Consolidated Financial Statements of

ENERSOURCE CORPORATION

Years ended December 31, 2005 and 2004

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Enersource Corporation as at December 31, 2005 and 2004 and the consolidated statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Toronto, Canada

February 24, 2006

ENERSOURCE CORPORATION

Consolidated Balance Sheets
(In thousands of dollars)

December 31, 2005 and 2004

	2005	2004
Assets		
Current assets:		
Cash and cash equivalents	$ 60,713	$ 26,508
Accounts receivable	57,420	50,889
Unbilled revenue	64,530	51,246
Inventory	5,011	4,333
Assets held for sale (note 2)	1,484	–
Prepaid expenses and deposits	1,459	905
	190,617	133,881
Capital assets (note 4)	394,072	417,853
Assets held for sale (note 2)	22,490	–
Other assets:		
Deposits and prudentials (note 5)	22,354	28,120
Deferred debt issue costs, net of amortization of $2,024 (2004 - $1,590)	2,312	2,746
Regulatory assets (note 6)	21,014	24,365
	45,680	55,231
	$ 652,859	$ 606,965
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 118,640	$ 76,452
Payments in lieu of corporate income taxes payable	6,673	1,405
Deferred revenue	2,347	2,136
Advance payments - subdividers	629	1,729
Regulatory liabilities (note 6)	8,678	8,181
	136,967	89,903
Long-term liabilities:		
Bonds payable (note 7)	290,000	290,000
Deposits	22,354	28,120
Employee retirement and post-retirement benefits (note 8)	2,140	2,049
	314,494	320,169
Non-controlling interest	193	208
Shareholders' equity:		
Capital stock (note 9)	175,691	175,691
Retained earnings	25,514	20,994
	201,205	196,685
Contingencies (note 11)		
Commitments (notes 5 and 12)		
Subsequent event (note 18)		
	$ 652,859	$ 606,965

See accompanying notes to consolidated financial statements.

On behalf of the Board:

_______________ Director _______________ Director

ENERSOURCE CORPORATION

Consolidated Statements of Income
(In thousands of dollars)

Years ended December 31, 2005 and 2004

	2005	2004
Revenue:		
Energy sales	$ 672,412	$ 534,046
Distribution	103,495	90,819
Services	14,906	8,307
Other	2,270	2,447
	793,083	635,619
Operating expenses:		
Energy purchases	672,412	534,046
Operations, maintenance and administration	34,120	32,378
Services	11,779	6,378
Amortization of capital assets	29,771	29,322
Amortization of regulatory assets	7,513	5,252
	755,595	607,376
Operating income	37,488	28,243
Interest:		
Income	1,915	1,802
Expense	(17,691)	(15,151)
	(15,776)	(13,349)
Income before the undernoted	21,712	14,894
Payments in lieu of corporate income taxes (note 3)	(9,018)	(5,118)
Income from continuing operations	12,694	9,776
Income from discontinued operations, net of payments in lieu of corporate income taxes (note 2)	726	1,875
Net income	$ 13,420	$ 11,651

Consolidated Statements of Retained Earnings
(In thousands of dollars)

Years ended December 31, 2005 and 2004

	2005	2004
Retained earnings, beginning of year	$ 20,994	$ 25,085
Net income	13,420	11,651
Dividends paid	(8,900)	(15,742)
Retained earnings, end of year	$ 25,514	$ 20,994

See accompanying notes to consolidated financial statements.

ENERSOURCE CORPORATION

Consolidated Statements of Cash Flows
(In thousands of dollars)

Years ended December 31, 2005 and 2004

	2005	2004
Cash provided by (used in):		
Operating activities:		
Income from continuing operations	$ 12,694	$ 9,776
Items not affecting cash:		
Amortization of debt issue costs	434	434
Amortization of capital assets	29,771	29,322
Amortization of regulatory assets	7,513	5,252
Loss (gain) on disposal of capital assets	191	(56)
Employee retirement and post-retirement benefits	91	78
	50,694	44,806
Change in non-cash operating working capital (note 10)	26,598	(12,238)
Cash provided by operating activities of continuing operations	77,292	32,568
Financing activities:		
Deposits	(5,766)	2,582
Dividends paid	(8,900)	(15,742)
Cash used in financing activities of continuing operations	(14,666)	(13,160)
Investing activities:		
Deposits and prudentials	5,766	(2,582)
Additions to capital assets	(30,245)	(27,518)
Proceeds on disposal of capital assets	86	293
Additions to regulatory assets	(4,162)	(8,233)
Cash used in investing activities of continuing operations	(28,555)	(38,040)
Increase (decrease) in cash and cash equivalents from continuing operations	34,071	(18,632)
Discontinued operations	134	421
Increase (decrease) in cash and cash equivalents	34,205	(18,211)
Cash and cash equivalents, beginning of year	26,508	44,719
Cash and cash equivalents, end of year	$ 60,713	$ 26,508
Supplemental cash flow information:		
Interest received	$ 1,903	$ 1,842
Interest paid	18,241	18,241
Payments in lieu of corporate income taxes paid	7,046	13,426

See accompanying notes to consolidated financial statements.

Enersource Corporation (the "Corporation"), incorporated under the Ontario Business Corporations Act, was formed to conduct electricity distribution, fibre optic and non-regulated utility service ventures. It is owned 90% by the City of Mississauga (the "City") and 10% by BPC Energy Corporation ("BPC"), a wholly owned subsidiary of the Ontario Municipal Employees Retirement Board.

