

**BRITISH COLUMBIA HYDRO AND POWER AUTHORITY**  
**Financial Statements**  
**March 31, 2006**

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## MANAGEMENT REPORT

The consolidated financial statements of British Columbia Hydro and Power Authority (BC Hydro) are the responsibility of management and have been prepared in accordance with Canadian generally accepted accounting principles, consistently applied and appropriate in the circumstances. The preparation of financial statements necessarily involves the use of estimates which have been made using careful judgment. In management's opinion, the consolidated financial statements have been properly prepared within the framework of the accounting policies summarized in the consolidated financial statements and incorporate, within reasonable limits of materiality, all information available at May 12, 2006 [Except for note 3 which is as of May 18, 2006]. The consolidated financial statements have also been reviewed by the Audit & Risk Management Committee and approved by the Board of Directors. Financial information presented elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

Management maintains systems of internal controls designed to provide reasonable assurance that assets are safeguarded and that reliable financial information is available on a timely basis. These systems include formal written policies and procedures, careful selection and training of qualified personnel and appropriate delegation of authority and segregation of responsibilities within the organization. An internal audit function independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to management and the Audit & Risk Management Committee.

The financial statements have been examined by independent external auditors. The external auditors' responsibility is to express their opinion on whether the financial statements, in all material respects, fairly present BC Hydro's financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles. The Auditors' Report, which follows, outlines the scope of their examination and their opinion.

The Board of Directors, through the Audit & Risk Management Committee, is responsible for ensuring that management fulfills its responsibility for financial reporting and internal controls. The Audit & Risk Management Committee, comprised of directors who are not employees, meets regularly with the external auditors, the internal auditors and management to satisfy itself that each group has properly discharged its responsibility to review the financial statements before recommending approval by the Board of Directors. The Audit & Risk Management Committee also recommends the appointment of external auditors to the Board of Directors. The internal and external auditors have full and open access to the Audit & Risk Management Committee, with and without the presence of management.



R.G. (Bob) Elton  
President  
and Chief Executive Officer



A. (Alister) Cowan  
Executive Vice-President Finance  
and Chief Financial Officer

Vancouver, Canada  
May 18, 2006

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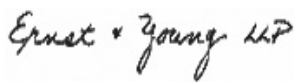
## AUDITORS' REPORT

The Lieutenant Governor in Council, Province of British Columbia:

We have audited the consolidated balance sheet of British Columbia Hydro and Power Authority as at March 31, 2006 and the consolidated statements of operations, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of British Columbia Hydro and Power Authority'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 consolidated financial statements present fairly, in all material respects, the financial position of British Columbia Hydro and Power Authority as at March 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The signature of Ernst & Young LLP is written in a cursive, handwritten style in black ink.

*Chartered Accountants*

*Vancouver, Canada*

*May 12, 2006 [Except for note 3 which is as of May 18, 2006]*

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## CONSOLIDATED STATEMENT OF OPERATIONS

for the years ended March 31 (in millions)	2006	2005
<b>Revenues</b>		
Domestic	\$ 2,765	\$ 2,704
Trade	1,546	1,021
	4,311	3,725
<b>Expenses</b>		
Energy costs:		
Domestic	1,196	1,095
Trade	1,292	864
Operations	373	293
Maintenance	267	246
General & administration	165	178
Amortization (Note 4)	411	410
Taxes	147	143
	3,851	3,229
<b>Operating Income</b>	460	496
Finance charges (Note 5)	435	318
Payment from Alcan Inc. (Note 10)	–	(137)
<b>Income Before Regulatory Accounts</b>	25	315
Net change in regulatory accounts (Note 3)	(241)	(87)
<b>Net Income</b>	\$ 266	\$ 402

See accompanying notes to consolidated financial statements

## CONSOLIDATED STATEMENT OF RETAINED EARNINGS

for the years ended March 31 (in millions)	2006	2005
Retained earnings, beginning of year	\$ 1,688	\$ 1,876
Regulatory provision for future removal and site restoration costs (Note 3)	–	(251)
Removal of British Columbia Transmission Corporation from consolidated accounts (Note 16)	(24)	
Net income	266	402
Payment to the Province (Note 3)	(223)	(339)
<b>Retained Earnings, end of year</b>	\$ 1,707	\$ 1,688

See accompanying notes to consolidated financial statements.

## CONSOLIDATED BALANCE SHEET


as at March 31 (in millions)

	2006	2005
<b>ASSETS</b>		
Property, Plant and Equipment, net (Note 6)	\$ 10,021	\$ 9,933
<b>Current Assets</b>		
Cash and cash equivalents	23	37
Accounts receivable and accrued revenue	446	398
Materials and supplies	135	97
Prepaid expenses	93	143
Mark-to-market gains	277	185
	974	860
<b>Other Assets and Deferred Charges</b>		
Sinking funds (Note 7)	846	992
Regulatory assets (Note 3)	863	578
	1,709	1,570
	\$ 12,704	\$ 12,363
<b>LIABILITIES AND EQUITY</b>		
Long-term debt net of sinking funds	\$ 5,696	\$ 5,777
Sinking funds presented as assets	846	992
<b>Long-Term Debt</b> (Note 8)	6,542	6,769
<b>Current Liabilities</b>		
Current portion of long-term debt (Note 8)	954	843
Accounts payable and accrued liabilities	1,089	1,104
Mark-to-market losses	301	183
	2,344	2,130
<b>Other Liabilities</b>		
Regulatory liabilities (Note 3)	440	396
Deferred contributions (Note 11)	856	835
Debt issue and related costs	125	42
Other long-term liabilities (Note 12)	538	417
Foreign currency contracts (Notes 8 and 9)	152	86
	2,111	1,776
<b>Retained Earnings</b>	1,707	1,688
	\$ 12,704	\$ 12,363

Commitments and Contingencies (Note 14)

See accompanying notes to consolidated financial statements.

Approved on Behalf of the Board:



L.I. (Larry) Bell  
Chair



W.C. (Wanda) Costuros  
Chair, Audit & Risk Management Committee

## CONSOLIDATED STATEMENT OF CASH FLOWS

for the years ended March 31 (in millions)

	2006	2005
<b>Operating Activities</b>		
Net income	\$ 266	\$ 402
Regulatory account transfers	(212)	(123)
Adjustments for non-cash items:		
Amortization of regulatory accounts	59	36
Amortization of property, plant and equipment	411	410
Foreign exchange translation losses (gains)	18	(105)
Amortization of debt issue and related costs	(9)	(9)
Deferred revenue	15	22
Unrealized mark-to-market losses	26	24
Sinking fund income	(54)	(48)
Employee benefit plan expenses	35	38
Other non-cash items	19	2
	574	649
Working capital changes	63	(60)
<b>Cash provided by operating activities</b>	<b>637</b>	<b>589</b>
<b>Investing Activities</b>		
Property, plant and equipment expenditures	(607)	(529)
Deferred contributions	68	66
Dismantling costs	(11)	(13)
Proceeds from property sales	2	5
<b>Cash used for investing activities</b>	<b>(548)</b>	<b>(471)</b>
<b>Financing Activities</b>		
Bonds issued	400	540
Bonds retired	(616)	(598)
Revolving borrowings	188	(42)
Sinking fund withdrawals	194	39
Debt issue and related costs	90	(5)
Payment to the Province	(339)	(73)
Settlement of derivative contracts	–	11
<b>Cash used for financing activities</b>	<b>(83)</b>	<b>(128)</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>6</b>	<b>(10)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>17</b>	<b>47</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 23</b>	<b>\$ 37</b>
<b>Supplemental disclosure of cash flow information</b>		
Interest paid	\$ 498	\$ 505

See accompanying notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 1: Significant Accounting Policies

#### **Purpose**

British Columbia Hydro and Power Authority (BC Hydro) was established in 1962 as a Crown corporation of the Province of British Columbia (the Province) by enactment of the Hydro and Power Authority Act. As directed by the Hydro and Power Authority Act, BC Hydro's mandate is to generate, manufacture, distribute and supply power. BC Hydro's corporate purpose is to provide "Reliable power, at low cost, for generations." BC Hydro is subject to regulation (see Note 3) by the British Columbia Utilities Commission (the Commission) which, among other things, approves the rates BC Hydro charges for its services.

