

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**A NALCOR ENERGY COMPANY**

Consolidated Financial Statements  
December 31, 2014



March 24, 2015

Honourable Derrick Dalley  
Minister of Natural Resources  
Government of Newfoundland and Labrador  
50 Elizabeth Avenue, 7<sup>th</sup> Floor  
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 Labrador Hydro (Hydro) for the year ended December 31, 2014.

A detailed account of Hydro's activities during the year ended December 31, 2014 is included in the Nalcor Energy 2014 Business and Financial Report.

Regards,



Ken Marshall, Chair  
Board of Directors

Attachment

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2014**

**DIRECTORS**

KEN MARSHALL  
President – Atlantic Region  
Rogers Communications

LEO ABBASS  
Corporate Director

ERIN BREEN  
Partner, Simmons+ Partners Defence

EDMUND MARTIN  
President and Chief Executive Officer

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

GERALD SHORTALL  
Chartered Accountant  
Corporate Director

**OFFICERS**

KEN MARSHALL  
Chairperson

EDMUND MARTIN  
President and Chief Executive Officer

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

GILBERT BENNETT  
Vice President, Lower Churchill Project

ROBERT HENDERSON  
Vice President, Newfoundland and Labrador Hydro

PAUL HUMPHRIES  
Vice President, System Operations and Planning

WAYNE CHAMBERLAIN  
General Counsel and Corporate Secretary

PETER HICKMAN  
Assistant Corporate Secretary

SCOTT PELLEY  
Corporate Treasurer

CARLA RUSSELL  
General Manager, Finance

**HEAD AND CORPORATE OFFICE**

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

## 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 statements of financial position as at December 31, 2014, December 31, 2013 and January 1, 2013, and the consolidated statements of profit and comprehensive income, changes in equity and cash flows for the years ended December 31, 2014 and December 31, 2013, 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 International Financial Reporting Standards, 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 audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits 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 in our audits is sufficient and appropriate to provide a basis for our audit opinions.

### 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, 2014, December 31, 2013 and January 1, 2013, and its financial performance and its cash flows for the years ended December 31, 2014 and December 31, 2013, in accordance with International Financial Reporting Standards.

*Deloitte LLP*

Chartered Professional Accountants  
March 18, 2015

**NEWFOUNDLAND AND LABRADOR HYDRO  
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

<i>As at (millions of Canadian dollars)</i>	Notes	December 31 2014	December 31 2013	January 1 2013
<b>ASSETS</b>				
Current assets				
Cash and cash equivalents	5	25.4	18.0	11.6
Short-term investments		3.3	-	-
Trade and other receivables	6	105.0	103.6	102.0
Inventories	7	97.1	75.2	62.0
Current portion of sinking funds	10	-	65.4	-
Prepayments		5.8	4.5	3.9
Derivative assets	19	2.7	0.2	-
<b>Total current assets</b>		<b>239.3</b>	266.9	179.5
Non-current assets				
Property, plant and equipment	8	2,037.9	1,865.4	1,820.4
Other long-term assets	10	262.9	254.4	315.0
Investment in joint arrangement		1.5	1.1	0.7
<b>Total assets</b>		<b>2,541.6</b>	2,387.8	2,315.6
Regulatory deferrals	9	124.2	64.4	65.1
<b>Total assets and regulatory deferrals</b>		<b>2,665.8</b>	2,452.2	2,380.7
<b>LIABILITIES AND EQUITY</b>				
Current liabilities				
Short-term borrowings	11	53.0	41.0	52.0
Trade and other payables	12	151.3	118.4	92.2
Current portion of long-term debt	11	8.4	82.2	8.2
Deferred credits		0.7	0.7	1.9
Current portion of deferred contributions	13	0.8	0.6	0.2
Derivative liabilities	19	0.2	0.4	-
<b>Total current liabilities</b>		<b>214.4</b>	243.3	154.5
Non-current liabilities				
Long-term debt	11	1,239.3	1,046.6	1,125.9
Deferred contributions	13	11.4	10.7	9.9
Decommissioning liabilities	14	28.0	24.8	26.7
Long-term payables		0.7	1.6	2.6
Employee benefits liability	15	127.7	105.5	108.9
<b>Total liabilities</b>		<b>1,621.5</b>	1,432.5	1,428.5
Shareholder's equity				
Share capital	16	22.5	22.5	22.5
Shareholder contributions	16	118.6	118.4	116.7
Reserves		(4.8)	(5.5)	3.3
Retained earnings		655.9	625.7	607.5
<b>Total equity</b>		<b>792.2</b>	761.1	750.0
Regulatory deferrals	9	252.1	258.6	202.2
<b>Total liabilities, equity and regulatory deferrals</b>		<b>2,665.8</b>	2,452.2	2,380.7

See accompanying notes

Commitments and contingencies (Note 21)

Explanation of transition to IFRS (Note 25)

Subsequent event (Note 26)

On behalf of the Board:

  
DIRECTOR

  
DIRECTOR

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**CONSOLIDATED STATEMENTS OF PROFIT AND COMPREHENSIVE INCOME**

<i>For the year ended December 31 (millions of Canadian dollars)</i>	Notes	<b>2014</b>	2013
Energy sales		<b>691.2</b>	681.3
Other revenue		<b>5.9</b>	6.6
<b>Revenue</b>		<b>697.1</b>	687.9
Fuels		<b>(268.1)</b>	(190.9)
Power purchased		<b>(68.3)</b>	(63.0)
Operating costs	17	<b>(210.1)</b>	(182.2)
Depreciation	8	<b>(69.8)</b>	(64.3)
Net finance income and expense	18	<b>(74.0)</b>	(73.1)
Other income and expense		<b>(0.5)</b>	(0.7)
Share of profit of joint arrangement		<b>0.4</b>	0.4
<b>Profit, before regulatory adjustments</b>		<b>6.7</b>	114.1
Regulatory adjustments	9	<b>66.3</b>	(57.1)
<b>Profit for the year</b>		<b>73.0</b>	57.0
<b>Other comprehensive income (loss) for the year</b>		<b>0.7</b>	(8.8)
<b>Total comprehensive income for the year</b>		<b>73.7</b>	48.2

*See accompanying notes*

**NEWFOUNDLAND AND LABRADOR HYDRO  
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

<i>(millions of Canadian dollars)</i>	Note	Share Capital	Shareholder Contributions	Fair Value Reserve	Employee Benefit Reserve	Retained Earnings	Total
<b>Balance at January 1, 2014</b>		<b>22.5</b>	<b>118.4</b>	<b>24.9</b>	<b>(30.4)</b>	<b>625.7</b>	<b>761.1</b>
<b>Profit for the year</b>		-	-	-	-	<b>73.0</b>	<b>73.0</b>
<b>Other comprehensive income</b>							
Net change in fair value of available-for-sale financial instruments		-	-	<b>27.4</b>	-	-	<b>27.4</b>
Actuarial loss on employee benefit liability	15	-	-	-	<b>(15.7)</b>	-	<b>(15.7)</b>
Net change in fair value of financial instruments reclassified to profit or loss		-	-	<b>(11.0)</b>	-	-	<b>(11.0)</b>
<b>Total comprehensive income (loss) for the year</b>		-	-	<b>16.4</b>	<b>(15.7)</b>	<b>73.0</b>	<b>73.7</b>
<b>Capital contributions</b>	16	-	<b>0.2</b>	-	-	-	<b>0.2</b>
<b>Dividends</b>	16	-	-	-	-	<b>(42.8)</b>	<b>(42.8)</b>
<b>Balance at December 31, 2014</b>		<b>22.5</b>	<b>118.6</b>	<b>41.3</b>	<b>(46.1)</b>	<b>655.9</b>	<b>792.2</b>
Balance at January 1, 2013		22.5	116.7	42.8	(39.5)	607.5	750.0
Profit for the year		-	-	-	-	57.0	57.0
<b>Other comprehensive income</b>							
Net change in fair value of available-for-sale financial instruments		-	-	(5.0)	-	-	(5.0)
Actuarial gain on employee benefit liability	15	-	-	-	9.1	-	9.1
Net change in fair value of financial instruments reclassified to profit or loss		-	-	(12.9)	-	-	(12.9)
<b>Total comprehensive income (loss) for the year</b>		-	-	<b>(17.9)</b>	<b>9.1</b>	<b>57.0</b>	<b>48.2</b>
<b>Capital contributions</b>	16	-	<b>1.7</b>	-	-	-	<b>1.7</b>
<b>Dividends</b>	16	-	-	-	-	<b>(38.8)</b>	<b>(38.8)</b>
<b>Balance at December 31, 2013</b>		<b>22.5</b>	<b>118.4</b>	<b>24.9</b>	<b>(30.4)</b>	<b>625.7</b>	<b>761.1</b>

