Financial Statements of

NIAGARA-ON-THE-LAKE HYDRO INC.

December 31, 2012

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INDEPENDENT AUDITORS' REPORT

To the Shareholder:

We have audited the accompanying financial statements of Niagara-on-the-Lake Hydro Inc. (the "Entity"), which comprise the balance sheet as at December 31, 2012, and the statements of operations and retained earnings and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Niagara-on-the-Lake Hydro Inc. as at December 31, 2012, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

April 25, 2013
St. Catharines, Canada

NIAGARA-ON-THE-LAKE HYDRO INC.

Balance Sheet

December 31, 2012, with comparative figures for 2011

	2012	2011
Assets		
Current assets:		
Cash	$ 300,861	$ 567,832
Accounts receivable	1,689,360	1,638,513
Unbilled revenue	1,884,708	1,196,019
PILs receivable	-	504,781
Due from affiliated companies (note 2)	32,628	591,079
Inventories	335,696	403,257
Prepaid expenses	72,979	83,202
	4,316,232	4,984,683
Property, plant and equipment (note 3)	21,535,930	19,940,827
Future PILs	1,162,991	776,084
Regulatory assets (note 9)	-	2,005,738
Special deposits	352,374	349,467
Investment (note 4)	10,194	10,194
	$ 27,377,721	$ 28,066,993

Liabilities and Shareholder's Equity

	2012	2011
Current liabilities:		
Demand instalment loans (note 6)	$ 3,139,566	$ 3,601,885
Ontario Infrastructure Projects Corporation loan (note 7)	100,000	100,000
Accounts payable and accrued liabilities (note 8)	3,085,162	4,481,077
PILs payable	454,318	-
	6,779,046	8,182,962
Ontario Infrastructure Projects Corporation loan (note 7)	1,216,667	1,316,667
Regulatory liabilities (note 9)	972,746	-
Employee future benefits (note 10)	440,376	454,343
Customer deposits	352,374	349,467
Note payable (note 11)	4,498,030	5,146,521
Shareholder's equity:		
Share capital (note 12)	2,632,307	2,632,307
Paid-up capital	4,269,026	4,269,026
Retained earnings	6,217,149	5,715,700
	13,118,482	12,617,033
	$ 27,377,721	$ 28,066,993

See accompanying notes to the financial statements.

Signed on behalf of the Board:

Director

Director

NIAGARA-ON-THE-LAKE HYDRO INC.

Statement of Operations and Retained Earnings

December 31, 2012 with comparative figures for 2011

	2012	2011
Service Revenue (note 13)	$ 21,424,305	$ 20,460,616
Cost of power purchased	16,963,635	15,545,062
Gross Margin	4,460,670	4,915,554
Other Income	269,654	477,143
Smart meter disposition (note 9)	125,761	-
	4,856,085	5,392,697
Other Expenditure:		
Distribution operations	883,753	819,343
Billing and collection	432,094	402,377
General administration	608,325	735,752
Financial expense	492,022	760,671
Amortization (note 17)	1,782,092	1,428,183
	4,198,286	4,146,326
Net income before income taxes	657,799	1,246,371
Income Taxes		
Current	462,731	(88,838)
Future	(306,381)	268,968
	156,350	180,130
Net income	501,449	1,066,241
Retained earnings, beginning of year	5,715,700	4,649,459
Retained earnings, end of year	$ 6,217,149	$ 5,715,700

See accompanying notes to the financial statements.

NIAGARA-ON-THE-LAKE HYDRO INC.