BC Hydro owns and operates electric generation and distribution facilities in the province of British Columbia. BC Hydro also owns transmission facilities in the province of British Columbia that are operated by British Columbia Transmission Corporation (BCTC), an independent Crown corporation of the Province.

#### **Consolidation**

The consolidated financial statements include the accounts of BC Hydro and its principal wholly owned operating subsidiaries Powerex Corp. (Powerex), Powertech Labs Inc., BCH Services Asset Corp., and Columbia Hydro Constructors Ltd. All intercompany transactions and balances are eliminated upon consolidation.

The accounts of BCTC were removed from BC Hydro's consolidated accounts effective April 1, 2005, when BCTC was considered operationally and financially independent of BC Hydro (Note 16).

#### **Use of Estimates**

Management of BC Hydro has made a number of estimates and assumptions relating to the reporting of assets and liabilities and to the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with Canadian GAAP. Actual results could differ from these estimates.

#### **Regulatory Accounting**

BC Hydro is regulated by the Commission, and they are both subject to general or special directives and directions issued by the Province. BC Hydro operates primarily under a cost of service regulation as prescribed by the Commission. Orders in Council from the Province establish the basis for determining BC Hydro's equity for regulatory purposes, as well as its allowed return on equity and the annual Payment to the Province. Calculation of its revenue requirements and rates charged to customers are established through applications filed with and approved by the Commission.

BC Hydro applies various accounting policies that differ from Canadian generally accepted accounting principles (GAAP) for enterprises that do not operate in a rate-regulated environment (see Note 3). Generally, these policies result in deferral and amortization of costs and recoveries to allow for adjustment of future rates. In the absence of rate-regulation, these amounts would otherwise be included in the determination of net income in the year the amounts are incurred. These accounting policies support BC Hydro's regulation and have been established through ongoing application by approval of the Commission.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 1: Significant Accounting Policies (continued)

#### **Revenues and Energy Costs**

Domestic revenues comprise sales to customers within the province of British Columbia, and sales of firm energy outside the province under long-term contracts that are reflected in BC Hydro's domestic load requirements. Other sales outside the province are classified as trade.

Trade revenues and energy costs include the effects of using commodity derivatives. The impacts on trading transactions of realized and unrealized gains and losses resulting from changes in fair value are reflected on a net basis.

Revenue is recognized on the basis of billing cycles and also includes accruals for electricity deliveries not yet billed.

#### **Foreign Currency Translation**

Foreign currency denominated revenues and expenses are translated into Canadian dollars at the rate of exchange in effect at the transaction date. Foreign currency denominated monetary assets and liabilities are translated into Canadian dollars at the rate of exchange prevailing at the balance sheet date.

#### **Property, Plant and Equipment**

Property, plant and equipment in service are recorded at cost which includes materials, direct and indirect labour, an appropriate allocation of administration overhead and finance charges capitalized during construction. Property, plant and equipment in service include the cost of plant financed by contributions in aid of construction and contributions arising from the Columbia River Treaty. Upon retirement or disposal, any gain or loss is charged to amortization.

Unfinished construction consists of costs of property, plant and equipment that are under construction or not ready for service. Costs are transferred to property, plant and equipment in service when the constructed asset is substantially complete and capable of operation at a significant level of capacity.

#### **Amortization**

Property, plant and equipment in service are amortized on an individual or pooled basis over the expected useful lives of the assets, generally using the straight-line method.

The expected useful lives, in years, of BC Hydro's main classes of property, plant and equipment are:

Generation	
Hydraulic	50 – 100
Thermal	10 – 50
Lines	35 – 100
Substations	20 – 50
Buildings	45 – 50
Equipment	7 – 20
Computer hardware & software	2 – 10
Service vehicles	7 – 20
Sundry	20 – 45

#### **Cash and Cash Equivalents**

Cash and cash equivalents include cash and units of a money market fund that are valued at the lower of cost or market.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

## Note 1: Significant Accounting Policies (continued)

### **Materials and Supplies**

Materials and supplies are valued at the lower of average cost and net realizable value.

### **Derivative Financial Instruments**

BC Hydro uses derivative financial instruments to manage interest rate and foreign exchange risks related to debt, and exposure to electricity and gas market prices.

Derivatives that are designated as hedges are deemed to be effective in offsetting the designated risk and are accounted for on a basis consistent with the underlying financial exposure. Payments and receipts under interest rate and cross-currency swap contracts are recognized as adjustments to finance charges. Gains and losses on terminated interest rate and cross-currency swaps, options and forward rate agreements that are accounted for as hedges are deferred and amortized on a straight-line basis over the original remaining term of the related contract.

If a derivative is not designated as a hedge or, if a derivative is no longer designated as a hedge or the hedging relationship is terminated, then the derivative is recorded at fair value from the date the hedging relationship ceases. The change in fair value is recorded as an adjustment of finance charges.

For energy trading activities and certain liability management derivatives that are not accounted for as hedges, mark-to-market accounting is applied. For energy trading, open trade positions that are derivative commodity instruments are recorded at fair value and recorded as assets or liabilities in the balance sheet. The changes in fair value of open positions, primarily resulting from changes in market prices subsequent to the transaction date, are recognized as gains or losses in the period of change. For energy trading activities, the gains or losses are included in trade revenues. For liability management activities, the related gains or losses are included in finance charges.

### **Fair Value**

The fair value of financial instruments and energy trading positions reflect changes in the level of commodity market prices, interest and foreign exchange rates. Fair value is determined based on exchange or over-the-counter quotations. Where no such information is available, fair value is established through pricing models and reflects the amount that BC Hydro expects it would receive or pay to terminate the position at the date that the value is established.

Fair value amounts reflect management's best estimates considering various factors including closing exchange or over-the-counter quotations, estimates of future prices and foreign exchange rates, time value and volatility. The assumptions used in establishing fair value amounts could differ from actual prices and the impact of such variations could be material.

### **Sinking Funds**

Sinking funds are held as individual portfolios or units in a pooled bond fund. Securities included in an individual portfolio are recorded at cost, adjusted by amortization of any discounts or premiums arising on purchase, on a yield basis over the estimated term to settlement of the security. Realized gains and losses are included in sinking fund income. Unrealized gains and losses are not recognized.

### **Deferred Revenue**

Deferred revenue consists principally of amounts received under the Skagit River Agreements. Under these agreements, BC Hydro is required to deliver a predetermined amount of electricity each year for an 80-year period ending in fiscal 2066. In return BC Hydro receives approximately US\$22 million each year for a 35-year period ending in fiscal 2021 and US\$100,000 (adjusted for inflation) each year for an 80-year period ending in fiscal 2066.

The amounts received under the Skagit River Agreements are deferred and included in income on an annuity basis over the electricity delivery period ending in fiscal 2066.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 1: Significant Accounting Policies (continued)

#### **Deferred Contributions**

Deferred contributions in aid of construction are amounts paid by certain customers toward the cost of property, plant and equipment required for the extension of services. These amounts are amortized over the expected useful life of the related assets.

Contributions arising from the Columbia River Treaty relate to three dams built by BC Hydro in the mid-1960s to regulate the flow of the Columbia River. The contributions were made to assist in financing the construction of the dams. These proceeds were deferred and are amortized to income over the period ending in fiscal 2025, the minimum term of the treaty.

#### **Asset Retirement Obligations**

Asset retirement obligation costs are legal obligations associated with the retirement of long-lived assets. A liability is recorded at the present value of the estimated future costs when a reasonable estimate of the fair value can be made. When a liability is initially recorded, BC Hydro capitalizes the costs by increasing the carrying value of the long-lived asset. The liability is adjusted for the passage of time through accretion (interest) expense and the capitalized cost is amortized over the useful life of the associated asset. Actual costs incurred upon settlement of an asset retirement obligation are charged against the related liability to the extent of the accrued balance. Any difference between the actual costs incurred upon settlement of the asset retirement obligation and the recorded liability is recognized as a gain or loss in earnings at that time.

