Financial Statements of

ENERSOURCE HYDRO MISSISSAUGA INC.

Year ended December 31, 2002

KPMG

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AUDITORS' REPORT TO THE SHAREHOLDER

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

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

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

KPMG LLP

Chartered Accountants

Toronto, Canada

March 7, 2003

ENERSOURCE HYDRO MISSISSAUGA INC.

Balance Sheet
(In thousands of dollars)

December 31, 2002, with comparative figures for 2001

	2002	2001
Assets		
Current assets:		
Cash and cash equivalents	$ –	$ 26,551
Accounts receivable	55,272	33,491
Unbilled revenue	66,464	41,500
Amounts due from related parties, without interest (note 12)	10,026	635
Recoverable payments in lieu of income taxes	–	1,094
Inventory	4,152	4,326
Prepaids and deposits	114	1,361
	136,028	108,958
Capital assets (note 3)	398,536	398,334
Other assets:		
Cash and cash equivalents held for consumer deposits	23,134	19,619
Deferred debt issue costs, net of amortization of $727 (2001 - $289)	3,613	4,051
Regulatory assets (note 4)	26,183	8,942
	52,930	32,612
	$ 587,494	$ 539,904
Liabilities and Shareholder's Equity		
Current liabilities:		
Bank overdraft	$ 8,062	$ –
Accounts payable and accrued liabilities	74,557	60,449
Amounts in lieu of corporate income taxes payable	254	–
Deferred revenue	–	1,818
Advance payments - subdividers	4,350	4,101
Due to related parties, without interest	7,262	–
	94,485	66,368
Long-term liabilities:		
Bonds payable (note 5)	290,000	290,000
Consumer deposits	23,134	19,619
Employee retirement and post-retirement benefits (note 8)	1,877	1,786
	315,011	311,405
Shareholder's equity:		
Capital stock (note 6)	155,629	155,629
Retained earnings	22,369	6,502
	177,998	162,131
Contingencies (note 9)		
Commitments (note 10)		
	$ 587,494	$ 539,904

See accompanying notes to financial statements.

On behalf of the Board:

________________________________ Director

________________________________ Director

ENERSOURCE HYDRO MISSISSAUGA INC.

Statement of Income and Retained Earnings
(In thousands of dollars)

Year ended December 31, 2002, with comparative figures for 2001

	2002	2001
Revenue:		
Energy sales	$ 650,921	$ 552,824
Services	7,895	6,212
Other	2,599	5,737
	661,415	564,773
Operating expenses:		
Energy purchases	566,333	495,214
Operations, maintenance and administration	26,803	21,353
Services	7,057	4,293
Amortization of capital assets	25,825	26,386
	626,018	547,246
Operating income	35,397	17,527
Interest:		
Income	724	1,786
Expense	(18,459)	(17,295)
	(17,735)	(15,509)
Income before amounts in lieu of income taxes	17,662	2,018
Amounts in lieu of income taxes (note 2)	1,795	266
Net income	15,867	1,752
Retained earnings, beginning of year	6,502	4,750
Retained earnings, end of year	$ 22,369	$ 6,502

See accompanying notes to financial statements.

ENERSOURCE HYDRO MISSISSAUGA INC.

Statement of Cash Flows
(In thousands of dollars)

Year ended December 31, 2002, with comparative figures for 2001

	2002	2001
Cash provided by (used in):		
Operating activities:		
Net income	$ 15,867	$ 1,752
Items not affecting cash:		
Amortization of debt issue costs	438	289
Amortization of capital assets	25,825	26,386
Gain on disposal of capital assets	(61)	(25)
Employee retirement and post-retirement benefits	91	82
	42,160	28,484
Change in non-cash operating working capital (note 7)	(33,566)	332
Cash provided by operating activities	8,594	28,816
Financing activities:		
Proceeds on issuance of bonds, net of issuance costs	–	285,660
Consumer deposits	3,515	5,278
Repayment of note payable	–	(269,214)
Cash provided by financing activities	3,515	21,724
Investing activities:		
Cash and cash equivalents held for consumer deposits	(3,515)	(5,278)
Additions to capital assets	(27,571)	(25,920)
Proceeds on disposal of capital assets	1,605	846
Additions to regulatory assets	(17,241)	(7,789)
Cash used in investing activities	(46,722)	(38,141)
Increase (decrease) in cash and cash equivalents	(34,613)	12,399
Cash and cash equivalents, beginning of year	26,551	14,152
Cash and cash equivalents, end of year	$ (8,062)	$ 26,551
Supplemental cash flow information:		
Interest received	$ 724	$ 1,772
Interest paid	18,241	15,040
Instalments paid in respect of amounts in lieu of income taxes	3,050	1,830

See accompanying notes to financial statements.

