YUKON DEVELOPMENT CORPORATION

FINANCIAL STATEMENTS

December 31, 2006

(audited)

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Yukon Development Corporation

MANAGEMENT RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of Yukon Development Corporation 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 and approximations, which have been made using careful judgement. In management's opinion, the consolidated financial statements have been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized 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, the careful selection and training of qualified personnel, and an organizational structure that provides for the appropriate delegation of authority and segregation of responsibilities.

The financial statements have been examined by an independent external auditor. The external auditor's responsibility is to express an opinion on whether the consolidated financial statements, in all material respects, fairly present the Corporation's financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles. In addition, the external auditor reports on whether proper books of account have been kept by the Corporation, the consolidated financial statements are in agreement therewith, and transactions, in all significant respects, are in accordance with the *Financial Administration Act* as applicable, the *Yukon Development Corporation Act* and the bylaws of the Corporation and its wholly-owned subsidiaries. The Auditor's Report, which follows, outlines the scope of this examination and the auditor's opinion.

The Corporation's Board of Directors, through its Audit and Finance Committee, oversees management's responsibilities for financial reporting. The Audit and Finance Committee meets with management and the independent external auditor to discuss auditing and financial matters, to gain assurance that management is carrying out its responsibilities and to review and approve the consolidated financial statements. The auditor has full and free access to the Audit and Finance Committee, with and without the presence of management.

David Morrison
Chief Executive Officer

Blaine Anderson, C.A.
Chief Financial Officer

Whitehorse, Yukon
April 19, 2007

Auditor General of Canada
Vérificatrice générale du Canada

AUDITOR'S REPORT

To the Minister Responsible for the Yukon Development Corporation

I have audited the consolidated balance sheet of the Yukon Development Corporation as at December 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 the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 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. As required by the *Yukon Development Corporation Act*, I report that, in my opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in my opinion, proper books of account have been kept by the Corporation and by its wholly-owned subsidiary and the consolidated financial statements are in agreement therewith and the transactions of the Corporation and of its wholly-owned subsidiary that have come to my notice during my audit of the consolidated financial statements have, in all significant respects, been in accordance with the *Financial Administration Act* and regulations, the *Yukon Development Corporation Act* and regulations, and the bylaws of the Corporation and its wholly-owned subsidiary.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Vancouver, Canada
April 19, 2007, except as to Note 23 which is as of April 30, 2007

240 rue Sparks Street, Ottawa, Ontario K1A 0G6

Yukon Development Corporation

Consolidated Balance Sheet

As at December 31, (in thousands of dollars)	2006	2005
Assets		
Current assets		
Cash and cash equivalents (note 4)	$ 8,476	$ 8,108
Accounts receivable (note 5)	4,148	4,154
Materials and supplies	2,039	2,099
Prepaid expenses	181	218
Current portion of investment (note 6)	475	419
	15,319	14,998
Restricted cash	-	2,617
Trust assets (note 7)	**704**	679
Investments (note 6)	**2,600**	3,075
Property, plant and equipment (note 8)	**151,612**	151,565
Diesel contingency fund (note 9)	**821**	791
Deferred uninsured losses (note 15)	**500**	-
Deferred charges (note 10)	**9,326**	8,298
	$ 180,882	$ 182,023
Liabilities		
Current liabilities		
Accounts payable	$ 3,891	$ 3,480
Current portion of long-term debt (note 14)	1,911	1,748
Regulatory liabilities (note 11)	1,483	1,775
	7,285	7,003
Long-term pension liability	**560**	360
Deferred revenue (note 12)	**7,499**	10,406
Trust liabilities	**704**	679
Long-term debt (note 14)	**19,179**	21,052
Deferred uninsured losses (note 15)	-	33
Contributions in aid of construction (note 16)	**6,086**	5,552
Regulatory provision for future removal and site restoration costs	**5,083**	5,618
Diesel contingency fund (note 9)	**821**	791
	47,217	51,494
Equity		
Contributed capital	**41,501**	41,501
Retained earnings	**92,164**	89,028
	133,665	130,529
	$ 180,882	$ 182,023

Contingencies and Commitments (notes 18 and 19)

The accompanying notes are an integral part of the financial statements.

Approved by the Board:

Chair

Director

Yukon Development Corporation

Consolidated Statement of Operations

For the year ended December 31, (in thousands of dollars)	2006	2005
Revenue		
Sales of Power	$ 27,096	$ 25,940
Interest income	428	236
Finance income	364	414
Other income	262	371
Contribution - Canada	-	288
Contribution - Yukon	-	141
	28,150	27,390
Expenses		
Administration	7,356	8,813
Operations and maintenance	5,375	4,879
Depreciation of property, plant and equipment	4,736	4,959
Interest on long-term debt	1,443	1,349
Amortization of deferred charges and water licensing costs	1,109	900
Programs	470	558
Provision for uninsured losses (note 15)	100	100
	20,589	21,558
Net income before rate stabilization and gains/losses	**7,561**	5,832
Gain on settlement of debt	-	**16,978**
Rate stabilization (note 19)	**(4,420)**	(3,658)
Loss on disposition of assets	**(5)**	(59)
Net income	**$ 3,136**	$ 19,093

The accompanying notes are an integral part of the financial statements.

Yukon Development Corporation

Consolidated Statement of Retained Earnings

For the year ended December 31, (in thousands of dollars)	2006	2005
Retained earnings, beginning of year As previously reported	$ 89,028	$ 69,935
Net income	3,136	19,093
Retained earnings, end of year	**$ 92,164**	$ 89,028

The accompanying notes are an integral part of the financial statements.

