

Financial Statements

WATERLOO NORTH HYDRO INC.

December 31, 2005

AUDITORS' REPORT TO THE SHAREHOLDER

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

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

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

Chartered Accountants

Waterloo, Canada
March 31, 2006

Waterloo North Hydro Inc.

BALANCE SHEET

As at December 31

	2005	2004
	\$	\$
ASSETS		
Current		
Cash and cash equivalents	15,390,494	8,640,038
Accounts receivable	8,859,541	10,200,844
Unbilled energy receivable	14,817,111	12,987,736
Inventories	2,111,244	2,159,762
Prepaid expenses	247,282	498,253
Total current assets	41,425,672	34,486,633
Capital assets - net of accumulated amortization [note 5]	84,608,533	83,801,434
Loan receivable [note 7]	1,200,000	1,200,000
Other	50,779	50,779
Total assets	127,284,984	119,538,846
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities	19,171,135	12,095,579
Due to related party [note 7]	1,642,565	1,577,775
Interest Payable – shareholder	2,719,825	4,216,894
Customer deposits	997,852	1,187,228
Bank Debt [note 8]	9,366,667	9,766,667
Total current liabilities	33,898,044	28,844,144
Long-term		
Long-term debt [note 9]	40,402,432	41,707,432
Customer deposits	1,375,106	1,723,043
Net Regulatory liabilities [note 6]	4,002,232	6,956,418
Post employment benefits [note 11]	3,126,842	3,037,234
Total long-term liabilities	48,906,612	53,424,127
Shareholder's equity		
Share capital [note 12]	26,526,424	24,370,424
Retained earnings	17,953,904	12,900,152
Total shareholder's equity	44,480,328	37,270,576
Total liabilities and shareholder's equity	127,284,984	119,538,846

See accompanying notes

On behalf of the Board:


Eugene Moser, Director


D. Charles Martin, Director

Waterloo North Hydro Inc.

STATEMENT OF RETAINED EARNINGS

Year ended December 31

	2005	2004
	\$	\$
Retained earnings, beginning of year	12,900,152	9,877,896
Net income	5,053,752	3,022,256
Retained earnings, end of year	17,953,904	12,900,152

See accompanying notes

Waterloo North Hydro Inc.**STATEMENT OF OPERATIONS**

Year ended December 31

	2005	2004
	\$	\$
REVENUES		
Sales of electricity	107,717,101	86,255,158
Distribution services revenue	22,367,695	22,033,560
	130,084,796	108,288,718
Power purchased	107,717,101	86,255,158
Operating Revenue	22,367,695	22,033,560
Other revenues		
Rental revenue	213,571	227,358
Billing services	663,635	571,632
Late payment charges	174,031	160,296
Gain (loss) on disposal of capital assets	(20,435)	24,808
Miscellaneous	183,380	151,093
	1,214,182	1,135,187
	23,581,877	23,168,747
EXPENSES		
Distribution	4,921,721	5,044,549
Billing and collecting	2,103,432	2,210,445
General administration	1,856,947	1,600,686
Amortization	5,610,064	5,468,550
Community relations	162,251	230,345
Provincial capital taxes	335,161	307,777
	14,989,576	14,862,352
Income before under noted items	8,592,301	8,306,395
Regulatory Asset Adjustments	2,664,021	-
Interest expense - net [note 13]	(3,113,954)	(3,326,755)
Income before provision for payments in lieu of corporate income taxes	8,142,368	4,979,640
Provision for payments in lieu of corporate income taxes [note 14]	(3,088,616)	(1,957,384)
Net income	5,053,752	3,022,256