See accompanying notes



**NEWFOUNDLAND AND LABRADOR HYDRO**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

<i>For the year ended December 31 (millions of Canadian dollars)</i>	Notes	2014	2013
Cash provided from (used in)			
Operating activities			
Profit for the year		<b>73.0</b>	57.0
Adjusted for items not involving a cash flow:			
Depreciation	8	<b>69.8</b>	64.3
Accretion	18	<b>1.3</b>	1.3
Amortization of deferred contributions	13	<b>(0.8)</b>	(0.7)
Employee benefits	15	<b>6.5</b>	5.7
Regulatory adjustments	9	<b>(66.3)</b>	57.1
Gain on disposal of property, plant and equipment		<b>(0.6)</b>	(1.2)
Share of profit of joint arrangement		<b>(0.4)</b>	(0.4)
Other		<b>(1.6)</b>	-
		<b>80.9</b>	183.1
Changes in non-cash working capital balances	23	<b>8.3</b>	10.8
<b>Net cash provided from operating activities</b>		<b>89.2</b>	<b>193.9</b>
Investing activities			
Additions to property, plant and equipment	8	<b>(242.9)</b>	(119.2)
Increase in short-term investments		<b>(3.3)</b>	-
Decrease (increase) in sinking funds		<b>101.0</b>	(27.6)
Additions to reserve fund	10	<b>(0.3)</b>	-
Withdrawal from reserve fund	10	<b>16.4</b>	-
Proceeds on disposal of property, plant and equipment		<b>3.3</b>	8.6
<b>Net cash used in investing activities</b>		<b>(125.8)</b>	<b>(138.2)</b>
Financing activities			
Issuance of long-term debt	11	<b>197.1</b>	-
Retirement of long-term debt	11	<b>(124.7)</b>	-
Dividends paid to Nalcor Energy	16	<b>(42.8)</b>	(38.8)
Increase (decrease) in short-term borrowings	11	<b>12.0</b>	(11.0)
Decrease (increase) in long-term receivables	10	<b>1.4</b>	(0.9)
Decrease in long-term payable		<b>(0.9)</b>	(1.0)
Increase in contributed capital	16	<b>0.2</b>	1.7
Increase in deferred contributions	13	<b>1.7</b>	1.9
Decrease in deferred credits		-	(1.2)
<b>Net cash provided from (used in) financing activities</b>		<b>44.0</b>	<b>(49.3)</b>
Net increase in cash and cash equivalents		<b>7.4</b>	6.4
Cash and cash equivalents, beginning of year		<b>18.0</b>	11.6
Cash and cash equivalents, end of year		<b>25.4</b>	18.0

Supplementary cash flow information (Note 23)

See accompanying notes

# NEWFOUNDLAND AND LABRADOR HYDRO

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 1. DESCRIPTION OF BUSINESS

Newfoundland and Labrador Hydro (Hydro or the Company) 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 is a 100% owned subsidiary of Nalcor Energy (Nalcor).

Hydro holds interests in the following entities:

A 65.8% interest in Churchill Falls (Labrador) Corporation Limited (Churchill Falls). 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).

A 51% interest in Lower Churchill Development Corporation (LCDC), an inactive subsidiary. 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.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### 2.1 Statement of Compliance and Basis of Measurement

These annual audited consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). Hydro adopted International Financial Reporting Standards (IFRS) as of January 1, 2014, with the date of transition effective January 1, 2013. Hydro has adopted accounting policies which are based on IFRS applicable as at December 31, 2014, and includes individual IFRS, International Accounting Standards (IAS), and interpretations made by the IFRS Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC). Upon adoption, Hydro followed the requirements of IFRS 1 - First time adoption of IFRS (IFRS 1) in its application of IFRS as disclosed in Note 25.

Previously, the annual audited consolidated financial statements of Hydro were prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP). An explanation of how the transition to IFRS has affected the Company's financial position, financial performance and cash flows is provided in Note 25.

These annual audited consolidated financial statements have been prepared on a historical cost basis, except for financial instruments 'at fair value through profit or loss' (FVTPL) and 'available-for-sale' (AFS) financial assets which have been measured at fair value. The annual audited consolidated financial statements are presented in Canadian Dollars and all values rounded to the nearest million, except when otherwise noted. These annual audited consolidated financial statements were approved by Hydro's Board of Directors (the Board) on March 13, 2015.

#### 2.2 Basis of Consolidation

The annual audited consolidated financial statements include the financial statements of Hydro, its subsidiary company, Lower Churchill Development Corporation (LCDC) and its share of investment in a joint arrangement. Intercompany transactions and balances have been eliminated upon consolidation.

Effective June 18, 1999, Hydro, Churchill Falls, and Hydro-Québec 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-Québec on the Board of Directors of Churchill Falls.

Although Hydro holds a 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of a joint operation. Accordingly, Hydro has recognized its share of assets, liabilities and profit or loss in relation to its interest in Churchill Falls subsequent to the effective date of the Shareholders' Agreement.

## NEWFOUNDLAND AND LABRADOR HYDRO

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Churchill Falls holds 33.3% of the equity share capital of Twin Falls. This investment is accounted for using the equity method.

#### 2.3 Cash and Cash Equivalents and Short-term Investments

Cash and cash equivalents consist of amounts on deposit with a Schedule 1 Canadian bank, as well as highly liquid short-term investments with original maturities of three months or less at date of purchase. Short-term investments with original maturities, at date of purchase, beyond three months and less than twelve months are classified as short-term investments. The effective interest rates on these investments at December 31, 2014 ranged from 1.21% to 1.23% (2013 — 1.12% to 1.15%) per annum. Cash and cash equivalents are recorded at cost which approximates fair value while short-term investments are measured at fair value.

#### 2.4 Trade and Other Receivables

Trade and other receivables are classified as 'loans and receivables' and are measured at amortized cost using the effective interest method.

#### 2.5 Inventories

Inventories are carried at the lower of cost and net realizable value. Cost is determined on a weighted average basis and includes expenditures incurred in acquiring the inventories and bringing them to their existing condition and location. Net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

#### 2.6 Property, Plant and Equipment

Items of property, plant and equipment are recognized using the cost model and thus are recorded at cost less accumulated depreciation and accumulated impairment losses. Cost includes materials, labour, contracted services, professional fees and, for qualifying assets, borrowing costs capitalized in accordance with Hydro's accounting policy as per Note 2.7. Costs capitalized with the related asset include all those costs directly attributable to bringing the asset into operation. When significant parts of property, plant and equipment are required to be replaced at intervals, Hydro recognizes such parts as individual assets with specific useful lives and depreciation, respectively. Likewise, when a major inspection is performed, its cost is recognized in the carrying amount of the plant and equipment as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are recognized in profit or loss as incurred. Property, plant and equipment are not revalued for financial reporting purposes. Depreciation of these assets commences when the assets are ready for their intended use.

#### Hydro

Depreciation 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
Other assets	5 to 55 years

Hydroelectric generation plant includes the powerhouse, turbines, governors and generators, as well as water conveying and control structures, including dams, dikes, 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, dikes and liners and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230,

## NEWFOUNDLAND AND LABRADOR HYDRO

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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138 and 69 kilovolt (kV). Terminal stations assets are used to step up voltages of electricity and to step down voltages for distribution.

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

Other assets include telecontrol, computer software, buildings, insulators and conductors which are carried at cost less accumulated amortization.

#### Churchill Falls

Depreciation 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	5 to 45 years

Hydro and Churchill Falls assets' residual values, useful lives and method of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate. The carrying value of property, plant and equipment is reviewed for impairment whenever events indicate that the carrying amounts of those assets may not be recoverable.

#### **2.7 Borrowing Costs**

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization. All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

#### **2.8 Impairment of Non-Financial Assets**

At the end of each reporting period, Hydro reviews the carrying amounts of its non-financial assets to determine whether there is any indication that those assets may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, Hydro estimates the recoverable amount of the cash-generating unit (CGU) to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual CGUs, or otherwise they are allocated to the smallest group of CGUs for which a reasonable and consistent allocation basis can be identified.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. If the recoverable amount of an asset (or CGU) is estimated to be less than its carrying amount, the carrying amount of the asset (or CGU) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss.