Yukon Development Corporation

Consolidated Statement of Cash Flows

For the year ended December 31, (in thousands of dollars)	**2006**	2005
Cash flows from		
Operating activities		
Cash receipts from customers	$ 24,457	$ 26,736
Cash paid to employees and suppliers	(19,441)	(20,589)
Interest paid	(1,443)	(1,349)
Interest received	792	650
	4,365	5,448
Financing activities		
Decrease in restricted cash	2,617	73
New long-term debt obtained	-	10,711
Repayment of long-term debt	(1,711)	(12,153)
Increase in trust assets	(25)	(16)
Increase in trust liabilities	25	16
	906	(1,369)
Investing activities		
Property and equipment purchased	(4,254)	(3,718)
Proceeds from disposition of investments	419	377
Payments related to regulatory provisions	(1,068)	691
	(4,903)	(2,650)
Net increase in cash and cash equivalents	**368**	1,429
Cash and cash equivalents, beginning of year	**8,108**	6,679
Cash and cash equivalents, end of year	**$ 8,476**	$ 8,108

The accompanying notes are an integral part of the financial statements.

1. Authority, objectives and operations

Yukon Development Corporation (the "Corporation") was originally established under the *Yukon Development Corporation Act* to participate with the private sector in the economic development of the Yukon, to make strategic investments to the benefit of the territory and to acquire and operate the assets of Northern Canada Power Commission (NCPC) in the Yukon.

In 1993, the Corporation's mandate was changed to restrict its new initiatives to energy-related activities designed to promote the economic development of the Yukon.

The Corporation's wholly-owned subsidiary, Yukon Energy Corporation (the "Utility") was incorporated under the *Yukon Business Corporations Act*. Yukon Energy Corporation generates, transmits, distributes and sells electrical energy in the Yukon and is subject to overall regulation by the Yukon Utilities Board (YUB) and specific regulation by the Yukon Territory Water Board. Both of these boards are independent from the Utility.

Yukon Energy Corporation is exempt from the Financial Administration Act (Yukon).

Rate Regulation

The Corporation's subsidiary, Yukon Energy Corporation, is regulated by the YUB pursuant to the *Public Utilities Act (Yukon).* There is no minimum requirement for the Utility to appear before the YUB to review rates. However, the Utility is not permitted to charge any rate for the supply of power that is not approved by an Order of the YUB. The Utility is subject to a cost of service regulatory mechanism under which the YUB establishes the revenues required (i) to recover the forecast operating costs, including depreciation and amortization, of providing the regulated service, and (ii) to provide a fair and reasonable return on utility investment or rate base. Whereas actual operating conditions may vary from forecast, actual returns achieved can differ from approved returns.

The regulatory hearing process used to establish or change rates typically begins when the Utility makes an application for its proposed electricity rate changes over the next one or two forecast years. The YUB must ensure that its decision, which fixes electricity rates, complies with appropriate principals of rate making, all relevant legislation including the *Public Utilities Act* and directives issued by the Yukon Government through Orders-In-Council that specify how the interests of the customer and Utility are to be balanced.

The YUB typically follows a two-stage decision process. In the first stage, the total costs that the Utility will incur to provide electricity to its customers over the immediate future are approved. The approval of these costs determines the total revenues the Utility is allowed to collect from its customers. It is the responsibility of the YUB to examine the legitimacy of three classes of costs:

- the costs to the Utility to run its operations and maintain its equipment (personnel and materials);
- the cost associated with the amortization of all capital equipment; and
- the return on rate base (the costs related to borrowing that portion of rate base which is financed with debt, and the costs to provide a reasonable rate of return on that portion of rate base which is financed with equity).

As well, in the first stage, the YUB reviews the addition of costs to rate base and assesses these costs to ensure they are prudent.

In the second stage, the YUB approves how the revenue will be raised. This stage essentially determines the electricity rates for the various customer classes in the Yukon: residential, government, commercial and industrial. This process is guided mainly by requirements of Yukon Government Order-in Council 1995/90 and can include a cost-of-service study which allocates the overall Utility's cost of service to the various customer classes on the basis of appropriate costing principles.

1. Authority, objectives and operations - continued

Rate Regulation - continued
Normally, the Utility applies for rates in advance of the applicable years. The last rate application was for the 2005 year. Interim hearings may be used between rate applications to deal with unforeseen circumstances which could result in the use of interim rates or riders until the next rate application when rates are reviewed and set as final.

Water Regulation
The Yukon Territory Water Board pursuant to the *Yukon Waters Act* decides if and for how long the Utility will have a water license for the purposes of operating hydro generation stations in the Yukon. The licenses will also indicate terms and conditions for the operation of these facilities.

2. Significant accounting policies

Financial statement presentation
The consolidated financial statements of Yukon Development Corporation have been prepared by management and conform to Canadian generally accepted accounting principles. The consolidated financial statements include the accounts of Yukon Development Corporation and its wholly-owned subsidiary, Yukon Energy Corporation. The consolidated financial statements reflect Canadian generally accepted accounting principles and practices of regulatory bodies. The regulatory accounting policies adopted may differ from the accounting policies otherwise expected using GAAP. In particular, the timing of the recognition of certain assets, liabilities, revenues and expenses as a result of regulation may differ from that of a non-regulated enterprise. Impacts of accounting for rate regulated operations are further described in Note 3. All significant inter-company transactions and balances have been eliminated on consolidation. Consequently, the significant accounting principles have been classified accordingly in the notes below:

Rate regulated accounting policies

Property, plant and equipment
The Utility capitalizes an allowance for funds used during construction ("AFUDC") at the weighted average cost of capital. Upon retirement or disposal, any gain or loss is charged to income in the current year for assets depreciated on an individual basis, or charged to accumulated depreciation for assets depreciated on a pooled basis.

Regulatory liabilities
Regulatory liabilities represent amounts ordered by the YUB to be held by the Utility on behalf of ratepayers. Typically these amounts are either refunded to the customers or applied to ratepayer deficits through the rate setting process.

Deferred uninsured losses
As a means of self-insurance, the Utility provides for uninsured losses. An annual provision is approved by the YUB and collected through customer rates. Variances between the approved annual provision and actual costs incurred are deferred until the following general rate application or until a specific application is made to the YUB requesting recovery from or refund to customers.

2. Significant accounting policies - continued

Rate regulated accounting policies - continued

Deferred charges
Deferred charges are recorded at cost less accumulated amortization. Cost of feasibility studies and infrastructure planning are amortized on a straight-line basis over five years. Regulatory hearing costs are amortized on a straight-line basis over three years. Other deferred charges are amortized to earnings on a straight-line basis over various terms approved by the YUB.