See accompanying notes

Waterloo North Hydro Inc.**STATEMENT OF CASH FLOWS**

Year ended December 31

	2005	2004
	\$	\$
OPERATING ACTIVITIES		
Net income	5,053,752	3,022,256
Add (deduct) charges to operations not requiring a current cash payment:		
Amortization	6,240,525	6,023,732
Loss (gain) on disposal of capital assets	20,435	(24,808)
Increase in regulatory liabilities	(2,954,186)	2,304,863
Decrease in other assets	-	16,143
Increase in post employment benefits liability	89,607	196,868
Net change in non-cash operating working capital	7,610,694	(432,963)
Cash provided by operating activities	16,060,827	11,106,091
INVESTING ACTIVITIES		
Additions to capital assets	(9,577,593)	(10,791,993)
Proceeds on disposal of capital assets	67,326	30,857
Cash (applied to) investing activities	(9,510,267)	(10,761,136)
FINANCING ACTIVITIES		
Increase in customer deposits	(537,313)	1,159,508
Decrease in long-term debt	(1,305,000)	(15,156,900)
Increase in bank debt	(400,000)	9,766,667
Decrease in loan receivable	—	400,000
Increase in contributed capital	2,442,209	3,026,860
Cash (applied to) financing activities	199,896	(803,865)
Net cash increase (decrease) during the year	6,750,456	(458,910)
Cash and cash equivalents, beginning of year	8,640,038	9,098,948
Cash and cash equivalents, end of year	15,390,494	8,640,038
Supplementary information:		
Interest paid	2,081,190	2,225,890
Interest received	326,380	259,816
Payments in lieu of corporate income taxes	2,126,970	2,060,712

See accompanying notes

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

1. INCORPORATION

Waterloo North Hydro Inc. [the Company] is a regulated electricity distribution company incorporated under the Business Corporations Act [Ontario] on May 1, 2000. The incorporation was required in accordance with the provincial government's Electricity Competition Act [Bill 35]. The Company is wholly-owned by Waterloo North Hydro Holding Corporation whose shareholders are the City of Waterloo and the Townships of Wellesley and Woolwich.

Under a municipal by-law, the former Hydro-Electric Commission of Waterloo, Wellesley and Woolwich and the City of Waterloo and the Townships of Wellesley and Woolwich transferred the net book value of the assets, liabilities, and the employees, associated with the distribution of electricity and associated business activities, to the new corporations.

Effective October 1, 2001, all electric utility companies in Ontario are subject to a number of taxes, which will be used to repay the stranded debt incurred by the former Ontario Hydro prior to the introduction of Bill 35. Details of these taxes are included in note 14.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles [GAAP], as well as guidance prescribed by the Ontario Energy Board [the OEB] in the handbook "*Accounting Procedures Handbook for Electric Distribution Utilities*" and reflect the significant accounting policies summarized below.

Cash and cash equivalents

Cash equivalents are readily convertible investments with maturities of three months or less from their date of acquisition. Investments are carried at cost, which approximates market value.

Inventories

Inventories consist of repair parts, supplies and material held for future capital expansion and are valued at lower of weighted average cost and net realizable value.

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Capital assets and amortization

Capital assets are stated at cost, including material and labour and are removed from the accounts at the end of their estimated average service lives, except in those instances where specific identification allows their removal at retirement or disposition. Gains or losses at retirement or disposition of such assets are credited or charged to other revenue.

Amortization is provided on a straight-line basis for capital assets available for use over their estimated service lives, at the following annual rates:

Buildings	1.7%
Transformer and substation equipment	4%
SCADA equipment	4%
Distribution system	4%
Meters	4%
General equipment	10 - 30%

Amortization on general equipment directly used in the installation of other capital assets, is capitalized to the new assets based on a pro-ration of time during the year they are used for such purposes.

Full amortization is recorded in the year of acquisition and none in the year of disposal. Construction in process is not amortized until the assets are put in use.

Pension plan

Waterloo North Hydro Inc. provides a pension plan for its employees through the Ontario Municipal Employees Retirement System [OMERS]. OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund [the "Fund"] and provides pensions for employees of Ontario municipalities, local boards, public utilities and school boards.

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

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 [*note 10*]. The Company recognizes the expense related to this plan as contributions are made.

Post-employment benefits

Post-employment benefits provided by WNHI include health, dental and life insurance benefits and accumulated sick leave credits. These plans provide benefits to certain employees when they are no longer providing active service. Post-employment benefit expense is recognized in the period in which the employees render the services.

Post-employment benefits are recorded on an accrual basis. The accrued benefit obligations and current service cost are calculated using the projected benefits 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. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees that are active at the date of amendment. Actuarial gains [losses] are amortized into expense over the average remaining service period of active employees to full eligibility.

Contributed capital

Effective May 1, 2000, the Company prospectively adopted the change in accounting policy for contributions received in aid of construction [contributed capital], as prescribed by the OEB "Accounting Procedures Handbook for Electric Distribution Utilities". Capital contributions received from outside sources are used to finance additions to capital assets. Capital contributions received are treated as a "credit" contra account included in the determination of capital assets. The amount is subsequently amortized by a charge to accumulated amortization and a credit to amortization expense, at an equivalent rate to that used for the amortization of the related capital assets.

