newfoundland labrador
hydro
a nalcor energy company

Hydro Place. 500 Columbus Drive.
P.O. Box 12400. St. John's. NL
Canada A1B 4K7
t. 709.737.1400 f. 709.737.1800
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April 30, 2014

Honourable Derrick Dalley,
Minister of Natural Resources

Minister's Office (Headquarters)
7th Floor, Natural Resources Building
50 Elizabeth Avenue
P.O. Box 8700
St. John's, NL A1B 4J6

Dear Minister Dalley:

Pursuant to Section 33 of the Hydro Corporation Act, 2007, please find attached the audited Consolidated Financial Statements of Newfoundland and Labrador Hydro (Hydro) for the year ended December 31, 2013.

A detailed account of Hydro's activities during the year ended December 31, 2013 is included in the Nalcor Energy 2013 Business and Financial Report.

Sincerely,

Ken Marshall
Acting Chair, Board of Directors

NEWFOUNDLAND AND LABRADOR HYDRO – A NALCOR ENERGY COMPANY

Consolidated Financial Statements

December 31, 2013

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013

DIRECTORS

TERRANCE STYLES*
Business Owner

LEO ABBASS
Corporate Director

ALLAN HAWKINS
Mayor, Grand Falls Windsor

ERIN BREEN
Partner, Simmons+ Partners Defence

ED MARTIN
President and Chief Executive Officer

TOM CLIFT
Professor
Faculty of Business Administration
Memorial University of Newfoundland and Labrador

KEN MARSHALL
President - Atlantic Region
Rogers Cable

GERALD SHORTALL
Chartered Accountant
Corporate Director

OFFICERS

TERRANCE STYLES*
Chairperson

ED MARTIN
President and Chief Executive Officer

GILBERT BENNETT
Vice President, Lower Churchill Project

ROB HENDERSON
Vice President, Newfoundland and Labrador Hydro

PAUL HUMPHRIES
Vice President, System Operations and Planning

DERRICK STURGE
Vice President, Finance and Chief Financial Officer

GERARD McDONALD
Vice President, Human Resources and Organizational Effectiveness

JOHN MacISAAC
Vice President, Project Execution and Technical Services

WAYNE CHAMBERLAIN
General Counsel and Corporate Secretary

PETER HICKMAN
Assistant Corporate Secretary

SCOTT PELLEY
Corporate Treasurer

S. KENT LEGGE**
General Manager, Finance and Corporate Services

HEAD OFFICE
Hydro Place,
P.O. Box 12400
500 Columbus Drive
St. John's, NL
Canada A1B 4K7

*Resigned February 28, 2014
**Resigned January 31, 2014

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INDEPENDENT AUDITOR'S REPORT

To the Lieutenant-Governor in Council, Province of Newfoundland and Labrador

We have audited the accompanying consolidated financial statements of Newfoundland and Labrador Hydro, which comprise the consolidated balance sheet as at December 31, 2013, and the consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated 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 consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of Newfoundland and Labrador Hydro as at December 31, 2013 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte LLP

Chartered Accountants
March 25, 2014

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	Notes	2013	2012
ASSETS			
Current assets			
Cash and cash equivalents		**18.3**	11.8
Short-term investments		**0.7**	0.5
Accounts receivable		**104.0**	102.3
Current portion of regulatory assets	4	**2.2**	2.2
Inventory		**75.2**	62.1
Prepaid expenses		**4.5**	3.9
Derivative assets		**0.2**	-
Current portion of sinking funds	5	**65.4**	-
		270.5	182.8
Property, plant and equipment	3	**1,845.0**	1,805.5
Regulatory assets	4	**62.2**	62.8
Other long-term assets	5	**254.4**	315.0
		2,432.1	2,366.1
LIABILITIES			
Current liabilities			
Short-term borrowings	7	**41.0**	52.0
Accounts payable and accrued liabilities		**118.4**	92.3
Current portion of long-term debt	7	**82.2**	8.2
Deferred credits	19	**0.7**	1.9
Current portion of regulatory liabilities	4	**214.0**	169.0
Current portion of asset retirement obligations	9	**0.4**	0.3
Derivative liabilities		**0.4**	-
		457.1	323.7
Long-term debt	7	**1,046.6**	1,125.9
Regulatory liabilities	4	**40.3**	33.2
Asset retirement obligations	9	**24.7**	24.6
Long-term payables	8	**1.6**	2.6
Employee future benefits	10	**75.3**	69.3
		1,645.6	1,579.3
SHAREHOLDER'S EQUITY			
Share capital	11	**22.5**	22.5
Contributed capital	11	**118.4**	116.7
		140.9	139.2
Accumulated other comprehensive income	11	**25.5**	42.8
Retained earnings		**620.1**	604.8
		645.6	647.6
		786.5	786.8
		2,432.1	2,366.1

Commitments and contingencies (Note 18)

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

For the year ended December 31 (millions of dollars)	Notes	**2013**	2012
Revenue			
Energy sales		**682.3**	641.9
Other revenue		**5.9**	6.0
		688.2	647.9
Expenses			
Fuels		**190.9**	182.4
Power purchased		**63.2**	60.8
Operating costs	12	**185.0**	177.2
Net finance expense	15	**72.3**	72.5
Amortization		**65.9**	60.2
Other (income) and expense		**1.1**	0.6
Regulatory adjustments	4	**55.6**	30.0
		634.0	583.7
Net income		**54.2**	64.2
Retained earnings at beginning of year		**604.8**	570.9
Dividends		**38.9**	30.3
Retained earnings at end of year		**620.1**	604.8

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31 (millions of dollars)	Notes	**2013**	2012
Net income		**54.2**	64.2
Other comprehensive loss			
Change in fair value of available for sale financial instruments		**(5.0)**	8.4
Amount recognized in net income		**(12.3)**	(12.0)
Comprehensive income		**36.9**	60.6

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31 (millions of dollars)	Notes	**2013**	2012
Cash provided by (used in)			
Operating activities			
Net income		**54.2**	64.2
Adjusted for items not involving a cash flow			
Amortization		**65.9**	60.2
Accretion of long-term debt		**0.5**	0.5
(Gain) loss on disposal of property, plant and equipment		**(0.8)**	3.4
Employee future benefits	10	**7.7**	8.6
Regulatory adjustments		**55.6**	30.0
Other		**0.7**	1.3
		183.8	168.2
Changes in non-cash working capital balances	16	**10.7**	(62.9)
		194.5	105.3
Financing activities			
Dividends paid to Nalcor		**(38.9)**	(30.3)
Increase in contributed capital		**1.7**	0.3
(Decrease) increase in short-term borrowings	7	**(11.0)**	52.0
(Increase) decrease in long-term receivables		**(0.9)**	0.8
Decrease in deferred credits		**(1.2)**	(1.6)
Decrease in long-term payable		**(1.0)**	(3.6)
		(51.3)	17.6
Investing activities			
Additions to property, plant and equipment	3	**(112.9)**	(107.7)
Increase in sinking fund	5	**(27.6)**	(26.1)
(Increase) decrease in short-term investments		**(0.2)**	9.1
Increase in reserve fund		**-**	(5.6)
Proceeds on disposition of property, plant and equipment		**4.0**	3.5
		(136.7)	(126.8)
Net increase (decrease) in cash position		**6.5**	(3.9)
Cash position at beginning of year		**11.8**	15.7
Cash position at end of year		**18.3**	11.8
Cash position is represented by:			
Cash		**18.3**	11.8
		18.3	11.8

Supplementary cash flow information (Note 16)

See accompanying notes

1. DESCRIPTION OF BUSINESS

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (the Province). The principal activity of Hydro is the generation, transmission and sale of electricity. Hydro's operations include both regulated and non-regulated activities. Hydro's head office is located in St. John's, Newfoundland and Labrador.