Regulatory provision for future removal and site restoration costs
The Utility maintains a provision for the future removal of property, plant and equipment and the costs of site restoration related to those assets. Per YUB Order 2005-12 no additional provision is permitted. This account provides for the costs of demolishing, dismantling, tearing down, or otherwise disposing of an asset and any site restoration costs, net of actual recoveries. This account is not used when the costs relate to an asset retirement obligation.

Deferred revenue
Deferred revenue represents a gain on fire insurance proceeds received related to a fire at the Whitehorse Rapids Generating Station in 1997. The gain is being amortized to income at the same rate as the replacement assets.

Diesel contingency fund
The Utility maintains a trust asset and an offsetting trust liability on behalf of ratepayers. The trust is used to reimburse the Utility for costs associated with diesel generation required when there is not sufficient water for hydraulic generation to meet demand. The Utility is required to file an annual report with the YUB on the fund's activity.

Generally accepted accounting principles ("GAAP")

The following policies adopted by the Corporation are in accordance with Canadian generally accepted accounting principles.

Cash equivalents
Cash equivalents represent short-term highly liquid investments and are carried at cost.

Revenue recognition
All revenues are recognized in the period earned. Revenue from the sale of power is recognized based on cyclical meter readings. Sales of power includes an accrual for electricity deliveries not yet billed.

Materials and supplies
Materials and supplies and diesel fuel are recorded at average cost. Obsolete materials and supplies are recorded at salvage value in the period when obsolescence is determined.

December 31, 2006 (tabular amounts in thousands of dollars)

2. Significant accounting policies - continued

Generally accepted accounting principles ("GAAP") - continued

Property, plant and equipment
Property, plant and equipment is stated at cost which includes materials, direct labour, a proportionate share of directly attributable administration overhead, and finance charges capitalized during construction, less accumulated amortization. Amortization is based on the straight-line method over the estimated economic life of the assets as follows:

Generation	
Hydro-electric plants	30 to 65 years
Diesel plants	25 to 45 years
Wind turbines	30 years
Transmission	40 to 50 years
Distribution	25 to 40 years
Buildings	20 to 40 years
Financial Information System	5 to 10 years
Transportation	9 to 31 years
Other equipment	5 to 20 years

Asset retirement obligations
On an annual basis the Utility identifies legal obligations associated with the retirement of tangible long-lived assets. Where a reasonable estimate of the fair value of these obligations can be determined, the total retirement costs are to be recorded as a liability at fair value, with a corresponding increase to property, plant and equipment.

The Utility has determined that it has tangible long lived assets with associated future legal obligations for retirement. As the Utility anticipates using the assets for an indefinite period, the date of removal of these assets cannot be reasonably determined, and therefore an asset retirement obligation has not been recorded. When the timing and amount of the retirement can be reasonably estimated, an asset retirement obligation and the corresponding increase in property, plant and equipment asset will be recognized.

Effective January 1, 2006, the Utility retroactively adopted the Canadian Institute of Chartered Accountant's ("CICA") Emerging Issues Abstract regarding conditional asset retirement obligations. This abstract requires an entity to record a liability for an asset retirement obligation where the timing and/or method of settlement are conditional upon the occurrence of a future event that may or may not be within the control of the entity. Adoption of this abstract had no effect on the financial statements for the year ended December 31, 2006.

Investments
Investments classified as current assets are carried at the lower of cost and market value. Other investments are carried at cost less a write-down, if necessary, for any impairment in value which is other than temporary.

Derivative financial instruments
The Corporation enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its long-term debt. The Corporation's policy is not to utilize derivative financial instruments for trading or speculative purposes. These swap agreements require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based.

The Corporation does not apply hedge accounting to its derivatives. Derivatives are recognized on the balance sheet upon issuance, and removed from the balance sheet when they expire or are terminated.

2. Significant accounting policies - continued

Generally accepted accounting principles ("GAAP") - continued

Derivative financial instruments - continued
Both on initial recognition and subsequently, each derivative is recognized as either an asset or a liability on the balance sheet at its fair value. Derivatives with a positive fair value are reported as derivative related amounts as a component of total assets. Derivatives with a negative fair value are reported as derivative related amounts as a component of liabilities. The change in the fair value of derivatives is recognized in income in the period in which it occurs. Management's intention is to hold derivatives to maturity resulting in the cumulative unrealized gains and losses on individual derivative instruments netting to zero over the life of the instrument.

Contributions in aid of construction
Certain property, plant and equipment additions are made with the assistance of cash contributions from customers. These contributions are amortized to income on the same basis as the assets to which they relate. Amortization of contributions from customers is netted on the statement of income against amortization expense.

Deferred water licensing costs
Costs related to obtaining water license renewals are deferred and amortized to earnings on a straight-line basis over the term of the license. The Utility operates its hydro generation facilities under three separate water licenses, with terms ranging from 17 to 25 years.

Employee pension plan
The Utility has a defined benefit pension plan which provides for pensions based on length of service and final average earnings. The cost of pension benefits is actuarially determined using the projected benefits method, prorated on service, and reflects management's best estimates of investment returns, wage and salary increases, and age at retirement. Adjustments resulting from plan enhancements, actuarial gains and losses, and changes in assumptions are amortized over the expected average remaining service period of active employees. Pension costs include the current cost of service and amortization of past service benefits and plan enhancements, and actuarial gains and losses. Amortization is on a straight-line basis over the expected average remaining service period of active employees, which is currently 14 years. The transitional asset that arose when this policy was first applied is amortized over the average remaining service period of active employees expected to receive benefits under the benefit plan as of January 1, 2000. The expected return on plan assets is based on the fair value of these assets.

Measurement uncertainty
The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. This mainly affects revenue, accounts receivable, property, plant and equipment, asset retirement obligations and employee pension obligations. Actual results could differ by a significant amount from these estimates. Management's estimates and assumptions, especially those affecting the reported amounts of assets and the Utility's ability to recover the cost of these assets through future rates, are subject to decisions of the YUB as described in note 3.