Enersource Hydro Mississauga Inc. (the "Corporation") is the electric distribution utility for residents of the City of Mississauga (the "City").

1. Significant accounting policies:

(a) Basis of accounting:

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada.

(b) Rate setting:

The Corporation 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.

In order to achieve a proper matching of revenue and expenses, in addition to the timing of recognition of certain revenue and expenses for the distribution of electricity, accounting methods may differ from those otherwise expected under generally accepted accounting principles for non-regulated businesses. Specifically:

(i) Capital and operating costs incurred in respect of the transition to competitive markets have been deferred with amortization to commence on the date that a rate increase is implemented to offset the amortization of the transition costs.

(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 provides for amounts in lieu of corporate income taxes using the taxes payable method.

(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.

1. Significant accounting policies (continued):

(c) 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, less bank overdraft.

(d) Revenue recognition:

Revenue is recognized on the accrual basis and includes an estimate of unbilled revenue representing 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 revenues are recognized as services are rendered or contract milestones are achieved.

(e) Measurement uncertainty:

The preparation of the Corporation's financial statements, in accordance with generally accepted accounting principles, requires management to make estimates 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 financial statements, including changes as a result of future decisions of the OEB or the Minister of Energy.

(f) 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):

(g) 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. The OEB requires that such contributions, whether in cash or in-kind, be offset against the related asset cost. Contributions in-kind are valued at their fair market value at the date of their contribution.

When identifiable assets, such as buildings, distribution station equipment and equipment and furniture 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 life.

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

	Estimated service life (years)	
	Range	Average
Buildings	30 - 60	55
Distribution station equipment	15 - 35	28
Transmission and distribution system	25 - 40	26
Equipment and furniture	4 - 10	8
Computer software	2	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.

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% (2001 - 6.9%).

1. Significant accounting policies (continued):

(h) 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.

(i) Consumer deposits:

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 customer deposits and invested in term deposits, which are reported separately from the Corporation's own cash and cash equivalents. Interest is paid on customer balances at prime rate less 1.9%.

(j) Pension and other post-employment benefits:

The Corporation accounts for its participation in the Ontario Municipal Employees Retirement System ("OMERS"), a multi-employer public sector pension fund, as a defined contribution plan.

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 ended at the earliest age the employee could retire and qualify for benefits.

(k) Regulatory assets:

Regulatory assets primarily represent costs that have been deferred because it is probable that they will be recovered in rates. Regulatory assets are comprised principally as follows:

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. To the extent that transition costs have been incurred that do not qualify for deferral, these costs have been expensed during the period they were incurred.

1. Significant accounting policies (continued):

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.

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:

(i) variances between the amount charged by the Independent Market Operator ("IMO") 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 wholesale market service rate; and

(ii) variances between the amounts charged by the IMO to allow for purchases of imported power as compared to the amounts billed to consumers based on the OEB approved rates.

On December 9, 2002, the Province enacted the Electricity Pricing, Conservation and Supply Act, 2002 ("Bill 210"), which amended the Electricity Act, 1998 and other statutes for the purpose of implementing the Electricity Action Plan announced by the Premier of Ontario on November 11, 2002. The more significant provisions of Bill 210 are as follows:

(i) Energy prices for low volume and designated consumers (as defined in Bill 210) are fixed at 4.3 cents per kWh;

(ii) Distribution rates are capped until at least April 30, 2006;

(iii) Effective December 1, 2002, the price paid by distributors to the IMO for wholesale market charges other than energy is largely fixed at the same price distributors are permitted to charge their customers; and

(iv) Bill 210 provides for the establishment or continuation of deferral accounts for certain amounts until disposition is addressed by the OEB. Specifically, these accounts include retail settlement variance accounts and transition costs.

