawa Holding Inc. pursuant to the first bonds issued by Hydro Ottawa Holding Inc. in 2005, plus 0.1% per annum. The management of Hydro Ottawa Holding Inc. has confirmed that it does not intend on calling these notes within one year.

The notes are subordinated and postponed to the obligation of the Company to a third party for the payment in full of any secured indebtedness and any and all security interests granted to secure such obligations of the Company.

The notes are convertible into fully paid and non-assessable Class A common shares at a conversion rate equal to 1 Class A common share for each \$1 of the principal amount converted.

	2005	2004
Current:		
7% promissory note payable on demand to Hydro Ottawa Holding Inc.	\$ -	\$ 232,185
Long-term:		
5.9% promissory note payable to Hydro Ottawa Holding Inc.	32,185	-
5.14% promissory note payable to Hydro Ottawa Holding Inc.	200,000	-
	<u>232,185</u>	<u>-</u>
	<u>\$ 232,185</u>	<u>\$ 232,185</u>

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11. SHARE CAPITAL

Authorized

- Unlimited voting first preferred shares, redeemable at \$1 per share
- Unlimited non-voting second preferred shares, redeemable at \$10 per share
- Unlimited non-voting third preferred shares, redeemable at \$100 per share
- Unlimited voting (10 votes per share) fourth preferred shares, redeemable at \$100 per share
- Unlimited voting Class A common shares
- Unlimited non-voting Class B common shares
- Unlimited non-voting Class C common shares

The above shares are without nominal or par value.

The Company may, at any time, purchase for cancellation the whole or part of the Class C common shares at the price at which such shares were issued.

Holdings of second preferred shares, fourth preferred shares and common shares are entitled to receive dividends as and when declared by the board of directors at their discretion.

	<u>2005</u>	<u>2004</u>
Issued		
154,798,000 Class A common shares	\$ 167,081	\$ 167,081

Any invitation to the public to subscribe for shares of the Company is prohibited by shareholder resolution.

12. INTEREST EXPENSE

	<u>2005</u>	<u>2004</u>
Short-term interest (net of interest income)	\$ 829	\$ 120
Interest on notes payable	11,846	16,021
Finance charges	158	-
Less: Allowance for funds used during construction	(467)	(1,225)
	\$ 12,366	\$ 14,916

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13. PAYMENTS IN LIEU OF CORPORATE INCOME TAXES

The provision for PILs differs from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rates. A reconciliation between the statutory and effective tax rates is provided as follows:

	2005		2004
Federal and Ontario statutory income tax rate	36.12%		36.12%
Income before provision for PILs	\$ 23,1	\$	17,377
Provision for PILs at statutory rate	8,3	\$	6,277
Increase (decrease) resulting from:			
Permanent differences	17		58
Tax effect of non-capital losses for which no benefit has been recorded	(6,7		(6,335)
Large corporations tax	623		761
Corporate minimum tax	185		-
Provision for PILs	\$ 2,427	\$	761
Effective income tax rate	10.48%		4.38%

Hydro Ottawa, as a rate regulated utility, does not recognize future income taxes to the extent they are expected to be included in future approved rates charged to customers and recovered from them. Hydro Ottawa has applied all unused tax losses (2004 - \$16,131,000) to offset taxable income in the current year. Hydro Ottawa has deductible temporary differences between the tax basis of assets and their carrying amount for accounting purposes of approximately \$79,725,000 (2004 - \$82,192,000). These amounts translate into an unrecognized future tax asset of approximately \$28,982,000 (2004 - \$29,688,000) that can be used to reduce payments in lieu of taxes calculated in future periods.

The Company is subject to PILs as long as it is exempt from federal taxation under paragraph 149(1)(d.6) of the ITA.

As prescribed by a regulatory rate order, income tax expense is recovered through customer rates based on the taxes payable method. Therefore, rates do not include the recovery of future income taxes related to unused tax losses or temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. Hydro Ottawa has not recognized future income taxes, as it is expected that when these amounts become payable, they will be recovered through future rate revenues. GAAP for unregulated businesses require the recognition of future income tax liabilities and future income tax assets. In the absence of rate regulation considerations under GAAP operating results in 2005 would be \$706,000 lower.