1. Significant accounting policies:

(a) Basis of consolidation:

These financial statements have been prepared by management in accordance with generally accepted accounting principles ("GAAP"). The consolidated financial statements include the accounts of the Corporation's wholly owned subsidiaries: Enersource Hydro Mississauga Inc. ("Enersource Hydro"), Enersource Services Inc., Enersource Telecom Inc., Enersource Technologies Inc. and Enersource Hydro Mississauga Services Inc. The consolidated financial statements also include the accounts of First Source Energy Corporation ("First Source"), a subsidiary in which the Corporation has a 57.7% ownership interest. Intercompany balances and transactions have been eliminated.

(b) Nature of operations:

Through its subsidiary, Enersource Hydro, the Corporation provides electricity distribution services to businesses and residences in the service area of Mississauga, Ontario.

Enersource Services Inc. is the parent company for the Corporation's non-regulated business, which includes the following:

(i) Enersource Telecom Inc. provides fibre optic telecommunications services for customers located in Ontario.

(ii) Enersource Hydro Mississauga Services Inc. provides utility services, including safety training and energy settlement services, specialized construction and streetlight construction and maintenance services to customers in Ontario. Enersource Hydro Mississauga Services Inc. is also the 100% owner of Enersource Technologies Inc., which is a dormant corporation.

(iii) First Source provided ongoing energy retailing services until May 2003 (note 2), at which point, its retail customer contracts were sold to Ontario Energy Savings Corporation ("OESC").

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

(c) Rate setting:

Enersource Hydro is regulated by the Ontario Energy Board ("OEB") under 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, revenues, losses or gains in the rates of a specified period, resulting in the change in the timing of accounting recognition from that which would be applied in an unregulated company. Specifically, the following accounting treatments have been applied:

(i) Capital and operating costs incurred in respect of the transition to competitive markets have been deferred with amortization to commence at a date that a rate increase is implemented to offset the amortization of the transition costs. In November 2003, the Province of Ontario introduced the Ontario Energy Board Amendment Act (Electricity Pricing) 2003 (the "2003 Act"). The 2003 Act impacts both the distribution and energy rates charged to customers and includes a provision for the recovery of regulatory assets (note 1(l)).

(ii) An amount to represent the cost of funds used during construction and development has been applied based on the value of construction in progress.

(iii) The Corporation does not record future income tax assets or liabilities for its regulated business activities to the extent that it is expected that the recovery or realization of these amounts will be included in future distribution rates.

(iv) The Corporation has deferred certain pre-market opening cost of power variances and post-market opening retail settlement variances in accordance with Article 490 of the OEB's Accounting Procedures Handbook.

(v) The Corporation has deferred the recognition of the employer's share of contributions to the Ontario Municipal Employees Retirement System ("OMERS") for its regulated business activities from 2004 onward to the extent that it is expected that these costs will be recovered through future distribution rates.

1. Significant accounting policies (continued):

(d) Cash and cash equivalents:

Cash and cash equivalents are defined as cash and bank term deposits or equivalent financial instruments with original maturities upon issue of less than 90 days.

(e) Revenue recognition:

Distribution revenue attributable to the delivery of electricity is based upon OEB-approved distribution tariff rates and is recognized as electricity is delivered to customers, which includes an estimate of unbilled revenue, which represents electricity consumed by customers since the date of each customer's last meter reading. Actual results could differ from estimates made of actual electricity usage.

Services and other revenue are recognized as services are rendered or contract milestones are achieved. Amounts received in advance of these milestones are presented as deferred revenue.

(f) Measurement uncertainty:

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of revenue, expenses, assets and liabilities, as well as the disclosure of contingent assets and liabilities at the financial statement date. Accounts receivable, unbilled revenue and regulatory assets are reported based on amounts expected to be recovered and an appropriate allowance for unrecoverable amounts. Inventories are recorded net of provisions for obsolescence.

Due to the inherent uncertainty involved in making such estimates, actual results could differ from estimates recorded in preparing these consolidated financial statements, including changes as a result of future decisions made by the OEB or the Minister of Energy. Amounts recorded for amortization of capital assets are based on estimates of useful life.

(g) Inventory:

Inventory, which consists of parts and supplies acquired for internal construction or consumption, is valued at the lower of cost and replacement cost. Cost is determined on a weighted moving average basis.

(In thousands of dollars)

1. Significant accounting policies (continued):

(h) Capital assets:

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 when applied. Certain assets may be acquired or constructed with financial assistance in the form of contributions from developers or customers.

When assets are retired or otherwise disposed of, their original cost and accumulated amortization are removed from the accounts and the related gain or loss is included in the operating results for the related fiscal period. The cost and related accumulated amortization of grouped assets, such as transmission and distribution facilities, is removed from the accounts at the end of their estimated service lives.

Amortization of capital asset values is charged to operations on a straight-line basis over their estimated service lives as follows:

	Estimated service life	
	Range	Average
Buildings	25 - 60 years	55
Distribution station equipment	15 - 35 years	28
Transmission and distribution system	25 - 40 years	26
Equipment and furniture	4 - 10 years	8
Fibre optic equipment	15 years	15
Computer software	2 years	2

Amortization is recorded at one-half the usual annual rate for assets placed into service in the current fiscal period.