December 31, 2006 (tabular amounts in thousands of dollars)

3. Financial statement effects of rate regulation

Certain items in these consolidated financial statements are accounted for differently than they would be in the absence of rate regulation.

Where regulatory decisions dictate, the Utility defers certain costs or revenues as assets or liabilities on the balance sheet and records them as expenses or revenues in the statement of income as it collects or refunds amounts through future customer rates. Any adjustments to these deferred amounts are recognized in earnings in the period that the YUB renders a subsequent decision.

Regulatory assets represent future revenues associated with certain costs, incurred in the current period or in prior periods, which are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process.

The following describes each of the circumstances in which rate regulation affects the accounting for a transaction or event:

	2006	2005	Expected remaining recovery/ settlement (years)	For 2006 In the absence of Rate Regulation the Utility's Net Income would have increased (decreased) by:
Regulatory assets				
Deferred charges (note 10), net book value				
Feasibility studies	$ 2,999	$ 1,498	2 to 5	$ (1,501)
Downsizing costs	71	119	2	48
Hearing costs	311	622	1	311
Dam safety review	49	89	2 to 4	40
Diesel contingency fund (note 9)	821	791	Indeterminate	(30)
	4,251	3,119		(1,132)
Regulatory liabilities:				
Faro Mine dewatering deferral revenue (note 11)	1,483	1,775	Indeterminate	(292)
Deferred gain on fire insurance proceeds (note 12)	7,499	7,789	29	(290)
Deferred uninsured losses (note 15)	(500)	33	Indeterminate	(533)
Regulatory provision for future removal and site restoration costs	5,083	5,618	Indeterminate	(535)
Diesel contingency fund (note 9)	821	791	Indeterminate	30
	14,386	16,006		(1,620)
Net impact	$ (10,135)	$ (12,887)		$ (2,752)

Regulatory assets

(a) Deferred charges

Deferred charges represent costs which have been deferred and are being amortized over various periods. In the absence of rate regulation, GAAP would require such costs to be recognized as expenses in the year incurred.

3. **Financial statement effects of rate regulation - continued**

Feasibility studies
The costs of determining the feasibility of future capital projects that did not result in a capital project are deferred and amortized over five years as approved in the Utility's 1991/92 General Rate Application and re-confirmed in YUB Order 2005-12. In the absence of rate regulation, expenses in 2006 would have been $1,501,000 higher (2005 - $632,000 higher expenses).

Downsizing costs
Costs incurred to assist in downsizing the Utility's workforce are capitalized and amortized to expense over seven years as approved in the Utility's 1993/94 General Rate Application and reconfirmed in YUB Order 2005-12. In the absence of rate regulation, expenses in 2006 would have been $48,000 lower (2005 - $48,000 lower expenses).

Hearing costs
These costs are associated with the YUB regulatory proceedings that were held in 2005. The costs consist primarily of legal and consulting costs incurred by the Utility, and reimbursement of YUB and intervenor costs. YUB Order 2005-12 directed the Utility to defer and amortize the approved hearing costs of $933,000 over 3 years commencing January 1, 2005. In the absence of rate regulation, expenses in 2006 would have been $311,000 lower (2005 - $297,000 higher expenses).

Dam safety review
The Utility has a program of conducting reviews of the safety of its dams in accordance with standards set by the Canadian Dam Association. External consultants are hired every five years with intermittent costs incurred in the interim periods. These costs are amortized over five years as approved by the Utility's 1991/92 General Rate Application and reconfirmed in YUB Order 2005-12. In the absence of rate regulation, expenses in 2006 would have been $40,000 lower (2005 - $63,000 higher expenses).

(b) Diesel contigency fund
The Diesel contingency fund ("DCF") was established by YUB Order 1996-6 through the Negotiated Settlement process. The DCF is administered by the Utility on behalf of the YUB, and as such is recorded as a trust asset and a trust liability. The DCF attracts interest based upon short-term bond rates in which the Utility invests the funds held in trust. Any negative balance attracts interest at the lowest short-term borrowing rate available to the Utility through its line of credit. Pursuant to YUB Order 1996-6, the Utility from time to time is required to transfer amounts to or from the trust it maintains on behalf of ratepayers to reimburse the Utility for costs associated with diesel generation required when there is not sufficient water for hydraulic generation to meet demand. In the absence of regulation, GAAP would have required the amounts transferred to and from the DCF, and any interest earned or incurred to be included in the Utility's net income in the year in which they occurred. In the absence of rate regulation, the Utility's net income in 2006 would have been higher by $30,000 from interest earned on the DCF (2005 - $19,000 higher net income).

Regulatory liabilities

(c) Faro Mine dewatering deferral revenue
As directed by YUB Order 1998-5, all revenues, less any incremental costs to provide the service, collected from the Faro Mine under Rate Schedule 34 (Faro Mine Firm Shutdown Power) prior to December 31, 2004, were deferred for the benefit of ratepayers pending direction from the YUB. YUB Order 2005-12 confirmed that effective January 1, 2005 the Faro minesite would be charged the General Service-Government rate so there will be no further increases to Faro Mine dewatering account. This order also enables the Utility to draw down on the Faro Mine dewatering revenue to fund its approved revenue shortfall. YUB Order 2006-4 set the approved 2006 revenue shortfall at $292,000. In the absence of rate regulation, GAAP would have required only the recognition of actual sales earned during the year.

3. **Financial statement effects of rate regulation - continued**

(c) Faro Mine dewatering deferral revenue - continued
As a result, the Utility's sales of power in 2006 would have been $292,000 lower (2005 - $292,000 lower). The period over which the remaining liability will be recognized as revenue for the benefit of ratepayers is dependent on future YUB Board orders and, therefore, cannot be estimated.

(d) Deferred gain on fire insurance proceeds
The deferred gain on fire insurance proceeds relates to a fire at the Whitehorse Rapids Generating Station in 1997 which, pursuant to Board Order 2000-3, is being amortized to income at the same rate as the replacement assets. In the absence of rate regulation, GAAP would have required the gain to have been completely recognized as income in the year received. As a result, the Utility's current year net income would have been lower by the amount of the amortization of $270,000 (2005 - $270,000 lower).