1. Significant accounting policies (continued):

As a result, the Corporation will not be able to implement the final rate increase to be able to achieve a 9.88% return on equity, nor will it be able to apply for recovery of transition costs expected to commence from 2003 rates. Bill 210 directed utilities to continue deferral of transition and energy variance accounts until their review by the OEB. In a January 23, 2003 letter to electricity distributors, the Minister of Energy indicated that he will ask the OEB to complete, before the end of 2003, a review to confirm the costs to be recovered, with recovery to commence no later than 2006.

The Corporation believes that it is probable the regulatory assets will be recovered through future rates. However, uncertainty as to full recovery is greater than before enactment of Bill 210. The likelihood of recovery of regulatory assets will be assessed on a regular basis. In the event that recovery from future rates is no longer considered probable or portions of those amounts deferred are determined not to be recoverable, such amounts will be expensed in the period this determination is made.

(l) Corporate income and capital taxes:

Under the Electricity Act, 1998, the Corporation is required to make payments in lieu of corporate taxes to Ontario Electricity Financial Corporation ("OEFC"), commencing October 1, 2001. 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 amounts in lieu of corporate income taxes relating to its regulated businesses using the taxes payable method. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes.

(In thousands of dollars)

2. Amounts in lieu of corporate income taxes:

Future income taxes have not been recorded in the accounts as they are expected to be recovered through future revenue. 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 is $33,220 (2001 - $34,627). These benefits have not been recorded in the accounts as there is uncertainty as to whether the Corporation will be able to retain these benefits. The Corporation was not subject to amounts in lieu of corporate income taxes prior to October 2001.

During the year ended December 31, 2002, the Corporation applied $11,728, representing the entire amount available of its non-capital loss carryforwards to reduce payments in lieu of taxes otherwise payable.

3. Capital assets:

	Cost	Accumulated amortization	2002 Net book value	2001 Net book value
Land	$ 3,921	$ –	$ 3,921	$ 3,921
Buildings	12,844	3,723	9,121	9,360
Distribution station equipment	68,256	27,402	40,854	39,628
Transmission and distribution system	517,545	196,832	320,713	325,804
Equipment and furniture	19,841	11,448	8,393	9,004
Computer software	2,993	1,613	1,380	1,374
Construction in progress:				
Electric distribution system	11,731	–	11,731	8,436
Transition costs	–	–	–	807
Computer software	2,423	–	2,423	–
	$ 639,554	$ 241,018	$ 398,536	$ 398,334

During the year, $772 (2001 - $752), representing an allowance for the cost of funds used during construction, was capitalized to construction in progress.

(In thousands of dollars)

4. Regulatory assets:

Regulatory assets can arise as a result of the rate-making process:

	2002	2001
Deferred transition costs	$ 11,324	$ 7,924
Pre-market opening cost of power variances	9,553	1,018
Post-market opening retail settlement variances	5,306	–
	$ 26,183	$ 8,942

The Corporation has recorded a reserve for the deferred transition costs in the amount of $2,450. The Corporation has not accrued interest on the deferral accounts for pre-market opening cost of power variances and post-market opening retail settlement variances.

5. Bonds payable:

	2002	2001
6.29% BPC-Enersource Series Bonds, Tranche 1, due May 3, 2011	$ 290,000	$ 290,000

Interest expense includes $18,241 (2001 - $17,453) in respect of interest on long-term liabilities and amortization of debt issue costs in the amount of $438 (2001 - $289).

6. Capital stock:

(a) Background:

Mississauga City Council approved a by-law, effective January 1, 2000, effecting the transfer of the electricity distribution business formerly conducted by the Mississauga Hydro-Electric Commission to the Corporation. The City received consideration in the form of a note receivable for $150,000 and common shares in exchange, at the time of the transfer. On December 6, 2001, the City received further consideration in the form of a note receivable for $119,214 and a dividend of $20,785 when it exchanged shares issued on January 1, 2000 for shares of Enersource Corporation, the Corporation's parent. The transfers were recorded at net book value.

(In thousands of dollars)

6. Capital stock (continued):

(b) Capital stock:

Authorized and issued capital stock at December 31 is as follows:

	2002	2001
Authorized:		
Unlimited common shares		
Issued:		
40 common shares	$ 155,629	$ 155,629

7. Change in non-cash operating working capital:

	2002	2001
Accounts receivable	$ (21,781)	$ (3,692)
Unbilled revenue	(24,964)	(2,775)
Amounts due to/from related parties	(2,129)	(635)
Recoverable payments in lieu of income taxes	1,094	(1,094)
Inventory	174	671
Prepaids and deposits	1,247	(674)
Accounts payable and accrued liabilities	14,108	5,791
Amounts in lieu of corporate income taxes payable	254	–
Deferred revenue	(1,818)	1,818
Advance payments - subdividers	249	922
	$ (33,566)	$ 332

8. Employee retirement and post-retirement benefits:

(a) Pensions:

A contribution holiday has been in effect for OMERS members since August 31, 1998. Accordingly, no contributions were required during the 2002 and 2001 fiscal years. Contributions resumed effective the first full pay period of 2003.