Statement of Cash Flows

December 31, 2012 with comparative figures for 2011

	2012	2011
Cash provided by (used in):		
Net income	$ 501,449	$ 1,066,241
Items not involving cash:		
Amortization (note 17)	1,892,987	1,508,884
Future income taxes	(306,381)	268,968
Loss (gain) on disposal of property, plant and equipment	51,592	(53,986)
Operating activities:		
Changes in non-cash working capital components (note 14a)	(1,098,568)	1,670,436
Employee future benefits	(13,967)	(24,720)
Change in regulatory liabilities	1,034,516	(1,609,600)
Funds provided by operating activities	2,061,628	2,826,223
Investing activities		
Due from affiliates	558,451	(22,266)
Additions to property, plant and equipment (note 14b)	(1,725,240)	(1,760,780)
Proceeds on disposal of property, plant and equipment	49,000	53,986
Special deposits	(2,907)	(1,984)
Customer deposits	2,907	1,984
Change in investment	-	2,201
Funds used in investing activities	(1,117,789)	(1,726,859)
Financing activities		
Demand instalment loans	(462,319)	(236,802)
Repayment of OIPC construction loan	(100,000)	(1,350,462)
Issuance of new debt OIPC loan	-	1,416,667
Repayment of long-term note payable	(648,491)	(600,317)
Funds provided by (used in) financing activities	(1,210,810)	(770,914)
Increase (decrease) in cash	(266,971)	328,450
Cash, beginning of year	567,832	239,382
Cash, end of year	$ 300,861	$ 567,832

On July 1, 2000, Niagara-on-the-Lake Hydro Inc. (the "Company") was incorporated under the Business Corporations Act (Ontario) along with its affiliated companies, Niagara-on-the-Lake Energy Inc. and Energy Services Niagara Inc. The incorporation was pursuant to the provisions of the Energy Competition Act, 1998.

1. Significant accounting policies:

These financial statements of Niagara-on-the-Lake Hydro Inc. have been prepared in accordance with Canadian generally accepted accounting principles. The Company and Energy Services Niagara Inc. are wholly-owned subsidiaries of Niagara-on-the-Lake Energy Inc. The Company has adopted accounting policies prescribed by the Canadian Institute of Chartered Accountants and therefore the financial statements are prepared in accordance with Part V of the CICA Handbook.

(a) Regulation

The Ontario Energy Board Act (Ontario), 1998 ("OEBA") conferred on the Ontario Energy Board ("OEB") increased powers and responsibilities to regulate the electricity industry in Ontario. These powers and responsibilities include approving or fixing rates for the transmission and distribution of electricity, providing continued rate protection for rural and remote electricity consumers, and ensuring that distribution companies fulfill obligations to connect and service customers. The OEB may also prescribe license requirements and conditions of service to electricity distributors which may include, among other things, record keeping, regulatory accounting principles, separation of accounts for distinct businesses, and filing and process requirements for the rate-setting process.

(b) Rate setting

The distribution rates of the Company are based on a revenue requirement that provides a regulated maximum allowable return on equity ("MARE") on the amount of shareholder's equity supporting the business of electricity distribution.

The OEB regulates the electricity distribution rates charged by an Ontario municipal electric utility ("LDC") using a combination of annual incentive rate mechanism ("IRM") adjustments and periodic cost of service reviews. Both such adjustments and reviews are based on applications made by LDC's to the OEB. The current ratemaking policy of the OEB requires a cost of service review every five years, followed by four successive years of IRM adjustments. The Company was approved for a one year extension on their next cost of service review and will file their application in 2013.

1. Significant accounting policies (continued):

(c) Regulatory accounting

The OEB has the authority to specify regulatory accounting treatments that may differ from Canadian generally accepted accounting principles for enterprises operating in a non-regulated environment. The OEB has the general power to include or exclude costs, revenues, losses or gains in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have applied in an unregulated company. Such change in timing involves the application of rate regulated accounting, giving rise to the recognition of regulatory assets and liabilities. The Company's regulatory assets represent certain amounts recoverable from customers in the future and costs that have been deferred for accounting purposes because it is probable that they will be recovered in future rates. The Company's regulatory liabilities represent certain amounts repayable to customers in the future with respect to non-distribution market related charges and variances that are expected to be settled in future periods.

(d) Inventories

Inventories are measured at the lower of cost, (first in, first out) and net realizable value. Major spare parts and standby equipment are presented as property, plant and equipment as they are used during more than one period.

(e) Property, plant and equipment

Property, plant and equipment are stated at cost and removed from the accounts when disposed or retired. Costs of assets which are pooled are removed from the accounts at the end of their estimated average service lives. Gains or losses at retirement or disposition of such assets are credited or charged to other income.

Amortization is provided for property, plant and equipment using the straight-line method based on the following estimated service lives:

Buildings	25 to 50 years
Transformer stations	40 years
Distribution stations	30 years
Distribution lines	25 years
Distribution transformers and meters	25 years
Other capital assets	3 to 15 years
Intangible assets	20 years

Work in progress assets are not amortized until the project is complete and in service. The Company has not capitalized interest to the cost of assets constructed.

