

Financial Statements of

**NIAGARA-ON-THE-LAKE
HYDRO INC.**

Year ended December 31, 2014



KPMG LLP

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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, 2014, 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, 2014, 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 Professional Accountants, Licensed Public Accountants

April 27, 2015
St. Catharines, Canada

NIAGARA-ON-THE-LAKE HYDRO INC.

Balance Sheet

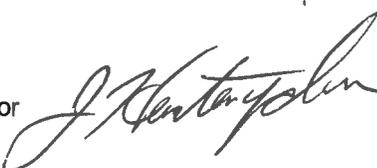
December 31, 2014, with comparative information for 2013

	2014	2013
Assets		
Current assets:		
Accounts receivable	\$ 2,320,799	\$ 1,828,991
Unbilled revenue	2,496,314	2,249,521
PILs receivable	341,907	50,225
Due from affiliated companies (note 2)	-	35,366
Inventories (note 3)	192,033	256,066
Prepaid expenses	11,494	74,458
	<u>5,362,547</u>	<u>4,494,627</u>
Property, plant and equipment (note 4)	23,500,945	22,567,588
Future PILs	864,372	1,320,786
Special deposits	340,997	353,577
Investment (note 5)	100	9,890
	<u>\$ 30,068,961</u>	<u>\$ 28,746,468</u>
Liabilities and Shareholder's Equity		
Current liabilities:		
Line of Credit	\$ 308,081	\$ 348,356
Demand instalment loans (note 7)	2,238,128	2,666,266
Ontario Infrastructure Projects Corporation loan (note 8)	100,000	100,000
Accounts payable and accrued liabilities (note 9)	5,291,436	3,524,954
Due to affiliated companies (note 2)	550,158	-
	<u>8,487,803</u>	<u>6,639,576</u>
Ontario Infrastructure Projects Corporation loan (note 8)	1,016,667	1,116,667
Regulatory liabilities (note 10)	1,509,355	2,271,537
Employee future benefits (note 11)	409,548	428,290
Customer deposits	340,997	353,577
Note payable (note 12)	3,304,613	3,800,929
Shareholder's equity:		
Share capital (note 13)	2,632,307	2,632,307
Paid-up capital	4,269,026	4,269,026
Retained earnings	8,098,645	7,234,559
	<u>14,999,978</u>	<u>14,135,892</u>
	<u>\$ 30,068,961</u>	<u>\$ 28,746,468</u>

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, 2014 with comparative information for 2013

	2014	2013
Service Revenue (note 14)	\$ 25,019,166	\$ 23,184,336
Cost of power purchased	20,290,110	18,045,856
Gross Margin	4,729,056	5,138,480
Other Income	166,134	248,832
	4,895,190	5,387,312
Other Expenditure:		
Distribution operations	904,236	983,263
Billing and collection	559,556	491,527
General administration	774,222	777,832
Financial expense	399,206	445,239
Regulatory adjustment	223,974	671,921
Amortization (note 18)	912,849	1,043,708
	3,774,043	4,413,490
Net income before income taxes	1,121,147	973,822
Income Taxes		
Current	(132,334)	416,547
Future	139,395	(460,135)
	7,061	(43,588)
Net income	1,114,086	1,017,410
Retained earnings, beginning of year	7,234,559	6,217,149
Dividends	(250,000)	-
Retained earnings, end of year	\$ 8,098,645	\$ 7,234,559

See accompanying notes to the financial statements.

NIAGARA-ON-THE-LAKE HYDRO INC.