(e) Deferred uninsured losses
The YUB has approved the use of a provision for uninsured damages and injuries as a means of self-insurance. The provision is maintained through an annual provision approved by the YUB. In order to eliminate the deficit rate payers held as a result of uninsured losses, the Utility was directed by YUB Order 2005-12 to transfer the insurance proceeds being held on behalf of rate payers of $744,000 to the provision for uninsured loss, and increase the annual charge from $50,000 to $100,000 for the years 2005 to 2007. In the absence of rate regulation, GAAP would require costs to be expensed as incurred and, therefore, expenses in 2006 would have been higher by $533,000 (2005 - $86,000 lower). The period over which the provision will be recovered is dependent on the magnitude of future actual losses incurred and cannot be estimated.

(f) Regulatory provision for future removal and site restoration costs
Pursuant to depreciation rates approved by the YUB in the Utility's previous general rate applications, under section 23(1)(b) of the Public Utilities Act, the Utility has maintained a provision for future removal and site restoration costs. As a result of the YUB Order 2005-12, effective January 1 2005, the Utility is required to maintain this provision as a regulatory provision in addition to any asset retirement obligations. The provision is not to exceed the cumulative value of the provision at December 31, 2004 of $5,757,000. In the absence of rate regulation, GAAP would have required the Utility to reverse the provision to retained earnings in 2004. YUB Order 2005-12 also directs the Utility to notify interveners and interested parties when the balance of the provision reaches $2,000,000. Costs of dismantling capital assets, including site remediation, will be applied to this regulatory liability if they do not otherwise relate to an asset retirement obligation. In a non-regulated industry, future removal and site restoration costs would be limited to asset retirement obligations, and the removal and site restoration costs would be expensed in the year incurred if they did not relate to an asset retirement obligation. In the absence of rate regulation, the Utility's 2006 expense would have been higher by the amount of actual removal and site restoration costs incurred in the year of $535,000 (2005 expenses - $139,000 higher). The period over which the provision will be settled is dependent on the future costs of demolishing, dismantling, tearing down, or otherwise disposing of the asset, and site restoration net of actual recoveries, and is, therefore, indeterminate.

(g) Fuel price adjustment
OIC 1998/90 directs the YUB to permit the Utility to adjust electricity rates to reflect fluctuations in the price of diesel fuel. The amount by which actual fuel prices vary from the YUB approved rates is deferred and recovered or refunded to customers in a future period.

In the absence of rate regulation, GAAP would require that actual diesel fuel expenses be included in the operation result of the year that they are incurred. In 2006, fuel expenses were deferred and consequently lower by $56,000 (2005 - $11,000).

December 31, 2006 (tabular amounts in thousands of dollars)

3. Financial statement effects of rate regulation - continued

Other items affected by rate regulation

The Utility is required under the *Public Utilities Act* to obtain prior approval from the YUB before making changes to depreciation, amortization, and depletion rates and methods. The YUB permits an allowance for funds used during construction ("AFUDC"), based on the Utility's weighted average cost of capital, to be included in the rate base. AFUDC is also included in the cost of property, plant and equipment for financial reporting purposes, and is depreciated over future periods as part of the total cost of the related asset, based on the expectation that depreciation expense, including the AFUDC component, will be approved for inclusion in future customer rates. Since AFUDC includes not only a cost of debt component, but also a cost-of-equity component, it exceeds the amount allowed to be capitalized in similar circumstances in the absence of rate regulation.

It is the Utility's policy to charge to income, in the year of disposal, any gain or loss upon retirement or disposal of land or vehicles. As approved by the YUB, the gain or loss on all other property, plant and equipment is charged to accumulated depreciation and deferred and amortized over the expected life of the remaining pool of similar assets. In the absence of rate regulation, GAAP would require the gain or loss on the disposal or retirement of all property, plant and equipment to be included in income in the period of disposal or retirement.

YUB Order 2005-12 disallows the Utility from earning a return on any additional costs incurred with respect to the Mayo-Dawson line as a result of pursuing any claims or counter claims against the general contractor and directs the Utility to record any recoveries from the general contractor in an interest-bearing deferred account for future review and disposition by the YUB.

The Utility's policy of maintaining a constant capital structure of 60% debt and 40% equity is reviewed by the YUB as part of the rate setting process and in the determination of the return on rate base. In the absence of rate regulation, the Utility would determine the appropriate capital structure solely based on decisions by the Board of Directors of the Utility, which may differ from the current policy.

All amounts maintained as regulatory assets and liabilities are expected to be recovered or settled over the periods noted above. However, there are risks and uncertainties associated with the recovery or settlement related to potential future decisions of the regulator which could result in material adjustments to these assets and liabilities.

4. Cash and cash equivalents

	2006	2005
Bank balance	$ 8,333	$ 5,880
Short-term investments	143	2,228
	$ 8,476	$ 8,108

Short-term investments are monies invested in a pooled money market fund. The short-term securities held in the fund have an average maturity less than 90 days. Earnings are distributed monthly on a pro-rata share of the total fund. Annual return on investment for 2006 was 4.08% (2005 - 2.75%). The fair market value of these investments is equal to the carrying amount (note 21).

Yukon Energy Corporation also has a demand line of credit facility with its banker that allows the Utility to borrow up to $10,000,000 at bank prime. The overdraft facility is guaranteed by the Yukon Government. At year end the Yukon Energy Corporation borrowed nil (2005 - nil) on the credit facility.

December 31, 2006 (tabular amounts in thousands of dollars)

5. Accounts receivable

	2006	2005
Wholesale energy sales	$ 2,764	$ 2,666
Retail energy sales	1,071	1,008
Other	313	480
	$ 4,148	$ 4,154

The Utility's wholesale energy sales are made to Yukon Electrical Company Limited, an unrelated company also regulated by the YUB. Wholesale energy sales in 2006 were approximately $18,111,000 (2005- $16,977,000).