#### **2.9 Investment in Joint Arrangement**

A joint arrangement is an arrangement of which two or more parties have joint control. Control exists when an entity has the power, directly or indirectly, to govern the financial and operating policies of another entity, so as to obtain benefits from its activities. A joint arrangement is either a joint operation or a joint venture.

Effective June 18, 1999, Hydro, Churchill Falls and Hydro-Québec 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 Hydro and Hydro-Québec who are members 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-Québec, with respect to Churchill Falls, from that of majority and minority

## **NEWFOUNDLAND AND LABRADOR HYDRO**

### **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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shareholders, respectively, to that of joint operators. Hydro accounts for its investment in Churchill Falls by recognizing its share of assets, liabilities and profit or loss in relation to its interest in the joint operation.

Hydro's joint operation, 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 using the equity method. Under the equity method, the interest in the joint venture is carried in the Statement of Financial Position at cost plus post acquisition changes in Churchill Falls' share of net assets of the joint venture. The Statements of Profit and Comprehensive Income reflect the share of the profit or loss of the joint venture.

#### **2.10 Employee Future Benefits**

(i) Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. Contributions by Hydro to this plan are recognized as an expense when employees have rendered service entitling them to the contributions.

(ii) Other Benefits

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 cost of providing these benefits is determined using the projected unit credit method, with actuarial valuations being completed every three years and extrapolated at the end of each reporting period based on service and Management's best estimate of salary escalation, retirement ages of employees and expected health care costs.

Actuarial gains and losses on Hydro's defined benefit obligation are recognized in reserves in the period in which they occur. Past service costs are recognized in operating costs as incurred.

The retirement benefit obligation recognized in the Statement of Financial Position represents the present value of the defined benefit obligation.

#### **2.11 Provisions**

A provision is a liability of uncertain timing or amount. A provision is recognized if Hydro has a present legal obligation or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognized for future operating losses. The provision is measured at the present value of the best estimate of the expenditures expected to be required to settle the obligation using a discount rate that reflects the current market assessments of the time value of money and the risks specific to the obligation. Provisions are re-measured at each Statements of Financial Position date using the current discount rate.

#### **2.12 Decommissioning, Restoration and Environmental Liabilities**

Legal and constructive obligations associated with the retirement of property, plant and equipment are recorded as liabilities when those obligations are incurred and are measured as the present value of the expected costs to settle the liability, discounted at a rate specific to the liability. The liability is accreted up to the date the liability will be incurred with a corresponding charge to net finance income and expense. The carrying amount of decommissioning, restoration and environmental liabilities is reviewed annually with changes in the estimates of timing or amount of cash flows added to or deducted from the cost of the related asset.

#### **2.13 Revenue Recognition**

Revenue from the sale of energy is recognized when Hydro has transferred the significant risks and rewards of ownership to the buyer, recovery of the consideration is probable and the amount of revenue can be reliably measured. Sales within the Province are primarily at rates approved by the Newfoundland and Labrador Board of

## **NEWFOUNDLAND AND LABRADOR HYDRO**

### **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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Commissioners of Public Utilities (PUB), whereas export sales and sales to certain major industrial customers are either at rates under the terms of the applicable contracts, or at market rates.

Churchill Falls provides energy to three primary customers: Hydro-Québec, Hydro and Twin Falls.

A power contract with Hydro-Québec dated May 12, 1969 (the Power Contract) 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 kWh. The rate during the term of the Renewed Power Contract is 2.0 mills per kW.

Churchill Falls also recognizes revenue from Hydro-Québec under a Guaranteed Winter Availability Contract (GWAC) through 2041. The GWAC was signed with Hydro-Québec in 1998 and provides for the sale of 682 MW of guaranteed seasonal availability to Hydro-Québec during the months of November through March in each of the remaining years until 2041.

The value of differences between energy delivered and the Annual Energy Base (AEB), as defined in the Power Contract, is tracked over a four-year period and then either recovered from or refunded to Hydro-Québec 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 (2013 - 7%).

Under the Power Contract, Churchill Falls has the right to recall 300 MW (Recall Power). All of the Recall Power is sold by Churchill Falls to Hydro. Churchill Falls also provides 225 MW to Twin Falls.

#### **2.14 Net Finance Income and Expense**

For all financial instruments measured at amortized cost and interest bearing financial assets classified as AFS, interest income or expense is recorded using the effective interest rate, which is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability.

#### **2.15 Foreign Currencies**

Transactions in currencies other than Hydro's functional currency (foreign currencies) are recognized using the prior month end close rate. At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates of exchange in effect at the period end date. Those foreign exchange gains and losses not included in regulatory deferrals are recorded in profit or loss as net finance income and expense.

#### **2.16 Income Taxes**

Hydro is exempt from paying income taxes under Section 149(1) (d) of the Income Tax Act.

#### **2.17 Financial Instruments**

Financial assets and financial liabilities are recognized in the Consolidated Statements of Financial Position 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. Financial instruments are classified into the following specified categories: financial assets 'at FVTPL', 'held-to-maturity' investments, 'AFS' financial assets, 'loans and receivables', financial liabilities 'at FVTPL', financial instruments used for hedging and other financial liabilities. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

## NEWFOUNDLAND AND LABRADOR HYDRO

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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#### Classification of Financial Instruments

Hydro has classified each of its financial instruments into the following categories: financial assets at FVTPL, loans and receivables, held-to-maturity investments, AFS financial assets, financial liabilities at FVTPL and other financial liabilities.

Cash and cash equivalents	Loans and receivables
Short-term investments	AFS financial assets
Trade and other receivables	Loans and receivables
Derivative instruments	At FVTPL
Sinking funds – investments in same Hydro issue	Held-to-maturity investments
Sinking funds – other investments	AFS financial assets
Long-term receivable	Loans and receivables
Trade and other payables	Other financial liabilities
Short-term borrowings	Other financial liabilities
Long-term debt	Other financial liabilities
Long-term payable	Other financial liabilities

#### (i) Effective Interest Method

The effective interest method is a method of calculating the amortized cost of a financial instrument and allocating interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial instrument, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Income or expense is recognized on an effective interest basis for financial instruments other than those financial assets and liabilities classified at FVTPL.

#### Financial Assets

#### (ii) Financial Assets at FVTPL

Financial assets are classified at FVTPL when the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling it in the near term; or
- on initial recognition it is part of a portfolio of identified financial instruments that Hydro manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with Hydro's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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- it forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on re-measurement recognized in other income and expense.

(iii) Loans and Receivables

Trade receivables, loans and other receivables with fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

(iv) Held-to-Maturity Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity dates that Hydro has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are measured at amortized cost using the effective interest method less any impairment, with revenue recognized on an effective yield basis.

(v) AFS Financial Assets

AFS financial assets are non-derivative financial assets that are designated as available for sale or are not classified in any of the previous categories. Gains and losses arising from changes in fair value are recognized in other comprehensive income and accumulated in the fair value reserve with the exception of impairment losses, interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets, which are recognized in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the fair value reserve is reclassified to profit or loss.

Financial Liabilities and Equity Instruments

(vi) Classification as Debt or Equity

Debt and equity instruments are classified as either financial liabilities or equity in accordance with the substance of the contractual arrangement and the definitions of a financial liability and equity instrument.

(vii) Financial Liabilities at FVTPL

A financial liability may be classified as at FVTPL if the contracted liability contains one or more embedded derivatives, and if the embedded derivative significantly modified the cash flows or if the embedded derivative is not closely related to the host liability. Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising from re-measurement recognized in profit or loss.

(viii) Other Financial Liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.



(ix) Derivative Instruments and Financial Instruments Used for Hedging

Derivative instruments are utilized by Hydro to manage market risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Derivatives are initially measured at fair value at the date the derivative contracts are entered into and are subsequently measured at their fair value at the end of each reporting period. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as a hedging relationship.

**2.18 Derecognition of Financial Instruments**

Hydro derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If Hydro neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, its retained interest in the asset and any associated liability for amounts it may have to pay is recognized. If Hydro retains substantially all the risks and rewards of ownership of a transferred financial asset, it continues to recognize the financial asset and also recognizes the collateralized borrowing for the proceeds received. Hydro derecognizes financial liabilities when, and only when, its obligations are discharged, cancelled or they expire.