14. NET CHANGE IN NON-CASH OPERATING WORKING CAPITAL AND REGULATORY ASSETS AND LIABILITIES

	2005		2004
(Increase) decrease in accounts receivable	\$ 3,576		\$(3,399)
(Increase) in unbilled revenue	(15,064)		(3,995)
Decrease in regulatory assets net of liabilities	5,536		2,976
Increase (decrease) in accounts payable and accrued liabilities	28,713		(1,589)
Increase in deferred revenue	1,635		-
(Increase) decrease in other	1,266		2,114
	\$ 25,662	\$	(3,893)

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15. CONTINGENT LIABILITIES

(i) A class action claiming \$500,000,000 in restitutionary payments plus interest was served on the former Toronto Hydro-Electric Commission on November 18, 1998. The action was initiated against the former Toronto Hydro-Electric Commission as the representative of the Defendant Class consisting of all municipal electric utilities in Ontario, including Hydro Ottawa, 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 electric utilities receiving interest at effective rates in excess of what is allowed under Section 347(1)(b) of the Criminal Code. This action has not yet been certified as a class action and no discoveries have been held, as parties were awaiting the outcome of a similar proceedings brought against The Consumers Gas Company Limited (now Enbridge Gas Distribution Inc.).

On April 22, 2004, the Supreme Court of Canada released a decision in the Enbridge Gas Distribution Inc. (EGD) case with respect to late payment penalties. The Court rejected all the defences which had been raised by EGD, however the Court did not permit the plaintiff class to recover damages for any period prior to the issuance of the Statement of Claim in 1994. At this time, it is not possible to quantify the effect, if any, and no amount has been accrued in the financial statements of the Company.

(ii) Purchasers of electricity in Ontario, through the IESO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. The IESO could draw on these guarantees if the Company fails to make a payment required by a default notice issued by the IESO. A prudential support obligation is calculated based upon a default protection amount and the distributor's trading limit less a reduction for the distributor's credit rating. At December 31, 2005, the Company had drawn standby letters of credit of \$22,000,000 against its credit facility to cover its prudential support obligation. In addition, the Company provided standby letters of credit of \$211,000 to the City of Ottawa as security for construction projects.

(iii) Various lawsuits have been filed against the Company for incidents that arose in the ordinary course of business. In the opinion of management, the outcomes of the lawsuits, now pending, are neither determinable nor material. Should any loss result from the resolution of these claims, such loss will be charged to operations in the year of resolution.

(iv) The Company participates with other electrical utilities in Ontario in an agreement to exchange reciprocal contracts of indemnity through the Municipal Electrical Association Reciprocal Insurance Exchange. The Company is liable for additional assessments to the extent premiums collected and reserves established are not sufficient to cover the cost of claims and costs incurred. If any additional assessments were required in the future, their cost would be charged to operations in the year in which they occur.

(v) The Company may be subject to environmental regulatory requirements related to the destruction of PCBs in distribution transformers and other clean up related to PCBs if draft federal legislation in its current form is ultimately passed. Proposed revisions to the Federal PCB Regulatory Framework under the Canadian Environmental Protection Act, 1999 recommends that certain equipment containing PCBs be removed from service by December 31, 2009 with final removal of PCB equipment expected by December 31, 2014. This legislation could result in approximately \$10,000,000 to \$11,000,000 being spent over the 4-year period from 2006 to 2009. No amount has been recorded in these financial statements.

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16. COMMITMENTS

(i) Hydro Ottawa has \$9,600,000 in open commitments for 2006. This includes \$3,200,000 for its customer information system application services agreement, and beginning in 2005 an arrangement to provide call centre services, with IBM Canada Limited. The minimum billable value of the agreement over its term is \$16,418,000 and is set to expire December 31, 2010.