6. Investments

The Corporation's investments are summarized as follows:

	2006	2005
Direct financing leases	$ 3,075	$ 3,494
Less: current portion	475	419
	$ 2,600	$ 3,075

In 1990, the Corporation acquired the building known as Old Yukon College from the Yukon Government for a nominal fee. The building was renovated and is being leased back to the Government for a period of 20 years. At the end of the lease term (in 2011) the Government may purchase the building from the Corporation for a nominal fee. Interest from the lease is recognized as finance income. The investment was $2,678,757 in 2006 (2005 - $3,097,781). The monthly lease payments on the building are $65,348.

In 2003, the Corporation financed an electric boiler system for the Yukon Hospital Corporation for a total cost of $595,898. The repayment terms on this lease stipulate that one half of the energy cost savings resulting from the boiler usage during the year will be repaid against the investment. Interest on this investment is earned at the rate of 7.5% per annum and is recognized as finance income. The investment balance was $395,898 in 2006 (2005 - $395,898).

7. Trust assets

	2006	2005
Energy infrastructure investment	**$ 704**	$ 679

Energy infrastructure investment represents monies held by Yukon Development Corporation on behalf of a Yukon First Nation for investment in energy infrastructure. The ultimate use of these funds is subject to the finalization of necessary investment agreements. An equal offsetting liability is recorded in trust liabilities.

The amount is recorded at cost. Fair value approximates the carrying amount due to the short term nature of the financial instrument.

December 31, 2006 (tabular amounts in thousands of dollars)

8. Property, plant and equipment

	Cost	Accumulated Depreciation	**2006** Net book Value	2005 Net book Value
Generation	$ 137,573	$ 46,048	$ 91,525	$ 92,051
Transmission	48,130	10,998	37,132	37,195
Buildings and other equipment	15,492	5,756	9,736	8,804
Distribution	14,596	5,114	9,482	8,750
Construction-in-progress	1,263	-	1,263	2,369
Transportation	1,981	590	1,391	1,143
Financial information system	1,315	1,312	3	173
Land and land rights	1,080	-	1,080	1,080
	$ 221,430	**$ 69,818**	**$ 151,612**	$ 151,565

9. Diesel contingency fund

	2006	2005
Balance, beginning of year	$ 791	$ 772
Interest	30	19
Balance, end of year	**$ 821**	$ 791

Diesel contingency funds are monies invested in a pooled money market fund. The short-term securities held in the fund have an average maturity less than 90 days. Earnings are distributed monthly on a pro-rata share of the total fund. Annual return on investment for 2006 was 4.08% (2005 - 2.75%). The fair market value of these investments is equal to the carrying amount.

10. Deferred Charges

	Cost	Accumulated Amortization	**2006** Net book Value	2005 Net book Value
Deferred water licensing costs	$ 8,352	$ 2,544	$ 5,808	$ 5,871
Feasibility studies and infrastructure planning	3,576	577	2,999	1,498
Regulatory Hearing costs	933	622	311	622
Downsizing costs	334	263	71	119
Dam safety review	213	164	49	89
Deferred financing costs	110	22	88	99
	$ 13,518	**$ 4,192**	**$ 9,326**	$ 8,298

December 31, 2006 (tabular amounts in thousands of dollars)

11. Regulatory liabilities

	2006	2005
Insurance proceeds held on behalf of ratepayers		
Opening balance	$ -	$ 744
Applied to Reserve for uninsured losses (notes 3 and 15)	-	(744)
Closing balance	-	-
Faro Mine dewatering revenue		
Opening balance	1,775	2,067
Applied to revenue shortfall YUB Order 2005-17 (note 3)	(292)	(292)
Closing balance	1,483	1,775
	$ 1,483	$ 1,775

12. Deferred revenue

	2006	2005
Deferred gain on fire insurance proceeds - capital assets (net of amortization and adjustments of $3,707 (2005 - $3,438))	$ 7,499	$ 7,789
Sustainable energy development funds	-	2,617
	$ 7,499	$ 10,406

13. Interest rate swap agreement

Interest rate swap agreements are transactions in which two parties exchange interest flows on a specified notional amount on predetermined dates for a specified period of time using agreed-upon fixed or floating rates of interest. Notional amounts upon which interest payments/receipts are based are not exchanged.

The Corporation has entered into an interest rate swap agreement with The Toronto Dominion Bank to reduce its exposure to fluctuations in interest rates on a portion of its debt (note 14) by exchanging its interest payments calculated at a floating banker's acceptance discount rate (4.35% at December 29, 2006) for fixed payments calculated at 4.62%. The swap agreement originated on March 30, 2005 and matures on March 30, 2017 with quarterly net settlements. The notional amount of the interest rate swap, which is reset quarterly to match a portion of the principal on the debt, is $7,100,000 as at December 31, 2006.

The fair market value of the swap agreement as at December 31, 2006 was ($103,867), (2005 - ($152,061)).

December 31, 2006 (tabular amounts in thousands of dollars)

14. Long-term debt

The Corporation's long-term debt is summarized as follows:

	2006	2005
The Toronto Dominion Bank $11,400,000 term facility by way of banker's acceptances, at a variable interest rate which resets quarterly (banker's acceptance discount rate plus stamping fee as at December 31, 2006 of 4.35%). Principal drawdowns are quarterly with the balance due on March 30, 2017	$ 9,890	$ 10,711
TD Canada Trust $12,400,000 term note bearing interest at 7.81% payable in monthly installments of $102,000 interest and principal, with the balance due September 30, 2011. The note is guaranteed by the Yukon Government	8,442	8,942
Great West Life $5,750,000 mortgage bearing interest at 11.5%, repayable in monthly installments of $60,269 interest and principal with the final payment due July 2011	2,758	3,147
	21,090	22,800
Less current portion	1,911	1,748
	$ 19,179	$ 21,052

Mortgage payable
The mortgage is secured by land and buildings described in note 8.

