

Financial Statements of

POWERSTREAM INC.

December 31, 2004

Auditors' Report

To the Shareholders of
PowerStream Inc.

We have audited the balance sheet of PowerStream Inc. as at December 31, 2004 and the statements of earnings and retained earnings and of cash flows for the seven month period 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, 2004 and the results of its operations and its cash flows for the period then ended, in accordance with Canadian generally accepted accounting principles.

“Deloitte & Touche LLP”

Chartered Accountants

Toronto, Ontario
April 15, 2005

POWERSTREAM INC.

Table of Contents

December 31, 2004

	<u>Page</u>
Balance Sheet	1
Statement of Earnings and Retained Earnings	2
Statement of Cash Flows	3
Notes to the Financial Statements	4-25

POWERSTREAM INC.

Balance Sheet

December 31, 2004

(in thousands of dollars)

	<u>(Note 4)</u>
ASSETS	
CURRENT	
Cash and cash equivalents	\$ 27,461
Restricted cash - current portion of customer deposits (Note 12)	11,662
Short-term investments	7,880
Accounts receivable	43,000
Unbilled revenue	61,298
Income taxes recoverable	4,616
Inventory	4,915
Prepays and other	486
	<hr/> 161,318
PROPERTY, PLANT AND EQUIPMENT (Note 6)	350,609
OTHER ASSETS	
Restricted cash - non-current portion of customer deposits (Note 12)	11,497
Deferred debt issue costs, net of amortization of \$1,403	4,224
Intangibles, net of amortization of \$391	1,036
Goodwill	32,988
	<hr/> \$ 561,672
<hr/>	
LIABILITIES	
CURRENT	
Accounts payable and accrued liabilities (Note 9)	\$ 74,130
Due to related parties (Note 10)	37,635
Liability for subdivision development	5,000
	<hr/> 116,765
LONG-TERM LIABILITIES	
Notes payable (Note 16)	146,102
Debentures payable (Note 11)	100,000
Regulatory liabilities (Note 7)	16,597
Customers' deposits (Note 12)	11,497
Employee future benefits (Note 13)	4,223
Other liabilities	106
	<hr/> 278,525
	<hr/> 395,290
<hr/>	
SHAREHOLDER'S EQUITY	
SHARE CAPITAL (Note 15(a))	142,633
CONTRIBUTED SURPLUS (Note 15(b))	16,030
RETAINED EARNINGS	7,719
	<hr/> 166,382
	<hr/> \$ 561,672
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APPROVED ON BEHALF OF THE BOARD

"Peter Meffe"

..... Director

"Don Cousens"

..... Director

POWERSTREAM INC.
Statement of Earnings and Retained Earnings
Seven months ended December 31, 2004
(in thousands of dollars)

	<u>(Note 4)</u>
REVENUE (Note 10)	
Energy and distribution	\$ 289,588
Other	7,043
	<u>296,631</u>
EXPENSES	
Cost of power purchased	235,661
High voltage transformation	589
Distribution	5,282
Utilization	870
Billing and collection	2,677
Administration and general	10,911
Taxes, other than amounts in lieu of corporate income taxes	1,306
	<u>257,296</u>
EARNINGS BEFORE AMORTIZATION, INTEREST AND INCOME TAXES	39,335
AMORTIZATION OF CAPITAL ASSETS AND INTANGIBLES (net of \$571 charged to other accounts)	14,862
INTEREST EXPENSE	11,680
INCOME BEFORE INCOME TAXES	12,793
INCOME TAX EXPENSE (Note 20)	5,074
NET EARNINGS FOR THE PERIOD AND RETAINED EARNINGS, END OF PERIOD	<u>\$ 7,719</u>

POWERSTREAM INC.
Statement of Cash Flows
Seven months ended December 31, 2004
(in thousands of dollars)

	<u>(Note 4)</u>
NET (OUTFLOW) INFLOW OF CASH RELATED TO THE FOLLOWING ACTIVITIES	
OPERATING	
Net earnings for the period	\$ 7,719
Adjustments to determine cash provided by operating activities	
Amortization of property, plant and equipment	15,106
Amortization of debt issue costs	346
Amortization of intangibles	327
Employee future benefits	773
Increase in regulatory liabilities	7,407
Gain on disposal of capital assets	(274)
Net change in non-cash operating working capital (Note 21)	(18,722)
	<u>12,682</u>
FINANCING	
Increase in liability for subdivisions development	1,548
Decrease due to related parties	(374)
Increase in customer's deposits	310
Decrease in bank loan	(25,000)
Increase in other liabilities	148
	<u>(23,368)</u>
INVESTING	
Proceeds on disposal of capital assets	312
Intangibles	(285)
Increase in restricted cash - customer deposits	(310)
Decrease in short term investments	1,194
Expenditure on capital assets, net of contribution of capital construction	(14,668)
	<u>(13,757)</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS DURING THE PERIOD	(24,443)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	51,904
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 27,461
SUPPLEMENTARY CASH FLOW INFORMATION (Note 22)	