**2.19 Impairment of Financial Assets**

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

Evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organization.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include Hydro's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, as well as observable changes in national or local economic conditions that correlate with defaults on receivables.

For financial assets carried at amortized cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognized in other comprehensive income are reclassified to profit or loss in the period.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

## NEWFOUNDLAND AND LABRADOR HYDRO

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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#### 2.20 Regulatory Deferrals

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 rate of return on rate base is 7.4% (2013 - 7.4%) +/- 15 basis points. Hydro applies various 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 are expected to be recovered or refunded in future rates. In the absence of rate regulation, these amounts would be included in the determination of profit or loss in the year the amounts are incurred. The effects of rate regulation on the consolidated financial statements are disclosed in Note 9.

### 3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the financial statements in conformity with IFRS requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Actual results may differ materially from these estimates, including changes as a result of future decisions made by the PUB. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the period in which the estimate is reviewed if the revision affects only that period or future periods.

#### 3.1 Use of Estimates

(i) Property, Plant and Equipment

Amounts recorded for depreciation are based on the useful lives of Hydro's assets. The useful lives of property, plant and equipment are determined by independent specialists and reviewed annually by Hydro. These useful lives are Management's best estimate of the service lives of these assets. Changes to these lives could materially affect the amount of depreciation recorded.

(ii) Decommissioning Liabilities

Hydro recognizes a liability for the fair value of the future expenditures required to settle obligations associated with the retirement of property, plant and equipment. Decommissioning liabilities are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. Accretion of decommissioning liabilities is included in profit or loss through net finance income and expense. Differences between the recorded decommissioning liabilities and the actual decommissioning costs incurred are recorded as a gain or loss in the settlement period.

(iii) Employee Benefits

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 benefits is accounted for on an accrual basis, and has been actuarially determined using the projected unit credit method prorated on service, and Management's best estimate of salary escalation, retirement ages of employees and expected health care costs.

(iv) Revenue

In the absence of a signed agreement with Hydro-Québec relating to the Annual Energy Base (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.

#### 3.2 Use of Judgment

(i) Property, Plant and Equipment

Hydro's accounting policy relating to property, plant and equipment is described in Note 2.6. In applying this policy, judgment is used in determining whether certain costs are additions to the carrying amount of the property, plant and equipment as opposed to repairs and maintenance. If an asset has been developed,

## NEWFOUNDLAND AND LABRADOR HYDRO

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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judgment is required to identify the point at which the asset is capable of being used as intended and to identify the directly attributable borrowing costs to be included in the carrying value of the development asset. Judgment is also used in determining the appropriate componentization structure for Hydro's property, plant and equipment.

(ii) Revenue

Management exercises judgment in estimating the value of electricity consumed by retail customers in the period, but billed subsequent to the end of the reporting period. Specifically, this involves an estimate of consumption for each retail customer, based on the customer's past consumption history.

When recognizing deferrals and related amortization of costs or credits in Hydro Regulated, Management assumes that such costs or credits will be recovered or refunded through customer rates in future years. Recovery of some of these deferrals are subject to a future PUB order. As such, there is a risk that some or all of the regulatory deferrals will not be approved by the PUB which could have a material impact on Hydro Regulated's net income in the year the order is received.

#### 4. FUTURE CHANGES IN ACCOUNTING POLICIES

Hydro has not applied the following new and revised IFRSs that have been issued but are not yet effective:

IFRS 9	Financial Instruments <sup>1</sup>
IFRS 15	Revenue from Contracts with Customers <sup>2</sup>
Amendments to IFRS 11	Accounting for Acquisitions of Interests in Joint Operations <sup>3</sup>
Amendments to IAS 16 and IAS 38	Clarification of Acceptable Methods of Depreciation and Amortization <sup>3</sup>
Amendments to IAS 19	Defined Benefit Plans: Employee Contributions <sup>4</sup>

<sup>1</sup>Effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

<sup>2</sup>Effective for annual periods beginning on or after January 1, 2017, with earlier application permitted.

<sup>3</sup>Effective for annual periods beginning on or after January 1, 2016, with earlier application permitted.

<sup>4</sup>Effective for annual periods beginning on or after July 1, 2014, with earlier application permitted.

##### 4.1 IFRS 9 Financial Instruments

IFRS 9 issued in November 2009 introduced new requirements for the classification and measurement of financial assets. IFRS 9 was subsequently amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for de-recognition, and in November 2013 to include the new requirements for general hedge accounting. Another revised version of IFRS 9 was issued in July 2014 mainly to include:

- a) impairment requirements for financial assets, and
- b) limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' (FVTOCI) measurement category for certain simple debt instruments.

Key Requirements of IFRS 9:

- All recognized financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement are required to be subsequently measured at amortized cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. Debt instruments that are held within a business model whose objective is achieved both by collecting contractual cash flows and selling financial assets, and that have contractual terms of the financial asset give rise on

specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, are measured at FVTOCI. All other debt investments and equity investments are measured at their fair value at the end of subsequent accounting periods. In addition, under IFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognized in profit or loss.

- With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 requires that the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributed to a financial liability's credit risk are not subsequently reclassified to profit or loss. Under IAS 39, the entire amount of the change in the fair value of the financial liability designated as fair value through profit or loss is presented in profit or loss.
- In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model, as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires an entity to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognized.
- The new general hedge accounting requirements retain the three types of hedge accounting mechanisms currently available in IAS 39. Under IFRS 9, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about an entity's risk management activities have also been introduced.

Management anticipates that the application of IFRS 9 in the future may have a material impact on amounts reported in respect of the Company's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until Management undertakes a detailed review.

#### **4.2 IFRS 15 Revenue from Contracts with Customers**

In May 2014, IFRS 15 was issued and establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 Revenue, IAS 11 Construction Contracts and the related interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the Standard introduces a five-step approach to revenue recognition:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognizes revenue when (or as) a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15

Management anticipates that the application of IFRS 15 in the future may have a material impact on the amounts reported and disclosures made in the Company's financial statements. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 15 until Management performs a detailed review.

**4.3 Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations**

The amendments to IFRS 11 provide guidance on how to account for the acquisition of a joint operation that constitutes a business as defined in IFRS 3 Business Combinations. Specifically, the amendments state that the relevant principles on accounting for business combinations IFRS 3 and other standards (i.e. IAS 36 Impairment of Assets regarding impairment testing of a CGU to which goodwill on acquisition of a joint operation has been allocated) should be applied. The same requirements should be applied to the formation of a joint operation if and only if an existing business is contributed to the joint operation by one of the parties that participate in the joint operation.

A joint operation is also required to disclose the relevant information required by IFRS 3 and other standards for business combinations.

The amendments of IFRS 11 apply prospectively for annual periods beginning on or after January 1, 2016. Management does not anticipate that the application of these amendments to IFRS 11 will have a material impact on the Company's financial statements.

**4.4 Amendments to IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortization**

The amendments to IAS 16 prohibit entities from using revenue-based depreciation methods for items of property, plant and equipment. The amendments to IAS 38 introduce a rebuttable presumption that revenue is not an appropriate basis for amortization of an intangible asset. This presumption can only be rebutted in the following two limited circumstances:

- a) when the intangible asset is expressed as a measure of revenue, or
- b) when it can be demonstrated that revenue and consumption of the economic benefits of the intangible asset are highly correlated.

The amendments apply prospectively for annual periods beginning on or after January 1, 2016. Currently, the Company uses the straight-line method for depreciation of its property, plant and equipment. Management believes that the straight-line method is the most appropriate method to reflect the consumption of economic benefit inherent in the respective assets and, accordingly, does not anticipate that the application of these amendments to IAS 16 and IAS 38 will have a material impact on the Company's financial statements.

**4.5 Amendments to IAS 19 Defined Benefit Plans: Employee Contributions**

The amendments to IAS 19 clarify how an entity should account for contributions made by employees or third parties to defined benefit plans, based on whether those contributions are dependent on the number of years of service provided by the employee.

For contributions that are independent of the number of years of service, the entity may either recognize the contributions as a reduction in the service cost in the period in which the related service is rendered, or attribute them to the employees' periods of service using the projected unit credit method; whereas for contributions that are dependent on the number of years of service, the entity is required to attribute them to the employees' periods of service.