Long-term debt repayment
Scheduled repayments for all long-term debt are as follows:

2007	$ 1,910
2008	1,982
2009	2,125
2010	2,275
2011	2,438
Thereafter	10,360
	$ 21,090

Fair value
Fair value at December 31, 2006 of $22,777,000 (2005 - $24,869,000) for all long-term debt was estimated using discounted cash flows based on an estimate of the Corporation's current borrowing rate for similar borrowing arrangements.

December 31, 2006 (tabular amounts in thousands of dollars)

15. Deferred uninsured losses

		2006		2005
Balance, beginning of year	$	33	$	(797)
Provision		100		100
Transfer from Regulatory liabilities (note 11)		-		744
Losses incurred				
Asset replacement		(633)		(14)
Balance, end of year	**$**	**(500)**	$	33

16. Contributions in aid of construction

		Cost		Accumulated Amortization		**2006** Net book Value		2005 Net book Value
Contributions from customers since 1998	$	4,087	$	295	$	3,792	$	3,123
Pre - 1998 contributions		1,739		923		816		882
Government of Yukon contributions		2,080		602		1,478		1,547
	$	**7,906**	**$**	**1,820**	**$**	**6,086**	$	5,552

The sources of contributions received prior to 1998 were not recorded separately.

17. Pension costs and obligations

Yukon Energy Corporation, (the Utility) sponsors a defined benefit pension plan which provides benefits based on length of service and final average earnings as follows:

- years of pensionable service,
- the average annual earnings during any 5 consecutive years of pensionable service where earnings are the highest, and
- the average of the years maximum pensionable earnings (Canada Pension Plan) for the same 5-year period

Annual cost of living increases to a maximum of 3.00% are provided to pensioners. The Utility contributes amounts as recommended by an independent actuary.

Employees make contributions to the plan as follows:

- 3.5% of earnings up to the year's maximum pensionable earnings
- 5.0% of earnings in excess of year's maximum pensionable earnings to a maximum of $2,500 per year.

The Utility has contracted with external organizations to provide services of trustee, administrator and investment manager for the pension plan.

December 31, 2006 (tabular amounts in thousands of dollars)

17. Pension costs and obligations - continued

An actuarial valuation for funding purposes was performed as of January 1, 2004 by the consulting actuarial firm AON Consulting Inc. The next valuation for funding purposes will be conducted as of January 1, 2007. The pension costs and obligations were based on the data used in the January 1, 2004 funding valuation and have been projected to December 31, 2006 in accordance with generally accepted actuarial standards.

The fair value of the plan assets is based on market values as reported by Group Retirement Services, the plan's custodian as at December 31, 2006. The plan assets are invested in a pooled balanced fund. The plan assets are invested as follows: equity investments (51.9%; 2005 - 62.4%), fixed income securities (38.3%; 2005 - 34.6%); short term securities and cash (0%; 2005 - 3.0%) and real estate (9.8%; 2005 - 0%).

Information about the Utility's defined benefit plan as at December 31, in aggregate, is as follows:

	2006	2005
Discount rate - accrued benefit obligation	5.25%	5.25%
Discount rate - benefit costs	6.00%	6.00%
Expected long-term rate of return on plan assets	6.50%	6.50%
Assumed rate of salary escalation	3.00%	3.00%
Assumed rate of pension indexing	2.50%	2.50%
Expected average remaining service period of active employees	14 years	14 years
Benefit obligation determined by actuarial valuation	$ 9,181	$ 8,269
Fair value of plan assets	7,006	6,144
Plan deficit	$ 2,175	$ 2,125
Unrecognized amount		
transitional asset	186	203
net actuarial losses	(1,741)	(1,907)
Accrued benefit liability	$ 620	$ 421
Pension expense	$ 506	$ 337
Employer contributions	$ 307	$ 306
Employee contributions	$ 115	$ 110
Benefits paid	$ 60	$ 97

The accrued benefit liability has been recorded on the Utility's books of account and its current portion of $60,000 (2005-$60,000) is included in accounts payable on the balance sheet.

Employees joining after January 1, 2002 are not eligible to participate in the defined benefit plan. The Utility makes contributions to a Registered Retirement Savings Plan ("RRSP") on behalf of these employees and to employees hired before January 1, 2002 who belonged to the defined benefit plan and elected to opt out of that plan. The RRSP is a defined contribution plan. The costs recognized for the period are equal to the Utility's contribution to the plan. In 2006 these were $149,000 (2005 - $122,000).

Total cash payments for employee future benefits for 2006, consisting of cash contributed by the Utility to its funded defined benefit pension plan and cash contributed directly to the RRSP were $456,000 (2005 - $428,000).

17. Pension costs and obligations - continued

As at December 31, 2006, the Utility's defined pension plan had 40 members (2005 - 40) and the RRSP had 40 members (2005 - 33).

18. Contingencies

Mayo to Dawson City transmission line project
The Utility completed the construction of the Mayo to Dawson City transmission line project during 2003. Subsequent to energization of the line, the Utility and the general contractor notified each other that they have numerous claims arising out of the agreement and the construction of the line. These claims total several million dollars on a net basis.

In November 2006, the Utility and the general contractor appeared in Yukon Supreme Court on an application to determine a legal process for settlement. The court has yet to render a decision. To date, the Utility has insufficient information to assess the financial exposure.

Federal Transfer Agreement
Most of the assets of the Utility were purchased under a March 31, 1987 Agreement of Purchase and Sale between the Government of Canada ("Canada"), Yukon Energy Corporation, the Government of Yukon ("YTG") and Northern Canada Power Commission ("NCPC") (the "Transfer Agreement"). There are several claims that the Utility has against Canada under the Transfer Agreement. The various claims are described below:

Yukon Energy Corporation claims against Canada

(i) Claim against Canada arising from requirement to obtain a fish authorization in relation to the Aishihik Facility
In January 2004, the Utility filed a Writ of Summons against Canada for damages caused by a breach of the Transfer Agreement arising from Canada's notification of the Utility in May, 1999 that the Aishihik Facility required an authorization under the Fisheries Act. The Utility alleges the requirement for a fish authorization was contrary to Canada's representations and warranties under the Transfer Agreement. More particularly it alleges it reasonably relied on warranties and representations given by Canada under the Transfer Agreement to the effect that the Utility had all authorizations necessary for the generation of electricity from the Aishihik Facility. As a result, the Utility incurred significant costs and expenses in negotiating and obtaining a Fisheries Act authorization for the Aishihik Facility and further, its ability to use the Aishihik Facility has been restricted by the terms of the authorization. A legal process was initiated in 2006 claiming damages however the amount of the damages can not be reasonably estimated at this time.