Capital contributions are netted against property, plant and equipment and amortized to income on the same basis as the related asset.

1. **Significant accounting policies (continued):**

(f) Investment

The Company's investment is accounted for using the cost method since the shares are not actively traded.

(g) Customer deposits and special deposits

Special deposits are cash collections from customers to guarantee the payment of electricity bills and are classified as a non-current asset.

(h) Employee future benefits

The Company pays certain medical, dental and life insurance benefits on behalf of its retired employees. The Company recognizes these post-retirement costs in the period in which the employees render the services. The excess of net actuarial gains (losses) over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the active employees.

(i) Paid-up capital

Paid-up capital reflects the balance of capital contributions received by the former Niagara-on-the-Lake Hydro-Electric Commission prior to January 1, 2000.

(j) Revenue recognition

Service revenue is recorded as revenue in the period to which it relates. Service revenue from the sale of electrical energy includes an estimated accrual for power supplied but not billed to customers from the last meter reading date to the year end.

(k) Payments in lieu of taxes (“PILs”)

The Company is currently exempt from taxes under the Income Tax Act (Canada) (“ITA”) and the Ontario Corporations Tax Act (“OCTA”).

Pursuant to the EA, the Company is required to compute taxes under the ITA and OCTA and remit such amounts there under computed to the Ministry of Finance (Ontario).

The Company provides for PILs using the asset and liability method. Under this method, future tax assets and liabilities are recognized, to the extent such are determined likely to be realized, for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

1. **Significant accounting policies (continued):**

(k) Payments in lieu of taxes ("PILs") (continued)

Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of the Company at that time.

PILs recoverable from loss carry forwards are recorded in future PILs on the balance sheet at the current enacted statutory tax rates expected to apply when recovery of the loss carry forwards are expected to be recovered.

(l) Financial instruments

The Company has classified its financial instruments as follows:

Cash and special deposits are classified as "assets held for trading".

Accounts receivable and investment are classified as "loans and receivables" and are measured at amortized cost.

Demand installment loans, Ontario Infrastructure Projects Corporation loan, accounts payable and accrued liabilities, customer deposits and note payable are classified as "other financial liabilities" which are measured at amortized cost.

The Company is required to classify fair value measurements using a fair value hierarchy, which includes three levels of inputs that may be used to measure fair value:

Level I - Quoted prices in active markets for identical assets or liabilities;

Level 2 - Quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets or quoted prices that are derived principally from or corroborated by observable market data or other means;

Level 3 - Unobservable inputs that are supported by little or no market activity.

The Company's financial instruments measured at fair value consist of cash and special deposits which are classified within Level 1 of the fair value hierarchy.

1. Significant accounting policies (continued):

(m) Measurement uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and note disclosures related thereto. Due to inherent uncertainty in making estimates, actual results could differ from these estimates recorded in preparing these financial statements including changes as a result of future regulatory decisions.

Accounts receivable, unbilled revenue and regulatory assets/liabilities are stated after evaluation of amounts expected to be collected and an appropriate allowance for doubtful accounts. Inventories are recorded net of provisions for obsolescence. Amounts recorded for depreciation and amortization of equipment are based on estimates of useful service life. Employee future benefits are based on certain assumptions, including interest (discount) rate, salary escalation, the average retirement age of employees, employee turnover and expected health and dental care costs.

2. Due From Affiliated Companies:

	2012	2011
Niagara-on-the-Lake Energy Inc.	$ 6,726	$ 5,016
Energy Services Niagara Inc.	25,902	586,063
	$ 32,628	$ 591,079

The balances are non-interest bearing with no fixed terms of repayment.