#### **Defined Benefit Plans**

The cost of pensions and other post-retirement benefits earned by employees is actuarially determined using the projected benefit method prorated on service and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs. For the purpose of calculating the return on plan assets, those assets are valued at fair value. The obligations are discounted using a market interest rate at the end of the year on high-quality corporate debt instruments that match the timing and amount of expected benefit payments.

Transitional obligations and assets and past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of active members at the date of amendment.

The excess of the net cumulative unamortized actuarial gain or loss over ten per cent of the greater of the benefit obligation and the fair value of plan assets at the beginning of the year is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the employee benefit plans is 11 years (2005 – 11 years). When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

#### **Environmental Expenditures and Liabilities**

BC Hydro conducts its operations in a manner that enables it to meet existing statutory requirements of environmental legislation or standards. The objective is to minimize the impact on the quality of the natural and social environment, providing enhancements wherever practical.

Environmental expenditures are expensed as part of operating activities, unless they constitute an asset improvement or act to mitigate or prevent possible future contamination, in which case the expenditures are capitalized and amortized to income. Environmental liabilities are accrued when environmental expenditures related to activities of BC Hydro are considered likely and the costs can be reasonably estimated. Estimated liabilities are reviewed periodically and these reviews can result in adjustments to previously recorded items.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 1: Significant Accounting Policies (continued)

#### **Taxes**

BC Hydro is subject to local government taxes that are paid to municipalities and regional districts. As a Crown corporation, BC Hydro is exempt from Canadian federal and provincial income taxes.

#### **Comparative Figures**

Certain amounts in the prior year's statements have been reclassified to conform to the current year's presentation.

### Note 2: Adoption of New Accounting Policy

#### **Disclosures by Entities Subject to Rate Regulation**

In May 2005, the Canadian Institute of Chartered Accountants (CICA) issued Accounting Guideline 19, *Disclosures by Entities Subject to Rate Regulation (AcG 19)*. AcG 19 requires certain aspects of disclosure and presentation of information in the financial statements of entities providing services or products for which customer rates are established, or subject to approval, by a regulator.

AcG 19 is effective for fiscal years ending on or after December 31, 2005. BC Hydro's consolidated financial statements and supporting notes reflect the requirements of AcG 19. As a result of these changes, certain regulatory amounts netted in the prior year's figures have been reclassified.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 3: Regulation

#### **Regulatory Assets and Liabilities**

The following regulatory assets and liabilities have been established through rate regulation. The impact of regulatory accounting has resulted in an increase to net income of \$241 million (2005 – \$87 million).

(in millions)	2005	Additions	Amortization	Net change	2006
<b>Regulatory Assets</b>					
Heritage Deferral Account	\$ 138	\$ 103	\$ –	\$ 103	\$ 241
Non-Heritage Deferral Account	131	74	–	74	205
BCTC Transition Account	–	25	–	25	25
Demand-Side Management Programs	207	90	(28)	62	269
Foreign Exchange Gains and Losses	(2)	4	–	4	2
Deferred Debt Costs	55	–	(55)	(55)	–
Dam Safety and Site Survey Investigation Costs	20	7	(27)	(20)	–
First Nation Negotiation, Litigation and Settlement Costs Account	29	96	(4)	92	121
<b>Total Regulatory Assets</b>	<b>\$ 578</b>	<b>\$ 399</b>	<b>\$ (114)</b>	<b>\$ 285</b>	<b>863</b>
<b>Regulatory Liabilities</b>					
Regulatory Provision for Future Removal and Site Restoration Costs	\$ 237	\$ –	\$ (11)	\$ (11)	\$ 226
Trade Income Deferral Account	115	99	–	99	214
Unitized Bond Fund Account	44	–	(44)	(44)	–
<b>Total Regulatory Liabilities</b>	<b>\$ 396</b>	<b>\$ 99</b>	<b>\$ (55)</b>	<b>\$ 44</b>	<b>\$ 440</b>
<b>Net</b>	<b>\$ 182</b>	<b>\$ 300</b>	<b>\$ (59)</b>	<b>\$ 241</b>	<b>\$ 423</b>

#### **Heritage Deferral Account**

Under a Special Directive issued by the Province, the Commission was directed to authorize BC Hydro to establish the Heritage Deferral Account. This account is intended to mitigate the impact of certain variances between the forecasted costs in the revenue requirements application and actual costs of service associated with the Heritage Resources by adjustment of net income. The amortization of balances will be subject to Commission approval. In the absence of rate regulation, GAAP would require the inclusion of these cost variances in operating results in the year in which they are incurred, which would have resulted in a \$103 million decrease in net income.

#### **Non-Heritage Deferral Account**

Under a Special Directive issued by the Province, the Commission approved the establishment of a Non-Heritage Deferral Account, which is intended to mitigate the impact of certain cost variances between the forecasted costs in the revenue requirements application and actual costs related to energy acquisition and maintenance of BC Hydro's distribution assets by adjustment of net income. The amortization of balances will be subject to Commission approval. In the absence of rate regulation, GAAP would require the inclusion of these cost variances in operating results in the year in which they are incurred, which would have resulted in a \$74 million decrease in net income.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 3: Regulation (continued)

#### ***BCTC Transition Deferral Account***

Under a Special Directive issued by the Province, variances that arise between the costs of transmission services included in BC Hydro's rates and BCTC's rates are deferred. The amortization of balances will be subject to Commission approval. In the absence of rate regulation, GAAP would require the inclusion of these cost variances in operating results in the year in which they are incurred, which would have resulted in a \$25 million decrease in net income.

#### ***Demand-Side Management Programs***

Established under a regulatory order from the Commission, demand-side management programs are designed to reduce the energy requirements on BC Hydro's system. Costs of the programs include materials, direct labour and applicable portions of administration charges, equipment costs, and incentives. Amounts are deferred and amortized on a straight-line basis over the anticipated period of benefit of the program, generally not in excess of ten years.

In the absence of rate regulation, GAAP would require period costs to be included in operating results in the year in which they are incurred. Costs relating to identifiable tangible assets that meet the capitalization criteria would be recorded as property, plant and equipment. In 2006, \$90 million of period costs were incurred and amortization of previously capitalized amounts totaled \$28 million. Consequently, net income would have been \$62 million lower than would have been recorded in the absence of rate regulation.

#### ***Foreign Exchange Gains and Losses on the Translation of Long-Term Foreign Denominated Monetary Items***

Established under a regulatory order, foreign exchange gains and losses arising from the translation of long-term foreign denominated monetary items are deferred and amortized over the term of the underlying items on a straight line basis. In the absence of rate regulation, these foreign exchange gains and losses would be recognized when realized. In 2006, \$4 million of realized losses were deferred in operating results. Consequently, net income would have been \$4 million lower than would have been recorded in the absence of rate regulation.

Gains and losses on foreign currency hedges of foreign denominated long-term debt are also deferred and amortized.

#### ***First Nation Negotiations, Litigation and Settlement Costs***

Established under a regulatory order, costs incurred for First Nation negotiations, litigation and settlements are deferred and amortized on a straight-line basis over a period of 10 years.

During the year, BC Hydro recorded a provision for future negotiation and settlement costs. These costs are outside the scope of the existing regulatory order. BC Hydro made an application to the Commission for approval of a designated regulatory account with respect to these costs and recover these amounts in future rates when amounts are actually incurred. On May 18, 2006 the Commission approved the establishment of a designated regulatory account in respect of these costs.

In the absence of rate regulation, these amounts would be substantially treated as period costs, and expensed in the year in which they are provided for or incurred. In 2006, \$96 million of period costs were recorded as regulatory assets, and the amortization of previously capitalized amounts totaled \$4 million. Consequently, net income would have been \$92 million lower than would have been recorded in the absence of rate regulation.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 3: Regulation (continued)

#### **Regulatory Provision for Future Removal and Site Restoration Costs**

As part of its October 2004 decision, the Commission ordered the establishment of a regulatory provision for future removal and site restoration costs. This account was established in 2005 by a one-time transfer of \$251 million from retained earnings. The costs of dismantling and disposal of property, plant and equipment will be applied to this regulatory liability if they do not otherwise relate to an asset retirement obligation.