Construction in progress comprises capital assets under construction, assets not yet placed into service and pre-construction activities related to specific projects expected to be constructed.

Commencing January 1, 2000, an allowance for the cost of funds used during the construction period has been applied. The rate applied for the current fiscal period is equal to the rate allowed by the OEB in respect of long-term borrowings, being 6.9% (2004 - 6.9%).

1. Significant accounting policies (continued):

(i) Deferred debt issue costs:

Deferred debt issue costs represent the cost of the issuance of the bonds. Amortization is provided on a straight-line basis over the term of the related bonds.

(j) Deposits and prudentials:

Customers may be required to post security to obtain electricity or other services. Where the security posted is in the form of cash or cash equivalents, these amounts are recorded in the accounts as deposits and prudentials, which are reported separately from the Corporation's own cash and cash equivalents. Interest rates paid on customer deposits changed effective August 1, 2004 from a variable rate of prime less 1.9% to a variable rate of prime less 2.0%, updated quarterly.

Also included in this balance are cash and securities lodged with the Corporation by counterparties under electricity supply agreements.

(k) Pension and other post-employment benefits:

The Corporation accounts for its participation in OMERS, a multi-employer public sector pension fund, as a defined contribution plan. The Corporation has obtained approval from the OEB to defer pension expenses, commencing January 1, 2004, incurred in the regulated utility for recovery in future rates.

The Corporation actuarially determines the cost of other employment and post-employment benefits offered to employees using the projected benefit method, prorated on service and based on management's best estimate assumptions. Under this method, the projected post-retirement benefit is deemed to be earned on a pro rata basis over the years of service in the attribution period commencing at date of hire, and ending at the earliest age the employee could retire and qualify for benefits.

1. Significant accounting policies (continued):

(l) Regulatory assets and liabilities:

Regulatory assets primarily represent costs that have been deferred because they are expected to be recovered in rates. Similarly, regulatory liabilities can arise from differences in amounts billed to customers under the regulated pricing mechanism and the corresponding wholesale market cost of power regulated by the utility. The OEB directed the distribution utilities to recover these variance balances as at December 31, 2003 plus accrued interest in the rates over a four-year period beginning April 2004.

Regulatory balances are comprised principally as follows:

(i) Transition costs - represent costs related to the transition to a competitive electricity market, mandated by the Electricity Act, 1998. The OEB has established rules in respect of transition costs, to qualify amounts for deferral and amortization against future revenue. The Corporation's transition costs have been reviewed via an oral hearing and recovery has been decided upon by the OEB in its December 9, 2004 decision.

(ii) Pre-market opening cost of power variances - represents amounts accumulated as a result of the excess of the cost of power purchased by the Corporation over the amount billed for this power prior to the market opening. The OEB directed utilities to accumulate such variances in the period leading up to market opening.

(iii) Post-market opening retail settlement variances - are variances that have occurred since May 1, 2002, when the competitive electricity market was declared open and that have accumulated pursuant to direction from the OEB. Specifically, these amounts include variances between the amount charged by the Independent Electricity System Operator ("IESO") for the operation of the markets and grid, as well as various wholesale market settlement charges, transmission charges as compared to the amount billed to consumers based on the OEB-approved rates.

In November 2003, the Province of Ontario introduced the 2003 Act, which implemented a new electricity pricing regime believed to better reflect the true cost of electricity.

1. Significant accounting policies (continued):

The 2003 Act, which received Royal Assent in December 2003, removed the 4.3¢ per kwh electricity price freeze established under the Electricity Pricing, Conservation and Supply Act, 2002 and gives the OEB the power to establish the electricity commodity price for low volume consumers and designated consumers who do not choose an electricity retailer. The OEB's new pricing regime took effect in May 2005. In the meantime, and beginning on April 1, 2004, the government has implemented an interim pricing plan under which the first 750 kwh consumed in any month by low volume and designated consumers is priced at 4.7¢ per kwh and consumption above that level for these consumers is priced at a higher rate of 5.5¢ per kwh. In the event that these interim prices exceed the costs paid by the Ontario Electricity Financial Corporation ("OEFC"), the 2003 Act includes provisions permitting the making of regulations requiring distributors, retailers or the IESO to credit consumers for the difference. Under the 2003 Act, regulations may also be made to compensate distributors, retailers and the IESO for making any such payments.

On March 11, 2005, the OEB announced further changes to electricity prices for residential, low-volume and designated customers to take effect April 1, 2005. Electricity prices increased effective April 1 from 4.7¢ per kwh to 5.0¢ per kwh for the first 750 kwh consumed in a month, and from 5.5¢ per kwh to 5.8¢ per kwh for consumption in excess of that amount. Commencing November 1, 2005, the price threshold will change twice a year. The price threshold will be 1,000 kwh per month during the November 1 through April 30 season and 600 kwh in the May 1 through October 31 season. The new plan is designed to ensure that electricity pricing to low-volume customers better reflects the true cost of power while also helping customers manage their electricity costs in a stable and predictable manner.