3. Property, Plant and Equipment:

			2012	2011
	Cost	Accumulated amortization	Net book value	Net book value
Land	$ 307,134	$ -	$ 307,134	$ 307,134
Buildings	1,040,648	370,292	670,356	661,840
Transformer stations	5,423,008	1,117,287	4,305,721	4,429,458
Distribution stations	160,630	112,703	47,927	51,000
Distribution Overhead lines	11,718,133	6,728,049	4,990,084	4,381,649
Distribution Underground lines	12,246,263	6,394,348	5,851,915	5,679,570
Distribution Transformers	5,720,122	3,284,778	2,435,344	2,419,793
Distribution meters	2,423,647	774,271	1,649,376	240,619
Equipment and trucks	4,450,411	3,253,373	1,197,038	1,047,001
Other	25,038	15,231	9,807	11,059
Work in progress	71,228	-	71,228	711,704
	$ 43,586,262	$ 22,050,332	$ 21,535,930	$ 19,940,827

Included in property, plant and equipment are intangible assets totaling $25,038 (2011 - $25,038) with a net book value of $9,807 (2011 - $11,059).

4. Investment:

	2012	2011
100 common shares of Utility Collaborative Services Inc. ("UCS") - at cost	$ 100	$ 100
Payments and costs incurred on behalf of UCS	10,094	10,094
	$ 10,194	$ 10,194

In 2009, the Company acquired a 12.5% interest in UCS. The purpose of this company is to provide billing system support services for the Company.

5. Related Party Transactions:

During the period, Niagara-on-the-Lake Hydro Inc. provided operation and administration services to its affiliates in the normal course of business in the following amounts:

	2012	2011
Energy Services Niagara Inc.	$ 181,329	$ 223,613

In the ordinary course of business, the Company enters into transactions with the Town of Niagara-on-the-Lake (the "Town") including its boards and agencies. The Company derives revenues from the sale of electricity and recovers costs of supplying electrical equipment and distribution system from these related parties. Purchases from related parties are measured at the exchange amount of consideration established and agreed to by the related parties. Account balances resulting from these transactions which are included in the balance sheet are settled in accordance with normal trade terms.

Interest paid on the long-term note payable is disclosed in note 11.

6. Demand Instalment Loans:

	2012	2011
Demand instalment loan, bearing interest at prime plus 0.75 %, repayable in monthly instalments of $15,556, due August 2013	$ 1,469,919	$ 1,728,146
Demand instalment loan, bearing interest at prime plus 0.75 %, repayable in monthly instalments of $13,333, due August 2015	1,669,647	1,873,739
	$ 3,139,566	$ 3,601,885

The security for the demand instalment loans, operating line, and letters of credit is a general security agreement in the first position, including an assignment of accounts receivable and inventories and a floating charge over all tangible properties subject to a third party agreement with Ontario Infrastructure Projects Corporation limiting this interest to $7,500,000 in specific borrowings. There are unlimited guarantees provided by Niagara-on-the-Lake Energy Inc. and Energy Services Niagara Inc. and an assignment and postponement of claim provided by the Corporation of the Town of Niagara-on-the-Lake in an amount that is unlimited.

6. Demand Instalment Loans:

Repayment terms for the demand installment loans have been negotiated for an amortization period of fifteen years. The principal payments due over the next five years are as follows:

2013	$ 362,890
2014	382,686
2015	403,562
2016	425,577
2017	448,794

7. Ontario Infrastructure Projects Corporation ("OIPC") Loan:

This loan is a debenture which bears interest at 4.27%, repayable in monthly principle instalments of $8,333 plus interest and due February 16, 2026. At December 31, 2012 the outstanding balance of this loan is $1,316,667 (2011 - $1,416,667). The security for the loan is a general security agreement in the second position, including an assignment of accounts receivable, inventories, equipment, chattel paper, instruments and securities, intangibles, books and accounts, real property and proceeds. In addition, guarantees have been provided by Niagara-on-the-Lake Energy Inc. and Energy Services Niagara Inc.

Repayment terms for the OIPC Loan have been negotiated for an amortization period of fifteen years. The principal payments due over the next five years are as follows:

2013	$ 100,000
2014	100,000
2015	100,000
2016	100,000
2017	100,000

8. Accounts payable and accrued liabilities:

Accounts payable and accrued liabilities also includes $435,896 (2011 - $1,386,572) due to the Town of Niagara-on-the-Lake. These payables arose from water and wastewater billings. The balance is non-interest bearing with no fixed terms of repayment.