Management does not anticipate that the application of these amendments to IAS 19 will have a significant impact on the Company's financial statements.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**5. CASH AND CASH EQUIVALENTS**

The composition of cash and cash equivalents is as follows:

<i>(millions of Canadian dollars)</i>	<b>December 31 2014</b>	December 31 2013	January 1 2013
Cash	<b>20.5</b>	11.4	11.6
Cash equivalents	<b>4.9</b>	6.6	-
	<b>25.4</b>	18.0	11.6

**6. TRADE AND OTHER RECEIVABLES**

The composition of trade and other receivables is as follows:

<i>(millions of Canadian dollars)</i>	<b>December 31 2014</b>	December 31 2013	January 1 2013
Trade receivables	<b>89.7</b>	99.9	92.9
Receivables due from related parties	<b>15.0</b>	12.2	11.8
Other receivables	<b>11.5</b>	0.9	1.9
Insurance receivables	-	-	4.6
Allowance for doubtful accounts	<b>(11.2)</b>	(9.4)	(9.2)
	<b>105.0</b>	103.6	102.0

The following is an aged analysis of receivables, net of allowance for doubtful accounts:

<i>(millions of Canadian dollars)</i>	<b>December 31 2014</b>	December 31 2013	January 1 2013
0-60 days	<b>104.0</b>	100.5	100.3
60+ days	<b>1.0</b>	3.1	1.7
	<b>105.0</b>	103.6	102.0

A reconciliation of the beginning and ending amount of allowance for doubtful accounts is as follows:

<i>(millions of Canadian dollars)</i>	<b>December 31 2014</b>	December 31 2013
Allowance for doubtful accounts at beginning of year	<b>(9.4)</b>	(9.2)
Amounts provided for during the year	<b>(1.9)</b>	(0.3)
Amounts written off as uncollectable	<b>0.1</b>	0.1
Allowance for doubtful accounts at end of year	<b>(11.2)</b>	(9.4)

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**7. INVENTORIES**

The composition of inventory is as follows:

<i>(millions of Canadian dollars)</i>	<b>December 31 2014</b>	December 31 2013	January 1 2013
Number 6 fuel	49.4	30.8	20.6
Material and other	36.9	35.0	32.6
Diesel fuel	4.4	4.2	4.0
Other fuel	4.1	2.7	2.3
Construction aggregates	2.3	2.5	2.5
	<b>97.1</b>	75.2	62.0

The cost of inventories recognized as an expense during the year is \$275.3 million (2013 - \$196.3 million)

**8. PROPERTY, PLANT AND EQUIPMENT**

<i>(millions of Canadian dollars)</i>	Generation Plant	Transmission and Distribution	Other	Construction in Progress	Total
<b>Cost</b>					
Balance at January 1, 2013	1,425.5	602.9	173.3	43.2	2,244.9
Additions	-	(0.1)	-	119.3	119.2
Decommissioning liability revisions	(2.0)	(0.6)	-	-	(2.6)
Disposals	(7.0)	(1.6)	(1.5)	-	(10.1)
Transfers	60.5	54.2	25.4	(140.1)	-
Other adjustments	0.2	0.1	0.2	-	0.5
<b>Balance at December 31, 2013</b>	<b>1,477.2</b>	<b>654.9</b>	<b>197.4</b>	<b>22.4</b>	<b>2,351.9</b>
<b>Additions</b>	<b>0.4</b>	<b>(0.1)</b>	<b>-</b>	<b>242.4</b>	<b>242.7</b>
<b>Disposals</b>	<b>(2.1)</b>	<b>(1.8)</b>	<b>(1.3)</b>	<b>-</b>	<b>(5.2)</b>
<b>Transfers</b>	<b>48.2</b>	<b>57.3</b>	<b>18.1</b>	<b>(123.4)</b>	<b>0.2</b>
<b>Decommissioning liability revisions</b>	<b>2.2</b>	<b>0.1</b>	<b>-</b>	<b>-</b>	<b>2.3</b>
<b>Balance at December 31, 2014</b>	<b>1,525.9</b>	<b>710.4</b>	<b>214.2</b>	<b>141.4</b>	<b>2,591.9</b>
<b>Depreciation</b>					
Balance at January 1, 2013	301.1	80.8	42.6	-	424.5
Depreciation expense	33.8	18.0	12.5	-	64.3
Disposals	(1.8)	(0.3)	(0.6)	-	(2.7)
Other adjustments	0.2	0.1	0.1	-	0.4
<b>Balance at December 31, 2013</b>	<b>333.3</b>	<b>98.6</b>	<b>54.6</b>	<b>-</b>	<b>486.5</b>
<b>Depreciation expense</b>	<b>38.1</b>	<b>18.9</b>	<b>12.8</b>	<b>-</b>	<b>69.8</b>
<b>Disposals</b>	<b>(1.2)</b>	<b>(0.4)</b>	<b>(0.9)</b>	<b>-</b>	<b>(2.5)</b>
<b>Transfers</b>	<b>(0.4)</b>	<b>0.5</b>	<b>0.1</b>	<b>-</b>	<b>0.2</b>
<b>Balance at December 31, 2014</b>	<b>369.8</b>	<b>117.6</b>	<b>66.6</b>	<b>-</b>	<b>554.0</b>
<b>Carrying value</b>					
Balance at January 1, 2013	1,124.4	522.1	130.7	43.2	1,820.4
Balance at December 31, 2013	1,143.9	556.3	142.8	22.4	1,865.4
<b>Balance at December 31, 2014</b>	<b>1,156.1</b>	<b>592.8</b>	<b>147.6</b>	<b>141.4</b>	<b>2,037.9</b>

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**9. REGULATORY DEFERRALS**

	January 1 2013	Regulatory activity	December 31 2013	Regulatory activity	December 31 2014	Remaining Recovery Settlement Period (years)
Regulatory asset deferrals						
Foreign exchange losses	62.6	(2.1)	60.5	(2.1)	<b>58.4</b>	27.0
Foreign exchange on fuel	0.1	(0.1)	-	0.3	<b>0.3</b>	n/a
Deferred lease costs	-	-	-	3.7	<b>3.7</b>	n/a
2014 cost deferral	-	-	-	45.9	<b>45.9</b>	n/a
Fuel supply deferral	-	-	-	9.6	<b>9.6</b>	n/a
Deferred energy conservation costs	2.4	1.5	3.9	2.4	<b>6.3</b>	n/a
	<b>65.1</b>	<b>(0.7)</b>	<b>64.4</b>	<b>59.8</b>	<b>124.2</b>	
Regulatory liability deferrals						
Rate stabilization plan (RSP)	(201.7)	(52.1)	(253.8)	7.8	<b>(246.0)</b>	n/a
Insurance proceeds (net)	-	(4.3)	(4.3)	(1.3)	<b>(5.6)</b>	n/a
Deferred power purchase savings	(0.5)	-	(0.5)	-	<b>(0.5)</b>	12.5
	<b>(202.2)</b>	<b>(56.4)</b>	<b>(258.6)</b>	<b>6.5</b>	<b>(252.1)</b>	

**9.1 Regulatory Adjustments Recorded in the Consolidated Statement of Profit and Comprehensive Income**

<i>(millions of Canadian dollars)</i>	2014	2013
RSP amortization	<b>41.2</b>	58.9
Rural rate adjustment	<b>9.1</b>	11.4
RSP fuel deferral	<b>(76.1)</b>	(35.3)
RSP interest	<b>18.0</b>	17.1
Total RSP activity	<b>(7.8)</b>	52.1
2014 cost deferral	<b>(45.9)</b>	-
Fuel supply deferral	<b>(9.6)</b>	-
Amortization of deferred foreign exchange losses	<b>2.1</b>	2.1
Deferred foreign exchange on fuel	<b>(0.3)</b>	0.1
Deferred energy conservation	<b>(2.4)</b>	(1.5)
Insurance proceeds (net)	<b>1.3</b>	4.3
Deferred lease costs	<b>(3.7)</b>	-
Total regulatory adjustments	<b>(66.3)</b>	57.1

The following section describes Hydro's regulatory deferrals which will be, or are expected to be, reflected in customer rates in future periods and have been established through the rate setting process. In the absence of rate regulation, these amounts would be reflected in operating results in the year and net income for 2014 would have decreased by \$66.3 million (2013 - \$57.1 million increase).