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

1. AMALGAMATION

On June 1, 2004, PowerStream Inc. ("PowerStream") was formed upon the amalgamation of Hydro Vaughan Distribution Inc. ("Hydro Vaughan"), Markham Hydro Distribution Inc. ("Markham Hydro") and Richmond Hill Hydro Inc. ("Richmond Hill Hydro"). At the effective time of the amalgamation, the issued and outstanding shares in the capital of the Amalgamating Corporations were converted into issued and fully paid shares of PowerStream, or cancelled, as follows:

- (a) the 1,000 issued and outstanding common shares of Hydro Vaughan owned by the City of Vaughan were converted into 590 issued and fully paid common shares of PowerStream;
- (b) the 1,000 issued and outstanding common shares of Markham Hydro owned by Markham Energy Corporation were converted into 410 issued and fully paid common shares of PowerStream;
- (c) the 1,001 common shares of Richmond Hill Hydro owned by Hydro Vaughan and the 1,001 common shares of Richmond Hill Hydro owned by Markham Hydro were cancelled without any repayment of capital in respect thereof.

The shareholders of PowerStream Inc., being the Corporation of the City of Vaughan and the Corporation of the Town of Markham (through its wholly-owned subsidiary, Markham Energy Corporation) entered into a Shareholders' Agreement effective June 1, 2004.

The Shareholders' Agreement, consistent with the original intent of the shareholders, provides the Town of Markham, through its wholly-owned subsidiary Markham Energy Corporation, with "substantive participating rights" that establish joint control with the City of Vaughan over the strategic operating, investing and financing policies of PowerStream.

The PowerStream joint venture contributions were recorded at the carrying value of the net assets of each of the shareholders (venturers).

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

1. AMALGAMATION (continued)

The contribution of the net assets of the amalgamating entities has been recorded as at June 1, 2004 in the balance sheet as follows:

Net assets contributed	
Current assets (including cash and cash equivalents of \$51,904)	\$ 170,876
Current liabilities	(145,276)
<hr/>	
Working capital	25,600
Property plant and equipment	351,085
Goodwill	32,988
Other assets	16,496
Long-term liabilities	(121,404)
<hr/>	
	\$ 304,765
<hr/>	
Consideration	
5.58% notes payable	\$ 146,102
Share capital - common shares	142,633
Contributed surplus	16,030
<hr/>	
	\$ 304,765
<hr/>	

As part of the Amalgamation Agreement, the City of Vaughan and Town of Markham agreed to adjust the capital structure of their respective utilities to be substantially similar to each other and the deemed capital structure, in so far that PowerStream's debt to equity ratio would not exceed 65:35 as a percentage of total capital. Prior to closing this adjustment was achieved, with the approval by both shareholders, through the exchange of common shares for a promissory note payable totalling \$33,236.

An adjustment of either a \$1,700 dividend or equity-to-debt conversion for the Town of Markham is required to fulfill the intent of the Amalgamation Agreement. This adjustment will be reflected in the financial statements of PowerStream in the period it is finalized and approved.

2. DESCRIPTION OF THE BUSINESS

The principal activity of the Corporation is to distribute electricity in the service area of Vaughan, Markham and Richmond Hill, in the Province of Ontario, under the licence issued by the Ontario Energy Board ("OEB"). The Corporation is regulated under the OEB and adjustments to the distribution rates require OEB approval.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

3. ELECTRICITY INDUSTRY REGULATION

The Energy Competition Act, 1998 (the "Act") was given Royal Assent on October 30, 1998. The Act provides for a competitive market in the sale of electricity and the regulation of the monopoly electricity delivery system in the Province of Ontario (the "Province") by the OEB. Electricity retailers began competing for customers as of March 1, 2000. On May 1, 2002, with the electricity market opening, or (Open Access), electricity retailers began to sell electricity.

The OEB has regulatory oversight of electricity matters in the Province. The Act sets out the OEB's powers to issue a distribution license, which must be obtained by any person owning or operating a distribution system under the Ontario Energy Board Act, 1998. The OEB may prescribe license requirements and conditions including, among other things, specified accounting records, regulatory accounting principles, separation of accounts for separate businesses and filing/process requirements for rate-setting purposes.

The Ontario Energy Board Act, 1998 gave the OEB increased powers and responsibilities to regulate the electricity industry. These powers and responsibilities include the power to approve or fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity customers and the responsibility for ensuring that distribution companies fulfill obligations to connect and service customers.

In December 2002, the Province passed Electricity Pricing, Conservation and Supply Act, 2002 ("Bill 210") which among other things:

- (a) Fixed the price of electricity paid by low volume and designated consumers at 4.3 cents per kWh (retroactive to May 1, 2002); and
- (b) Capped distribution rates at current levels and deferred further rate increases and certain cost recoveries by distributors.

The price freeze and rate caps were originally expected to continue until at least May 1, 2006.