Hydro holds interests in the following subsidiary and jointly controlled companies:

Churchill Falls (Labrador) Corporation Limited (Churchill Falls) is incorporated under the laws of Canada and owns and operates a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (MW).

Twin Falls Power Corporation (Twin Falls) is incorporated under the laws of Canada and has developed a 225 MW hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Lower Churchill Development Corporation (LCDC) is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the lower Churchill River. LCDC is inactive.

Hydro and its subsidiary and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of Presentation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP).

2.2 Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary, LCDC (51% owned). Intercompany transactions and balances have been eliminated upon consolidation.

Effective June 18, 1999, Hydro, Churchill Falls and Hydro-Quebec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Quebec on the Board of Directors of Churchill Falls. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Quebec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has applied the proportionate consolidation method of accounting for its interest in Churchill Falls subsequent to the effective date of the shareholders' agreement.

Churchill Falls holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives Churchill Falls joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.3 Use of Estimates

Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where Management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, environmental and asset retirement obligations, amortization of property, plant, and equipment and other employee future benefits. Actual results may differ materially from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB).

2.4 Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed range on rate of return on rate base is 7.4% (2012 - 7.4%) +/- 15 basis points. Hydro applies certain accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally, these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future customer rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on these consolidated financial statements are more fully disclosed in Note 4.

2.5 Cash and Cash Equivalents and Short-Term Investments

Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and Banker's Acceptances (BAs). Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than 12 months are classified as short-term investments. The short-term investments bear interest rates of 1.12% to 1.30% (2012 - 1.34% to 1.35%) per annum. Cash and cash equivalents and short-term investments are measured at fair value.

2.6 Inventory

Inventory is recorded at the lower of average cost and net realizable value.

2.7 Property, Plant and Equipment

Property, plant and equipment is recorded at cost, which comprises materials, labour, contracted services and other costs directly related to construction costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment in progress is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment or the fair value of assets contributed. Contributions are recorded as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

Gains and losses on the disposal of property, plant and equipment are recognized in other income and expense as incurred.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.7 Property, Plant and Equipment (cont'd.)

Hydro

Electricity Generation, Transmission and Distribution
Construction in progress includes the costs incurred in engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to Hydro's embedded cost of debt.

Amortization is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Generation plant	
Hydroelectric	45 to 100 years
Thermal	35 to 65 years
Diesel	25 to 55 years
Transmission	
Lines	30 to 65 years
Terminal stations	40 to 55 years
Distribution system	30 to 55 years

Hydroelectric generation plant includes the powerhouse, turbines, governors and generators, as well as water conveying and control structures, including dams, dykes, tailrace, penstock and intake structures. Thermal generation plant is comprised of the powerhouse, turbines and generators, boilers, oil storage tanks, stacks and auxiliary systems. Diesel generation plant includes the buildings, engines, generators, switchgear, fuel storage and transfer systems, dykes and liners and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators, and conductors.

Other assets include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment which are carried at cost less accumulated amortization. Amortization is calculated on a straight-line basis over estimated useful lives ranging from 5 to 55 years.

Churchill Falls
Amortization is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Hydroelectric generation plant	45 to 100 years
Transmission and terminals	30 to 65 years
Service facilities and other	7 to 45 years

Twin Falls
Amortization is calculated on a straight-line basis over the estimated useful lives of 33 years.

Amortization methods, useful lives and residual values are reviewed at each reporting date.

2.8 Capitalized Interest

Interest is charged to construction in progress until the project is complete at rates equivalent to the embedded cost of debt. Capitalized interest cannot exceed actual interest incurred.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.9 Impairment of Long-Lived Assets

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

2.10 Asset Retirement Obligations

The fair value of future expenditures required to settle obligations associated with the retirement of property, plant and equipment, is recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. Accretion of asset retirement obligations is included in net income through amortization. Differences between the recorded asset retirement obligations and the actual retirement costs incurred are recorded as a gain or loss in the settlement period.

2.11 Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and Management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of cumulative net actuarial gains and losses over 10% of the accrued benefit obligation is amortized over the expected average remaining service life of the employee group.

2.12 Revenue Recognition

Revenue is recognized on the accrual basis, as power and energy deliveries are made. Sales within the Province are primarily at rates approved by the PUB, whereas sales to certain major industrial customers and export sales are either at rates under the terms of the applicable contracts, or at market rates.

A power contract with Hydro-Quebec (Power Contract), dated May 12, 1969, provides for the sale of a significant amount of the energy from Churchill Falls until 2041. The Power Contract has a 40 year term to 2016 which then renews for a further term of 25 years. The rate is predetermined in the Power Contract and decreases from the existing rate of 2.5426 mills per kilowatt hour (kWh) to 2.0 mills per kWh upon renewal in 2016.

Churchill Falls receives revenues from Hydro-Quebec, under a guaranteed winter availability contract (GWAC) through 2041. The GWAC provides for the sale of 682 MW of guaranteed seasonal availability to Hydro-Quebec during the months of November through March in each of the remaining years until the end of the Power Contract.

The value of differences between energy delivered and the Annual Energy Base (AEB), as defined in the Power Contract, is measured over a four-year period and then either recovered from or refunded to Hydro-Quebec over the subsequent four-year period, unless the balance is less than $1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2012 - 7%).

In the absence of a signed agreement with Hydro-Quebec related to the AEB, Churchill Falls continues to apply the terms of the previous agreement which expired August 31, 2012. Management continues to work to negotiate terms of a new agreement.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.13 Foreign Currency Translation

Foreign currency transactions are translated into their CAD equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At the date of settlement and at each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income, except gains or losses on purchases of fuel which are included in the cost of fuel inventory.

2.14 Financial Instruments and Hedging Activities

Financial Instruments

Financial assets and financial liabilities are recognized on the consolidated balance sheet when Hydro becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Hydro has classified each of its financial instruments into the following categories: financial assets and liabilities held for trading, loans and receivables, financial assets held to maturity, financial assets available for sale, and other financial liabilities.

Hydro has classified its financial instruments as follows:

Cash and cash equivalents	Held for trading
Short-term investments	Available for sale
Accounts receivable	Loans and receivables
Derivative assets	Held for trading
Sinking funds - investments in same Hydro issue	Held to maturity
Sinking funds - other investments	Available for sale
Reserve fund	Available for sale
Long-term receivables	Loans and receivables
Accounts payable and accrued liabilities	Other financial liabilities
Short-term borrowings	Other financial liabilities
Derivative liabilities	Held for trading
Long-term debt	Other financial liabilities
Long-term payable	Other financial liabilities

Each of these financial instruments is measured at amortized cost, except for cash and cash equivalents and short-term investments, reserve fund, sinking fund – other investments, derivative assets and derivative liabilities which are measured at fair value.