This liability has been recognized solely as a result of rate regulation as costs for future removal and site restoration have been established in excess of amounts required as asset retirement obligations. In the absence of rate regulation, it would be anticipated that a liability would not be recognized. The amortization of previously capitalized amounts totaled \$11 million in the current year. Consequently, net income would be \$11 million lower than would have been recorded in the absence of rate regulation.

#### **Trade Income Deferral Account**

Established under a Special Directive issued by the Province, this account is intended to mitigate the uncertainty associated with forecasting the net income of BC Hydro's trade activities. The impact is to defer the difference between the Trade Income forecast in the revenue requirements application and actual Trade Income. For the purposes of this calculation, Trade Income is defined as the net income of Powerex based on Canadian GAAP. The difference between the Trade Income forecast and actual Trade Income is deferred except for amounts arising from a net loss in Trade Income or the portion of Trade Income in excess of \$200 million. The amortization of balances will be subject to Commission approval.

In the absence of rate regulation, GAAP would require the inclusion of actual Trade Income to be reflected in operating results, regardless of the variance between forecast and actual amounts, which would have resulted in a \$99 million increase in net income.

#### **Other Regulatory Accounts**

As a result of a review of all regulatory accounts, BC Hydro has decided not to seek recovery of certain amounts through future rates. These accounts include dam safety and site survey investigation costs, deferred debt costs, foreign exchange gains and losses, and the unitized bond fund account. As a result, a net amount of \$11 million was written off through the amortization of regulatory accounts.

For certain of the regulatory items identified above, the expected recovery or settlement period, or likelihood of recovery or settlement, is affected by risks and uncertainties relating to the ultimate authority of the Commission and operating results experienced during the year.

#### **Payment to the Province**

Under a Special Directive from the Province, BC Hydro is required to make an annual Payment to the Province (the Payment) on or before June 30 of each year. The Payment is equal to 85 per cent of BC Hydro's distributable surplus for the most recently completed fiscal year assuming that the debt to equity ratio, as defined by the Province, after deducting the Payment, is not greater than 80:20. If the Payment would result in a debt to equity ratio exceeding 80:20, then the Payment will be based on the greatest amount that can be paid without causing the debt to equity ratio to exceed 80:20.

#### **Rate Regulation**

On October 29, 2004, the Commission issued its decision related to BC Hydro's Revenue Requirements Application dated December 15, 2003 that covered BC Hydro's 2005 and 2006 fiscal years. As a result of this decision, BC Hydro was entitled to a rate increase of 4.85 per cent effective April 1, 2004. As a result of the approved rate increases, the allowed rate of return totaled 13.51 per cent.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 4: Amortization

(in millions)	2006	2005
Amortization of property, plant and equipment in service	\$ 406	\$ 429
Amortization of deferred contributions	(44)	(43)
Property, plant and equipment written-off	49	11
Dismantling costs	11	15
Salvage proceeds	(11)	(2)
	<u>\$ 411</u>	<u>\$ 410</u>

During the year, BC Hydro recorded a write-down of thermal generation assets to reflect a reduction in their future use. The write-down, totalling \$23 million, is included in property, plant and equipment written-off.

### Note 5: Finance Charges

(in millions)	2006	2005
Interest on long-term debt	\$ 493	\$ 500
Sinking fund income	(54)	(48)
Other financial income	(3)	(11)
Foreign exchange translation losses (gains)	18	(105)
Amortization of debt issue and related costs	(9)	(9)
	<u>\$ 445</u>	<u>\$ 327</u>
Less: Assigned to unfinished construction	(10)	(9)
	<u>\$ 435</u>	<u>\$ 318</u>

### Note 6: Property, Plant and Equipment

(in millions)	2006				2005			
	Property, Plant and Equipment in Service	Accumulated Amortization	Unfinished Construction	Net Book Value	Property, Plant and Equipment in Service	Accumulated Amortization	Unfinished Construction	Net Book Value
<b>Generation</b>								
Hydraulic	\$ 5,476	\$ 1,754	\$ 101	\$ 3,823	\$ 5,382	\$ 1,723	\$ 142	\$ 3,801
Thermal	454	257	5	202	456	219	–	237
	<u>5,930</u>	<u>2,011</u>	<u>106</u>	<u>4,025</u>	<u>5,838</u>	<u>1,942</u>	<u>142</u>	<u>4,038</u>
<b>Lines</b>	<u>6,736</u>	<u>2,742</u>	<u>261</u>	<u>4,255</u>	<u>6,404</u>	<u>2,519</u>	<u>250</u>	<u>4,135</u>
<b>Substations</b>	<u>2,262</u>	<u>1,147</u>	<u>71</u>	<u>1,186</u>	<u>2,218</u>	<u>1,107</u>	<u>24</u>	<u>1,135</u>
<b>Other</b>								
Land and buildings	397	179	1	219	408	137	4	275
Equipment	305	228	3	80	282	210	1	73
Computer hardware & software	437	292	30	175	426	267	45	204
Service vehicles	102	60	5	47	113	67	3	49
Sundry	37	17	14	34	36	15	3	24
	<u>1,278</u>	<u>776</u>	<u>53</u>	<u>555</u>	<u>1,265</u>	<u>696</u>	<u>56</u>	<u>625</u>
<b>Total</b>	<u>\$16,206</u>	<u>\$ 6,676</u>	<u>\$ 491</u>	<u>\$ 10,021</u>	<u>\$ 15,725</u>	<u>\$ 6,264</u>	<u>\$ 472</u>	<u>\$ 9,933</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 7: Sinking Funds

Sinking funds are held by the Trustee (the Minister of Finance for the Province) for the redemption of long-term debt. The sinking fund balances at the balance sheet date include the following investments:

(dollar amounts in millions)	2006		2005	
	Carrying Value	Weighted Average Effective Rate <sup>1</sup>	Carrying Value	Weighted Average Effective Rate <sup>1</sup>
Money market funds <sup>2</sup>	\$ 48	3.7 %	\$ 34	1.0 %
Province and BC Crown corporation bonds	331	4.8	354	4.4
Federal and other provincial government securities	467	4.8	604	4.2
	<b>\$ 846</b>		<b>\$ 992</b>	

<sup>1</sup> Rate calculated on market yield to maturity.

<sup>2</sup> Money market funds consist of federal and provincial government paper and high-grade commercial paper with a maturity of one year or less.

### Sinking Fund Requirements

Effective December 12, 2005, all sinking fund payment requirements on all new and outstanding debt have been removed.

### Note 8: Long-Term Debt and Debt Management

BC Hydro's long-term debt comprises bonds and debentures and revolving borrowings obtained under an agreement with the Province.

Under the Hydro and Power Authority Act, BC Hydro is subject to a borrowing limit of \$8,800 million after deduction of sinking funds. As at March 31, 2006, BC Hydro's total debt under the borrowing limit was \$6,650 million (2005 – \$6,620 million). The authorized commercial paper borrowing program, which includes revolving borrowings, is limited to \$1,400 million under the Fiscal Agency Agreement between BC Hydro and the Province. At March 31, 2006, the outstanding amount under the borrowing limit was \$880 million (2005 – \$896 million).

During fiscal 2006, BC Hydro issued bonds totalling \$400 million (2005 – \$540 million) with a weighted average effective interest rate of 4.8 per cent (2005 – 5.4 per cent) and a weighted average term to maturity of 25.8 years (2005 – 11.9 years).