In November 2003, the Province of Ontario announced its intention to allow electricity distributors to recover deferred transition costs and energy variances over a four-year period commencing April 1, 2004. In January 2004, in compliance with regulatory direction, Enersource Hydro submitted to the OEB an application to recover 25% of the December 31, 2002 balance of these regulatory assets. On December 9, 2004, the OEB awarded Enersource Hydro $26,800 representing the full recovery of regulatory balances as at December 31, 2003, plus interest, as determined by a Regulatory Hearing. These financial statements include a net interest adjustment in the amount of $3,948 to record the interest component of that decision for the period ended December 31, 2004.

1. Significant accounting policies (continued):

On April 1, 2005, the Corporation implemented the final rate increase, as permitted by the OEB, toward achieving a market-based rate of return. The initial 12 months of this incremental revenue will be fully invested in electricity conservation and demand management strategies by September 2007.

(m) Payments in lieu of corporate income taxes:

Under the Electricity Act, 1998, the Corporation is required to make payments in lieu of corporate income taxes ("PILs") 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 Corporations Tax Act (Ontario), as modified by the Electricity Act, 1998, and related regulations.

The Corporation provides for payments in lieu of corporate income taxes related 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.

Management believes that when unrecorded future income taxes become payable, or the assets are realized, it is expected that they will be included in rates approved by the OEB and recovered from customers at that time.

For its non-regulated businesses, the Corporation applies the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of enactment or substantive enactment.

(In thousands of dollars)

2. Discontinued operations:

During the second quarter of 2003, the Corporation's Board of Directors approved the sale of the retail customer contracts of First Source. This sale closed on May 1, 2003. On January 23, 2006, Enersource Hydro Mississauga Services Inc. closed a transaction for the sale of its water heaters and associated customer rental contracts. Enersource Telecom Inc. has negotiated the sale of certain assets which is expected to close in the second quarter of 2006.

These financial statements have adopted the recommendation of The Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 3475, Disposal of Long-lived Assets and Discontinued Operations ("Section 3475").

(a) Income from discontinued operations:

The income from discontinued operations for 2005 of $726 (2004 - $1,875) is made up of the Corporation's 57.7% interest in First Source's net income (loss), Enersource Telecom Inc.'s net income and net income from Enersource Hydro Mississauga Service Inc.'s water heaters ("Water Heaters").

	2005	2004
First Source (57.7% interest)	$ 12	$ (77)
Enersource Telecom Inc.	118	1,371
Water Heaters	596	581
Income from discontinued operations	$ 726	$ 1,875

(b) Net assets of First Source:

	2005	2004
Cash	$ 740	$ 714
Accounts receivable	–	56
Other non-current assets	1	–
Accounts payable and accrued liabilities	(282)	(277)
Net assets of discontinued operations	$ 459	$ 493
Non-controlling interest in subsidiary	$ 193	$ 208

(In thousands of dollars)

2. Discontinued operations (continued):

(c) Assets held for sale:

In an effort to focus resources on its core energy businesses, agreements have been reached to sell certain assets within Enersource Telecom Inc. and Water Heaters. An agreement has been reached to sell over 12,000 electric water heater customer contracts, rental agreements and related assets to Union Energy Limited Partnership with a closing date that will be effective January 23, 2006. A separate agreement is being finalized to sell specific Enersource Telecom Inc. assets. This agreement will be finalized about the end of the first quarter of 2006, with the expected transaction closing in the second quarter. Results from these operations are disclosed as discontinued operations for both 2005 and 2004 and assets to be sold are disclosed as assets held for sale on the consolidated balance sheet for 2005 only as prescribed in Section 3475 in the CICA Handbook. A summary of the assets and liabilities held for sale is as follows:

Assets held for sale - current:

Water Heaters:	
Inventory	$ 16
Fixed assets	1,468
	$ 1,484

Assets held for sale - long-term:

Enersource Telecom Inc.:	
Inventory	$ 205
Prepaid expenses and deposits	67
Fixed assets	22,288
Deferred revenue	(70)
	$ 22,490

(In thousands of dollars)

3. 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 rate. 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	$ 21,712	$ 14,894
Income from discontinued operations	1,086	2,232
	$ 22,798	$ 17,126
Provision for PILs at statutory rate	$ 8,235	$ 6,186
Increase (decrease) resulting from:		
Depreciation less than capital cost allowance	361	(1,516)
Tax effect of non-capital losses for which no benefit has been recorded	568	662
Recovery of regulatory assets for accounting purposes in excess of recovery for tax purposes	(620)	(810)
Large Corporations Tax	834	953
Less PILs on discontinued operations	(360)	(357)
Provision for PILs	$ 9,018	$ 5,118
Effective income tax rate	41.1%	31.2%

Based on substantively enacted income tax rates, the potential benefit of unrecorded future income tax assets arising substantially from differences between accounting and tax values for capital assets of the regulated business is $43,923 (2004 - $36,353). Future income taxes relating to the regulated businesses have not been recorded in the accounts as they are expected to be recovered through future revenue.

The Corporation does not have any significant future income tax assets or liabilities arising from the non-regulated businesses.

(In thousands of dollars)

3. Payments in lieu of corporate income taxes (continued):

At December 31, 2005, certain other subsidiaries have non-capital loss carryforwards totalling $12,401 (2004 - $13,066) available, which will expire after tax years ending between 2008 and 2014. The potential benefit relating to these amounts has not been recorded given the uncertainty as to their realization.