Transaction costs related to financial instruments are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short-term investments which are expensed as incurred through interest and finance charges, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Derivative Instruments and Hedging Activities

Derivative instruments are utilized by Hydro to manage market risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Hydro may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Hydro formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges. Hydro had no cash flow hedges or fair value hedges in place at December 31, 2013 (2012 - $nil).

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.15 Future Accounting Changes – International Financial Reporting Standards (IFRS)

The Canadian Accounting Standards Board (AcSB) amended the introduction to Part 1 if the Canadian Institute of Chartered Professional Accountants (CICPA) Handbook – Accounting to allow qualifying entities with rate-regulated activities to defer the adoption of IFRS to January 1, 2015. Hydro is a qualifying entity and has chosen to avail of the deferral option for the year ended December 31, 2013.

Although IFRS and Canadian GAAP are based on a similar conceptual framework, there are a number of differences in recognition, measurement and disclosure. The areas with the highest potential impact on Hydro are property, plant and equipment, regulatory assets and liabilities. In January 2014, the IASB issued interim standard *IFRS 14 Regulatory Deferral Accounts*, which will be applicable to rate-regulated entities who have not yet converted to IFRS. The purpose of the interim standard is to enhance the comparability of financial reporting by entities that are engaged in rate-regulated activities. The interim standard is effective for first-time adopters of IFRS for a period beginning on or after January 1, 2016 with early adoption permitted.

Hydro continues to assess the financial reporting impacts of the adoption of IFRS; however, the impact of IFRS will depend on the IFRS standards in effect at the time of conversion and the accounting elections made.

3. PROPERTY, PLANT AND EQUIPMENT

	Property Plant and Equipment in Service	Contributions in Aid of Construction	Accumulated Amortization	Construction in Progress	Net Book Value
(millions of dollars)			**2013**		
Generation plant					
Hydroelectric	**1,367.2**	**2.4**	**379.2**	**6.3**	**991.9**
Thermal	**126.8**	**-**	**20.7**	**3.8**	**109.9**
Diesel	**40.2**	**-**	**4.4**	**2.5**	**38.3**
Transmission and distribution	**696.1**	**19.4**	**110.8**	**6.2**	**572.1**
Other	**212.8**	**24.1**	**59.4**	**3.5**	**132.8**
	2,443.1	**45.9**	**574.5**	**22.3**	**1,845.0**
(millions of dollars)			2012		
Generation plant					
Hydroelectric	1,349.6	2.4	356.5	6.6	997.3
Thermal	98.1	-	12.5	8.5	94.1
Diesel	37.9	-	2.7	0.3	35.5
Transmission and distribution	644.2	18.5	92.7	21.5	554.5
Other	189.3	23.1	48.4	6.3	124.1
	2,319.1	44.0	512.8	43.2	1,805.5

4. REGULATORY ASSETS AND LIABILITIES

(millions of dollars)	**2013**	2012	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Foreign exchange losses	**60.5**	62.6	28.0
Deferred energy conservation costs	**3.9**	2.4	n/a
Total regulatory assets	**64.4**	65.0	
Less current portion	**2.2**	2.2	
	62.2	62.8	
Regulatory liabilities			
Rate stabilization plan (RSP)	**253.8**	201.7	n/a
Deferred purchased power savings	**0.5**	0.5	13.5
Total regulatory liabilities	**254.3**	202.2	
Less current portion	**214.0**	169.0	
	40.3	33.2	

4.1 Regulatory Adjustments Recorded in the Consolidated Statement of Income

(millions of dollars)	**2013**	2012
RSP recovery	**58.9**	60.4
Rural rate adjustment	**11.4**	7.0
RSP fuel deferral	**(35.3)**	(49.3)
RSP interest	**17.1**	13.2
Amortization of deferred foreign exchange losses	**2.1**	2.1
Deferred foreign exchange losses on fuel	**-**	(0.4)
Employee future benefit actuarial losses	**(1.7)**	(2.3)
Amortization of major extraordinary repairs	**-**	0.6
Deferred energy conservation	**(1.5)**	(1.4)
Insurance proceeds	**4.6**	0.2
Deferred purchased power savings	**-**	(0.1)
	55.6	30.0

Hydro has operations that are regulated by the PUB.

Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that 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. Amounts deferred as regulatory assets and liabilities are subject to PUB approval. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities is no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following sections describe each of the circumstances in which rate regulation affects the accounting for a transaction or event.

4. REGULATORY ASSETS AND LIABILITIES (cont'd.)

4.2 Rate Stabilization Plan

On January 1, 1986, Hydro, having received the approval of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Balances accumulating in the RSP, including financing charges, are to be recovered or refunded in the following year, with the exception of hydraulic variations, which will be recovered or refunded at a rate of 25% of the outstanding balance at year end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect. A portion of the RSP balance totaling $134.4 million has been set aside with $115.3 million to be refunded to retail customers, $10.9 million to be used to phase in Island Industrial rate increases and $8.2 million subject to a future regulatory ruling. This balance is mainly due to fuel savings at the Holyrood Thermal Generating Station (HTGS) as a result of the shutdown of a portion of the pulp and paper industry in the Province in 2007.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian GAAP would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2013, $35.3 million was deferred (2012 - $49.3 million) as an RSP fuel deferral and $58.9 million (2012 - $60.4 million) was recovered through rates and included in energy sales.

Hydro's rural rates on the Island Interconnected and Isolated systems are primarily based upon rates ordered by the PUB. Therefore, when a rural rate electricity adjustment has been approved by the PUB, Hydro's rural customers are charged the approved rate change. In 2013, Hydro recognized in regulatory adjustments a rural rate adjustment that reduces income and increases the RSP liability by $11.4 million (2012 - $7.0 million). In the absence of rate regulation, the rural rate adjustment would have been recorded in income.

Hydro is required to charge or pay interest on balances accumulating in the RSP at a rate equal to Hydro's weighted average cost of capital. As a result, Hydro recognized in regulatory adjustments an RSP interest expense of $17.1 million in 2013 (2012 - $13.2 million).

4.3 Deferred Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding, to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty year period. This amortization, of $2.1 million (2012 - $2.1 million), is included in regulatory adjustments.

4. REGULATORY ASSETS AND LIABILITIES (cont'd.)

4.4 Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $0.5 million, subject to PUB approval on a case-by-case basis. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs were amortized over a five year period. In the absence of rate regulation, Canadian GAAP would require that Hydro expense the boiler tube repairs in the year incurred. In 2013, there was amortization of $nil (2012 - $0.6 million) as a regulatory adjustment.

4.5 Deferred Energy Conservation Costs

Pursuant to Order No. P.U. 35 (2013), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include this program as operating costs in the year incurred. In 2013, Hydro recognized $1.5 million (2012 - $1.4 million) in regulatory adjustments. Discharge of the balance will be dealt with as part of the General Rate Application currently before the PUB.

4.6 Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Quebec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer and amortize the benefits of a reduced initial purchased power rate over a 30 year period. The remaining unamortized savings in the amount of $0.5 million (2012 - $0.5 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

4.7 Property, Plant and Equipment

The PUB permits major inspections and overhauls to be included in the cost of capital and amortized over the average expected period of the next major inspection. In 2013, $3.5 million (2012 - $6.8 million) was recognized as property, plant and equipment. In the absence of rate regulation, Canadian GAAP would require that Hydro include the major inspections as operating costs in the year incurred.