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

Long-term debt, expressed in Canadian dollars, is summarized in the following table by year of maturity:

	2006				2005			
	Canadian	Foreign	Total	Weighted Average Interest Rate <sup>1</sup>	Canadian	Foreign	Total	Weighted Average Interest Rate <sup>1</sup>
Maturing in fiscal:								
2006	\$ –	\$ –	\$ –	–	\$ 413	\$ 188	\$ 601	5.7
2007	314	210	524	5.3	314	217	531	4.5
2008	9	584	593	5.5	9	605	614	4.2
2009	94	–	94	10.0	124	–	124	8.6
2010	574	58	632	6.5	574	60	634	6.5
2011	150	–	150	6.5	–	–	–	–
Total								
1 – 5 years	1,141	852	1,993	6.1	1,434	1,070	2,504	5.4
6 – 10 years	1,425	233	1,658	6.1	1,425	242	1,667	6.2
11 – 15 years	975	–	975	8.7	525	–	525	5.4
16 – 20 years	706	584	1,290	8.3	1,306	–	1,306	10.1
21 – 25 years	–	–	–	–	–	605	605	6.6
26 – 30 years	800	–	800	5.5	400	–	400	6.3
Over 30 years	–	350	350	7.4	–	363	363	7.4
Bonds and debentures	5,047	2,019	7,066	6.8	5,090	2,280	7,370	6.7
Revolving borrowings	412	18	430	3.8	220	22	242	2.7
	<u>\$ 5,459</u>	<u>\$ 2,037</u>	<u>7,496</u>		<u>\$ 5,310</u>	<u>\$ 2,302</u>	<u>7,612</u>	
Less: Current portion			954				843	
Long-term debt			<u>\$ 6,542</u>				<u>\$ 6,769</u>	

<sup>1</sup> The weighted average interest rate represents the effective rate of interest on fixed-rate bonds and the current interest rate in effect at March 31 for floating-rate bonds, all before considering the effect of derivative financial instruments used to manage interest rate risk.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

The following interest rate contracts were in place at March 31, 2006 and 2005, with a carrying value of \$nil at March 31, 2006 (2005 – \$2 million). Floating rates are based on the effective rates at the balance sheet date and vary over time.

(dollar amounts in millions)	2006	2005
<b>Receive fixed, pay floating rate swaps</b>		
Notional amount <sup>1</sup>	\$ 1,792	\$ 1,152
Weighted average receive rate	4.57%	4.91%
Weighted average pay rate	3.93%	2.71%
Weighted terms	6 years	6 years
<b>Receive floating, pay fixed rate swaps</b>		
Notional amount <sup>1</sup>	\$ 290	\$ 808
Weighted average receive rate	3.94%	1.71%
Weighted average pay rate	4.90%	4.35%
Weighted terms	7 years	3 years
<b>Receive floating, pay floating rate swaps</b>		
Notional amount <sup>1</sup>	\$ 175	\$ 181
Average receive rate	4.95%	2.95%
Average pay rate	4.58%	3.05%
Remaining term	1 years	2 years

<sup>1</sup> Notional amount for a derivative instrument is defined as the contractual amount on which payments are calculated.

The net carrying value of foreign exchange forward contracts in place at March 31, 2006 was \$(5) million (2005 – \$(4) million).

The following foreign currency contracts with a net carrying value of \$(152) million (2005 – \$(86) million) were in place at March 31, 2006 and 2005. Such contracts are used to hedge foreign dollar principal and interest payments.

(dollar amounts in millions)	2006	2005
<b>Cross-Currency Swaps</b>		
BC Hydro receives foreign currency:		
United States dollar – notional amount <sup>1</sup>	US \$1,334	US \$445
United States dollar – weighted average exchange rate	1.29	1.41
Remaining term	12 years	5 years

<sup>1</sup>Notional amount for a derivative instrument is defined as the contractual amount on which payments are calculated.

Total long-term debt, sinking funds and foreign currency contracts are stated in the following table showing the Canadian dollar equivalent of the currency in which they are payable.

(in millions)	2006						2005
	-----In Canadian Dollars-----						
	In Currency Units	At the closing exchange rates at the balance sheet date	Foreign Currency Contracts	Sinking Funds	Net Principal Outstanding Before Hedging	Net Principal Outstanding After Hedging	Net Principal Outstanding After Hedging
Canadian	\$ 5,459	\$ 5,459	\$ –	\$ (517)	\$ 4,942	\$ 6,439	\$ 5,375
US	1,745	2,037	152	(329)	1,860	363	1,375
		\$ 7,496	\$ 152	\$ (846)	\$ 6,802	\$ 6,802	\$ 6,750

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 9: Financial Instruments

#### Fair Value

At March 31, 2006 and 2005, BC Hydro's financial instruments included cash and cash equivalents, accounts receivable, sinking funds, loans receivable, accounts payable, long-term debt and interest rate, foreign exchange and commodity derivative financial instruments. Some of these derivative financial instruments are held with the Province, which enters into such agreements with third parties on BC Hydro's behalf.

BC Hydro's financial instruments not shown in the following table have fair values that approximate carrying amounts (bracketed amounts represent liabilities):

(in millions)	2006		2005	
	Carrying Value <sup>1</sup>	Fair Value <sup>2</sup>	Carrying Value <sup>1</sup>	Fair Value <sup>2</sup>
Bonds and debentures	\$ (7,066)	\$ (8,706)	\$ (7,370)	\$ (8,804)
Revolving borrowings <sup>3</sup>	(430)	(430)	(242)	(242)
Long-term debt before current portion	\$ (7,496)	\$ (9,136)	\$ (7,612)	\$ (9,046)
Sinking funds	\$ 846	\$ 844	\$ 992	\$ 1,006
Derivative financial instruments				
Net foreign currency contracts	\$ (152)	\$ (147)	\$ (86)	\$ (88)
Interest rate swaps	–	(12)	2	22
Foreign exchange forward contracts	(5)	(5)	(4)	(4)
Commodity derivatives	27	6	4	(12)

<sup>1</sup> Carrying value represents the amount which is recorded in BC Hydro's financial statements.

<sup>2</sup> Market rates and prices used in determining fair value are as of the balance sheet date.

<sup>3</sup> As the interest rates on revolving borrowings are reset on a regular basis, fair value approximates carrying value.

#### Credit Risk Management

BC Hydro is directly exposed to counterparty credit risk as a result of the sale of electricity and related services to its domestic customers and purchase of electricity from independent power producers. BC Hydro is also exposed to credit risk as a result of the trade activities of Powerex. Powerex's principal counterparties are utilities, energy marketers, independent power producers, industrials, power pools, and municipalities in the western United States, western Canada, as well as parts of the eastern United States and eastern Canada. With respect to Powerex's sales and purchases, credit risk is managed by authorizing transactions with only credit-worthy counterparties as determined by BC Hydro Board-approved policies, and by monitoring the credit risk and credit standing of counterparties on a regular basis.

### Note 10: Payment from Alcan Inc.

In December 2004, Alcan Inc. paid Powerex US\$110.4 million representing an arbitration award of US\$100 million plus interest related to Alcan Inc.'s payment obligation under a Power Purchase and Sale Agreement between Powerex and Enron Power Marketing, Inc.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 11: Deferred Contributions

(in millions)	2006	2005
Contributions in aid of construction	\$ 681	\$ 651
Contributions arising from the Columbia River Treaty	175	184
	\$ 856	\$ 835

### Note 12: Other Long-Term Liabilities

(in millions)	2006	2005
Environmental liabilities	\$ 33	\$ 33
Pension liabilities	89	72
Contingent liabilities	88	–
Deferred revenue	313	297
Asset retirement obligations	15	15
	\$ 538	\$ 417

For asset retirement obligations, BC Hydro estimates the undiscounted amount of cash flows required to settle the asset retirement obligation is approximately \$22 million, which will be incurred between 2008 and 2018. A discount rate of 5.9 per cent was used to calculate the carrying value of the asset retirement obligations.

### Note 13: Employee-Defined Benefit Plans

BC Hydro provides a defined benefit statutory pension plan to substantially all employees, as well as supplemental arrangements which provide pension benefits in excess of statutory limits. Pension benefits are based on years of membership service and highest five-year average pensionable earnings. Annual cost-of-living increases are provided to pensioners to the extent that funds are available in the indexing fund. Employees make basic and indexing contributions to the plan funds based on a percentage of current pensionable earnings. BC Hydro contributes amounts as prescribed by an independent actuary. BC Hydro is responsible for ensuring that the statutory pension plan has sufficient assets to pay the pension benefits upon retirement of employees. The supplemental arrangements are unfunded. The most recent actuarial funding valuation for the statutory pension plan was performed at December 31, 2003. The next valuation for funding purposes will be as of December 31, 2006.