**9.2 Rate Stabilization Plan (RSP)**

The PUB ordered Hydro to implement a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, hydrology and load and associated interest. Additionally, the RSP also includes costs associated with the island interconnected and isolated systems. Adjustments required in utility rates to cover the amortization of the balance are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

During 2014 Hydro recorded a net decrease in regulatory liabilities of \$7.8 million (2013 - \$52.1 million increase) resulting in an RSP ending balance for 2014 of \$246.0 million (2013 - \$253.8 million). Included in the balance is \$75.6 million (2013 - \$119.4 million) which is to be refunded in the following year, with the exception of hydraulic variations, which will be refunded at a rate of 25% of the outstanding balance at year end. The remaining portion of



## NEWFOUNDLAND AND LABRADOR HYDRO

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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the RSP balance totaling \$170.4 million (2013 - \$134.4 million) has been set aside with \$124.0 million (2013 - \$115.3 million) to be refunded to Newfoundland Power's retail customers, \$10.9 million (2013 - \$10.9 million) to be used to phase in Island Industrial rate increases and \$35.5 million (2013 - \$8.2 million) subject to a future regulatory ruling.

#### **9.3 Deferred Foreign Exchange Losses**

In 2002, the PUB ordered Hydro to defer realized foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt and amortize the balance over a 40-year period. Accordingly, these costs were recognized as a regulatory asset. During 2014, the amortization of \$2.1 million (2013 - \$2.1 million) reduced regulatory assets.

#### **9.4 Deferred Energy Conservation Costs**

The PUB ordered the deferral of costs associated with an electrical conservation program for residential, industrial, and commercial sectors. In 2014, Hydro recognized \$2.4 million (2013 - \$1.5 million) as a regulatory asset. Recovery of this balance will be addressed as part of Hydro's General Rate Application currently before the PUB.

#### **9.5 Deferred Purchased Power Savings**

In 1997, the Pub ordered Hydro to defer \$1.1 million in benefits related to a reduced initial purchased power rate relating to interconnecting communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system and amortize the balance over a 30-year period. The remaining unamortized savings in the amount of \$0.5 million (2013 - \$0.5 million) are deferred as a regulatory liability.

#### **9.6 Deferred Foreign Exchange on Fuel**

Hydro purchases a significant amount of fuel for Holyrood Thermal Generating Station (HTGS) in USD. The RSP allows Hydro to defer variances in fuel prices (including foreign exchange fluctuations). During 2014, Hydro recognized in regulatory assets, foreign exchange losses on fuel purchases of \$0.3 million (2013 - \$0.1 million gain).

#### **9.7 Insurance Proceeds (Net of Amortization)**

Pursuant to Order No. P.U. 13 (2012), Hydro records net insurance proceeds against the capital costs and amortizes the balance over the life of the asset. Under IFRS, Hydro is required to recognize the insurance proceeds and corresponding amortization in regulatory liabilities. During 2014, Hydro recorded an increase to regulatory liabilities related to insurance proceeds of \$1.8 million (2013 - \$4.5 million) and amortization of \$0.5 million (2013 - \$0.2 million) related to those assets.

#### **9.8 Deferred Lease Costs**

As per Order no. P.U. 28 (2013), Hydro received approval to defer lease costs associated with the 16 MW diesel plant and other necessary infrastructure to ensure black start capability at the HTGS. In 2014, Hydro recognized \$3.7 million (2013 - \$nil) in regulatory assets. Recovery of this balance is subject to a future PUB Order.

#### **9.9 Fuel Supply Deferral**

Pursuant to Order no. P.U. 56 (2014), Hydro received approval to defer additional capacity related supply costs incurred during the three months ended March 31, 2014. In 2014, Hydro deferred \$9.6 million (2013 - \$nil) in regulatory assets. Recovery of this balance is subject to a future PUB Order.

#### **9.10 2014 Cost Deferral**

As per Order no. P.U. 58 (2014), Hydro received approval to defer \$45.9 million in relation to Hydro's proposed 2014 revenue requirement (2013 - \$nil). Accordingly, these costs have been recognized as a regulatory asset. Recovery of this balance is subject to a future PUB Order.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**10. OTHER LONG-TERM ASSETS**

<i>(millions of Canadian dollars)</i>		<b>December 31 2014</b>	December 31 2013	January 1 2013
Long-term receivables	<b>(a)</b>	<b>0.3</b>	1.7	0.8
Reserve fund	<b>(b)</b>	<b>34.2</b>	50.5	50.9
Sinking funds	<b>(c)</b>	<b>228.4</b>	267.6	263.3
		<b>262.9</b>	319.8	315.0
Less: current portion of sinking funds		-	(65.4)	-
		<b>262.9</b>	254.4	315.0

- (a) The balance of \$0.3 million (2013 - \$1.7 million) includes the non-current portion of receivables associated with customer payment plans and the long-term portion of employee purchase programs.
- (b) 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. Churchill Falls invested \$17.0 million in each of 2007, 2008 and 2009 and \$8.0 million in each of 2010, 2011 and 2012. In October 2014, \$23.4 million was withdrawn to fund a portion of 2014 capital expenditures. As per the terms of the shareholders' agreement, these funds will be replaced over a five-year period with \$5.84 million due in each of 2015, 2016 and 2017 and \$2.92 million due in 2018 and 2019.

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Reserve fund holdings consist of securities issued by the Government of Canada, various provinces of Canada and Schedule 1 and 2 Canadian Chartered Banks.

The reserve fund consists of the following:

<i>(millions of Canadian dollars)</i>	<b>2014</b>	2013
Opening balance	<b>50.5</b>	50.9
Principal withdrawals	<b>(15.4)</b>	-
Earnings withdrawn	<b>(1.0)</b>	-
Net discount (premium)	<b>0.3</b>	-
Mark to market adjustment	<b>(0.2)</b>	(0.4)
Fair value of reserve fund	<b>34.2</b>	50.5

- (c) As at December 31, 2014, sinking funds include \$228.4 million (2013 - \$267.6 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 2017 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 Statements of Financial Position 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 1.52% to 9.12% (2013 - 1.17% to 9.86%).

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

The sinking fund consists of the following:

<i>(millions of Canadian dollars)</i>	<b>2014</b>	2013
Balance, beginning of year	<b>267.6</b>	263.3
Contributions	<b>8.3</b>	8.2
Earnings	<b>11.0</b>	13.6
Disposals	<b>(74.2)</b>	-
Valuation adjustment	<b>16.5</b>	(17.5)
Gain on sale of	<b>(0.8)</b>	-
Balance, end of year	<b>228.4</b>	267.6
Less: current portion of sinking funds	-	65.4
	<b>228.4</b>	202.2

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

<i>(millions of Canadian dollars)</i>	2015	2016	2017	2018	2019
Sinking fund instalments	8.1	8.1	6.7	6.7	6.7

**11. DEBT**

**11.1 Short-term Borrowings**

Hydro used promissory notes to fulfil its short-term funding requirements. As at December 31, 2014, there was \$53.0 million in short-term borrowings outstanding (2013 - \$41.0 million).

Hydro also maintains a \$50.0 million CAD or USD equivalent unsecured demand operating credit facility with its banker and at year end there were no amounts drawn on this facility (2013 - \$nil). Advances may take the form of a Prime Rate Advance or the issuance of a Bankers' Acceptances (BA). The facility also provides coverage for overdrafts on Hydro's bank accounts. At year end, Hydro has one letter of credit outstanding, reducing the availability of the credit facility by \$0.3 million (2013 - \$0.3 million).

Churchill Falls maintains a \$10.0 million CAD or USD equivalent unsecured demand operating credit facility with its banker and at December 31, 2014 there were no amounts drawn on this facility (2013 - \$nil). Borrowings in CAD may take the form of Prime Rate Advances and BAs and borrowings in USD may take the form of Base Rate Advances. 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.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**11.2 Long-term Debt**

<i>(millions of Canadian dollars)</i>	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	December 31 2014	December 31 2013	January 1 2013
Hydro							
V*	0.3	10.50	1989	2014	<b>0.3</b>	125.0	124.8
X*	150.0	10.25	1992	2017	<b>149.7</b>	149.5	149.4
Y*	300.0	8.40	1996	2026	<b>294.3</b>	294.0	293.8
AB*	300.0	6.65	2001	2031	<b>305.9</b>	306.1	306.3
AD*	125.0	5.70	2003	2033	<b>123.7</b>	123.7	123.7
AE	225.0	4.30	2006	2016	<b>224.6</b>	224.4	224.2
AF	200.0	3.60	2014	2045	<b>197.1</b>	-	-
Total debentures	1,300.3				<b>1,295.6</b>	1,222.7	1,222.2
Less: Sinking fund investments in own debentures					<b>47.9</b>	93.9	88.1
					<b>1,247.7</b>	1,128.8	1,134.1
Less: payments due within one year					<b>8.4</b>	82.2	8.2
Total debentures					<b>1,239.3</b>	1,046.6	1,125.9

\*Sinking funds have been established for these issues.