4.8 Foreign Exchange Gains and Losses

Hydro purchases a significant amount of fuel for HTGS in USD. The RSP allows Hydro to defer variances in fuel prices (including foreign exchange fluctuations). During 2013, Hydro deferred, in regulatory adjustments, foreign exchange losses on fuel purchases of $nil (2012 - loss of $0.4 million). In the absence of rate regulation, Canadian GAAP would require that Hydro include gains and losses on foreign currencies in net finance expense in the period incurred.

4.9 Insurance Proceeds

Pursuant to Order No. P.U. 13 (2012), Hydro records net insurance proceeds in excess of $50,000 against the capital costs of the related assets. During 2013, Hydro recorded, in regulatory adjustments, net insurance proceeds of $4.5 million (2012 - $0.2 million) with an offset against costs of the related assets. In the absence of rate regulation, Canadian GAAP would require Hydro to include insurance proceeds in net income.

4.10 Employee Future Benefits

Pursuant to Order No. P.U. 13 (2012), Hydro defers the amortization of employee future benefit actuarial losses. During 2013, Hydro recorded in, regulatory adjustments a deferral of actuarial gains and losses of $1.7 million (2012 - $2.3 million). In the absence of rate regulation, Canadian GAAP would require Hydro include employee future benefits gains and losses in net income.

5. OTHER LONG-TERM ASSETS

(millions of dollars)		**2013**	2012
Long-term receivables	(a)	**1.7**	0.8
Sinking funds	(b)	**202.2**	263.3
Reserve fund	(c)	**50.5**	50.9
		254.4	315.0

(a) The balance of $1.7 million (2012 - $0.8 million) includes the non-current portion of receivables associated with customer time payment plans and the long-term portion of employee purchase programs of $0.2 million (2012 - $0.2 million). The remaining balance of $1.5 million (2012 - $0.6 million) relates to differences between the AEB in the Churchill Falls Power contract and energy delivered accumulating over the four-year period from September 2012 to August 2016.

(b) As at December 31, 2013, sinking funds include $202.2 million (2012 - $263.3 million) related to repayment of Hydro's long-term debt. Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada, provincial governments or Schedule 1 banks, and have maturity dates ranging from 2014 to 2033.

Hydro debentures, which are intended to be held to maturity, are deducted from debt while all other sinking fund investments are shown separately on the consolidated balance sheet as assets. Annual contributions to the various sinking funds are in accordance with bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 1.17% to 9.86% (2012 - 2.57% to 9.86%).

(millions of dollars)	**2013**	2012
Sinking funds at beginning of year	**263.3**	247.0
Contributions	**8.2**	8.2
Earnings	**13.6**	11.7
Valuation adjustment	**(17.5)**	(3.6)
Sinking funds at end of year	**267.6**	263.3
Current portion of sinking funds	**65.4**	-
	202.2	263.3

Sinking fund instalments due for the next five years are as follows:

(millions of dollars)	2014	2015	2016	2017	2018
Sinking fund instalments	8.1	8.1	8.1	6.7	6.7

(c) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a $75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. A summary of Hydro's 65.8% share of the reserve fund is as follows:

(millions of dollars)	**2013**	2012
Opening balance	**50.9**	45.4
Contribution	**-**	5.3
Net interest	**-**	0.3
Mark-to-market adjustment	**(0.4)**	(0.1)
Fair value of reserve fund	**50.5**	50.9

6. JOINT VENTURE

The following amounts represent Hydro's proportionate share of Churchill Falls' assets and liabilities at December 31 and its proportionate interest in Churchill Falls' operations for the year then ended:

(millions of dollars)	**2013**	2012
Current assets	**37.6**	39.9
Long-term assets	**434.0**	383.2
Current liabilities	**19.4**	20.5
Long-term liabilities	**16.4**	15.6
Revenues	**76.8**	73.5
Expenses	**56.8**	48.6
Net income	**20.0**	24.9
Cash provided by (used in)		
Operating activities	**40.8**	33.1
Financing activities	**(0.2)**	(2.5)
Investing activities	**(32.3)**	(23.8)

Income tax expense in the amount of $0.1 million (2012 - $0.1 million) related to Twin Falls has been included in expenses.

7. LONG-TERM DEBT

Details of long-term debt are as follows:

Series	**Face Value**	**Coupon Rate %**	**Year of Issue**	**Year of Maturity**		
(millions of dollars)					**2013**	2012
V *	125.0	10.50	1989	2014	**125.0**	124.8
X *	150.0	10.25	1992	2017	**149.5**	149.4
Y *	300.0	8.40	1996	2026	**294.0**	293.8
AB *	300.0	6.65	2001	2031	**306.1**	306.3
AD *	125.0	5.70	2003	2033	**123.7**	123.7
AE	225.0	4.30	2006	2016	**224.4**	224.2
Total debentures	1,225.0				**1,222.7**	1,222.2
Less sinking fund investments in own debentures					**93.9**	88.1
					1,128.8	1,134.1
Less: payments due within one year					**82.2**	8.2
					1,046.6	1,125.9

* Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 25 basis points annually on the total debt (net of sinking funds) with a remaining term to maturity less than 10 years and 50 basis points annually on total debt (net of sinking funds) with a remaining term to maturity greater than 10 years. The fee for 2013 was $3.7 million (2012 - $3.7 million).

7. LONG-TERM DEBT (cont'd.)

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2013, there was $41.0 million in promissory notes outstanding (2012 - $52.0 million).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured demand operating credit facility with its banker and at year end there were no amounts drawn on the facility (2012 - $nil). Advances may take the form of a Prime Rate Advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year end, Hydro had one letter of credit outstanding, reducing the availability of the credit facility by $0.3 million (2012 - $18.9 million).

Required repayments of long-term debt over the next five years will be as follows:

(millions of dollars)	2014	2015	2016	2017	2018
Long-term debt repayment	125.0	-	225.0	150.0	-

Churchill Falls maintains a $10.0 million Canadian or US equivalent unsecured demand operating credit facility with its banker and at year end there were no amounts drawn on the facility (2012 - $nil). Advances may take the form of a Prime Rate Advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee.

Churchill Falls has issued three irrevocable letters of credit totaling $2.0 million to ensure satisfactory management of its waste management system and compliance with a certificate of approval for the transportation of special and hazardous wastes, granted by the Provincial Department of Environment and Conservation.

8. LONG-TERM PAYABLES

The long-term payable to Hydro-Quebec as at December 31, 2013 is the accumulation of differences between energy delivered and the AEB billed during the four-year period from September 1, 2008 to August 31, 2012. Monthly repayments commenced in September 2012 and will terminate on August 31, 2016. The current portion of $1.0 million (2012 - $1.0 million) is included in accounts payable and accrued liabilities. The long-term portion is $1.6 million (2012 - $2.6 million).

9. ASSET RETIREMENT OBLIGATIONS

(millions of dollars)	**2013**	2012
Asset retirement obligations at beginning of year	**24.9**	20.2
Liabilities incurred	**-**	0.3
Revisions	**(0.7)**	3.7
Accretion	**0.9**	0.8
Settlements	**-**	(0.1)
Asset retirement obligations at end of year	**25.1**	24.9
Less: current portion	**0.4**	0.3
	24.7	24.6

9. ASSET RETIREMENT OBLIGATIONS (cont'd.)

The total undiscounted estimated cash flows required to settle the HTGS obligations at December 31, 2013 are $32.1 million (2012 - $32.1 million). Payments to settle the liability are expected to occur between 2020 and 2024. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rate of 2.8% (2012 - 2.8%). Hydro has recorded $22.6 million (2012 - $ 21.8 million) related to HTGS obligations.