BC Hydro also provides post-retirement benefits other than pensions including medical, extended health and life insurance coverage for retirees who have at least 10 years of service and qualify to receive pension benefits. Certain benefits, including the short-term continuation of health care and life insurance, are provided to terminated employees or to survivors on the death of an employee. These other post-retirement benefits and post-employment benefits are not funded. Post-employment benefits include the pay-out of benefits that vest or accumulate, such as banked vacation. Information about the benefit plans, post-retirement benefits and post-employment benefits other than pensions is as follows:

(a) The net expense for BC Hydro's benefit plans is as follows:

(in millions)	Pension Benefit Plans		Other Benefit Plans	
	2006	2005	2006	2005
Net expense	\$ 34	\$ 40	\$ 40	\$ 35

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

In fiscal 2004, the transfer of approximately 260 employees to BCTC resulted in the curtailment of an insignificant portion of the BC Hydro defined benefit pension plan and other post-retirement benefit plans. The curtailment and related settlement of a portion of the plans was accounted for in fiscal 2005.

(b) Information about BC Hydro's benefit plans as at March 31, in aggregate, is as follows:

(in millions)	Pension Benefit Plans		Other Benefit Plans	
	2006	2005	2006	2005
Accrued benefit obligation	\$ 2,396	\$ 2,290	\$ 332	\$ 282
Fair value of plan assets	2,142	2,048	–	–
Plan deficit	\$ (254)	\$ (242)	\$ (332)	\$ (282)
Unamortized net actuarial losses	380	376	159	133
Unamortized past service costs	8	9	–	–
Unamortized transition (asset) liability	(89)	(104)	40	46
Accrued benefit asset (liability)	\$ 45	\$ 39	\$ (133)	\$ (103)

The pension plan assets and obligations are measured as at December 31, 2005. The other benefit plan obligations are measured as at March 31, 2006. No valuation allowance was required in 2006 and 2005. None of the above benefit plans were fully funded.

(c) The significant assumptions adopted in measuring BC Hydro's accrued benefit obligations are as follows:

	Pension Benefit Plans		Other Benefit Plans	
	2006	2005	2006	2005
Discount rate				
– benefit cost	6.0%	7.0%	6.0%	7.0%
– accrued benefit obligation	5.5%	6.0%	5.5%	6.0%
Expected long-term				
rate of return on plan assets	7.0%	7.0%	n/a	n/a
Rate of compensation increase				
– benefit cost	3.5%	5.0%	n/a	n/a
– accrued benefit obligation	3.5%	3.5%	n/a	n/a

Health care cost trend rate:

	2006	2005
Weighted average health care cost trend rate	7.5 %	7.2 %
Weighted average ultimate health care cost trend rate	4.2 %	4.1 %
Year in which ultimate health care cost trend rate will be achieved	2011	2011

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

(d) Other information about BC Hydro's benefit plans is as follows:

(in millions)	Pension Benefit Plans		Other Benefit Plans	
	2006	2005	2006	2005
Employer contributions	\$ 34	\$ 31	\$ –	\$ –
Employee contributions	\$ 15	\$ 15	\$ –	\$ –
Benefits paid	\$ 109	\$ 104	\$ 10	\$ 9
Settlement payments	\$ 82	\$ 13	\$ –	\$ –

The actuarial valuation as at December 31, 2003 revealed a specific funding requirement of approximately \$166 million. BC Hydro is required to make these payments with interest over a five-year period ending December 31, 2008. These amounts represent funding commitments to fulfill certain requirements specified by the BC Pension Benefits Standards Act related to the unlikely event that BC Hydro ceases to operate, and are designated as contributions to the BC Hydro pension plan. Amounts contributed are in addition to existing funding commitments and do not impact operating results in the period in which the payments are made.

BC Hydro requested an extension from the Financial Institutions Commission of B.C. ("FICOM") for making the specific funding payment that would have otherwise been due in July 2005. The extension was sought to allow BC Hydro time to pursue an alternative to the required funding. FICOM has granted BC Hydro an extension to October 31, 2006 to complete the resolution of the funding alternative. Future payments will be funded with cash or through alternative means.

(e) Asset allocation of the defined benefit statutory pension plan as at the measurement date:

	Target Allocation	2006	2005
Equities	60%	60%	60%
Fixed income investments	30%	30%	30%
Real estate	10%	10%	10%

Plan assets are re-balanced within ranges around target applications. The expected return on plan assets is determined by considering long-term historical returns, future estimates of long-term investment returns and asset allocations.

### Note 14: Commitments and Contingencies

#### Energy Commitments

BC Hydro (excluding Powerex) has long-term energy purchase contracts to meet a portion of its expected future domestic electricity requirements. The minimum obligations to purchase energy under these contracts have a total value of approximately \$7,899 million of which approximately \$2,558 million relates to the purchase of natural gas and natural gas transportation contracts, at market prices over 30 years. The remaining commitments are at predetermined prices. Powerex has energy purchase commitments with a minimum payment obligation of \$5,358 million and purchase commitments for energy and capacity services with a value of \$139 million.

The total combined payments for the next five years are approximately (in millions): 2007 – \$1,660; 2008 – \$1,028; 2009 – \$895; 2010 – \$849; 2011 – \$817.

Powerex has energy sales commitments over the next five years with a total value of \$974 million.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### **Lease and Service Agreements**

BC Hydro has entered into various agreements to lease facilities or assets, or to purchase business support services. The agreements cover periods of up to 10 years, and the aggregate minimum payments are approximately \$890 million. Payments for the next five years are approximately (in millions): 2007 – \$143; 2008 – \$142; 2009 – \$141; 2010 – \$140; 2011 – \$140.

### **Demand-Side Management Programs**

BC Hydro has entered into Power Smart incentive and energy study agreements with customers. BC Hydro has committed to payments under these agreements totalling approximately \$9 million over the next two years as follows (in millions): 2007 – \$7; 2008 – \$2.

### **Legal Contingencies**

- (a) California Power Markets: At March 31, 2006, Powerex was owed US\$268 million (Cdn\$313 million) by the markets operated by the California Power Exchange (Cal Px) and the California Independent System Operator (Cal ISO) related to Powerex's electricity trade activities in California during fiscal 2001. As a result of payment defaults by a number of California utilities in 2001, the Cal Px and Cal ISO were unable to pay these amounts to Powerex. In addition, certain California parties requested the Federal Energy Regulatory Commission (FERC) consider whether refunds should be made to the Cal Px, the Cal ISO and the California Department of Water Resources by various suppliers, including Powerex. The FERC is calculating the extent to which sellers' receivables may be offset by refunds to the Cal Px and Cal ISO markets, while FERC's refund orders themselves are before U.S. appellate courts.

Since 2000, Powerex has been named, in some cases along with other energy providers, as a defendant in a number of lawsuits and U.S. federal regulatory proceedings which seek damages and/or contract rescission based on allegations that, during part of 2000 and 2001, the California wholesale electricity markets were unlawfully manipulated and that the energy prices were not just and reasonable. Collectively, these proceedings are in various stages. A number of issues and findings are presently on appeal. Certain issues have been ordered by the U.S. Court of Appeals for the Ninth Circuit to be remanded to the FERC for further proceedings, but the court's remand order is subject to pending rehearing applications and remands have not yet occurred.

On March 26, 2004, the FERC approved a settlement agreement between the FERC Trial Staff and Powerex that acknowledged that there was no evidence that Powerex engaged in any gaming practices or concerted partnership practices with any other market participants, and further noted that Powerex was a valuable and reliable supplier of energy and ancillary services to the California market throughout the energy crisis. However, at the request of certain parties, this settlement is still subject to rehearing at FERC and FERC's final order may subsequently be appealed to the courts.

BC Hydro was also joined as a defendant in the California Consumer Class Action lawsuit through cross-claims by other defendants. In response to an application by BC Hydro to be dismissed from the lawsuit, a U.S. Federal District Court judge ruled that BC Hydro is immune from these claims in the United States by virtue of the Foreign Sovereign Immunities Act. The U.S. Court of Appeals for the Ninth Circuit upheld this finding. The court also upheld the District Court's finding that Powerex does not enjoy foreign sovereign entity status and therefore remains a party to the lawsuit, which was ordered to be remanded back to California State Court. Powerex is seeking appeal of the latter decision and related Ninth Circuit rulings to the U.S. Supreme Court.