Revenue recognition

Revenue is recorded on the basis of regular meter readings. Estimates of customer usage since the last meter reading date to the end of the year are recorded as unbilled revenue.

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Customer deposits

Customer deposits are cash collections from customers to guarantee the payment of energy bills. Deposits expected to be refunded to customers within the next fiscal year are classified as a current liability.

Use of estimates

The preparation of financial statements in conformance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the year. Actual results could differ from estimates.

Corporate income taxes and capital taxes

The current tax-exempt status of the Company under the Income Tax Act [Canada] and the Corporations Tax Act [Ontario] reflects the fact that the Company is wholly owned by municipalities. This tax-exempt status might be lost in a number of circumstances, including if the municipality ceases to own 90% or more of the shares or capital of the Company, or if a non-government entity has rights immediately or in the future, either absolutely or contingently, to acquire more than 10% of the shares of the Company.

Commencing October 1, 2001, the Company is required, under the Electricity Act, 1998, to make payments in lieu of corporate taxes to Ontario Electricity Financial Corporation. These payments are calculated in accordance with the rules for computing income and capital tax 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.

As a result of becoming subject to payments in lieu of corporate income taxes [PILs], the Company's taxation year was deemed to have ended immediately beforehand and a new taxation year was deemed to have commenced immediately thereafter. The Company was therefore deemed to have disposed of each of its assets at its then fair market value and to have reacquired such assets at that same amount for purposes of computing its future income subject to PILs. For purposes of certain provisions, the Company was deemed to be a new company and, as a result, tax

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

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NOTES TO FINANCIAL STATEMENTS

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES cont'd

Corporate income taxes and capital taxes cont'd

credits or tax losses not previously utilized by the Company would not be available to it after the change in tax status. Essentially, the Company was taxed as though it had a “fresh start” at the time of its change in tax status.

The Company provides for PILs relating to its regulated business using the taxes payable method as allowed by the OEB. Under the taxes payable method, no provisions are booked for temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes as a result of temporary differences between tax basis and accounting purposes become payable, they will be charged to the statement of operations at that time.

3. ELECTRIC INDUSTRY RESTRUCTURING AND REGULATION

The Company is regulated by the Ontario Energy Board, under the authority granted by the Ontario Energy Board Act (1998). The OEB has the power and responsibility to approve or fix rates for the transmission and distribution of electricity, providing continued rate protection for rural and remote electricity consumers, and ensuring that distribution companies fulfill obligations to connect and service customers. The OEB may also prescribe license requirements and conditions of service to electricity distributors which may include, among other things, record keeping, regulatory accounting principles, separation of accounts for distinct businesses, and filing and process requirements for rate setting purposes. In its capacity to approve or set rates, the OEB has the authority to specify regulatory accounting treatments that may differ from Canadian generally accepted accounting principles for enterprises operating in a non-rate regulated environment.

In January 2000, the OEB established that distribution rates would be subject to Performance Based Regulation (“PBR”), a method of regulation whereby distribution rates are reduced annually to reflect productivity improvements required of the Company. Under this rate methodology, rates also include regulated amounts for return on Company equity and debt, which were initially determined by the OEB to be 9.88% and 7.25%, respectively. While the initial PBR regulatory framework provided for those regulatory rates of return, subsequent regulation and Provincial Government initiatives prevented distribution companies from fully achieving the theoretical rate of return on equity.

Distribution charges were also to be increased to permit the recovery of costs incurred by the Company to prepare for the opening of the competitive electricity market in Ontario (“Market

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

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3. ELECTRIC INDUSTRY RESTRUCTURING & REGULATION cont'd

Opening"). The Company has capitalized these costs as regulatory assets. In 2004, the Company filed applications to adjust its distribution charges to provide for the recovery of its regulatory assets over a four year period. The applications were approved by the OEB effective April 1, 2004.

In 2005, the Company filed rate applications to adjust its distribution charges to provide for the full theoretical regulatory rate of return of 9.88% and continued recovery of its regulatory assets. As mandated by the OEB, the rate increase is subject to a financial commitment by the Company to invest \$1,205,000 in conservation and demand management activities over the period April 1, 2005 to September 30, 2007. The rate applications and applications for the approval of its conservation and demand management programs have since been approved by the OEB.