In November 2003, the Province announced its intention to increase (effective April 1, 2004) the price of electricity payable by low volume and designated customers from 4.3 to 4.7 cents per kWh on the first 750 kWhs consumed during a month and 5.5 cents per kWh thereafter and directed the OEB to develop new pricing mechanisms (to take effect no later than May 1, 2005) for setting the price of electricity payable by low volume and designated customers.

The Province also announced its intention in November 2003 to permit electricity distributors to make rate applications to the OEB earlier than had been contemplated under Bill 210 with respect to the:

- (a) Recovery of regulatory assets (based on year-end balances at December 31, 2002) to be phased in over a four-year period effective March 1, 2004; and
- (b) The final adjustment necessary to achieve a market-based rate of return (subject to a one-time investment in conservation and demand management initiatives equal to one year of additional revenue resulting from such rate increase) effective March 1, 2005.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

3. ELECTRICITY INDUSTRY REGULATION (continued)

In December 2003, the OEB issued filing guidelines with respect to the recovery of regulatory assets. The OEB's filing guidelines provided that:

- (a) PowerStream was permitted to recover 25% to 30% of certain regulatory assets in rate adjustments to become effective March 1, 2004;
- (b) The 2004 rate adjustment was implemented on April 1, 2004 (with a gross-up added to the recovered amount to allow recovery over 11 months);
- (c) The OEB provided additional instructions with respect to the filing of evidence to facilitate the OEB's review of the balance of the regulatory assets; and
- (d) Permitted recoveries will be phased in over a four-year period (2004 through 2007).

During the period that the price freeze is in effect, it is expected that distributors and retailers will be compensated by the Ontario Electricity Financial Corporation (OEFC) as follows:

- (a) In the case of distributors, for amounts by which the price paid by distributors for electricity purchased by them in the wholesale market on behalf of low volume and designated consumers is greater than the fixed price per kWh; and
- (b) In the case of retailers, for amounts by which the retail contract price between retailers and low volume and designated consumers is greater than the fixed price per kWh.

Consumers other than designated consumers who annually utilize more than 250,000 kWh continue to be eligible to receive Business Protection Plan ("BPP") rebates (formerly received under the Market Power Mitigation Agreement) from Ontario Power Generation Inc. ("OPG") to the extent that electricity prices exceed certain prescribed thresholds.

On December 9, 2004, the Province passed the Electricity Restructuring Act. The purpose of this act is to provide stable prices for consumers that reflect the true cost of electricity, facilitate new supply additions and promote conservation and demand management. The act also creates the Ontario Power Authority, with a mandate to ensure an adequate, long-term supply of electricity in Ontario. The Independent Electricity System Operator (IESO) (formerly the Independent Electricity Market Operator) will continue to be responsible for operating the system and the spot market, and shorter-term system planning.

The continuing restructuring of Ontario's electricity industry and other regulatory developments, including current and future possible consultations between the OEB and interested stakeholders, may affect the distribution rates, including payments in lieu of taxes ("PILS") collected from customers, that the Corporation may charge and the costs that the Corporation may recover, including the balance of its regulatory assets.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

3. ELECTRICITY INDUSTRY REGULATION (continued)

The Corporation will not be able to implement the final rate increase to be able to achieve a 9.88% return on equity until 2005, at which time the monies will be directed specifically to demand side management and energy conservation initiatives for a one year period. Beginning in 2006, the Corporation expects rates to be established allowing the ability to achieve a 9.88% return on equity.

4. BASIS OF PRESENTATION

The Corporation's financial statements are prepared by management in accordance with Canadian generally accepted accounting principles and accounting policies provided by its regulator, the OEB, as contained in the Accounting Procedures Handbook, issued under the authority of the Ontario Energy Board Act, 1998.

(a) Period reporting

The Statements of Earnings and Retained Earnings, and of Cash Flows have been provided for the period from June 1, 2004 (date of amalgamation) to December 31, 2004 and the Balance Sheet has been provided as at the December 31, 2004 year end.

(b) Seasonality of operations

The Corporation's operations are seasonal. Electricity consumption is typically highest in the summer and winter months, July through September and January through March.

5. SIGNIFICANT ACCOUNTING POLICIES

The financial statements reflect the following significant accounting policies:

(a) Rate setting

The Corporation is regulated by the 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, the timing of recognition of certain revenue and expenses for the distribution of electricity, accounting policies may differ from that otherwise expected under Canadian generally accepted accounting principles for non-rate regulated enterprises. 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 (Note 7).

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

(a) Rate setting (continued)

- (ii)* The Corporation provides for amounts in lieu of corporate income taxes using the taxes payable method for its regulated activities as permitted by The Canadian Institute of Chartered Accountants (CICA).
- (iii)* 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 (Note 7).

(b) Cash and cash equivalents

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

(c) Short-term investments

Short-term investments are recorded at the lower of cost and fair market value.