(ii) Hydro Ottawa has committed to provide support for a community park in the Village of Casselman. The total amount of the commitment remaining is \$27,000, which will be paid in 2006.

17. RELATED PARTY TRANSACTIONS

Trade amounts due from and to the Hydro Ottawa group of companies are non-interest bearing and have no specific terms of repayment, but are generally repaid within one month.

The Company is wholly owned by Hydro Ottawa Holding Inc., which in turn is wholly owned by the City of Ottawa. Hydro Ottawa Holding Inc. is also the sole shareholder of Energy Ottawa Inc. and the Telecom Ottawa group of companies ("Telecom Ottawa").

The Company provides certain services to the City of Ottawa, Hydro Ottawa Holding Inc., Energy Ottawa Inc. and Telecom Ottawa in the normal course of business at commercial rates.

For the year ended December 31, 2005, the Company earned revenues related to the:

- sale of electricity, and the provision of street lighting services in the amount of \$29,157,000 (2004 - \$30,128,000) to the City of Ottawa.
- provision of administration and corporate services in the amount of \$279,000 (2004 - \$176,000) to Hydro Ottawa Holding Inc.
- provision of administration and corporate services and the recovery of expenses by service level agreement in the amount of \$343,000 (2004 - \$585,000) to Energy Ottawa Inc.
- rental of poles and ducts in the amount of \$517,000 (2004 - \$1,182,000) to Telecom Ottawa.
- provision of administration and corporate services and other recoverable work in the amount of \$283,000 (2004 - \$245,000) to Telecom Ottawa.

The Company purchases certain services from the City of Ottawa, Hydro Ottawa Holding Inc., Energy Ottawa Inc. and Telecom Ottawa in the normal course of business at commercial rates.

For the year ended December 31, 2005, the Company purchased:

- certain services related to water and sewer charges, fuel and permits from the City of Ottawa in the amount of \$351,000 (2004 - \$480,000).
- certain administration and corporate services from Hydro Ottawa Holding Inc. totaling \$1,490,000 (2004 - \$2,407,000). During the year the Company also paid Hydro Ottawa Holding Inc. for interest charged on temporary and long-term borrowings as well as finance charges related to credit facility and bond issue costs amounting to \$12,833,000 (2004 - \$76,000).
- power from Energy Ottawa Inc. in the amount of \$7,058,000 (2004 - \$4,089,000).
- broadband data services from Telecom Ottawa in the amount of \$1,467,000 (2004 - \$1,574,000).

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17. RELATED PARTY TRANSACTIONS (Continued)

For the year ended December 31, 2005, the Company incurred property taxes payable to the City of Ottawa of \$1,658,000 (2004 - \$1,644,000).

There was no interest payable to the City of Ottawa in 2005 (2004 - \$16,021,000) as the promissory note payable to the City of Ottawa in the amount of \$232,185,000 was assigned to Hydro Ottawa Holding Inc. on December 31, 2004 (Note 10).

During the year, the Company transferred office furniture at their net book value of \$57,000 to Energy Ottawa Inc.

At the end of the year, the amounts due from and to related parties which are included in account receivable and accounts payable and accrued liabilities are as follows:

	<u>2005</u>	<u>2004</u>
Due from related parties:		
Hydro Ottawa Holding Inc.	\$ -	\$ 1,168
Telecom Ottawa Limited	-	1,217
Energy Ottawa Inc.	-	451
	<u>\$ -</u>	<u>\$ 2,836</u>
Due to related parties:		
Hydro Ottawa Holding Inc.	\$ 1,095	\$ -
Telecom Ottawa Holding Inc.	218	1,489
Energy Ottawa Inc.	503	1,770
	<u>\$ 1,816</u>	<u>\$ 3,259</u>
Advances from parent company	<u>\$ 2,000</u>	<u>\$ 17,000</u>
Notes payable to parent company (Note 10)	<u>\$ 232,185</u>	<u>\$ 232,185</u>

18. COMPARATIVE FIGURES

In certain instances, the 2004 information presented for comparative purposes has been reclassified to conform to the financial statement presentation adopted for the current year.