9. Regulatory Liabilities:

The OEB has established in its Electricity Distribution Rate Handbook and its Accounting Procedures Handbook for Electricity Distribution Utilities provisions for recording deferral and variance account regulatory assets or liabilities on the Company's balance sheet. Deferral and variance account regulatory assets/liabilities primarily represent costs that have been deferred in anticipation of future cost recoveries as determined by the OEB.

Settlement variances represent amounts that have accumulated since January 1, 2007 and are comprised of:

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

As part of the OEB's 2009 rate application process, the recovery through distribution rates of specific amounts of the Company's deferral and variance account regulatory asset balances as at December 31, 2007 was approved and is to be recovered over a four year period ending April 30, 2013.

As part of the OEB's 2011 rate application process, the recovery through distribution rates of specific amounts of the Company's deferral and variance account regulatory asset balances as at December 31, 2009 was approved and is to be recovered over a one year period ending April 30, 2012.

As part of the OEB's 2012 rate application process, the recovery through distribution rates of specific amounts of the Company's deferral and variance account regulatory asset balances as at December 31, 2010 was approved and is to be recovered over a one year period commencing May 1, 2012.

As at December 31, 2012, the Company has accumulated $64,483 (2011 - $(2,962,441)) in deferral and variance accounts on the balance sheet. It is management's belief that these assets/liabilities are consistent with the OEB's deferral criteria.

9. Regulatory Liabilities (continued):

	2012	2011
Deferral and variance accounts:		
Deferred PILS variances	$ -	$ 316,682
Settlement variances	(377,117)	575,838
Renewable generation connection and Smart grid development deferral accounts	391,927	384,290
Other deferral accounts	(52,573)	(132,009)
Smart meter deferral accounts	-	1,684,475
Stranded meters	102,246	133,165
	64,483	2,962,441
Regulatory liability for future taxes	(1,037,229)	(956,703)
	$ (972,746)	$ 2,005,738

Smart meters disposition:

The OEB approved the disposition of the smart meter regulatory accounts effective July 1, 2012. As part of the disposition, the customer billings and costs related to the smart meters of prior years, included in the regulatory accounts, are included in the current year Statement of Earnings. This resulted in net revenue of $125,761 included in revenue as follows:

Smart Meter Revenue	$ 353,589
Expenses:	
Operations and maintenance	184,671
Interest expense	43,157
	227,828
Net revenue	$ 125,761

10. Employee Future Benefits:

Defined Benefit Plan Information

	2012	2011
Accrued benefit obligation, beginning of year	$ 373,219	$ 369,721
Actuarial gain	(32,337)	-
Expense for the year	26,612	12,181
Interest expense	-	18,247
Benefits paid during the year	(35,617)	(26,930)
Accrued benefit obligation, end of year	331,877	373,219
Unamortized actuarial gain	108,499	81,124
Employee future benefits liability	$ 440,376	$ 454,343

An actuarial valuation was done for the year ended December 31, 2012.

Amortization of the actuarial gain was $4,962 (2011 - $3,709).

The main actuarial assumptions employed for the valuation are as follows:

General Inflation - Future general inflation levels, as measured by changes in the Consumer Price Index (CPI), were assumed at 2.5% in 2012 and thereafter.

Interest (Discount) Rate - The present value of future liabilities and the expense were determined using discount rates of 4.4%.

Salary Levels - Future general salary and wage levels were assumed to increase at 3.3% per annum.

Medical Costs - Medical costs were assumed to be 8% for 2012, decreasing by approximately 0.53% annually until 2018 where it has been graded down to 4.8% and 4.8% thereafter.

Dental Costs - Dental costs were assumed to be 4.8% in 2012 and thereafter.

11. Long-Term Note Payable:

Long-term note payable to the Town of Niagara-on-the-Lake, bears interest at 7.25%, amounts paid and accrued for the year amounted to $351,855 (2011 – $400,031). During the year, there were repayments of $648,491 (2011 – $600,317) to the Town. The long-term note payable is unsecured and there are no fixed terms of repayment.