Statement of Cash Flows

December 31, 2014 with comparative information for 2013

	2014	2013
Cash provided by (used in):		
Net income	\$ 1,114,086	\$ 1,017,410
Items not involving cash:		
Amortization (note 18)	1,005,866	1,070,499
Future income taxes	139,395	(460,135)
Loss on disposal of property, plant and equipment	43,023	2,882
Operating activities:		
Changes in non-cash working capital components (note 15a)	903,746	(491,044)
Employee future benefits	(18,742)	(12,086)
Change in regulatory liabilities	(445,163)	1,465,424
Funds provided by operating activities	2,742,211	2,592,950
Investing activities		
Due to/from affiliated companies	(14,476)	(2,738)
Additions to property, plant and equipment (note 15b)	(2,067,183)	(1,974,425)
Proceeds on disposal of property, plant and equipment	44,387	5,093
Special deposits	12,580	(1,203)
Customer deposits	(12,580)	1,203
Change in investment	9,790	304
Funds used in investing activities	(2,027,482)	(1,971,766)
Financing activities		
Advance of loan from affiliated company	600,000	-
Dividend	(250,000)	-
Repayment of demand instalment loans	(428,138)	(473,300)
Repayment of OIPC construction loan	(100,000)	(100,000)
Repayment of long-term note payable	(496,316)	(697,101)
Funds used in financing activities	(674,454)	(1,270,401)
Increase (decrease) in cash	40,275	(649,217)
Cash, beginning of year	(348,356)	300,861
Cash, end of year	\$ (308,081)	\$ (348,356)

See accompanying notes to the financial statements.

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

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 CPA Canada Handbook and therefore the financial statements are prepared in accordance with Part V of the CPA Canada 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 filed their cost of service application in 2013 for rates effective May 1, 2014.

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

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	30 to 60 years
Transformer stations	45 to 55 years
Distribution - overhead	45 to 60 years
Distribution - underground	45 to 65 years
Distribution - transformers	45 years
Distribution - meters	15 to 40 years
Equipment, trucks and other	3 to 15 years

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

1. Significant accounting policies (continued):

(e) Property, plant and equipment (continued):

On January 1, 2013, the Corporation implemented regulatory accounting changes for capitalization policies and depreciation expense. Overheads are now based on costs directly attributable to asset acquisition and maintenance. At the same time, the estimated useful service life of the assets was revised using the actual life of the assets experienced by the Corporation and industry sponsored asset life studies. In accordance with the requirements of the regulator, the Corporation has recorded the net effect of the changes as an adjustment to earnings with an offsetting amount recorded in regulatory liabilities. The accounting policy change has been accounted for prospectively in accordance with the direction of the regulator.

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.

(f) Investment:

The Company's investment is accounted at cost.

(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.

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

1. Significant accounting policies (continued):

(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 Electricity Act, 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).

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.

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, special deposits and interest rate swap agreements are classified as "assets held for trading".

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

Line of credit, demand installment loans, Ontario Infrastructure Projects Corporation loan, accounts payable and accrued liabilities, customer deposits and note payable are classified as "other 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 1 - 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;

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

1. Significant accounting policies (continued):

(l) Financial instruments (continued):

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, line of credit, and special deposits which are classified within Level 1 of the fair value hierarchy. Interest rate swap agreements measured at fair value, classified within Level 3 of the fair value hierarchy.

(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 (to) from affiliated companies:

	2014	2013
Niagara-on-the-Lake Energy Inc.	\$ 12,027	\$ 8,827
Energy Services Niagara Inc.	(562,185)	26,539
	<u>\$(550,158)</u>	<u>\$ 35,366</u>

The balances are non-interest bearing, with the exception of a \$600,000 loan from ESNI which has an interest rate of 3.50%. There are no fixed terms of repayment.

3. Inventories:

The amount of inventory expensed during the year is \$769 (2013 - \$326).

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

4. Property, plant and equipment:

			2014	2013
	Cost	Accumulated amortization	Net book value	Net book value
Land	\$ 307,134	\$ -	\$ 307,134	\$ 307,134
Buildings	1,047,425	405,096	642,329	654,025
Transformer stations	5,434,064	1,315,267	4,118,797	4,206,782
Distribution stations	160,630	160,630	-	-
Distribution Overhead lines	12,421,168	6,899,581	5,521,587	5,258,231
Distribution Underground lines	13,302,639	6,752,399	6,550,240	6,271,143
Distribution Transformers	5,806,900	3,338,233	2,468,667	2,469,385
Distribution meters	2,501,349	1,028,903	1,472,446	1,567,281
Equipment and trucks	4,996,577	3,929,664	1,066,913	1,255,598
Other	-	-	-	8,555
Work in progress	1,352,832	-	1,352,832	569,454
	\$ 47,330,718	\$ 23,829,773	\$ 23,500,945	\$ 22,567,588

5. Investment:

	2014	2013
100 common shares of Utility Collaborative Services Inc. ("UCS") - at cost	\$ 100	\$ 100
Payments and costs incurred on behalf of UCS	-	9,790
	\$ 100	\$ 9,890

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.