4. Capital assets:

2005	Cost	Accumulated amortization	Net book value
Land	$ 4,071	$ –	$ 4,071
Buildings	14,065	4,462	9,603
Distribution station equipment	78,168	33,970	44,198
Transmission and distribution system	571,056	253,593	317,463
Equipment and furniture	23,632	13,244	10,388
Computer software	2,236	1,200	1,036
Construction in progress:			
Buildings	1	–	1
Electric distribution system	7,312	–	7,312
	$ 700,541	$ 306,469	$ 394,072

2004	Cost	Accumulated amortization	Net book value
Land	$ 3,921	$ –	$ 3,921
Buildings	13,745	4,218	9,527
Distribution station equipment	75,827	31,825	44,002
Transmission and distribution system	554,123	233,883	320,240
Equipment and furniture	24,577	13,892	10,685
Fibre optic equipment	27,486	5,454	22,032
Computer software	5,625	3,571	2,054
Construction in progress:			
Regulatory assets	39	–	39
Buildings	2	–	2
Electric distribution system	4,973	–	4,973
Fibre optic equipment	378	–	378
	$ 710,696	$ 292,843	$ 417,853

During the year, $438 (2004 - $583), representing an allowance for the cost of funds used during construction, was capitalized to construction in progress.

(In thousands of dollars)

5. Deposits and prudentials:

The following outlines the deposits and prudentials of the Corporation, posted as security. The amounts are comprised of cash and cash equivalents in the form of deposits and letters of credit/letters of guarantee, under which the Corporation is contingently liable.

	2005		2004	
	Cash and cash equivalents	Letters of credit/ letters of guarantee	Cash and cash equivalents	Letters of credit/ letters of guarantee
Customer deposits	$ 22,354	$ –	$ 28,120	$ –
Supplier deposits	–	3,000	–	6,000
Security with IESO	–	16,618	–	16,618
	$ 22,354	$ 19,618	$ 28,120	$ 22,618

Security deposits:

(a) Customer deposits:

The Corporation collects cash and cash equivalents as deposits from certain customers to reduce credit risk.

Contingent obligations:

(b) Supplier deposits:

The Corporation's financial energy supply contracts were formed based on the International Swap Dealers Association ("ISDA") templates. Counterparty agreements dictate the method, nature and calculation of various credit-related positions.

5. Deposits and prudentials (continued):

At December 31, 2005, the Corporation had issued to Ontario Power Generation Corporation $3,000 in the form of a parental guarantee (2004 - $6,000). The Corporation has a letter of credit guarantee from OESC in the amount of $1,600 (2004 - $2,000) in respect of the Corporation's requirement to post parental guarantees.

In accordance with the Shareholders' Agreement, the Corporation is liable for 57.7% of the parental guarantee to Ontario Power Generation Corporation, with Veridian Corporation liable for the remaining 42.3%.

(c) Margin calls:

In accordance with the ISDA contracts between the counterparties, margin calls can be initiated when forward market prices change.

Forward market prices are monitored weekly by the Corporation to ensure that margin calls are anticipated in advance as the forward price approaches the trigger rate. The Corporation places a margin call on OESC in response to reaching the forward pricing trigger rate and OESC indemnifies the cash collateral obligation of the Corporation.

(d) Security with Independent Electricity System Operator ("IESO"):

Purchasers of electricity in Ontario through the IESO are required to post security to mitigate the risk of their default on their expected activity in the market.

At December 31, 2005, the Corporation has posted a letter of credit as security in the amount of $16,618 (2004 - $16,618).

(In thousands of dollars)

6. Regulatory assets and liabilities:

Regulatory assets and liabilities can arise as a result of the rate-making process. The following table demonstrates the impact on 2005 earnings net of PILs as a result of regulated accounting requirements.

	2005	2004	Estimated remaining settlement period (yrs)	2005 impact on earnings net of PILS ((a)(i))
Regulatory assets:				
Deferred OMERS employer contributions ((a)(ii))	$ 1,916	$ 874	1 - 2	$ 1,042
Other regulatory assets ((a)(iii))	1,436	486	1 - 2	950
	3,352	1,360		1,992
Regulatory assets approved for recovery ((a)(iv))	17,662	23,005	2 - 3	(3,184)
	$ 21,014	$ 24,365		$ (1,192)
Regulatory liabilities:				
Retail settlement variances ((a)(v))	$ 2,276	$ 8,181	1	$ (334)
Global adjustment retail settlement variance ((a)(vi))	6,402	–	1	360
	$ 8,678	$ 8,181		$ 26

(a) Explanatory notes:

(i) The 2005 impact on earnings net of PILs represents the effect on the consolidated net income as a result of the treatment under rate regulated accounting.

(ii) The OEB has approved the deferral of Enersource Hydro's employer portion of pension contributions to OMERS retirement fund. The deferred OMERS employer contributions amount reflects Enersource Hydro's required contributions for 2005 and 2004 plus interest charged at an OEB approved rate.

(iii) The OEB has approved the deferral of Enersource Hydro's OEB assessed costs and requires that Enersource Hydro record and defer the difference between revenue and costs associated with providing retailers with customer settlement services as RCVA deferrals. These items are included in other regulatory assets.

6. Regulatory assets and liabilities (continued):

(iv) On December 9, 2004, the OEB approved the recovery of Enersource Hydro's regulatory assets as at December 31, 2003. This amount reflects the total approved regulatory asset for recovery plus interest charged at an OEB approved rate less amounts recovered through distribution rates since April 1, 2004.