The total undiscounted estimated cash flows required to settle the PCB obligations at December 31, 2013 are $3.3 million (2012 - $3.6 million). Payments to settle the liability are expected to occur between 2014 and 2025. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rates ranging between 3.1% and 5.7% (2012 - 3.1% and 5.5%). Hydro has recorded $1.5 million (2012 - $ 2.1 million) related to PCB obligations.

A significant number of assets include generation plants, transmission assets and distribution systems. These assets can continue to run indefinitely with ongoing maintenance activities. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is required to remove, an asset retirement obligation for those assets will be recognized at that time.

10. EMPLOYEE FUTURE BENEFITS

10.1 Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $5.7 million (2012 - $5.4 million) are expensed as incurred.

10.2 Other Benefits

Hydro provides group life insurance and health care benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2013, cash payments to beneficiaries for its unfunded other employee future benefits were $2.9 million (2012 - $2.8 million). An actuarial valuation was performed as at December 31, 2012, with an extrapolation to December 31, 2013. The next actuarial valuation will be performed at December 31, 2015.

(millions of dollars)	**2013**	2012
Accrued benefit obligation		
Balance at beginning of year	**109.1**	108.1
Current service cost	**4.1**	3.8
Interest cost	**4.5**	4.7
Actuarial gain	**(9.1)**	(4.7)
Benefits paid	**(2.7)**	(2.8)
Balance at end of year	**105.9**	109.1
Plan deficit	**105.9**	109.1
Unamortized actuarial loss	**(25.2)**	(36.1)
Unamortized past-service cost	**(0.2)**	(0.2)
Regulatory adjustments	**(5.2)**	(3.5)
Accrued benefit liability at end of year	**75.3**	69.3

10. EMPLOYEE FUTURE BENEFITS (cont'd.)

10.2 Other Benefits (cont'd.)

(millions of dollars)	**2013**	2012
Components of benefit cost		
Current service cost	**4.1**	3.8
Interest cost	**4.5**	4.7
Actuarial gain	**(9.1)**	(4.7)
	(0.5)	3.8
Difference between actuarial gain or loss and amount recognized	**11.2**	7.6
Benefit expense	**10.7**	11.4

The significant actuarial assumptions used in measuring the accrued benefit obligations and benefit expense are as follows:

	2013	2012
Discount rate – benefit cost	**4.00%**	4.55%
Discount rate – accrued benefit obligation	**5.00%**	4.00%
Rate of compensation increase	**3.50%**	3.50%

Assumed health care trend rates:

	2013	2012
Initial health care expense trend rate	**6.00%**	6.00%
Cost trend decline to	**4.50%**	4.50%
Year that rate reaches the rate it is assumed to remain at	**2020**	2020

A 1% change in assumed health care trend rates would have had the following effects:

Increase	**2013**	2012
Current service and interest cost	**2.1**	2.0
Accrued benefit obligation	**20.0**	20.6

Decrease	**2013**	2012
Current service and interest cost	**(1.5)**	(1.5)
Accrued benefit obligation	**(15.3)**	(15.7)

11. SHAREHOLDER'S EQUITY

11.1 Share Capital

(millions of dollars)	**2013**	2012
Common shares of par value $1 each		
Authorized: 25,000,000		
Issued and outstanding 22,503,942	**22.5**	22.5

11. SHAREHOLDER'S EQUITY (cont'd.)

11.2 Contributed Capital

(millions of dollars)	**2013**	2012
Total contributed capital	**118.4**	116.7

On February 3, 2010, the Province established the Churchill Falls (Labrador) Corporation Trust (the Trust) with Churchill Falls as the beneficiary. The purpose of this Trust is to fund the external costs and expenses incurred in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. During 2013, the Trust contributed capital of $1.7 million (2012 - $0.3 million).

11.3 Accumulated Other Comprehensive Income

(millions of dollars)	**2013**	2012
Balance at beginning of year	**42.8**	46.4
Other comprehensive loss	**(17.3)**	(3.6)
Balance at end of year	**25.5**	42.8

12. OPERATING COSTS

(millions of dollars)	**2013**	2012
Salaries and benefits	**104.5**	100.1
Maintenance and materials	**30.4**	28.8
Transmission rental	**20.5**	19.7
Professional services	**13.6**	12.4
Rental and royalty	**3.7**	4.3
Other operating costs	**12.3**	11.9
Total	**185.0**	177.2

13. CAPITAL MANAGEMENT

A summary of the capital structure is outlined below:

(millions of dollars)	**2013**		2012	
Debt				
Long-term debt	**1,046.6**		1,125.9	
Short-term borrowings	**41.0**		52.0	
Current portion of long-term debt	**82.2**		8.2	
Sinking funds	**(267.6)**		(263.3)	
	902.2	**53.4%**	922.8	54.0%
Equity				
Share capital	**22.5**		22.5	
Contributed capital	**118.4**		116.7	
Accumulated other comprehensive income	**25.5**		42.8	
Retained earnings	**620.1**		604.8	
	786.5	**46.6%**	786.8	46.0%
Total debt and equity	**1,688.7**	**100.0%**	1,709.6	100.0%

13. CAPITAL MANAGEMENT (cont'd.)

13.1 Hydro

Hydro's principal business requires ongoing access to capital in order to maintain assets to ensure the continued delivery of safe and reliable service to its customers. Therefore, Hydro's primary objective when managing capital is to ensure ready access to capital at a reasonable cost, to minimize its cost of capital within the confines of established risk parameters, and to safeguard Hydro's ability to continue as a going concern.

The capital managed by Hydro is comprised of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

Hydro's unsecured demand operating facility has covenants restricting the issuance of debt such that the debt to total capitalization ratio cannot exceed 70%. The covenants further stipulate that the debt service coverage ratio should at all times be greater than 1.5. As at December 31, 2013, Hydro was in compliance with these covenants.

Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity and its interest coverage.

For the regulated portion of Hydro's operations a capital structure comprised of 75% debt and 25% equity is maintained, a ratio which Management believes to be optimal with respect to its cost of capital. This capital structure is maintained by a combination of dividend policy, contributed equity and debt issuance. The issuance of any new debt with a term greater than one year requires prior approval of the PUB.

Legislation stipulates that the total of the short-term loans issued by Hydro and outstanding at any time shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short-term loans are those loans issued with a term not exceeding two years. The current limit is set at $300.0 million. There was $41.0 million outstanding as at December 31, 2013 (2012 - $52.0 million). Issuance of long-term and short-term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both long and short-term debt, to $1.6 billion at any point in time.

13.2 Churchill Falls

Churchill Falls' objective when managing capital is to maintain its ability to continue as a going concern. Churchill Falls' requirements for capital in the future are expected to increase, coincident with the aging of the plant and related infrastructure and the execution of the long-term asset management plan. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. Managing the level of dividend payments is a key aspect of ensuring the availability of funding to maintain the plant and infrastructure.