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

6. 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 amount:

	2014	2013
Energy Services Niagara Inc.	\$ 138,252	\$ 133,459

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 12.

7. Demand instalment loans:

	2014	2013
Demand instalment loan, bearing interest at prime plus 0.75 %, repayable in monthly instalments of \$15,556	\$ 965,527	\$ 1,214,107
Demand instalment loan, bearing interest at prime plus 0.75 %, repayable in monthly instalments of \$13,333	1,272,601	1,452,159
	\$ 2,238,128	\$ 2,666,266

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.

The Company has entered into interest rate swap agreements to fix the interest rates on the demand instalment loans. See note 19.

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

7. Demand instalment loans (continued):

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

2015	\$ 403,562
2016	425,577
2017	448,794
2018	382,468
2019	216,903

8. 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, 2014 the outstanding balance of this loan is \$1,116,667 (2013 - \$1,216,667). The security for the loan is a general security agreement in the second position, including an assignment of accounts receivable, inventories, equipment, intangibles, and 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:

2015	\$ 100,000
2016	100,000
2017	100,000
2018	100,000
2019	100,000

9. Accounts payable and accrued liabilities:

Accounts payable and accrued liabilities also includes \$289,263 (2013 - \$296,268) 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.

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

10. 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 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 2013 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, 2013 were approved and are to be recovered over a one year period commencing May 1, 2014.

As at December 31, 2014, the Company has accumulated \$1,091,485 (2013 - \$1,536,648) 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.

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

10. Regulatory liabilities (continued):

	2014	2013
Deferral and variance accounts:		
Settlement variances	\$ (129,940)	\$ (1,240,126)
Renewable generation connection and Smart grid development deferral accounts	6,047	17,457
Other deferral accounts	(207,214)	261,048
Adjustment for change in accounting policy	(799,820)	(671,921)
Stranded meters	39,442	96,894
	(1,091,485)	(1,536,648)
Regulatory liability for future taxes	(417,870)	(734,889)
	\$ (1,509,355)	\$ (2,271,537)

11. Employee future benefits:

Defined Benefit Plan Information

	2014	2013
Accrued benefit obligation, beginning of year	\$ 323,365	\$ 331,877
Actuarial gain	-	-
Expense for the year	14,379	13,839
Interest expense	13,111	13,552
Benefits paid during the year	(42,597)	(35,903)
Accrued benefit obligation, end of year	308,258	323,365
Unamortized actuarial gain	101,290	104,925
Employee future benefits liability	\$ 409,548	\$ 428,290

An actuarial valuation was done as at January 1, 2012.

Amortization of the actuarial gain was \$3,635 (2013 - \$3,574).

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 2014 and thereafter.

Interest (Discount) Rate - The present value of future liabilities and the expense were determined using discount rates of 3.9%.

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

11. Employee future benefits (continued):

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 6.93% for 2014, 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 2014 and thereafter.

12. 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 \$254,031 (2013 - \$303,245). During the year, there were repayments of \$496,316 (2013 - \$697,101) to the Town. The long-term note payable is unsecured and there are no fixed terms of repayment.

13. Share capital:

Authorized
Unlimited number of common shares

	2014	2013
Issued		
1,001 common shares	\$ 2,632,307	\$ 2,632,307

14. Service revenue:

	2014	2013
Residential energy	\$ 8,722,861	\$ 8,588,537
General <50kW energy	4,643,991	4,343,104
General >50kW energy	7,819,527	7,047,492
Unmetered scattered load energy	12,351	17,526
Street lighting energy	354,526	274,708
Sales for retailers	774,428	450,777
Non-competitive charges	2,691,482	2,462,192
Service revenue	\$ 25,019,166	\$ 23,184,336

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

15. Statement of cash flows:

(a) Changes in working capital components include:

	2014	2013
Accounts receivable	\$ (491,808)	\$ (139,631)
Unbilled revenue	(246,793)	(364,813)
PILs receivable/payable	(291,682)	(504,543)
Inventories	104,583	79,630
Prepaid expenses	62,964	(1,479)
Accounts payable and accrued liabilities	1,766,482	439,792
	<u>\$ 903,746</u>	<u>\$ (491,044)</u>

(b) Acquisition of capital assets

During the period, capital assets were acquired in the amount of \$2,775,647 (2013 - \$2,546,934). Capital contributions received from third parties amounted to \$708,464 (2013 - \$572,509). Cash payments of \$2,067,183 (2013 - \$1,974,425) were made to purchase capital assets.