4. BANK INDEBTEDNESS

Waterloo North Hydro Inc. has a line of credit available to it in the amount of \$10,000,000, which was not utilized at December 31, 2005 [2004 - nil]. The line is unsecured and bears interest at the bank prime rate less 0.65%. At December 31, 2005, bank prime was 5.0% [2004 - 4.25%].

5. CAPITAL ASSETS

	<u>2005</u>		<u>2004</u>	
	<u>Cost</u>	<u>Accumulated amortization</u>	<u>Cost</u>	<u>Accumulated amortization</u>
	\$	\$	\$	\$
Land and easements	1,790,435	-	1,785,889	-
Buildings	7,388,747	2,023,881	7,261,750	1,899,277
Transformer and substation equipment,	22,711,479	7,917,593	22,951,671	7,554,664
SCADA equipment	2,091,268	1,367,292	2,048,811	1,250,111
Distribution system	115,660,684	48,419,948	108,303,136	43,966,393
Meters	8,269,271	4,139,493	7,860,994	3,870,363
General equipment	12,694,334	9,013,673	11,167,615	7,769,712
Contributed capital	(14,857,883)	(1,742,078)	(12,415,674)	(1,147,762)
	155,748,335	71,139,802	148,964,192	65,162,758
Less accumulated amortization	71,139,802		65,162,758	
Net book value	84,608,533		83,801,434	

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

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6. NET REGULATORY ASSETS/LIABILITIES

Net regulatory assets (liabilities) represent costs incurred by the company in excess of amounts billed to the consumer at OEB approved rates less recoveries. These amounts have been accumulated pursuant to the Electricity Act (EA) and deferred in anticipation of their future recovery in electricity distribution rates. Management assesses the future uncertainty with respect to the final regulatory disposition of those amounts, and to the extent required, makes accounting provisions to reduce the deferred balances accumulated or to increase the recorded liabilities. Upon rendering of the final regulatory decision adjusting distribution rates, the provisions are adjusted to reflect the final impact of that decision, and such adjustment is reflected in net earnings for the period.

Regulatory assets (liabilities) earn (incur) interest at the rate of 7.25% simple interest per annum.

Transition costs - represent specific and incremental costs to the Company for systems and process changes to support the opening of the competitive electricity market in Ontario on May 1, 2002 ("Market Opening"). These costs have been deferred pursuant to regulation underlying the EA and are subject to review and approval for recovery by the OEB. The Company filed for recovery of these costs in January, 2004 and it is expected that these costs will be recovered over a four year period.

Pre-market opening cost of power variances - represent the excess of the cost of the commodity electricity to the Company over the amount billed to its customers prior to Market Opening. The Company filed for recovery of these costs in January, 2004 and it is expected that these costs will be recovered over a four year period.

Post-market opening retail settlement variances - represent amounts that have accumulated since Market Opening and comprise:

- a) variances between amounts charged by the Independent Electricity System Operator ("IESO") for the operation of the wholesale electricity market and grid, various wholesale market settlement charges and transmission charges, and the amounts billed to customers by the Company based on the OEB approved wholesale market service rate; and,
- b) variances between the amounts charged by the IESO for energy commodity costs and the amounts billed to customers by the Company based on OEB approved rates.

The Company filed for recovery of these costs in January, 2004 over a four year period. The application was approved by the OEB effective April 1, 2005.

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

6. NET REGULATORY ASSETS/LIABILITIES cont'd

Deferred payments in lieu of taxes – represent variances that result from the difference between OEB approved PILs recoverable in electricity distribution services charges and the actual amount of these charges to customers that relates to the recovery of PILs.

The continuing restructuring of Ontario's electricity industry and other regulatory developments, including current and possible future consultations between the OEB and interested stakeholders, may affect the distribution rates that the Company may charge and the costs that the Company may recover, including the balance of its regulatory assets.

In the absence of rate regulation, generally accepted accounting principles would require the Company to record the costs and recoveries described above in the operating results of the year in which they are incurred and reported earnings before income taxes would be \$2,954,186 lower in 2005 and \$2,304,863 higher in 2004 than reported.