(d) Revenue recognition

Revenue from the sale of electricity is recorded on a basis of cyclical billings and also includes unbilled revenue accrued in respect of electricity delivered but not yet billed. The related cost of power is recorded on the basis of power used.

Long-term value-added service contract revenue is accounted for under the percentage of completion method, with revenue recognized proportionately with the degree of completion of the services under contract. Losses on contracts are fully recognized when they become evident. Actual results could differ from estimates.

(e) Inventory

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

(f) Property, plant and equipment and amortization

Property, plant and equipment are recorded at cost and include contracted services, materials, labour, engineering costs and overheads. Certain assets may be acquired or constructed with financial assistance in the form of contributions from developers or customers and may be refunded by the Corporation based on economic evaluation (discounted cash flow), in accordance with the OEB Distribution System Code. Such contributions, whether in cash or in-kind, are offset against the related asset cost. Contributions in-kind are valued at their fair market value at the date of their contribution.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

(f) Property, plant and equipment and amortization (continued)

When identifiable assets, such as buildings, distribution station equipment and equipment and furniture are retired or otherwise disposed of, their original cost and related 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 property, plant and equipment is provided for on the straight-line basis over the estimated service life of the assets. Amortization of contributions from developers or customers are amortized at the rates corresponding with the useful lives of the related capital assets. The estimated service lives of the various assets used in calculating amortization are summarized below:

Buildings	10 to 60 years
Transformer stations	40 years
Transformers and meters	25 to 40 years
Plant and equipment	10 to 30 years
Other	3 to 5 years

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

(g) Impairment of long-lived assets

The Corporation reviews long-lived assets for impairment whenever events or circumstances indicate that the carrying amount of the long-lived assets is not recoverable. Any resulting impairment loss is recorded in the period in which the impairment occurs.

(h) Intangibles

Intangibles include corporate restructuring costs related to amalgamation. Intangibles are stated at cost and are amortized on a straight-line basis over three years.

(i) Regulatory assets and liabilities

Regulatory assets primarily represent costs that have been deferred because it is probable that they will be recovered through future rates. Similarly, regulatory liabilities can arise from differences in amounts billed to customers and retailers that the OEB directs the distributor to account for. The Corporation accrues interest on certain regulatory assets and liabilities as allowed by the OEB. The Minister of Energy issued a letter dated December 19, 2003 (the "Minister's letter") stating an intention to allow electricity distributors to make application to the OEB to recover regulatory assets (based on year-end balances as at December 31, 2002) to be phased in over a four year period; and to earn the full 9.88% return on equity anticipated under market design effective March 1, 2005.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Regulatory assets and liabilities (continued)

The Corporation received approval on March 11, 2004, effective April 1, 2004 for the recovery of its balances at December 31, 2002 as follows:

- a) Hydro Vaughan 25% of its retail settlement variance accounts balances.
- b) Markham Hydro 30% of its retail settlement variance account balances.
- c) Richmond Hill Hydro 30% of its retail settlement variance accounts balances.

Management has provided a “valuation allowance” on its deferred qualifying transition costs and pre-market opening energy variances as at December 31, 2004. Management continues to assess the likelihood of recovery of its regulatory assets and believes that it is probable that its regulatory assets net of the valuation allowance and liability balances will be factored into setting of future rates.

Regulatory assets and liabilities are comprised principally as follows:

- (i) Transition costs represent costs related to the transition to a competitive electricity market as 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 in which they were incurred.
- (ii) Pre-market opening cost of power variances represent 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:
 - (a) variances between the amount charged by the Independent Electricity System Operator (“IESO”) for the operation of the markets and grid, the purchase of imported power by the IESO to augment Ontario's power supply and charged by the IESO as an uplift charge that is part of the wholesale market service charges, 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
 - (b) the differences between the amount charged by the IESO and billed to consumers for energy costs due to line losses.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

(j) Deferred debt issue costs

Deferred debt issue costs represent the discount and the cost of the issue of debentures. Amortization is provided on a straight-line basis over the term of the debenture.

(k) Goodwill

Goodwill represents the excess of the purchase price over the fair value assigned to the Corporation's interest of the net identifiable assets acquired on the acquisition of the former Richmond Hill Hydro Inc. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. When the carrying amount of goodwill exceeds the implied fair value of goodwill an impairment loss is recognized in an amount equal to the excess.

(l) Pension and other post-employment benefits

The Corporation accounts for its participation in the Ontario Municipal Employees Retirement Fund ("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. Compensated absences and termination benefits that do not vest or accumulate are recognized as an expense when the event occurs. This accounting policy for future employee benefits was applied on the prospective basis. The transitional obligation resulting from this treatment is being amortized over the average remaining service period of employees.

(m) Customer's deposits

Customer deposits are cash collections from customers to guarantee the payment of energy bills and fulfillment of construction obligations. Deposits estimated to be refundable to customers within the next fiscal year are classified as a current liability. Interest is paid on customer balances at rates established from time to time by the Corporation.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

(n) Payment in lieu of income taxes

In accordance with Ontario Regulation 162/01 made under the Electricity Act, 1998, the Corporation is required to make payments in lieu of corporate income 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 Corporation Tax Act (Ontario) as modified by the Electricity Act, 1998, and related regulations.