(v) The OEB requires Enersource Hydro to record and defer the difference between energy charged to its customers and the actual cost of power incurred and paid to the IESO and to Hydro One. The retail settlement variance reflects this difference since January 1, 2004 plus interest charged at an OEB approved rate.

(vi) The Global Adjustment accounts for differences between the market price and rates paid to regulated and contracted generators and is set by the IESO. This adjustment may be positive or negative. The Global Adjustment retail settlement variance captures the unpaid or recoverable amounts due to or recoverable from Enersource Hydro's customers.

The Corporation has accrued interest on the deferral account balances for the regulatory assets and retail settlement variances, as directed by the OEB. As at December 31, 2005, this net accrued interest amounted to $1,022 (2004 - $3,702).

(b) Financial statement effects of rate regulation:

(i) General information regarding rate regulation and its economic effects:

The operations of the Corporation's subsidiary, Enersource Hydro, are regulated by the OEB. The OEB exercises statutory authority over matters such as construction, rates and underlying accounting practices, and rate setting issues with Enersource Hydro's customers.

Enersource Hydro has submitted a rate application to the OEB for the rate period beginning May 1, 2006 and ending on April 30, 2007. These rates are set by the OEB under a cost of service methodology that allows revenue to recover utility operating costs plus a regulated rate of return on the equity financed portion of Enersource Hydro's rate base. The allowed rate of return for this rate period is set by the OEB at 9.0%. This application is currently under review by the OEB and a decision regarding Enersource Hydro's rates is expected in April 2006.

6. Regulatory assets and liabilities (continued):

(ii) Regulatory risk and uncertainties affecting recovery or settlement:

The regulatory assets and liabilities recorded in the financial statements are based upon an expectation of the future actions of the OEB. To the extent that the OEB's future actions are different from Enersource Hydro's expectations, the timing and amount of recovery or settlement of amounts recorded on the consolidated balance sheet could be significantly different from the timing and amounts that are eventually recovered or settled.

(iii) Financial statement effects:

In order to recognize the economic effects of the actions or expected actions of the regulator, the timing of recognition of certain revenue and expenses in these operations may differ from that otherwise expected under GAAP for non rate-regulated entities.

Regulatory assets represent amounts that are expected to be recovered from customers in future periods through the rate setting process. In the absence of rate regulated accounting, GAAP would not permit deferral of regulatory assets and, therefore, the earnings impact would be recorded in the period of recovery. Long-term regulatory assets are recorded in other assets in the consolidated balance sheets.

Regulatory liabilities represent amounts that are expected to be refunded to customers as a result of the rate-setting process. The GAAP treatment of regulatory liabilities and the resulting earnings impact is the same as that under rate regulated accounting because the liabilities represent contractual obligations. Regulatory liabilities are recorded in current liabilities in the consolidated balance sheets.

(In thousands of dollars)

6. Regulatory assets and liabilities (continued):

(c) Other items affected by rate regulation:

Future income taxes:

Enersource Hydro's regulated activities recover tax expense based on the taxes payable method as prescribed by the OEB. As such, the rates approved by the OEB do not include the recovery of future income taxes related to temporary differences. Consequently, the financial statements pertaining to the regulated operations do not record future income taxes as the future income taxes will be recovered in future rates when they become payable. GAAP requires the recognition of future income tax liabilities and future income tax assets in the absence of rate regulation.

7. Bonds payable:

	2005	2004
6.29% BPC-Enersource Series Bonds, Tranche 1, due May 3, 2011	$ 290,000	$ 290,000

Interest expense includes $18,241 (2004 - $18,241) in respect of interest on long-term liabilities and amortization of debt issue costs in the amount of $434 (2004 - $434).

(In thousands of dollars)

8. Employee retirement and post-retirement benefits:

(a) Pensions:

During fiscal 2005, the Corporation made contributions of $1,728 (2004 - $1,595). With the OEB's approval, the Corporation has deferred $1,042 of its 2005 pension expense in the regulated utility for recovery in future rates (2004 - $874).

(b) Other retirement and post-retirement benefits:

	2005	2004
Change in benefit obligations:		
Benefit obligation, beginning of year	$ 2,049	$ 1,971
Service cost	32	30
Interest cost	133	122
Benefits paid	(74)	(74)
Benefit obligation, end of year	$ 2,140	$ 2,049
Change in plan assets:		
Fair value of plan assets, beginning of year	$ –	$ –
Employers' contributions	74	74
Benefits paid	(74)	(74)
Fair value of plan assets, end of year	$ –	$ –
Discount rate	6.5%	6.5%
Expected return on plan assets	6.5%	6.5%
Rate of compensation increase	3.0%	3.5%

The principal funding obligation of the plan is to fund life insurance benefits based on employment date and years of service. A limited group of former employees who elected to retire under a special early retirement incentive plan is entitled to continuation of health and dental premiums until age 65. Accordingly, based on the current participation profile, changes in health and dental care costs will not significantly impact the estimates of the plan obligations. The total estimated plan obligation at December 31, 2005 is $2,140 (2004 - $2,049). There is no unamortized past service component.