Due to the ongoing nature and uncertain status of the regulatory and legal proceedings related to the California power markets, management cannot predict at this time the outcome of the claims against Powerex and BC Hydro. BC Hydro has recorded provisions for uncollectible amounts and legal costs associated with the ongoing legal and regulatory impacts of the California energy crisis during fiscal 2001. These provisions are based on management's best estimates, and are intended to adequately provide for any exposure. However, the amounts that may ultimately be collected may differ from management's current estimates. Management has not disclosed the provision amounts or ranges of expected outcomes due to the potentially adverse effect on the collection process.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

(b) Facilities and Right of Ways

BC Hydro is subject to existing and pending legal claims relating to alleged infringement and damages in the operation and use of facilities owned by BC Hydro. These claims may be resolved unfavourably with respect to BC Hydro and may have a significant adverse effect on BC Hydro's financial position. For existing claims in respect of which settlement negotiations have advanced to the extent that potential settlement amounts can reasonably be predicted, management has recorded a provision for the potential costs of those settlements. For pending claims, management believes that any loss exposure that may ultimately be incurred may differ materially from management's current estimates. Management has not disclosed the ranges of expected outcomes due to the potentially adverse effect on the negotiation process for these pending claims.

(c) Due to the size, complexity and nature of BC Hydro's operations, various other legal matters are pending. It is not possible at this time to predict with any certainty the outcome of such litigation. Management believes that any settlements related to these matters will not have a material effect on BC Hydro's consolidated financial position or results of operations.

### Note 15: Geographic Information

Revenues, based on point of delivery, are as follows:

(in millions)	2006	2005
British Columbia	\$ 2,765	\$ 2,704
Canada (excluding British Columbia)	484	204
United States	1,062	817
	\$ 4,311	\$ 3,725

Substantially all of BC Hydro's assets are located in the Province of British Columbia.

### Note 16: British Columbia Transmission Corporation

The consolidated financial statements of BC Hydro include the accounts of BCTC for the year ended March 31, 2005. BC Hydro removed BCTC from its consolidated accounts effective April 1, 2005 when BCTC was considered operationally and financially independent of BC Hydro. The consolidated financial statements of BC Hydro for the year ended March 31, 2005 include the following impacts related to consolidation o

(in millions)	2005
Increase in assets	\$ 84
Increase in liabilities	60
Increase in retained earnings	24
Increase in revenue	1
Decrease in expenses	(2)
Increase in net income	3



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005

### Note 17: Related Party Transactions

As Crown corporations of the Province, BC Hydro, BCTC and the Province are considered related parties. As a regulatory agency of the Province, the Commission would also be considered a related party of BC Hydro as both organizations are subject to common significant influence by the Province. All transactions between BC Hydro and its related parties are considered to possess commercial substance and are consequently recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties. The related party transactions are summarized below:

(in millions)	2006	2005
Province of B.C.		
Water rental fees	\$ 272	\$ 234
Taxes	147	143
Finance charges	432	443
Payment to the Province	223	339
BCTC		
Cost of energy	72	–
Operating costs	90	–
Other	33	–
	<u>\$ 1,269</u>	<u>\$ 1,159</u>

At March 31, 2006, accounts receivable included \$86 million (2005 – \$80 million) due from the Province and/or BCTC. Accounts payable and accrued liabilities included \$291 million (2005 – \$373 million) due to the Province and/or BCTC.

BC Hydro's debt is either held or guaranteed by the Province (see Note 8). Under an agreement with the Province, BC Hydro indemnifies the Province for any credit losses incurred by the Province related to interest rate and foreign currency contracts entered into by the Province on BC Hydro's behalf. At March 31, 2006, the aggregate exposure under this indemnity totaled approximately \$175 million (2005 – \$111 million). BC Hydro has not experienced any losses to date under this indemnity.

## FINANCIAL STATISTICS

for the years ended or as at March 31 (millions of dollars)	2006 <sup>1</sup>	2005 <sup>1</sup>	2004	2003	2002
<b>Revenues<sup>2</sup></b>	\$ 4,311	\$ 3,725	\$ 3,424	\$ 3,107	\$ 6,311
<b>Expenses</b>					
Energy costs <sup>2</sup>	2,488	1,959	1,580	1,126	4,407
Operating costs <sup>3</sup>	805	717	621	573	550
Amortization	411	410	526	417	386
Taxes	147	143	147	145	166
Finance charges	435	318	452	457	544
Payment from Alcan Inc.	–	(137)	–	–	–
Restructuring costs	–	–	8	37	–
	4,286	3,410	3,334	2,755	6,053
<b>Income Before Regulatory Account</b>					
<b>Transfers</b>	25	315	90	352	258
Regulatory Transfers	241	87	–	–	–
Rate Stabilization Account	–	–	21	66	145
<b>Net Income</b>	\$ 266	\$ 402	\$ 111	\$ 418	\$ 403
<b>Property, Plant and Equipment</b>					
At cost	\$ 16,697	\$ 16,197	\$ 15,841	\$ 15,609	\$ 15,067
Less: Accumulated depreciation	6,676	6,264	5,941	5,816	5,557
Net Book Value	\$ 10,021	\$ 9,933	\$ 9,900	\$ 9,793	\$ 9,510
Property, Plant and Equipment Expenditures					
Sustaining	\$ 363	\$ 331	\$ 375	\$ 367	\$ 333
Expansion	247	197	199	329	198
Total property, plant and equipment expenditures <sup>4</sup>	\$ 610	\$ 528	\$ 574	\$ 696	\$ 531
Demand-side management (DSM) programs	90	71	63	45	14
Total property, plant and equipment and DSM program expenditures	\$ 700	\$ 599	\$ 637	\$ 741	\$ 545
Less: Contributions in aid of construction	68	66	56	62	54
<b>Net Property, Plant and Equipment Expenditures</b>	\$ 632	\$ 533	\$ 581	\$ 679	\$ 491
<b>Net Long-Term Debt<sup>5</sup></b>	\$ 6,627	\$ 6,583	\$ 6,853	\$ 6,849	\$ 6,889

<sup>1</sup> The results reflect the impact of Accounting Guideline 19, Disclosure by Entities Subject to Rate Regulation, regarding the recognition and measurement of assets and liabilities subject to rate regulation. Prior years have not been restated

<sup>2</sup> During fiscal 2004, in response to changes in United States accounting standards, BC Hydro amended its accounting policy related to revenue recognition for electricity trade activities that are supported by derivatives such as swaps, forward sales and options. Revenues and energy costs associated with these derivatives are presented on a net basis for fiscal years 2003 to 2006. Revenues and energy costs for fiscal years prior to 2003 have not been re-stated.

<sup>3</sup> Maintenance, operations and general and administrative costs.

<sup>4</sup> Total property, plant and equipment expenditures include non-cash items.

<sup>5</sup> Consists of long-term debt, including the current portion, net of sinking funds and cash and cash equivalents.