The Corporation provides for payments in lieu of corporate income taxes 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. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of the Corporation at that time.

(o) Guarantees

The Canadian Institute of Chartered Accountants ("CICA") has issued Accounting Guideline 14, - disclosure of guarantees - ("AcG-14"), which addresses the disclosure to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees.

AcG-14 requires the guarantor to disclose the nature of the guarantees, the maximum potential amount of future payments and the current carrying amount of the liability for the non-contingent component of the guarantee, which is the obligation to stand ready to perform in the event that specified triggering events or conditions occur. The disclosure is required even if it is not probable that payments will be required under the guarantee or if the guarantee was issued with a premium payment or as part of a transaction with multiple elements.

(p) Measurement uncertainty

The preparation of the financial statements in conformity with Canadian generally accepted accounting principles 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, regulatory assets/liabilities and employee future benefits are reported based on amounts expected to be recovered and an appropriate allowance has been provided based on managements' estimate of unrecoverable amounts. Inventory is recorded net of provisions for obsolescence.

Due to the inherent uncertainty involved in making such estimates, actual results could differ from amounts recorded in these financial statements, including changes as a result of future decisions made by the OEB or the Minister of Energy.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

6. PROPERTY, PLANT AND EQUIPMENT

	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
Land and Land Rights	\$ 2,673	\$ 117	\$ 2,556
Buildings	1,891	327	1,564
Transformer stations	78,002	17,889	60,113
Transformers and meters	201,927	92,827	109,100
Plant and equipment	474,942	211,748	263,194
Other	24,062	14,605	9,457
Construction in progress	4,501	-	4,501
	<u>787,998</u>	<u>337,513</u>	<u>450,485</u>
Capital Contributions	112,861	12,985	99,876
	<u>\$ 675,137</u>	<u>\$ 324,528</u>	<u>\$ 350,609</u>

7. REGULATORY ASSETS AND LIABILITIES

Regulatory assets and liabilities arise as a result of the rate-making process and consist of the following:

Deferred qualifying transition costs	\$ 4,107
Pre-market opening cost of power variances	13,016
	<u>17,123</u>
Provision for above regulatory assets	<u>(5,228)</u>
	11,895
Other regulatory assets (liabilities)	(943)
Retail settlement variance accounts	(21,356)
Estimated over-recovery of payment in lieu of taxes	(105)
Regulatory asset recovery	(6,088)
Net regulatory assets (liabilities)	<u>\$ (16,597)</u>

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

8. BANK INDEBTEDNESS AND CREDIT FACILITY

The Corporation requested and received an unsecured credit facility with a Canadian chartered bank and the related agreement was executed on March 23, 2005. This credit facility agreement provides an extendible 364-day revolving credit facility of \$125 million. This facility replaces the credit facilities that were in place for Hydro Vaughan, Markham Hydro and Richmond Hill Hydro. The credit facilities for Markham Hydro and Richmond Hill Hydro were cancelled and the credit facility of \$60 million for Hydro Vaughan was maintained until the new credit facility was finalized.

As at December 31, 2004, the Corporation had utilized \$15.7 million of the credit facility to provide the IESO with a letter of credit for prudential support. With the opening of Ontario's electricity market to wholesale and retail competition on May 1, 2002 ("Open Access"), the IESO requires all purchasers of electricity in Ontario to provide security to mitigate the risk of their default based on their expected purchases from the IESO administered spot market. The IESO could draw on the letter of credit if the Corporation defaults on its payment.

The existing credit facility can be drawn upon by either direct advances, bearing interest at prime less 0.50% or Bankers' Acceptances, with a stamping fee of 30 basis points, or by way of letter of credit with a fee of 30 basis points per annum. A commitment fee of 10 basis points per annum is paid on the unused portion of the credit facility.

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable - energy purchased	\$ 36,274
Current portion of customer's deposits	11,662
Other accounts payable and accrued liabilities (including construction deposits to be refunded within one year in the amount of \$1,533)	26,194
	<hr/> \$ 74,130 <hr/>

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

10. RELATED PARTY BALANCES AND TRANSACTIONS

The amount due to the Corporation of the City of Vaughan (“City”) and the Corporation of the Town of Markham (“Town”) is comprised of amounts payable to the City and Town and their wholly-owned companies established under the provisions of the Ontario Business Corporation Act in order to comply with provisions of provincial legislation enacted to restructure the publicly-owned electricity business in Ontario.