At present, the capital position of Churchill Falls is comprised entirely of equity capital (issued capital, shareholder contributions, reserves and retained earnings). The capital structure is adjusted through the amount of dividends paid to shareholders.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

14.1 Fair Value

The estimated fair values of financial instruments as at December 31, 2013 and 2012 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions.

As a significant number of Hydro's assets and liabilities do not meet the definition of a financial instrument, the fair value estimates below do not reflect the fair value of Hydro as a whole.

Establishing Fair Value

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the nature of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

		Carrying Value	**Fair Value**	Carrying Value	Fair Value
(millions of dollars)	Level	**2013**		2012	
Financial assets					
Cash and cash equivalents	1	**18.3**	**18.3**	11.8	11.8
Short-term investments	1	**0.7**	**0.7**	0.5	0.5
Accounts receivable	2	**104.0**	**104.0**	102.3	102.3
Sinking funds – investments in same Hydro issue	2	**93.9**	**105.1**	88.1	107.3
Sinking funds – other investments including amount due within one year	2	**267.6**	**267.6**	263.3	263.3
Long-term receivable	2	**1.7**	**1.8**	0.8	0.8
Derivative assets	2	**0.2**	**0.2**	-	-
Reserve fund	2	**50.5**	**50.5**	50.9	50.9
Financial liabilities					
Accounts payable and accrued liabilities	2	**118.4**	**118.4**	92.3	92.3
Short-term borrowings	1	**41.0**	**41.0**	52.0	52.0
Derivative liabilities	2	**0.4**	**0.4**	-	-
Long-term debt including amount due within one year (before sinking funds)	2	**1,222.7**	**1,545.5**	1,222.2	1,668.6
Long-term payable	2	**1.6**	**1.7**	2.6	2.8

The fair value of cash and cash equivalents and short-term investments approximates their carrying values due to their short-term maturity.

There were no financial assets or liabilities valued using Level 3 of the fair value hierarchy as at December 31, 2013 and 2012.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

14.2 Risk Management

Hydro is exposed to certain credit, liquidity and market price risks through its operating and financing activities. Financial risk is managed in accordance with a board approved policy, which outlines the objectives and strategies for the management of financial risk, including the use of derivative contracts. Permitted financial risk management strategies are aimed at minimizing the volatility of Hydro's expected future cash flows.

Credit Risk

Hydro's expected future cash flow is exposed to credit risk through its operating activities, primarily due to the potential for non-performance by its customers, and through its financing and investing activities, based on the risk of non-performance by counterparties to its financial instruments. The degree of exposure to credit risk on cash and cash equivalents, short-term investments, long-term investments and derivative assets as well as from the sale of electricity to customers, including the associated accounts receivable, is determined by the financial capacity and stability of those customers and counterparties. The maximum exposure to credit risk on these financial instruments is represented by their carrying values on the consolidated balance sheet at the reporting date.

Credit risk on cash and cash equivalents is minimal, as Hydro's cash deposits are held by a Canadian Schedule 1 Chartered Bank with a rating of A+ (Standard and Poor's).

Credit risk on short-term investments is minimized by limiting holdings to high-quality, investment grade securities issued by Federal and Provincial governments, as well as Bankers' Acceptances and term deposits issued by Canadian Schedule 1 Chartered Banks.

Credit exposure on Hydro's sinking funds is limited by restricting the holdings to long-term debt instruments issued by the Government of Canada or any province of Canada, crown corporations and Canadian Chartered Banks. The following credit risk table provides information on credit exposures according to issuer type and credit rating for the remainder of the long-term investment portfolio:

	Issuer Credit Rating	**Fair Value of Portfolio (%)**	**Issuer Credit Rating**	**Fair Value of Portfolio (%)**
	2013		2012	
Provincial Governments	**AA- to AAA**	**2.72%**	AA- to AAA	4.07%
Provincial Governments	**A- to A+**	**38.84%**	A- to A+	55.95%
Provincially owned utilities	**AA- to AAA**	**13.99%**	AA- to AAA	-
Provincially owned utilities	**A- to A+**	**41.34%**	A- to A+	33.96%
Schedule 1 Canadian banks	**AA- to AAA**	**1.07%**	AA- to AAA	-
Schedule 1 Canadian banks	**A- to A+**	**2.04%**	A- to A+	1.89%
Provincially owned utilities	**BBB+**	**-**	BBB+	4.13%
		100.00%		100.00%

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

14.2 Risk Management (cont'd.)

Credit Risk (cont'd.)
Credit exposure on the reserve fund is mitigated by adhering to an investment policy which restricts the holdings to long-term debt instruments issued or guaranteed by the Government of Canada or any province of Canada. Investment in the long-term debt instruments of Canadian banks are also permitted, provided the bank is rated A or higher by Standard and Poor's. With the exception of Government of Canada, holdings of any one issuer are limited to 10% of the total principal amount of the portfolio. The following credit risk table provides information on credit exposures according to issuer type and credit rating for the reserve fund:

	Issuer Credit Rating	Fair Value of Portfolio (%)	Issuer Credit Rating	Fair Value of Portfolio (%)
	2013		2012	
Provincial Governments	**AA- to AAA**	**8.94%**	AA- to AAA	13.19%
Canadian Schedule 1 or 2 banks	**AA- to AAA**	**16.70%**	AA- to AAA	12.70%
Provincial Governments	**A- to A+**	**21.25%**	A- to A+	20.86%
Provincially owned utilities	**AA- to AAA**	**9.09%**	AA- to AAA	-
Provincially owned utilities	**A- to A+**	**6.06%**	A- to A+	13.39%
Canadian Schedule 1 banks	**A- to A+**	**37.96%**	A- to A+	39.86%
		100.00%		100.00%

Credit exposure on derivative assets is limited by the Financial Risk Management Policy, which restricts available counterparties for hedge transactions to Canadian Schedule 1 Chartered Banks, and Federally Chartered US Banks.

Hydro's exposure to credit risk on its energy sales and associated accounts receivable is determined by the credit quality of its customers. Hydro's three largest customers account for 81.8% (2012 - 89.9%) of total energy sales and 68.8% (2012 - 58.6%) of accounts receivable. These customers are comprised of rate regulated entities and/or organizations with investment grade credit ratings.

Hydro does not have any significant amounts that are past due and uncollectable, for which a provision has not been recognized at December 31, 2013.

Liquidity Risk
Hydro is exposed to liquidity risk with respect to its contractual obligations and financial liabilities, including any derivative liabilities related to hedging activities. Liquidity risk management is aimed at ensuring cash is available to meet those obligations as they become due.

Short-term liquidity is mainly provided through cash and cash equivalents on hand, funds from operations, and a \$300.0 million promissory note program. In addition, Hydro maintains a \$50.0 million (2012 - \$50.0 million) unsecured demand operating facility with its primary banker in order to meet any requirements beyond those forecasted for a given period. Churchill Falls also maintains a \$16.0 million minimum cash balance.

Long-term liquidity risk for Hydro is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues, with the exception of the issue maturing in 2016.