Hydro's promissory notes and debentures 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 2014 was \$3.7 million (2013 - \$3.7 million).

On September 15, 2014, Hydro raised new long-term debt through the sale of \$200.0 million of Series AF debentures to its underwriting syndicate. The debentures mature on December 31, 2045 with a coupon of 3.6% paid semi-annually.

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

<i>(millions of Canadian dollars)</i>	2015	2016	2017	2018	2019
Long-term debt repayment	0.3	225.0	150.0	-	-

**12. TRADE AND OTHER PAYABLES**

The composition of trade and other payables is as follows:

<i>(millions of Canadian dollars)</i>	December 31 2014	December 31 2013	January 1 2013
Trade payables	<b>100.6</b>	74.6	47.0
Accrued interest payable	<b>28.8</b>	28.7	28.7
Payables due to related parties	<b>2.7</b>	2.5	3.7
Other payables	<b>19.2</b>	12.6	12.8
	<b>151.3</b>	118.4	92.2

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**13. DEFERRED CONTRIBUTIONS**

Hydro has received contributions in aid of construction of property, plant and equipment. These contributions are deferred and amortized to other revenue over the life of the related item of property, plant and equipment.

<i>(millions of Canadian dollars)</i>	<b>December 31 2014</b>	December 31 2013
Deferred contributions, beginning of year	<b>11.3</b>	10.1
Additions	<b>1.7</b>	1.9
Amortization	<b>(0.8)</b>	(0.7)
Deferred contributions, end of year	<b>12.2</b>	11.3
Less: current portion	<b>(0.8)</b>	(0.6)
	<b>11.4</b>	10.7

**14. DECOMMISSIONING LIABILITIES**

Hydro has recognized liabilities associated with the retirement of portions of the HTGS and disposal of Polychlorinated Biphenyls (PCB).

The reconciliation of the beginning and ending carrying amounts of decommissioning liabilities for December 31, 2014 and December 31, 2013 are as follows:

<i>(millions of Canadian dollars)</i>	<b>December 31 2014</b>	December 31 2013
Decommissioning liabilities, beginning of year	<b>24.8</b>	26.7
Liabilities settled	<b>(0.1)</b>	(0.1)
Accretion	<b>1.0</b>	0.8
Revisions	<b>2.3</b>	(2.6)
Decommissioning liabilities, end of year	<b>28.0</b>	24.8

The total estimated undiscounted cash flows required to settle the HTGS obligations at December 31, 2014 are \$32.1 million (2013 - \$32.1 million). Payments to settle the liability are expected to occur between 2020 and 2024. The fair value of the decommissioning liabilities was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rate of 2.6% (2013 - 3.6%). Hydro has recorded \$25.8 million (2013 - \$22.7 million) related to HTGS obligations.

The total estimated undiscounted cash flows required to settle the PCB obligations at December 31, 2014 are \$2.5 million (2013 - \$2.5 million). Payments to settle the liability are expected to occur between 2015 and 2025. The fair value of the decommissioning liabilities was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rate of 2.8% to 4.6% (2013 - 3.8% and 5.5%). Hydro has recorded \$2.2 million (2013 - \$2.2 million) related to PCB obligations.

A significant number of Hydro's 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 decommissioning liability 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, a decommissioning liability for those assets will be recognized at that time.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**15. EMPLOYEE BENEFITS LIABILITY**

**15.1 Pension Plan**

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of \$6.2 million (2013 - \$5.7 million) are expensed as incurred.

**15.2 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 2014, cash payments to beneficiaries for its unfunded other employee future benefits were \$2.4 million (2013 - \$2.9 million). An actuarial valuation was performed as at December 31, 2012, with an extrapolation to December 31, 2014. The next actuarial valuation will be performed at December 31, 2015.

<i>For the year ended December 31 (millions of Canadian dollars)</i>	<b>2014</b>	2013
Accrued benefit obligation		
Balance, beginning of year	<b>105.5</b>	108.9
Current service cost	<b>3.5</b>	4.1
Interest cost	<b>5.4</b>	4.5
Benefits paid	<b>(2.4)</b>	(2.9)
Actuarial loss (gain)	<b>15.7</b>	(9.1)
Balance, end of year	<b>127.7</b>	105.5

<i>For the year ended December 31 (millions of Canadian dollars)</i>	<b>2014</b>	2013
Component of benefit cost		
Current service cost	<b>3.5</b>	4.1
Interest cost	<b>5.4</b>	4.5
Total benefit expense for the year	<b>8.9</b>	8.6

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

	<b>2014</b>	2013
Discount rate - benefit cost	<b>5.00%</b>	4.00%
Discount rate - accrued benefit obligation	<b>4.20%</b>	5.00%
Rate of compensation increase	<b>3.50%</b>	3.50%

Assumed healthcare trend rates:

	<b>2014</b>	2013
Initial health care expense trend rate	<b>6.00%</b>	6.00%
Cost trend decline to	<b>4.50%</b>	4.50%
Year that rate reaches the rate it is assumed to remain at	<b>2020</b>	2020

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

<i>Increase (millions of Canadian dollars)</i>	<b>2014</b>	2013
Current service and interest cost	<b>2.0</b>	2.1
Accrued benefit obligation	<b>27.4</b>	20.0

<i>Decrease (millions of Canadian dollars)</i>	<b>2014</b>	2013
Current service and interest cost	<b>(1.5)</b>	(1.5)
Accrued benefit obligation	<b>(20.6)</b>	(15.3)

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**16. SHAREHOLDER'S EQUITY**

**16.1 Share Capital**

The share capital of Hydro is summarized below:

<i>(millions of Canadian dollars)</i>	<b>December 31 2014</b>	December 31 2013	January 1 2013
Common shares of par value of \$1 each			
Authorized - 25,000,000			
Issued and outstanding - 22,503,902	<b>22.5</b>	22.5	22.5

**16.2 Shareholder Contributions**

<i>(millions of Canadian dollars)</i>	<b>December 31 2014</b>	December 31 2013	January 1 2013
Total contributed capital	<b>118.6</b>	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 2014, the Trust contributed capital in the amount of \$0.2 million (2013 - \$1.7 million).

**16.3 Dividends**

<i>(millions of Canadian dollars)</i>	<b>December 31 2014</b>	December 31 2013
Declared during the year		
Final dividend for prior year: \$0.15 per share (2013 - \$0.10)	<b>3.5</b>	2.2
Interim dividend for current year: \$1.75 per share (2013 - \$1.63)	<b>39.3</b>	36.6
	<b>42.8</b>	38.8

**17. OPERATING COSTS**

<i>For the year ended December 31 (millions of Canadian dollars)</i>	<b>2014</b>	2013
Salaries and benefits expense	<b>110.5</b>	101.8
Transmission rental	<b>20.4</b>	20.5
Maintenance and materials	<b>36.8</b>	29.5
Professional services	<b>19.7</b>	13.3
Rental and royalty expense	<b>3.1</b>	3.7
Travel and transportation costs	<b>8.3</b>	7.9
Other operating costs	<b>11.3</b>	5.5
	<b>210.1</b>	182.2

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**18. NET FINANCE INCOME AND EXPENSE**

<i>For the year ended December 31 (millions of Canadian dollars)</i>	<b>2014</b>	2013
Finance income		
Interest on sinking fund	<b>15.8</b>	19.4
Interest on reserve fund	<b>1.3</b>	1.5
Other interest income	<b>0.5</b>	0.6
	<b>17.6</b>	21.5
Finance expense		
Long-term debt	<b>85.5</b>	90.5
Foreign exchange loss	<b>4.4</b>	0.7
Debt guarantee fee	<b>3.7</b>	3.7
Accretion	<b>1.3</b>	1.3
Other	<b>1.5</b>	0.6
	<b>96.4</b>	96.8
Interest capitalized during construction	<b>(4.8)</b>	(2.2)
	<b>91.6</b>	94.6
Net finance income and expense	<b>74.0</b>	73.1

**19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

**19.1 Fair Value**

The estimated fair values of financial instruments as at December 31, 2014, December 31, 2013 and January 1, 2013 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. For assets and liabilities that are recognized at fair value on a recurring basis, the Company determines whether transfers have occurred between levels in the hierarchy by reassessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period. There were no transfers between Level 1, 2 and 3 fair value measurements during the years ended December 31, 2014 and 2013.