(In thousands of dollars)

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

(b) Other retirement and post-retirement benefits:

	2002	2001
Change in benefit obligations:		
Benefit obligation, beginning of year	$ 1,786	$ 1,704
Service cost	29	28
Interest cost	123	118
Benefits paid	(61)	(64)
Benefit obligation, end of year	$ 1,877	$ 1,786
Change in plan assets:		
Fair value of plan assets, beginning of year	$ –	$ –
Employer's contributions	61	64
Benefits paid	(61)	(64)
Fair value of plan assets, end of year	$ –	$ –
Discount rate	7.0%	7.0%
Expected return on plan assets	7.0%	7.0%
Rate of compensation increase	3.5%	3.5%

The principal funding obligation of the plan is to fund life insurance benefits based on employment date and years of service. A small group of former employees who elected to retire under a special early retirement incentive plan are entitled to a 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 plan obligations. The total estimated plan obligation at December 31, 2002 is $1,877 (2001 - $1,786). There is no unamortized past service component. The next actuarial valuation will be completed for the 2003 fiscal year end.

9. 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. Effective January 1, 2001, coverage is provided to a level of $30,000 per incident.

The Corporation has been jointly named as a defendant in several actions. No provision has been made for these potential liabilities as the Corporation 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 these financial statements.

(In thousands of dollars)

10. Commitments:

(a) Guarantees:

Purchasers of electricity in Ontario, through the IMO, are required to provide security to mitigate the risk of their default on their expected activity in the market. The market could draw on these guarantees if the Corporation failed to make payment required by a default notice issued by the IMO. The Corporation's parent company has guaranteed the obligations of the Corporation in the amount of $28,115 (2001 - nil).

(b) Commitments:

The Corporation leases equipment under operating lease agreements. Minimum lease payments due in future fiscal periods under these agreements are as set out below:

2003	$ 57
2004	35
2005	13
2006	3

11. Financial instruments:

The carrying values of accounts receivable, cash and cash equivalents held for consumer deposits, bank overdraft, accounts payable and accrued liabilities and advance payments - subdividers, approximate fair values because of the short maturity of these instruments.

The bonds payable, having a carrying value of $290,000 (2001 - $290,000), have a fair value of $305,486 (2001 - $293,335) based on year-end quoted market prices for similar debt.

Financial assets held by the Corporation expose it to credit risk. As at December 31, 2002, 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 would account for revenue or an accounts receivable balance in excess of 10% of the respective reported balances.

(In thousands of dollars)

12. Related party transactions:

The Corporation provides electricity and services to the principal shareholder of its parent company, 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:

	2002	2001
Electrical energy	$ 8,291	$ 7,388
Streetlighting maintenance	1,879	1,826
Streetlighting energy	2,653	2,408

The Corporation charged the City $3,357 (2001 - $1,994) for other construction services in 2002.

Interest expense includes interest of nil (2001 - $628) on the note payable to the City.

At December 31, 2002, accounts payable and accrued liabilities include $109 (2001 - $80) due to the City and accounts receivable includes $2,288 (2001 - $1,110) due from the City.

Amounts due from related parties include $691 (2001 - $616) from a company under common control and $9,335 (2001 - $19) from the parent company.

Amounts due to related parties include $11 (2001 - nil) to a company under common control and $7,251 to the parent company (2001 - nil).

13. Energy purchases:

As a participant in the competitive electricity market, effective May 1, 2002, all electricity purchases for standard supply customers are subject to pricing determined by the IMO, a provincial government body.

Included in accounts payable and accrued liabilities as at December 31, 2002 is $45,227 owed in respect of electricity purchases through the IMO. Prior to the opening of the competitive electricity market, all electricity purchases were made from Ontario Power Generation and at December 31, 2001, $49,756 was included in accounts payable and accrued liabilities.