For Churchill Falls, long-term liquidity risk is managed by maintenance of the reserve fund in accordance with the June 1999 shareholders' agreement and a dividend management policy that meets long-term liquidity requirements associated with Churchill Falls capital expenditure program.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

14.2 Risk Management (cont'd.)

Liquidity Risk (cont'd.)
The following are the contractual maturities of Hydro's financial liabilities, including principal and interest, as at December 31, 2013:

(millions of dollars)	**<1 Year**	**1-3 Years**	**3-5 years**	**> 5 Years**	**Total**
Accounts payable and accrued liabilities	118.4	-	-	-	118.4
Short-term borrowings	41.0	-	-	-	41.0
Long-term payable	-	1.6	-	-	1.6
Long-term debt including amount due within one year	125.0	225.0	150.0	725.0	1,225.0
Interest	83.3	152.6	112.8	536.4	885.1
	367.7	379.2	262.8	1,261.4	2,271.1

Market Risk
In the course of carrying out its operating, financing and investing activities, Hydro is exposed to possible market price movements that could impact expected future cash flow and the carrying value of certain financial assets and liabilities. Market price movements to which Hydro has significant exposure include those relating to prevailing interest rates, foreign exchange rates, most notably the USD/CAD, and current commodity prices, most notably the spot prices for diesel fuel, electricity, and No. 6 fuel. These exposures were addressed as part of the Financial Risk Management Strategy.

Interest Rates
Changes in prevailing interest rates will impact the fair value of financial assets and liabilities classified as held for trading or available-for-sale, which includes Hydro's cash and cash equivalents, short-term investments, sinking funds and reserve fund. Expected future cash flows associated with those financial instruments can also be impacted. The impact of a 0.5% change in interest rates on net income and other comprehensive income associated with cash and cash equivalents, short-term investments and debt and short-term debt was negligible throughout 2013 due to the short time period to maturity.

The table below shows the impact of a 50 basis point change in interest rates on net income and other comprehensive income associated with the sinking funds at the balance sheet date:

	Net Income		**Other Comprehensive Income**	
(millions of dollars)	**0.5% Decrease**	**0.5% Increase**	**0.5% Decrease**	**0.5% Increase**
Interest on sinking fund	-	-	5.3	(21.2)
Interest on reserve fund	-	-	0.6	(0.6)
	-	-	5.9	(21.8)

Foreign Currency and Commodity Exposure
Hydro's primary exposure to both foreign exchange and commodity price risk arises from its purchases of No. 6 fuel for consumption at the HTGS and USD denominated electricity sales. These exposures are addressed in accordance with the board-approved Financial Risk Management Policy. Tactics include the use of forward rate agreements and fixed price commodity swaps.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

14.2 Risk Management (cont'd.)

Market Risk (cont'd.)
During 2013, total electricity sales denominated in USD were $54.7 million (2012 - $33.8 million). In 2013, Hydro mitigated foreign exchange risk on these sales through the use of foreign currency forward contracts. In January of 2013, Hydro entered into a series of 12 monthly foreign exchange forward contracts with a notional value of $23.0 million USD to hedge foreign exchange risk on a portion of Hydro's planned USD electricity sales for the year. These contracts had an average exchange rate of $1.01 CAD per USD. In April of 2013, Hydro entered into a series of ten monthly foreign exchange forward contracts with a notional value of $14.4 million USD to hedge foreign exchange risk on a portion of Hydro's planned USD electricity sales for the year. These contracts had an average exchange rate of $1.03 CAD per USD. In 2013, Management elected not to implement commodity price hedges aimed at addressing electricity price risk due to depressed market pricing conditions. During 2013, $0.1 million in gains from these derivative contracts was included in other income and expense (2012 - $0.1 million in gains).

In December of 2013, Hydro entered into a series of 12 monthly foreign exchange forward contracts with a notional value of $38.5 million USD to hedge foreign exchange risk on a portion of Hydro's planned USD electricity sales to the end of 2014. These contracts have an average exchange rate of $1.08 CAD per USD. Hydro also entered into a series of 12 electricity price forward contracts with a notional value of $14.2 million USD. The average price of these contracts was USD $38.74 per MWh (On Peak) and USD $28.42 per MWh (Off Peak). At December 31, 2013, $0.3 million in losses from these derivative contracts was recognized in other income and expense.

These forward contracts impact other income and expense by a net $0.2 million in losses for 2013 (2012 - $0.1 million gain).

15. NET FINANCE EXPENSE

(millions of dollars)	**2013**	2012
Finance income		
Interest on sinking fund	**19.4**	18.0
Interest on reserve fund	**1.5**	1.6
Other interest income	**(0.1)**	0.9
	20.8	20.5
Finance expense		
Interest on long-term debt	**90.5**	90.5
Accretion	**0.5**	0.5
Debt guarantee fee	**3.7**	3.7
Other	**0.6**	1.0
	95.3	95.7
Interest capitalized during construction	**(2.2)**	(2.7)
	93.1	93.0
Net finance expense	**72.3**	72.5

16. SUPPLEMENTARY CASH FLOW INFORMATION

(millions of dollars)	**2013**	2012
Accounts receivable	**(1.7)**	(6.0)
Inventory	**(13.1)**	1.3
Prepaid expenses	**(0.6)**	(0.7)
Accounts payable and accrued liabilities	**26.1**	(57.5)
Changes in non-cash working capital balances	**10.7**	(62.9)
Interest received	**2.4**	1.9
Interest paid	**91.1**	91.4
Income taxes paid	**0.1**	0.1

17. SEGMENT INFORMATION

Hydro operates in four business segments. Hydro Regulated activities encompass sales of electricity to customers within the Province. Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Quebec. Hydro's Energy Marketing activities include the sale of electricity to markets outside the Province. Other encompasses other non-regulated activities. The designation of segments has been based on a combination of regulatory status and Management accountability. The segments' accounting policies are the same as those previously described in Note 2.

Segments	**Hydro Regulated**	**Churchill Falls**	**Energy Marketing**	**Other**	**Inter-segment**	**Total**
(millions of dollars)			**2013**			
Revenue						
Energy sales	**543.1**	**76.5**	**66.7**	**-**	**(4.0)**	**682.3**
Other revenue	**2.3**	**0.3**	**-**	**-**	**3.3**	**5.9**
	545.4	**76.8**	**66.7**	**-**	**(0.7)**	**688.2**
Expenses						
Fuels	**190.9**	**-**	**-**	**-**	**-**	**190.9**
Power purchased	**59.4**	**-**	**7.7**	**-**	**(3.9)**	**63.2**
Operations and administration	**114.7**	**42.3**	**27.1**	**0.9**	**-**	**185.0**
Net finance expense	**73.5**	**(1.5)**	**0.3**	**-**	**-**	**72.3**
Amortization	**51.7**	**14.2**	**-**	**-**	**-**	**65.9**
Other income and expense	**(0.9)**	**1.8**	**0.2**	**-**	**-**	**1.1**
Regulatory adjustments	**55.6**	**-**	**-**	**-**	**-**	**55.6**
	544.9	**56.8**	**35.3**	**0.9**	**(3.9)**	**634.0**
Net income (loss) from operations	**0.5**	**20.0**	**31.4**	**(0.9)**	**3.2**	**54.2**
Preferred dividends	**-**	**3.2**	**-**	**-**	**(3.2)**	**-**
Net income (loss)	**0.5**	**23.2**	**31.4**	**(0.9)**	**-**	**54.2**
Capital expenditures	**80.6**	**32.3**	**-**	**-**	**-**	**112.9**
Total assets	**1,954.0**	**472.4**	**5.7**	**-**	**-**	**2,432.1**