## KEY FINANCIAL AND OPERATING COMPARATIVES

### FINANCIAL COMPARATIVES

millions of dollars unless otherwise stated	2006 <sup>1</sup>	2005 <sup>1</sup>	2004	2003	2002
Revenues <sup>2</sup>	\$ 4,311	\$ 3,725	\$ 3,424	\$ 3,107	\$ 6,311
Net income	\$ 266	\$ 402	\$ 111	\$ 418	\$ 403
Property, Plant and Equipment	\$ 10,021	\$ 9,933	\$ 9,900	\$ 9,793	\$ 9,510
Net long-term debt <sup>3</sup>	\$ 6,627	\$ 6,583	\$ 6,853	\$ 6,849	\$ 6,889
Retained earnings	\$ 1,707	\$ 1,688	\$ 1,876	\$ 1,609	\$ 1,529
Capital and deferred expenditures	\$ 700	\$ 599	\$ 637	\$ 741	\$ 545
Debt to equity	70:30	70:30	70:30	72:28	72:28
Return on equity (%)	9.26	14.24	3.74	15.47	15.24
Interest coverage	1.06	1.56	1.22	1.75	1.43

### OPERATING COMPARATIVES

millions of dollars unless otherwise stated	2006 <sup>1</sup>	2005 <sup>1</sup>	2004	2003	2002
Number of customers	1,704,892	1,675,258	1,650,655	1,629,186	1,609,871
Generating capacity (MW):					
Hydroelectric	10,219	10,218	10,207	10,009	10,009
Thermal	1,094	1,093	1,093	1,099	1,093
Peak one-hour demand (MW)	9,317	9,437	9,619	8,481	8,692
Average annual kWh use per residential customer	10,846	10,722	10,761	10,476	10,695
Average number of customers per employee	399	378	372	266	265
Domestic sales (GWh)	52,440	51,205	50,151	48,677	47,801
Trade sales (GWh)	36,547	32,346	28,373	31,182	20,666
Total electricity sold per employee (GWh)	19.45	18.41	17.82	13.14	11.32

<sup>1</sup> The results reflect the impact of Accounting Guideline 19, Disclosure by Entities Subject to Rate Regulation, regarding the recognition and measurement of assets and liabilities subject to rate regulation. Prior years have not been re-stated

<sup>2</sup> During fiscal 2004, in response to changes in United States accounting standards, BC Hydro amended its accounting policy related to revenue recognition for trade activities that are supported by derivatives such as swaps, forward sales and options. Revenues associated with these derivatives are presented on a net basis in fiscal years 2003 to 2006. Revenues for fiscal years prior to 2003 have not been re-stated.

<sup>3</sup> Consists of long-term debt, including the current portion, net of sinking funds and cash and cash equivalents.

## OPERATING STATISTICS

for the years ended or as at March 31	2006	2005	2004	2003	2002
<b>Generating Capacity (megawatts)</b>					
Hydroelectric <sup>1</sup>	10,219	10,218	10,207	10,009	10,009
Thermal	1,094	1,093	1,093	1,099	1,093
<b>Total</b>	<b>11,313</b>	<b>11,311</b>	<b>11,300</b>	<b>11,108</b>	<b>11,102</b>
<b>Peak One-Hour Demand</b>					
<b>Integrated System (megawatts)</b>	<b>9,016</b>	<b>9,437</b>	<b>9,619</b>	<b>8,481</b>	<b>8,692</b>
<b>Customers</b>					
Residential	1,511,435	1,484,339	1,462,079	1,442,597	1,424,505
Light industrial and commercial	189,764	187,313	185,065	183,188	182,025
Large industrial	146	138	136	133	132
Other	3,326	3,265	3,202	3,092	3,064
Trade	221	203	173	176	145
<b>Total</b>	<b>1,704,892</b>	<b>1,675,258</b>	<b>1,650,655</b>	<b>1,629,186</b>	<b>1,609,871</b>
<b>Electricity Sold (gigawatt-hours)</b>					
Residential	16,261	15,814	15,646	15,024	15,170
Light industrial and commercial	17,913	17,459	17,175	16,757	16,446
Large industrial	16,428	16,177	15,505	15,179	14,513
Other	1,838	1,755	1,825	1,717	1,672
Domestic	52,440	51,205	50,151	48,677	47,801
Trade	36,547	32,346	28,373	31,182	20,666
<b>Total</b>	<b>88,987</b>	<b>83,551</b>	<b>78,524</b>	<b>79,859</b>	<b>68,467</b>
<b>Domestic Change Over Previous Year (%)</b>	<b>2.4</b>	<b>2.1</b>	<b>3.0</b>	<b>1.8</b>	<b>(0.7)</b>
<b>Revenues (millions)</b>					
Residential	\$ 1,046	\$ 1,016	\$ 960	\$ 923	\$ 930
Light industrial and commercial	989	967	912	893	874
Large industrial	584	573	525	516	482
Other energy sales	91	88	89	88	89
Domestic electric	2,710	2,644	2,486	2,420	2,375
Miscellaneous	55	60	67	55	75
Domestic	2,765	2,704	2,553	2,475	2,450
Trade <sup>2</sup>	1,546	1,021	871	632	3,861
<b>Total</b>	<b>\$ 4,311</b>	<b>\$ 3,725</b>	<b>\$ 3,424</b>	<b>\$ 3,107</b>	<b>\$ 6,311</b>

## OPERATING STATISTICS (continued)

for the years ended or as at March 31	2006	2005	2004	2003	2002
<b>Average Revenue (per kilowatt-hour)</b>					
Residential	6.4¢	6.4¢	6.1¢	6.1¢	6.1¢
Light industrial and commercial	5.5	5.5	5.3	5.3	5.3
Large industrial	3.6	3.5	3.4	3.4	3.3
Other	5.0	5.0	4.9	5.1	5.3
Trade <sup>3</sup>	7.8	9.7	6.8	6.2	18.7
<b>Average Annual Kilowatt-Hour Use Per Residential Customer</b>	10,846	10,722	10,761	10,476	10,695
<b>Lines In Service</b>					
Distribution (kilometres) <sup>4</sup>	55,224	55,254	54,617	55,734	53,748
Transmission (circuit kilometres)	18,234	18,286	18,300	18,284	18,025
<b>Number of Employees<sup>5</sup></b>	4,203	4,396	4,406	6,013	6,144

<sup>1</sup> Maximum sustained generating capacity.

<sup>2</sup> During fiscal 2004, in response to changes in United States accounting standards, BC Hydro amended its accounting policy related to revenue recognition for trade activities that are supported by derivatives such as swaps, forward sales and options. The revenues and costs associated with these derivatives are presented on a net basis for fiscal 2003 to 2006. Revenues for fiscal years prior to 2003 have not been re-stated.

<sup>3</sup> The method used to calculate the trade revenue per kilowatt hour is based on gross trade revenues for fiscal 2003 to 2006.

<sup>4</sup> The method used to track the distance of the 3 phase underground power lines was changed in Fiscal 2004.

<sup>5</sup> Includes full-time and part-time employees of BC Hydro, and its subsidiaries. As of April 1, 2005, 318 employees were removed when BCTC became operationally and financially independent of BC Hydro. At April 1, 2003, approximately 1,600 employees were transferred to Accenture Business Services of British Columbia.

## TOTAL REQUIREMENTS FOR ELECTRICITY AND SOURCES OF SUPPLY

for the years ended March 31	2006			2005		2004	
	Generating Capacity (Megawatts)	Gigawatt-Hours	%	Gigawatt-Hours	%	Gigawatt-Hours	%
<b>Requirements</b>							
Domestic	11,313	52,440	59.9	51,205	59.8	50,151	60.1
Electricity trade		29,906	34.1	29,706	34.7	28,373	34.0
		82,346	94.0	80,911	94.5	78,524	94.1
Line loss and system use		5,318	6.0	4,660	5.5	4,969	5.9
		87,664	100.0	85,571	100.0	83,493	100.0
<b>Sources Of Supply</b>							
Hydroelectric generation							
Gordon M. Shrum	2,730	14,628	16.7	11,738	13.7	14,567	17.4
Revelstoke	1,980	7,915	9.0	7,283	8.5	7,552	9.0
Mica	1,805	7,006	8.0	5,993	7.0	6,389	7.7
Kootenay Canal	580	3,300	3.8	3,339	3.9	2,507	3.0
Peace Canyon	694	3,580	4.1	2,981	3.5	3,604	4.3
Seven Mile	790	3,082	3.5	3,039	3.6	2,867	3.4
Bridge River	476	2,736	3.1	2,597	3.0	2,555	3.1
Other	1,164	4,603	5.3	4,631	5.4	4,499	5.4
	10,219	46,850	53.5	41,601	48.6	44,540	53.3
Thermal generation							
Burrard	950	39	0.0	456	0.5	136	0.2
Other	144	337	0.4	325	0.4	312	0.4
Purchases under long-term commitments		11,275	12.9	10,992	12.9	10,681	12.8
Purchases under short-term commitments		29,793	33.9	32,637	38.1	29,042	34.8
Exchange net		(630)	(0.7)	(440)	(0.5)	(1,218)	(1.5)
	11,313	87,664	100.0	85,571	100.0	83,493	100.0