Net regulatory assets and liabilities consist of the following:

	2005	2004
	\$	\$
Regulatory assets		
Transition costs	924,556	1,038,396
<u>Pre-market opening variances</u>	<u>3,221,003</u>	<u>2,355,905</u>
	4,145,559	3,394,301
<u>Reserve for Impairment</u>	<u>-</u>	<u>(3,392,903)</u>
	4,145,559	1,398
Post market opening variances	(8,740,522)	(7,287,478)
<u>Regulatory Repayments net of recoveries</u>	<u>592,731</u>	<u>329,662</u>
<u>Net regulatory assets and liabilities</u>	<u>(4,002,232)</u>	<u>(6,956,418)</u>

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

7. RELATED PARTY TRANSACTIONS

The Company conducted transactions with related parties during the year ended December 31, 2005. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

During the year, the company provided street lighting energy and street lighting maintenance services to the City of Waterloo in the amounts of \$426,971 and \$205,781 respectively [2004 - \$421,030 and \$195,938, respectively]. In addition, the Company performs regular billing and collections services on behalf of the City of Waterloo for municipal water and sewer charges. In 2004, the Company collected \$20,567,369 [2004 - \$18,591,288] on behalf of the City of Waterloo relating to these charges. The Company charged administrative fees in the amount of \$591,711 [2004 - \$534,170] to the City of Waterloo for this service. The City of Waterloo is the majority shareholder of Waterloo North Hydro Holding Corporation.

At year-end, the Company owed the City of Waterloo \$1,699,885 [2004 - \$1,577,775] in unremitted collections.

In 2003 the company loaned \$1,600,000 to Waterloo North Hydro Holding Corporation. This debt bears interest at the prime rate of the Corporation's banker minus 65 basis points per annum and has no set repayment terms. In 2004, \$400,000 of this debt was repaid. At year end the prime rate was 5.0%. Total interest in the amount of \$44,836 [2004 - \$53,726] was received on this debt during the year.

8. BANK DEBT

In 2004, the company borrowed \$10,000,000 from the Canadian Imperial Bank of Commerce. This loan is at a variable interest rate plus a stamping fee of .45% with principal repayment amortized over 25 years. This rate is hedged by way of an interest rate swap at 4.932%. This debt is secured by a General Security Agreement in favour of the CIBC bank. Total interest in the amount of \$512,602 was paid on this debt during the year. The replacement cost of the interest rate swap as at December 31, 2005 was \$407,507.

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

9. LONG-TERM DEBT

	2005 \$	2004 \$
Senior long-term note payable [a]	24,155,492	25,460,492
Junior long-term note payable [b]	16,246,940	16,246,940
	40,402,432	41,707,432

[a] The senior long-term note payable is due to Waterloo North Hydro Holding Corporation, the Company's parent, bears interest at a rate of 6.0% per annum, has no set principal repayment terms and is due on demand.

Waterloo North Hydro Holding Corporation has waived the right to demand repayment of any portion of the note during the next fiscal year.

The company repaid \$1,305,000 of this debt in 2005.

[b] The junior long-term note payable is due to Waterloo North Hydro Holding Corporation, bears interest at a rate of 1 1/8% per annum above the interest rate on debt which the Ontario Energy Board permits the corporation to pay for rate making purposes in the establishment of distribution rates, has no set principal repayment terms and is due on demand.

Waterloo North Hydro Holding Corporation has waived the right to demand repayment of any portion of the note during the next fiscal year.

10. PENSION PLAN

WNHI incurred current service pension costs of \$444,774 for the year ended December 31, 2005 [2004 – \$410,659]. Effective August 1, 1998, OMERS provided a temporary contribution holiday, with no Company or employee pension contributions required until after December 31, 2002. In January 2003, OMERS contributions resumed on a phased-in basis with full contributions starting in January 2004.

Waterloo North Hydro Inc.

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11. POST EMPLOYMENT BENEFITS

The Company has a number of unfunded defined benefit plans providing other retirement and post-employment benefits to most of its employees. These plans include life insurance, health and dental benefits and accumulated sick leave. The last actuarial valuation was done as at December 31, 2004.

Information about these defined benefit plans are as follows:

	2005	2004
	\$	\$
Accrued benefit obligation		
Balance, beginning of year	3,037,234	2,840,366
Current service cost	101,263	68,524
Interest cost	172,218	170,818
Actuarial gain	-	81,392
Benefits Paid	(183,873)	(123,866)
Balance, end of year	<u>3,126,842</u>	<u>3,037,234</u>
Projected accrued benefit obligation at December 31	<u>3,083,613</u>	<u>2,937,342</u>

The significant actuarial assumptions adopted in measuring the accrued benefit obligations are as follows:

	%
Discount rate	5.75
Future general salary and wage levels increase	3.0
Dental costs increase	4.0
Medical costs increase	7.5% in 2005, then 5.0% thereafter

The approximate effect on the accrued benefit obligation and the estimated net benefit expense if the health care trend rate assumption was increased or decreased by 1% is as follows:

	Accrued Benefit Obligation	Periodic Cost
1% increase in health care trend rate	\$190,820	\$25,702
1% decrease in health care	(\$172,409)	(\$22,961)

Waterloo North Hydro Inc.