17. SEGMENT INFORMATION (cont'd.)

Segments	Hydro Regulated	Churchill Falls	Energy Marketing	Other	Inter-segment	Total
(millions of dollars)			2012			
Revenue						
Energy sales	520.7	73.0	52.2	-	(4.0)	641.9
Other revenue	2.1	0.5	-	-	3.4	6.0
	522.8	73.5	52.2	-	(0.6)	647.9
Expenses						
Fuels	182.4	-	-	-	-	182.4
Power purchased	57.0	0.1	7.7	-	(4.0)	60.8
Operations and administration	109.5	42.0	25.1	0.6	-	177.2
Net finance expense	74.0	(1.6)	0.1	-	-	72.5
Amortization	47.5	12.7	-	-	-	60.2
Other income and expense	5.3	(4.6)	(0.1)	-	-	0.6
Regulatory adjustments	30.0	-	-	-	-	30.0
	505.7	48.6	32.8	0.6	(4.0)	583.7
Net income (loss) from operations	17.1	24.9	19.4	(0.6)	3.4	64.2
Preferred dividends	-	3.4	-	-	(3.4)	-
Net income (loss)	17.1	28.3	19.4	(0.6)	-	64.2
Capital expenditures	77.6	30.1	-	-	-	107.7
Total assets	1,906.4	456.2	3.5	-	-	2,366.1

18. COMMITMENTS AND CONTINGENCIES

(a) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, Management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.2 million (2012 - $0.3 million).

(b) One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $22.0 million (2012 - $21.9 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate outcome of this action cannot be ascertained at this time, in the opinion of Hydro's Management, following consultation with its legal counsel, no liability should be recognized.

(c) Outstanding commitments for capital projects total approximately $25.4 million (2012 - $18.5 million).

18. COMMITMENTS AND CONTINGENCIES (cont'd.)

(d) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	In-service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	390 kW	2010	Continual
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

Estimated payments due in each of the next five years are as follows:

(millions of dollars)	2014	2015	2016	2017	2018
Power purchases	24.5	24.3	24.5	24.8	25.1

(e) Hydro has issued one irrevocable letter of credit to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement. Churchill Falls has issued three irrevocable letters of credit, totaling $2.0 million to ensure satisfactory management of its waste management and compliance with a certificate of approval for the transportation of special hazardous wastes, granted by the Department of Environment and Conservation.

(f) Hydro has received funding, in the amount of $3.0 million, from the Atlantic Canada Opportunities Agency (ACOA) in relation to a wind-hydrogen-diesel research development project in the community of Ramea. This funding is repayable in annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2013 there have been no commercial implementations.

(g) On February 23, 2010, Churchill Falls filed a motion against Hydro-Quebec in the Quebec Superior Court. The motion is seeking a modification to the pricing terms of the 1969 Power Contract as of November 30, 2009. The trial took place during the autumn of 2013. It is anticipated that the court will issue its decision on the matter in 2014. In July 2013, Hydro-Quebec filed a Motion for Declaratory Judgment in Quebec Superior Court relating to the interpretation of the 1969 Power Contract between Churchill Falls and Hydro-Quebec. The Motion, and its possible outcomes are presently under consideration by Churchill Falls' legal advisors.

(h) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, Churchill Falls is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. Beginning in 2015, Churchill Falls is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.

At the expiry of the sublease, certain assets of Twin Falls will revert to Churchill Falls. Management is currently evaluating the extent of its responsibility, if any, for any potential related environmental or decommissioning liabilities.

18. COMMITMENTS AND CONTINGENCIES (cont'd.)

(i) The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but that further monitoring be carried out. Monitoring was performed throughout 2010 with no remediation required. However, the 2010 sampling did indicate some increase in PCB concentrations in sediment and fish flesh in specific locations, and an increased frequency of monitoring was recommended. Further sampling was conducted in 2013, however, the consultant's report is not yet available.

(j) Hydro has entered into power sales agreements with third parties. To facilitate market access, Hydro had entered into a transmission service agreement with Hydro-Quebec TransEnergie which concludes in 2024.

The transmission rental payments for the next five years are estimated to be as follows:

2014	\$19.5 million
2015	\$19.7 million
2016	\$19.9 million
2017	\$20.1 million
2018	\$20.3 million

(k) Hydro has entered into a Power Purchase Agreement with Muskrat Falls Corporation (Muskrat Falls) for the purchase of energy capacity from the Muskrat Falls Plant. The supply period under the agreement is 50 years and commences at date of commissioning.

(l) In 2013, Hydro entered into the Transmission Funding Agreement (TFA) with Labrador-Island Link Operating Corporation (LIL Opco), in which Hydro has committed to make payments which will be sufficient for LIL Opco to recover all costs associated with rent payments under the LIL Lease and the payment, operating and maintenance costs incurred by LIL Opco. Hydro will be required to begin mandatory payments associated with the TFA upon commissioning of the LIL assets. The term of the TFA is anticipated to continue until the service life of the LIL assets has expired.

19. RELATED PARTY TRANSACTIONS

Hydro enters into various transactions with its parents, subsidiaries and other affiliates. These transactions occur within the normal course of operations and are measured at the exchange amount, which is the amount of consideration agreed to by the related parties. Related parties with which Hydro transacts are as follows:

Related Party	Relationship
Nalcor Energy (Nalcor)	100% shareholder of Hydro
The Province	100% shareholder of Nalcor
Churchill Falls	Jointly controlled subsidiary of Hydro
Twin Falls	Jointly controlled subsidiary of Churchill Falls
Trust	Created by the Province with Churchill Falls as the beneficiary
Nalcor Energy – Bull Arm Fabrication	Wholly owned subsidiary of Nalcor
Nalcor Energy – Oil and Gas	Wholly owned subsidiary of Nalcor
PUB	Agency of the Province
Labrador-Island Link Limited Partnership	Partnership in which Nalcor owns 75 Class A Units
Muskrat Falls	Wholly owned subsidiary of Nalcor

19. RELATED PARTY TRANSACTIONS (cont'd.)

Intercompany transactions and balances have been eliminated upon consolidation. The amounts included in the consolidated financial statements for related party transactions are as follows:

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $6.1 million (2012 - $6.1 million) of the power produced by Churchill Falls.

(b) Hydro is required to contribute to the cost of operations of the PUB as well as the cost of hearings and applications costs. During 2013, Hydro incurred $0.6 million (2012 - $1.5 million) in costs related to the PUB of which $0.2 million (2012 - $0.6 million) was included in accounts payable and accrued liabilities.

(c) As at December 31, 2013, Hydro has a payable to related parties of $1.8 million (2012 - $2.3 million) and a receivable from related parties for $2.3 million (2012 - $0.7 million). This payable/receivable consists of various intercompany operating costs and power purchases.

(d) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, Churchill Falls must pay rentals and royalties to the Province annually. As at December 31, 2013, $5.6 million (2012 - $6.2 million) was payable.

(e) Hydro received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2013, $0.7 million (2012 - $1.9 million) has been recorded in deferred credits.

(f) On February 3, 2010, the Province established the Trust with Churchill Falls as the beneficiary. The purpose of this Trust is to fund the external costs and expenses in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. To date, $3.8 million (2012 - $1.8 million) has been received and $0.8 million (2012 - $0.2 million) has been accrued as due from the Trust.

(g) The debt guarantee fee for 2013 was $3.7 million. It was paid to the Province in April 2013 (2012 - $3.7 million).