Components of the amounts due to related parties are as follows:

The Corporation of the City of Vaughan	
Accounts payable - Hydro Vaughan Dividend	\$ 25,000
Accrued interest at 5.58% on Hydro Vaughan Dividend	814
Accounts payable - Hydro Vaughan Dividend - interest free	1,900
Accrued interest on note payable of \$78,236 at an annual rate of 5.58% (Note 16)	1,100
Net balance payable of inter entity transactions, without interest	5,951
	<hr/> 34,765 <hr/>
The Corporation of the Town of Markham	
Accrued interest on note payable of \$67,866 at an annual rate of 5.58% (Note 16)	955
Net balance payable of inter entity transactions, without interest	1,915
	<hr/> 2,870 <hr/>
	<hr/> \$ 37,635 <hr/>

Interest on the notes payable, aggregating \$4,780 was charged to interest expense. In addition, interest at 5.58% in the amount of \$814 on the Hydro Vaughan Dividend was charged to interest expense during the period. As at December 31, 2004, the amounts shown as due to related parties included an aggregate accrual of \$2,869 related to such interest.

Other significant related party transactions not otherwise disclosed separately in the financial statements, are summarized below:

	<u>City of Vaughan</u>	<u>Town of Markham</u>
Revenue		
Energy and distribution	\$ 1,697	\$ 1,166
Shared services	\$ 1,606	\$ -
Expenses		
Facilities rental	\$ 517	\$ 602
Realty taxes	\$ 124	\$ 190
Operations	\$ 1,014	\$ 931

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

11. DEBENTURES PAYABLE

6.45% unsecured Debentures due August 15, 2012, interest payable in arrears semi-annually on August 15 and February 15	\$ 100,000
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In August 2002, the three predecessor corporations (Note 1) raised gross proceeds of \$100,000 through a private placement offering. These corporations were three of five local distribution companies ("LDC") that participated in the Electricity Distributors Finance Corporation ("EDFIN") 10 Year Debentures Issued (Series 2002-1) that was offered on a private placement. EDFIN is a specific purpose corporation managed by MEARIE Management Inc., for the purpose of providing LDC with efficient access to the debt capital markets. Each LDC has executed a debenture which is a direct and unsecured obligation of the LDC. The LDC's obligations are several and not joint, and each LDC is liable for its own obligation and not that of any other LDC.

The Corporation assumed the obligations of the three predecessor corporations pursuant to an assumption agreement dated June 1, 2004.

The unsecured debentures, totaling \$100,000 represents the Corporation's debenture payable of \$35,000 (Hydro Vaughan), \$30,000 (Markham Hydro) and \$35,000 (Richmond Hill Hydro).

Interest expense, including amortization of deferred debt issue costs, was \$4,116 during the seven month period.

12. CUSTOMERS' DEPOSITS

Service deposits	\$ 23,159
Less amounts expected to be refunded within one year, included in accounts payable and accrued liabilities (Note 9)	11,662
	\$ 11,497

13. EMPLOYEE FUTURE BENEFITS

The Corporation pays certain health, dental and life insurance benefits on behalf of its retired employees. The Corporation recognizes these post-retirement costs in the period in which the employees rendered their services.

The benefits liability for the Corporation is being recorded in the accounts prospectively. Accordingly, the transitional obligation is being amortized over the average remaining service period of active employees of 11 years as determined by actuarial methodology.

The projected benefit obligations for active employees and retirees as at December 31, 2004 is \$8,027 and the expense for the period ended December 31, 2004 of \$823 was based on actuarial valuation using a discount rate of approximately 6%.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

13. EMPLOYEE FUTURE BENEFITS (continued)

Payments for the period ended December 31, 2004 are estimated to be equal to the estimated claims for extended health, dental benefits and life insurance in respect of retirees, and the assumed expenses and taxes associated with their benefits.

A reconciliation of the funded status of PowerStream's post-retirement benefit plan to the amounts recorded in the financial statements is as follows:

Accrued benefit obligation	\$ 8,027
Unamortized transitional obligation	(2,164)
Unamortized net actuarial losses	(1,640)
Accrued benefit liability	\$ 4,223

Details of the accrued benefit obligation are as follows:

Accrued benefit obligation, beginning of the year	\$ 4,472
Current service cost	236
Interest cost on obligation	297
Benefit payments	(75)
Actuarial loss on obligation	3,097
Accrued benefit obligation, end of the year	\$ 8,027

The plan expense for the year is determined as follows:

Current service cost	\$ 236
Interest cost on obligation	297
Amortization of transitional obligation	187
Amortization of net actuarial loss	103
Plan expense	\$ 823

The significant actuarial assumptions adopted in measuring PowerStream's accrued benefit obligation as follows:

Discount rate	5.75%-6%
Rate of compensation increase	3.0%-3.25%
Medical benefits costs escalation - hospitalization	10.0%-10.50%
Medical benefits costs escalation - extended health care	10.0%-10.50%
Dental benefits costs escalation	4.5%-5.0%

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

13. EMPLOYEE FUTURE BENEFITS (continued)

Sensitivity analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects for 2004:

	<u>Increase</u>	<u>Decrease</u>
Total service and interest cost	\$ 147	\$ (123)
Accrued benefit obligation	\$ 948	\$ (820)

14. PENSION

The Corporation provides a pension plan for its employees through OMERS. OMERS is a multi-employer pension plan which provides pensions for employees of Ontario municipalities, local boards, public utilities and school boards. The fund is a contributory defined benefit pension plan, which is financed by equal contributions from participating employers and employees, and by the investment earnings of the fund. The Corporation incurred \$919 of contribution expense during the seven month period-ended December 31, 2004.