12. Share Capital:

Authorized
Unlimited number of common shares

	2012	2011
Issued		
1,001 common shares	$ 2,632,307	$ 2,632,307

13. Service Revenue:

	2012	2011
Residential energy	$ 8,042,054	$ 6,826,336
General <50kW energy	4,157,083	3,579,691
General >50kW energy	6,523,951	6,306,823
Unmetered scattered load energy	15,897	17,559
Street lighting energy	278,434	225,124
Sales for retailers	473,433	807,061
Non-competitive charges	1,933,453	2,698,022
Service revenue	$ 21,424,305	$ 20,460,616

14. Statement of Cash Flows:

(a) Changes in working capital components include:

	2012	2011
Accounts receivable	$ (50,847)	$ 598,250
Unbilled revenue	(688,689)	470,070
PILs receivable/payable	959,099	(195,301)
Inventories	67,561	(184,747)
Prepaid expenses	10,223	9,177
Accounts payable and accrued liabilities	(1,395,915)	972,987
	$ (1,098,568)	$ 1,670,436

14. Statement of Cash Flows (continued):

(b) Acquisition of capital assets

During the period, capital assets were acquired in the amount of $2,107,695 (2011 - $2,206,446). Capital contributions received from third parties amounted to $382,455 (2011 - $445,666). Cash payments of $1,725,240 (2011 – $1,760,780) were made to purchase capital assets.

(c) Non-cash activity

Smart meters in the amount of $1,832,523 (2011 - $nil) have been transferred from regulatory assets to capital assets.

Regulatory liabilities have increased by $80,526 (2011 - $83,592) related to an increase in future tax asset.

(d) Interest and payments in lieu of taxes

	2012	2011
Interest received	$ 6,371	$ 8,029
Interest paid	585,211	648,125
Payments in lieu of taxes paid	-	111,463
Payments in lieu of taxes received	558,202	-

15. Pension Agreement:

The Company makes contributions to the Ontario Municipal Employees Retirement Systems ("OMERS"), which is a multi-employer plan, on behalf of approximately 17 members of its staff. The plan is a defined benefit plan which specifies the amount of the retirement benefit to be received by the employees based on the length of service and rates of pay.

The amount contributed to OMERS for 2012 was $121,451 (2011 - $105,143) for current service.

16. General Liability Insurance:

The Company is a member of the Municipal Electric Association Reciprocal Insurance Exchange ("MEARIE") which is a pooling of general liability insurance risks. Members of MEARIE would be assessed, on a pro-rata basis, based on the total of their respective deposit premiums should losses be experienced by MEARIE, in excess of reserves and supplementary insurance, for the years in which the Company or the former Niagara-on-the-Lake Hydro-Electric Commission was a member.

Participation in MEARIE covers a three year underwriting period which expires January 1, 2013. To December 31, 2012, the Company has not been made aware of any additional assessments.

17. Amortization:

	2012	2011
Amortization		
Amortization of capital assets charged to operations	$ 1,782,092	$1,428,183
Amortization of capital assets charged to operating assets	110,895	80,701
	$ 1,892,987	$1,508,884

18. Financial Instruments:

Recognition and Measurement

The fair value of cash, accounts receivable, special deposits, accounts payable and accrued liabilities, demand installment loans and customer deposits correspond to their carrying values due to their short term maturity.

It is not practicable to determine the fair value of the investment and the note payable to the Town of Niagara-on-the-Lake due to the limited amount of comparable market information available.

Level 3

The OIPC Loan has a carrying value of $1,316,667 and fair value of approximately $1,401,000 using current rates of interest for similar instruments with similar maturity dates.

Credit Risk

The Company, in the normal course of business, monitors the financial condition of its customers and reviews the credit history of new customers. The Company is currently holding customer deposits on hand in the amount of $352,374 (2011 - $349,467) which are reflected on the balance sheet. Allowances are also maintained for potential credit losses. Management believes that it has adequately provided for any exposure to normal customer credit risk.

18. Financial Instruments (continued):

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk is to ensure that it always has sufficient cash and credit facilities to meet its obligations when due.

The Company manages this risk by developing cash forecasts as well as the annual preparation of a 12 month operating plan and the annual preparation of a 60 month capital plan.

Interest Rate Risk

The Company has entered into two fair value swap transactions, with the intent of fixing the interest rate on the first $1,469,919 demand instalment loan at 6.03% and the second $1,669,647 demand instalment loan at 5.38% to the final maturity dates of August, 2018 and October, 2020 respectively.