(c) Transfer of capital assets to inventory

Capital assets decreased by \$40,550 (2013 - \$nil) due to a transfer to inventory.

(d) Non-cash activity

Regulatory liabilities have decreased by \$317,019 (2013 - \$302,340) related to a decrease in future tax asset.

(e) Interest and refunds received/payments in lieu of taxes

	2014	2013
Interest received	\$ 6,016	\$ 6,606
Interest paid	(442,938)	(518,189)
Payments in lieu of taxes received	51,076	-
Payments in lieu of taxes paid	(327,892)	(930,422)

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

16. 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 2014 was \$130,254 (2013 - \$140,327) for current service.

17. 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, 2014. To December 31, 2014, the Company has not been made aware of any additional assessments.

18. Amortization:

	2014	2013
Amortization		
Amortization of capital assets charged to operations	\$ 912,849	\$ 1,043,708
Amortization of capital assets charged to operating assets	93,017	26,791
	<u>\$ 1,005,866</u>	<u>\$ 1,070,499</u>

19. Financial instruments:

Recognition and Measurement

The fair value of cash, accounts receivable, special deposits, accounts payable and accrued liabilities, line of credit, 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 due to the limited amount of comparable market information available. It is not practicable to estimate the fair value of the note payable to the Town of Niagara-on-the-lake as there are no terms of repayment.

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

19. Financial instruments:

Level 3

The OIPC Loan has a carrying value of \$1,116,667 and fair value of approximately \$1,227,000 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 \$340,997 (2013 - \$353,577) 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.

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 \$965,527 demand instalment loan at 6.03% and the second \$1,272,601 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 a financial institution to realize favourable contracts or settle unfavourable contracts, taking into account interest rates as at December 31, 2014. At December 31, 2014 the interest rate swaps were in a net unfavorable position of \$170,962 (2013 - \$216,414). 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 in financial expense of \$45,452 (2013 - \$110,410).

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 \$22,800.

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

19. Financial instruments (continued):

Operating line of credit

As at December 31, 2014, the Company had a line of credit of \$2,000,000, \$308,081 (2013 - \$348,356) 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 7.

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, 2014, \$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 7.

20. 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, 2014 shareholder's equity amounts to \$14,999,978 (2013 - \$14,135,892) and long-term debt amounts to \$6,659,408 (2013 - \$7,683,862). The Company's capital structure as at December 31, 2014 is 31% debt and 69% equity (2013 - 35% debt and 65% equity). There have been no changes in the Company's approach to capital management during the year.

21. 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.

NIAGARA-ON-THE-LAKE HYDRO INC.

Notes to Financial Statements

Year ended December 31, 2014

21. Emerging accounting issues (continued):

In October 2010, the AcSB approved the incorporation of a one year deferral of adoption of IFRS into Part 1 of the CPA Canada Handbook for qualifying entities with activities subject to rate regulation. Part 1 of the CPA Canada Handbook specifies that first-time adoption is mandatory for interim and annual financial statements relating 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.

Accounting for rate regulated activities under IFRS:

The International Accounting Standards Board ("IASB") has issued IFRS 14 *Regulatory Deferral Accounts* in January 2014. This standard provides specific guidance on accounting for the effects of rate regulation and permits first-time adopters of IFRS to continue using previous GAAP to account for regulatory deferral account balances while the IASB completes its comprehensive project in this area. Adoption of this standard is optional for entities eligible to use it. Deferral account balances and movements in the balances will be required to be presented as separate line items on the face of the financial statements distinguished from assets, liabilities, income and expenses that are recognised in accordance with other IFRSs. Extensive disclosures will be required to enable users of the financial statements to understand the features and nature of and risks associated with rate regulation and the effect of rate regulation on the entity's financial position, performance and cash flows.