15. (A) SHARE CAPITAL

The Corporation's authorized share capital is made up of an unlimited number of common shares. The issued share capital as at December 31, 2004 is as follows:

1,000 common shares (Note 1)	\$ 142,633
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Of the total 1,000 common shares issued 590 common shares are registered under The Corporation of the City of Vaughan and 410 common shares are registered under Markham Energy Corporation (wholly owned by The Corporation of the Town of Markham).

(B) CONTRIBUTED SURPLUS

Contributed surplus represents the difference between the total of the net assets contributed by The Corporation of the City of Vaughan and Markham Energy Corporation and the amount reported as stated capital in the financial statements of PowerStream Inc., upon amalgamation on June 1, 2004.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

16. NOTES PAYABLE

Promissory note issued to the City of Vaughan	\$ 78,236
Promissory note issued to the Town of Markham	<u>67,866</u>
	<u>\$ 146,102</u>

On June 1, 2004 an unsecured 20 year term promissory note was issued to The Corporation of the City of Vaughan ("City") in the amount of \$78,236. Interest thereon commences on June 1, 2004 at an annual rate of 5.58%.

On June 1, 2004 an unsecured 20 year term promissory note was issued to the Corporation to the Town of Markham ("Town") in the amount of \$67,866. Interest thereon commences on June 1, 2004 at an annual rate of 5.58%.

The two promissory notes are repayable 90 days following demand by the City or the Town, no earlier than January 1, 2006. These notes have been classified as long term as it is not the intent of the City or the Town to demand repayment within the next year.

17. COMMITMENTS

Shared services agreement

Pursuant to a shared services agreement between the former Vaughan Hydro-Electric Commission and the Corporation of the City of Vaughan ("City"), the Corporation charges the City, at agreed rates, for various administrative functions. In addition, the City performs certain shared services, which are charged to the Corporation. The Corporation also provides water billing services to the Town of Markham. The net charges made for services under these agreements were \$981.

Long-term operating leases

The Corporation rents buildings and facilities from the Corporation of the City of Vaughan and the Town of Markham under long-term operating leases. The Corporation has signed a long-term lease with the Town of Markham and has exercised its option to renew a lease on a monthly basis with the City of Vaughan. For the period from June 1 to December 31, 2004, the rental for the buildings and facilities was approximately \$1,061. The cost of the rent including both the rent charged under the operating leases and rent not covered by operating leases aggregated \$1,346.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

18. CONTINGENCIES

(a) Legal claims

The Corporation has been named as a defendant in several actions. No provision has been recorded 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 restitution 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 was that late payment penalties resulted 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.

(c) Other contingencies

The provision for income taxes reflects management's position that the treatment of regulatory assets and liabilities is the same for tax purposes as for accounting purposes. Primarily as a result of the recovery of revenues through standard provincial transmission rates, there may be additional taxes payable at December 31, 2004 in the amount of approximately \$2.2 million. The Minister of Energy has approved the corporation's application for a rate change to address the over-recovery, reduce the rates and ultimately eliminate these amounts. As this is unique and a result of a timing issue and because the "payment-in-lieu of income taxes" regime is relatively new, with no specific precedent in tax assessing practices, it is not determinable whether or not a liability will materialize and no provision has been made for this amount in the financial statements. The above mentioned timing differences will eventually reverse.

(d) Environmental

Under the shareholders agreement, the Corporation is obligated to remediate all transformers and equipment with polychlorinated biphenyl (PCB) contamination in excess of 50 ppm on or before August 31, 2007. A program will be put in place to test relevant transformers and equipment. The estimated future expenditures for the disposal of the PCBs based on the net present value is estimated to be approximately \$100. No provision for this contingency has been recorded in the financial statements.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

19. RISK MANAGEMENT

The Corporation understands the risks inherent in its business and defines them broadly as anything that could impact its ability to achieve its strategic objectives.

Fair value of financial assets and liabilities

The fair value of the Corporation's cash and cash equivalents, short term investments, accounts receivable, unbilled revenues, accounts payable and accrued liabilities and refundable customer deposits approximate their carrying amount because of the short maturity of these instruments.

The fair value amount of the debenture payable in the amount of \$100,000 was \$109,550 as at December 31, 2004 based on quoted market prices.

The fair value of the Corporation's note payable for the Corporation of the City of Vaughan, the Corporation of the Town of Markham and due to related parties is not determined due to their related party nature and variable terms.