The fair value of the interest rate swap agreements are based on amounts quoted by CIBC to realize favourable contracts or settle unfavourable contracts, taking into account interest rates as at December 31, 2012. At December 31, 2012 the interest rate swap was in a net unfavourable position of $326,824 (2011 - $445,025). This unfavourable amount has been included in the demand instalment loan balance. The net current year impact of the change in fair value of the interest rate swap included in the statement of operations is a decrease (increase) in financial expense of $118,201 (2011 – $(89,514)).

The Company is also exposed to fluctuations in interest rates relating to the interest rate swap agreements. An increase or decrease of 1% on the agreements would result in interest expense being higher or lower by approximately $30,000.

Operating Line of Credit

As at December 31, 2012, the Company had a line of credit of $2,000,000 no amount of which had been drawn down. The line of credit consists of revolving operating and term facilities that bear interest at prime rate plus 0.15% and are covered under the security issued for the demand instalment loans as described in note 6.

Letters of Credit/Guarantees

The Company had arranged for a total letter of credit or guarantee in the amount of $1,400,000. As at December 31, 2012, $1,349,198 is available to the IESO no amount of which had been drawn upon. This is to provide a prudential letter of credit in support of the purchase of electrical power from the IESO. Any draw under this facility will be converted into a capital loan facility with a monthly repayment program to be negotiated. This facility is covered under the security issued for the demand instalment loans as described in note 6.

19. Capital Management:

The Company's main objectives when managing capital are to:

- ensure ongoing access to funding to maintain and improve the electricity distribution system
- meet any capital needs of its other related companies should the need arise
- ensure compliance with covenants related to its credit facilities, demand loan payable and the Town note payable

The Company's definition of capital includes shareholder's equity and long term debt which includes demand instalment loans, OIPC loan and the long-term note payable. As at December 31, 2012 shareholder's equity amounts to $13,118,482 (2011 - $12,617,033) and long-term debt amounts to $8,954,263 (2011 - $10,165,073). The Company's capital structure as at December 31, 2012 is 41% debt and 59% equity (2011 - 45% debt and 55% equity). There have been no changes in the Company's approach to capital management during the year.

20. Emerging Accounting Issues:

Transition to International Financial Reporting Standards ("IFRS"):

The Canadian Accounting Standards Board ("AcSB") adopted a strategic plan that will have Canadian GAAP converge with IFRS, effective January 1, 2011 which will require entities to restate, for comparative purposes, their interim and annual financial statements and their opening financial position.

In October 2010, the AcSB approved the incorporation of a one year deferral of adoption of IFRS into Part 1 of the Canadian Institute of Chartered Accountants ("CICA") Handbook for qualifying entities with activities subject to rate regulation. Part 1 of the CICA Handbook specifies that first-time adoption is mandatory for interim and annual financial statements relating to annual periods beginning on or after January 1, 2012. This deferral has subsequently been deferred further to annual periods beginning on or after January 1, 2015.

The amendment also requires entities that do not prepare its interim and annual financial statements in accordance with Part 1 of the Handbook during the annual period beginning on or after January 1, 2011 to disclose that fact.

The Corporation has decided to implement IFRS commencing on January 1, 2015.

20. Emerging Accounting Issues (continued):

Accounting for rate regulated activities under IFRS:

IFRS does not currently provide guidance on accounting for the effects of rate regulation and the recognition of regulatory assets and liabilities. Currently, rate regulated entities do not recognize regulatory assets and liabilities in their IFRS compliant financial statements. The impact of rate regulated accounting has been disclosed in note 9.

IFRS 1 provides an exemption from retroactive restatement for entities with operations subject to rate regulation. This exemption permits, at the date of transition, an entity to use the carrying values of property, plant and equipment and intangible assets as deemed cost, thus avoiding the need to restate historical balances using IFRS principles or to determine fair value. The Corporation has elected to apply this exemption for all items of property, plant and equipment and intangible assets subject to rate regulation upon the adoption of IFRS.

On July 28, 2009, the OEB issued its Report of the Board – Transition to IFRS, which contains recommendations on how regulatory reporting requirements should change in response to IFRS. The OEB has now initiated a second phase in its transition project, which involves amending certain regulatory instruments. The Corporation continues to evaluate the potential impacts of the recommendations contained in the Report of the Board on both the activities of the Corporation and its IFRS transition plan.