(In thousands of dollars)

8. Employee retirement and post-retirement benefits (continued):

The amounts presented are based upon an actuarial valuation performed as of December 31, 2003 on March 15, 2004. The next valuation is expected to be performed for the year ended December 31, 2006.

The Corporation's net benefit expense is as follows:

	2005	2004
Current service cost	$ 32	$ 30
Interest cost	133	122
	$ 165	$ 152

9. Capital stock:

	2005	2004
Authorized:		
Unlimited Class A shares, voting		
1,000 Class B shares, non-voting		
100 Class C shares, voting		
Issued:		
180,555,562 Class A shares	$ 155,628	$ 155,628
1,000 Class B shares	1	1
100 Class C shares	20,062	20,062
	$ 175,691	$ 175,691

On November 9, 2004, the Corporation adopted the Dividend Policy and Procedure document that was approved by the Board of Directors. Subsequently, the Articles of the Corporation were amended in 2005 to align with the terms of the Dividend Policy.

The Class A and Class C shareholders are entitled to annual non-cumulative dividends not to exceed 60% of the prior year's consolidated after-tax net income on a residual basis. Dividends will be declared and paid during the fourth quarter of each fiscal year; provided they are approved by a Board resolution and all compliance issues have been addressed. The annual dividends will be based on the financial results of the Corporation as presented in the audited financial statements. Exceptions to this policy will be at the sole discretion and mutual consent of all shareholders.

(In thousands of dollars)

9. Capital stock (continued):

In 2005, a dividend of $8,900 (2004 $15,742) was declared and paid to the shareholders.

The shareholders of the Corporation are parties to a Put Agreement by which the City holds an option to sell its shares to BPC in accordance with the Agreement. The effective period for this option commences July 1, 2008 and expires on December 31, 2008.

10. Change in non-cash operating working capital:

	2005	2004
Accounts receivable	$ (6,179)	$ (5,857)
Unbilled revenue	(13,284)	(4,785)
Inventory	(702)	631
Prepaid expenses and deposits	(571)	561
Accounts payable and accrued liabilities	42,282	2,742
Payments in lieu of corporate income taxes payable	5,268	(4,679)
Deferred revenue	387	(429)
Advance payments - subdividers	(1,100)	(2,610)
Regulatory liabilities	497	2,188
	$ 26,598	$ (12,238)

11. Contingencies:

(a) Insurance claims:

The Corporation is a member of the Municipal Electric Association Reciprocal Insurance Exchange ("MEARIE"). 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. MEARIE is licensed to provide general liability insurance to its members.

Insurance premiums charged to each member consist of a levy per thousand dollars of service revenue subject to a credit or surcharge based on each member's claims experience. Current liability coverage is provided to a level of $30,000 per incident.

11. Contingencies (continued):

Enersource Hydro has been jointly named as a defendant in several actions. No provision has been made for these potential liabilities as Enersource Hydro expects that these claims are adequately covered by its insurance.

(b) Other claims:

A class action claiming $500,000 in restitutionary payments plus interest was served on Toronto Hydro 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 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 Corporation. It is the Corporation's position that any late payment charges that are required to be repaid to customers as a result of this class action would be included in a rate adjustment application to the OEB for full recovery.

On April 22, 2004, the Supreme Court of Canada released its decision in a case commenced against Enbridge Gas Distribution ("EGD") by a customer with respect to late payment penalties. The Supreme Court of Canada determined that EGD would be required to repay a portion of amounts paid to it as late payment penalties from April 1994. Any implications of EGD decision in the Toronto Hydro class action cannot be determined at this time.

12. Commitments:

Purchasers of electricity in Ontario, through the IESO, are required to provide security to mitigate the risk of their default on their expected activity in the market. The IESO could draw on this security if the Corporation failed to make payment required by a default notice issued by the IESO. The Corporation has posted a letter of credit as security in the amount of $16,618 (2004 - $16,618).

12. Commitments (continued):

The Corporation has also guaranteed the obligations of a subsidiary's financial energy supply contracts in the amount of $3,000 (2004 - $6,000). The Corporation has a letter of guarantee from OESC in the amount of $1,600 (2004 - $2,000) in respect of the Corporation's requirement to post parental guarantees. The Corporation is liable for 57.7% of the parental guarantee to Ontario Power Generation Corporation with the minority interest shareholder liable for the remaining 42.3%.

13. Financial instruments:

The carrying values of cash and cash equivalents, accounts receivable, deposits and prudentials, accounts payable and accrued liabilities, and advance payments - subdividers, approximate fair values because of the short maturity of these financial instruments.

The bonds, having a carrying value of $290,000 (2004 - $290,000), have a fair value of $316,329 (2004 - $317,538), based on year-end quoted market prices. Financial assets held by the Corporation expose it to credit risk. As at December 31, 2005 and 2004, there were no significant concentrations of credit risk with respect to any class of financial assets. The Corporation earns its revenue from a broad base of customers located principally in Mississauga. No single customer in either year would account for revenue or an accounts receivable balance in excess of 10% of the respective reported balances.