The Corporation is not exposed to significant interest rate risk as a result of the short-term maturity of its monetary current assets and current liabilities.

Fair value of financial assets and liabilities (continued)

Financial assets held by the Corporation expose it to credit risk. As at December 31, 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 in the City of Vaughan, the Town of Markham and the Town of Richmond Hill. In the seven month period ended December 31, 2004, the Corporation derived approximately 4% of its revenue from one customer. As at December 31, 2004, the one customer represented \$2,524 of the outstanding accounts receivable balance.

Insurance

The Corporation maintains appropriate types and levels of insurance with major insurers. With respect to liability insurance, the Corporation is a member of the Municipal Electricity 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 thousands of dollars of service revenue subject to a credit or surcharge based on each member's claims experience. Effective June 1, 2004, coverage is provided to a level of \$20,000 per incident.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

20. CORPORATE INCOME TAXES

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

Rate reconciliation	
Income from operations before PILs	\$ 12,793
Statutory Canadian federal and provincial income tax rate	36.12%
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Expected tax provision on income at statutory rates	4,621
Increase (decrease) in income taxes resulting from	
Large corporations tax net of surtax	378
Other timing differences non-benefited	
Amortization/CCA differences	117
Post employment benefits	279
Eligible capital expenditures	(45)
Other	(97)
Permanent differences	63
Other	(242)
<hr/>	
Provision for PILs	\$ 5,074
<hr/>	
Component of provision for PILs	
LCT	\$ 378
Income tax expense	4,696
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Provision for PILs	\$ 5,074
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Future income taxes relating to the regulated businesses have not been recorded in the accounts as they are expected to be recovered through future electricity rate revenues. As at December 31, 2004, future income tax assets of \$43,671 (consisted mostly of non-deductible reserves and the difference between the tax and book bases of fixed assets), based on substantively enacted income tax rates, have not been recorded on the balance sheet.

21. NET CHANGE IN NON-CASH OPERATING WORKING CAPITAL

Accounts receivable	\$ (10,633)
Unbilled revenue	(4,916)
Income taxes recoverable	(7,936)
Inventory	3,417
Prepaid and other	331
Accounts payable and accrued liabilities	1,015
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	\$ (18,722)
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POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

22. SUPPLEMENTAL CASH FLOW INFORMATION

(a) Cash paid during the period for:

Interest	\$ 7,493
Payments in lieu of taxes	\$ 7,398

(b) Non-cash financing activities:

Share capital exchanged for unsecured debt (5.58% promissory note) (see Note 1)	\$ 33,236
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23. GUARANTEES

The Corporation adopted the new Canadian Accounting Guideline AcG-14, which requires certain disclosures of guarantees.

In the normal course of business, the Corporation enters into agreements that meet the definition of a guarantee. The Corporation's primary guarantees subject to the disclosure requirements of AcG-14 are as follows:

- (a) The Corporation has provided indemnities under lease agreements for the use of various operating facilities. Under the terms of these agreements the Corporation agrees to indemnify the counterparties for various items including, but not limited to, all liabilities, loss, suites, and damages arising during, on or after the term of the agreement. The maximum amount of any potential future payment cannot be reasonably estimated.
- (b) Indemnity has been provided to all directors and/or officers of the Corporation for various items including, but not limited to, all costs to settle suits or actions due to association with the Corporation, subject to certain restrictions. The Corporation has purchased directors' and officers' liability insurance to mitigate the cost of any potential future suits or actions. The term of the indemnification is not explicitly defined, but is limited to the period over which the indemnified party served as a trustee, director or officer of the Corporation. The maximum amount of any potential future payment cannot be reasonably estimated.

POWERSTREAM INC.
Notes to the Financial Statements
December 31, 2004
(in thousands of dollars)

23. GUARANTEES (continued)

- (c) In the normal course of business, the Corporation has entered into agreements that include indemnities in favour of third parties, such as purchase and sale agreements, confidentiality agreements, engagement letters with advisors and consultants, outsourcing agreements, leasing contracts, information technology agreements and service agreements. These indemnification agreements may require the Corporation to compensate counterparties for losses incurred by the counterparties as a result of breaches in representation and regulations or as a result of litigation claims or statutory sanctions that may be suffered by the counterparty as a consequence of the transaction. The terms of these indemnities are not explicitly defined and the maximum amount of any potential reimbursement cannot be reasonably estimated.

The nature of these indemnification agreements prevents the Corporation from making a reasonable estimate of the maximum exposure due to the difficulties in assessing the amount of liability which stems from the unpredictability of future events and the unlimited coverage offered to counterparties. Historically, the Corporation has not made any significant payments under such or similar indemnification agreements and therefore no amount has been accrued in the balance sheet with respect to these agreements.

24. SUBSEQUENT EVENT

On March 24, 2005, the Corporation purchased Aurora Hydro Connections Inc. at a purchase price of \$34,500 (subject to closing adjustments) with a proposed closing date of June 1, 2005. The purchase agreement is subject to OEB approval.