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12. SHARE CAPITAL

	2005	2004
	\$	\$
Authorized		
Unlimited common shares		
Unlimited Class A special shares		
Issued		
1,000 common shares	24,370,424	24,370,424
215,600 Class A special shares - \$10 Par value Non-voting, non cumulative	2,156,000	-
—	26,526,424	24,370,424

13. INTEREST (EXPENSE) INCOME

The Company has interest [expense] income relating to the following:

	2005	2004
	\$	\$
Interest on debt with Waterloo North Hydro Holding Corporation		
Senior long-term notes payable	(1,525,699)	(1,828,282)
Junior long-term notes payable	(1,359,145)	(1,360,681)
Other debt	(555,491)	(397,608)
Interest income	326,381	259,816
Net interest expense	(3,113,954)	(3,326,755)

Waterloo North Hydro Inc.

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14. CORPORATE INCOME AND CAPITAL 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. Reconciliation between the statutory and effective tax rates is provided as follows:

Statement of operations

	2005 \$	2004 \$
Rate reconciliation		
Income from continuing operations before income taxes	8,142,368	4,979,640
Statutory Canadian federal and provincial income tax rate	36.12%	36.12%
Expected taxes on income	2,941,023	1,798,646
Increase (decrease) in income taxes resulting from:		
Large corporations tax net of surtax	-	25,413
Permanent differences	-	3,289
Other temporary differences not benefited	147,593	130,036
Income tax expense	3,088,616	1,957,384
Effective tax rate	37.93%	39.31%
Components of income tax expense		
Income Tax	3,088,616	1,931,971
Large Corporations Tax	-	25,413
Income tax expense	3,088,616	1,957,384

Balance sheet

Future income taxes relating to the regulated businesses have not been recorded in the accounts. As at December 31, 2005, future income tax assets of \$6,923,853 [2004 - \$6,806,976] based on substantively enacted income tax rates, have not been recorded.

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NOTES TO FINANCIAL STATEMENTS

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15. PRUDENTIAL SUPPORT OBLIGATION

Waterloo North Hydro Inc. purchases power from the IESO on behalf of its customers and retailers. The IESO is responsible for ensuring that prudential support is posted by all market participants to mitigate the impact of an event of default by a market participant on the rest of the market. In this regard Waterloo North Hydro Inc. posted an irrevocable standby letter of credit in the amount of \$15,927,424 underwritten by the corporation's principal bank. This instrument expires April 15, 2006.

16. FINANCIAL INSTRUMENTS

The carrying values of cash and cash equivalents, accounts receivable, unbilled energy receivable, accounts payable and accrued liabilities, and amounts due to related party approximate fair values because of the short maturity of these instruments. The carrying value of the loan receivable and the bank loan approximates fair value because these instruments bear interest at current rates. No fair value is available for the long-term note payable since there are no specified repayment terms.

Financial assets held by the Corporation, such as accounts receivable, expose it to credit risk.

The Corporation earns its revenue from a broad base of customers located in the City of Waterloo and the Townships of Wellesley and Woolwich. No one customer accounts for more than 1% of revenue.

17. CONTINGENT LIABILITY

A class action lawsuit claiming \$500 million in restitutionary payments plus interest was served on Toronto Hydro on November 18, 1998. The action was initiated against Toronto Hydro Electric Commission as the representative of the Defendant Class consisting of all municipal electric utilities in Ontario which have charged late payment charges on overdue utility bills at any time after April 1, 1981.

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

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

Waterloo North Hydro Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2005

18. GENERAL LIABILITY INSURANCE

The Corporation is a member of the Municipal Electric Association Reciprocal Insurance Exchange [MEARIE] which is a pooling of general liability insurance risks. Members of MEARIE would be assessed on a pro-rata basis should losses be experienced by MEARIE, for the years in which the Corporation was a member.

To December 31, 2005, the Corporation has not been made aware of any additional assessments. Participation in MEARIE expires December 31, 2006. Notice to withdraw from MEARIE must be given six months prior to the commencement of the next underwriting term.