(ii) Soil contamination at the Whitehorse Facility
The Utility has notified Canada of a claim it has for indemnification for expenditures it incurred on site restoration at the Whitehorse Rapids Dam site for hydrocarbon contamination caused by a diesel fuel spill which occurred when Canada owned the facility. This contamination was discovered in 1999 and was rectified in 2000. In addition, further testing in 2004 revealed one additional area of contamination caused during Canada's ownership of the site. The Utility's claim of approximately $260,000 for indemnification arises under the Transfer Agreement. Although it was expected this matter would be resolved in 2006, this did not occur. The Utility has recently had discussions with Canada and it is expected that this matter will be resolved in 2007.

19. Commitments

Aishihik Water License
The Yukon Territory Water Board issued a water use license in 2002, valid until December 31, 2019, for the Utility's Aishihik Lake facility. In addition to maintaining a minimum and maximum water level, this license commits the Utility to meet a number of future requirements including:

- annual payments of $25,000 until 2011 for the purpose of construction and maintenance of a heritage camp and delivery of programs at the camp;
- a Heritage Mitigation Plan. The Utility spent approximately $6,000 in 2006 on heritage projects, expects to spend up to $30,000 in 2007 on heritage projects, and the balance which has not yet been determined in the future; and
- annual fish monitoring programs.

Fish monitoring programs are also required under an authorization provided by the Federal Government Department of Fisheries and Oceans, which is valid until December 31, 2019. The costs of meeting these requirements are accounted for as water license costs in the year they are paid.

Mayo – Dawson Apprenticeship Benefits Agreement
Under this agreement, the Utility is obligated to annual payments of $15,000, adjusted by the percentage change in the Canadian consumer price index, to both The Tr'ondek Hwech'in and the First Nation of Nacho Nyak Dun. The agreement came into effect July 1, 2004 and expires June 30, 2024. The costs of meeting these requirements are expensed to Administration in the year to which they relate.

Mayo – Dawson Transmission Line Option Agreement
The Utility has provided an option to two Yukon First nations to acquire up to a $14,470,000 "indirect interest" in the Mayo-Dawson transmission line system project. The option agreement provides for issuance by the Utility of a long-term instrument repayable over forty years, bearing interest equal to the Utility's blended cost of capital, including a component limited to the Utility's realized return on equity. The option expires on January 4, 2007. In accordance with the agreement, one First Nation excercised the option to extend this deadline to July 4, 2007.

Funding of Energy Solutions Centre Programs
As part of the transfer of operations of the Canada Yukon Energy Solutions Centre to the Department of Energy, Mines and Resources, Yukon Development Corporation has agreed to provide funding of $400,000 per calendar year for 2006 and 2007 to be used for delivery of Energy Solutions Centre programs.

Rate Stabilization Fund
On March 30, 2005, the Yukon Government announced the continuation of the Rate Stabilization Fund from April 1, 2005 until 2007 with the Yukon Development Corporation required by OIC 2005/49 to contribute up to $9,000,000 of internally generated funds before April 1, 2007. At December 31, 2006, Yukon Development Corporation had contributed $7,812,111.

20. Environmental liabilities

Yukon Energy Corporation's activities are subject to various federal and territorial laws and regulations governing the protection of the environment or to minimize any adverse impact thereon. The Utility conducts its operations so as to protect public health and the environment and believes its operations are materially in compliance with all applicable laws and regulations. Liabilities will be recorded when the occurrence of an environmental expenditure, related to present or past activities of the Utility, is considered probable and the costs can be reasonably estimated. To date, no such specific liabilities have been recorded in the Utility's accounts.

21. Risk management and financial instruments

The fair value of cash and cash equivalents, accounts receivable, restricted cash, diesel contingency fund, accounts payable approximate the carrying amount of these instruments due to the short period to maturity. The fair value of long-term debt and of interest rate swap agreements are described in notes 13 and 14 respectively. The Utility also has access to a $10 million line of credit. The renewal date on the line of credit is October 31, 2009. The account accrues interest on withdrawals at prime rate. The facility was not drawn on at year end.

The Utility is not exposed to significant interest rate risk due to its long-term debt having fixed interest rates. The Utility's credit risk is minimal in that its primary customer is a regulated utility.

22. Non-consolidated financial information

The nature and size of operations of the Corporation and its subsidiary, Yukon Energy Corporation differ substantially. Audited financial statements of Yukon Energy Corporation for the year ended December 31, 2006 are also prepared.

23. Subsequent events

On February 8, 2007, the Utility signed a Power Purchase Agreement (PPA) with Minto Explorations Limited, an industrial mining customer. Under this agreement, the Utility has agreed to construct a power line to the mine site to deliver electricity from its grid for the mine's operation. The mine is expected to be in operation by mid-2007 and the current estimate of the mine's life is 7.2 years. There is no immediate financial effect on the Corporation from the signing of this agreement. The agreement was conditional on receiving Yukon Utilities Board approval of that agreement by April 30, 2007. On April 30th the YUB denied the Utility's application for approval. In its decision the YUB directed the parties to endeavor to reach a new agreement in principle consistent with the YUB findings. Subject to the parties coming to such an agreement (and that agreement being approved, as and if required, by the YUB), and also assuming the Utility receives a number of other regulatory and internal approvals, the line is currently forecast to be constructed and operational by the third quarter of 2008. The cost is expected to be funded by contributions from Minto Explorations Ltd, the Yukon Government and the parent, Yukon Development Corporation.

24. Comparative figures

Certain 2005 figures, which are presented for comparative purposes, have been reclassified to conform with the current year's presentation.