As part of the Asset Transfer Agreement executed to complete the sale of the retail customer contracts, the Corporation assigned its existing portfolio of energy supply contracts. The energy supply contracts were put in place as part of a strategy to manage price volatility for a portion of the electricity the retail customer contracts provided under these fixed pricing arrangements and not for speculative purposes. The contracts require the Corporation to exchange with counterparties the difference between fixed and variable amounts based on a notional quantity of electricity. Under provisions of the Asset Transfer Agreement, the purchaser is required to provide standby letters of credit (note 5) to guarantee any margin call related to the Corporation's portfolio of energy supply contracts. These letters of credit are necessary as the Corporation remains a guarantor to the original counterparties that it contracted with to provide electricity at a fixed price, notwithstanding assignment of these contracts to the purchaser of the retail customer contracts.

(In thousands of dollars)

14. Related party transactions:

The Corporation's operations include the provision of electricity and services to its principal shareholder, the City. Electrical energy is sold to the City at the same prices and terms as other electricity customers consuming equivalent amounts of electricity. Streetlighting maintenance services are provided at rates determined in relation to other service providers. Other construction services are provided at cost. A summary of amounts charged by the Corporation to the City is as follows:

	2005	2004
Electrical energy	$ 7,572	$ 8,787
Streetlighting maintenance	2,061	1,878
Streetlighting energy	4,013	3,170

The Corporation charged the City $1,918 for other construction services in 2005 (2004 - $2,927).

At December 31, 2005, accounts payable and accrued liabilities include $96 (2004 - $76) due to the City and accounts receivable include $2,647 (2004 - $5,273) due from the City.

The Corporation charged BPC $159 (2004 - nil) for consulting services in 2005. These transactions were recorded at the exchange amount being the amount agreed to by the parties. At December 31, 2005, accounts receivable included $24 (2004 - nil) due from BPC.

Enerpower Corporation is an organization in which the Corporation has a 10% ownership interest. The Corporation was charged $6,385 by Enerpower Corporation during 2005 (2004 - $4,996) for the construction of distribution infrastructure. The Corporation received a dividend from Enerpower Corporation during 2005 of $66 (2004 - $25).

15. Energy purchases:

All electricity purchases for standard supply customers are subject to pricing determined by the IESO, a provincial government body.

Included in accounts payable and accrued liabilities as at December 31, 2005 is $64,832 (2004 - $48,060) owed in respect of electricity purchases through the IESO.

16. Interest and asset coverage ratios:

Interest coverage on long-term debt	1.69 times
Net tangible asset coverage on long-term debt	1.53 times

17. Segmented information:

The Corporation operates primarily in two operating segments, electricity distribution services and other operations. Other operations are primarily comprised of specialized design, construction and maintenance services for utilities and developers. The sale of water heater rental assets closed in January 2006 and the sale of fibre optic telecommunication assets is expected to close in the second quarter of 2006 and are presented below as income (loss) from discontinued operations Energy retail operations ceased with the sale of energy contracts effective May 1, 2003 and are also presented below as income (loss) from discontinued operations.

(In thousands of dollars)

17. Segmented information (continued):

The designation of segments is based on a combination of regulatory status and the nature of the products and services provided. The accounting policies followed by the segments are the same as those described in the summary of significant accounting policies.

2005	Electricity distribution services	Other operations	Intersegment eliminations	Total
Revenue	$ 782,362	$ 15,029	$ (4,308)	$ 793,083
Operating expenses	707,786	14,833	(4,308)	718,311
Amortization	37,279	5	–	37,284
	745,065	14,838	(4,308)	755,595
	37,297	191	–	37,488
Interest revenue	1,718	197	–	1,915
Interest expense	(17,677)	(14)	–	(17,691)
Income before the undernoted	21,338	374	–	21,712
Payments in lieu of corporate income taxes	(8,559)	(459)	–	(9,018)
Income (loss) from discontinued operations	–	(122)	848	726
Net income	$ 12,779	$ (207)	$ 848	$ 13,420
Assets:				
From continued operations	$ 623,925	$ 209,356	$ (204,396)	$ 628,885
Held for sale	–	23,974	–	23,974
Total assets	$ 623,925	$ 233,330	$ (204,396)	$ 652,859
Capital expenditures	$ 30,224	$ 21	$ –	$ 30,245
Cash provided by (used in) operations	78,323	(1,031)	–	77,292

ENERSOURCE CORPORATION

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars)

Years ended December 31, 2005 and 2004

17. Segmented information (continued):

2004	Electricity distribution services	Other operations	Intersegment eliminations	Total
Revenue	$ 628,539	$ 8,421	$ (1,341)	$ 635,619
Operating expenses	565,377	8,766	(1,341)	572,802
Amortization	34,573	1	–	34,574
	599,950	8,767	(1,341)	607,376
	28,589	(346)	–	28,243
Interest revenue	1,782	20	–	1,802
Interest expense	(15,055)	(96)	–	(15,151)
Income (loss) before the undernoted	15,316	(422)	–	14,894
Payments in lieu of corporate income taxes	(4,826)	(292)	–	(5,118)
Income from discontinued operations	–	717	1,158	1,875
Net income	$ 10,490	$ 3	$ 1,158	$ 11,651
Assets	$ 577,793	$ 227,892	$ (198,720)	$ 606,965
Capital expenditures	27,483	35	–	27,518
Cash provided by (used in) operations	33,689	(1,121)	–	32,568

18. Subsequent event:

On January 23, 2006, Enersource Hydro Mississauga Services Inc. closed the transaction to sell over 12,000 electric water heaters, associated customer contracts and rental agreements and related assets to Union Energy Limited Partnership for the amount of $4,402.