As of December 31, 2014, Hydro did not have any level 3 instruments.



**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

	Level	Carrying Value	Fair Value	Carrying Value	Fair Value	Carrying Value	Fair Value
		December 31, 2014	December 31, 2014	December 31, 2013	December 31, 2013	January 1, 2013	January 1, 2013
<i>(millions of Canadian dollars)</i>							
<b>Financial assets</b>							
Cash and cash equivalents	1	25.4	25.4	18.0	18.0	11.6	11.6
Short-term investments	1	3.3	3.3	-	-	-	-
Trade and other receivables	1	105.0	105.0	103.6	103.6	102.0	102.0
Derivative assets	2	2.7	2.7	0.2	0.2	-	-
Sinking funds - investments in same							
Hydro issue	2	47.9	62.3	93.9	105.1	88.1	107.3
Sinking funds - other investments	2	228.4	228.4	267.6	267.6	263.3	263.3
Reserve fund	2	34.2	34.2	50.5	50.5	50.9	50.9
Long-term receivables	2	0.3	0.3	1.7	1.8	0.8	0.8
<b>Financial liabilities</b>							
Trade and other payables	1	151.3	151.3	118.4	118.4	92.2	92.2
Short-term borrowings	1	53.0	53.0	41.0	41.0	52.0	52.0
Derivative liabilities	2	0.2	0.2	0.4	0.4	-	-
Long-term debt (including amount due within one year before sinking funds)							
	2	1,295.6	1,694.6	1,222.7	1,545.5	1,222.2	1,668.6
Long-term payables	2	0.7	0.8	1.6	1.7	2.6	2.8

The fair value of cash and cash equivalents, short-term investments, trade and other receivables, trade and other payables and short-term borrowings approximates their carrying values due to their short-term maturity.

**19.2 Risk Management**

Hydro is exposed to certain credit, liquidity and market price risks through its operating, investing 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 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 Statements of Financial Position 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 Schedule 1 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:

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

	Issuer Credit Rating	Fair Value of Portfolio (%)	Issuer Credit Rating	Fair Value of Portfolio (%)
	2014		2013	
Provincial Governments	AA- to AAA	4.93%	AA- to AAA	2.72%
Provincial Governments	A- to A+	41.74%	A- to A+	38.84%
Provincially owned utilities	AA- to AAA	19.70%	AA- to AAA	13.99%
Provincially owned utilities	A- to A+	31.39%	A- to A+	41.34%
Schedule 1 Canadian banks	AA- to AAA	-	AA- to AAA	1.07%
Schedule 1 Canadian banks	A- to A+	2.24%	A- to A+	2.04%
		<b>100.00%</b>		<b>100.00%</b>

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 (%)
	2014		2013	
Provincial Governments	AA- to AAA	-	AA- to AAA	8.94%
Canadian Schedule 1 or 2 banks	AA- to AAA	9.14%	AA- to AAA	16.70%
Provincial Governments	A- to A+	29.28%	A- to A+	21.25%
Provincially owned utilities	AA- to AAA	2.10%	AA- to AAA	9.09%
Provincially owned utilities	A- to A+	9.15%	A- to A+	6.06%
Canadian Schedule 1 banks	A- to A+	50.33%	A- to A+	37.96%
		<b>100.00%</b>		<b>100.00%</b>

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 81.6% (2013 - 81.9%) of total energy sales and 64.7% (2013 - 72.2%) of accounts receivable. These customers are comprised of rate regulated entities or organizations with investment grade credit ratings.

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 (2013 - \$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 (2013 - \$16.0 million) minimum cash balance as well as a \$10.0 million (2013 - \$10.0 million) unsecured demand operating facility with its banker.

Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2015 to 2045. Sinking funds have been established for these issues, with the exception of the issues maturing in 2016 and 2045.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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.

The following are the contractual maturities of Hydro's financial liabilities, including principal and interest, as at December 31, 2014:

<i>(millions of dollars)</i>	<b>&lt;1 Year</b>	<b>1-3 Years</b>	<b>3-5 years</b>	<b>&gt; 5 Years</b>	<b>Total</b>
Trade and other payables	151.3	-	-	-	151.3
Short-term borrowings	53.0	-	-	-	53.0
Long-term payable	-	0.7	-	-	0.7
Long-term debt	8.4	385.3	13.3	893.3	1,300.3
Interest	84.5	150.1	119.0	670.8	1,024.4
	297.2	536.1	132.3	1,564.1	2,529.7

**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 are 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 and sinking funds. 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 and short-term debt was negligible throughout 2014 due to the short time period to maturity.

The table below shows the impact of a 50 basis point change in interest rates on other comprehensive income associated with the sinking funds at the Statement of Financial Position date:

<i>(millions of dollars)</i>	<b>Other Comprehensive Income</b>	
	<b>0.5% Decrease</b>	<b>0.5% Increase</b>
Interest on sinking fund	9.7	(11.4)
Interest on reserve fund	0.8	0.1
	10.5	(11.3)

**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. For the purchase of No. 6 fuel oil, these risks are mitigated through the operation of the RSP. Exposures in USD denominated electricity sales 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.

During 2014, total electricity sales denominated in USD were \$56.4 million (2013 - \$54.7 million). In 2014, Hydro mitigated foreign exchange risk on these sales through the use of foreign currency forward contracts. 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 for the year. These contracts had an average exchange rate of \$1.08 CAD per USD. In December 2013, Hydro also entered into a series of

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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). During 2014, \$2.2 million in losses from these derivative contracts was recognized in other income and expense (2013 - \$0.2 million loss).

In December of 2014, Hydro entered into a series of 12 electricity price forward contracts with a notional value of \$32.5 million USD. The average price of these contracts was USD \$43.60 per MWh (On Peak) and USD \$30.10 per MWh (Off Peak). As at December 31, 2014, the fair value of the derivative asset was \$2.7 million (2013 - \$0.2 million) and the derivative liability was \$0.2 million (2013 - \$0.4 million) as presented on the Statement of Financial Position. During 2014, \$2.6 million in unrealized gains from these contracts was included in other income and expense (2013 - \$nil).

**20. RELATED PARTY TRANSACTIONS**

Hydro enters into various transactions with its parent and other affiliates. These transactions occur in 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)	100.0% shareholder of Hydro
The Province	100.0% shareholder of Nalcor
Churchill Falls	Jointly controlled subsidiary of Hydro
Twin Falls	Jointly controlled subsidiary of Churchill Falls
The Churchill Falls (Labrador) Corporation 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
Lower Churchill Management Corporation	Wholly owned subsidiary of Nalcor
Nalcor Energy Marketing (NEM)	Wholly owned subsidiary of Nalcor

- (a) Hydro has received funding from the Province for wind feasibility studies in Labrador. As at December 31, 2014, \$0.7 million (2013 - \$0.7 million) has been recorded in deferred credits.
- (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 2014, Hydro incurred \$3.1 million (2013 - \$0.6 million) in costs related to the PUB, of which, \$2.4 million (2013 - \$0.2 million) was included in accounts payable and accrued liabilities.
- (c) As at December 31, 2014, Hydro has a payable to related parties of \$0.9 million (2013 - \$0.4 million) and a receivable from related parties for \$2.5 million (2013 - \$0.6 million). This payable/receivable consists of various intercompany operating costs and power purchases.
- (d) The debt guarantee fee for 2014 was \$3.7 million (2013 - \$3.7 million). It was paid in advance to the Province in March 2014.
- (e) As at December 31, 2014, Hydro recovered \$5.8 million (2013 - \$5.5 million) of operating costs from related parties representing the provision of administrative services.
- (f) As at December 31, 2014, Hydro has purchased \$27.9 million (2013 - \$29.6 million) of power generated from assets related to Exploits, which are held by the Province.
- (g) As at December 31, 2014, Hydro has a net intercompany labour expense of \$2.9 million (2013 - \$1.9 million).

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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- (h) Under the terms of the Churchill Falls (Labrador) Corporation Limited (Lease) Act, 1961 (the Lease) and amendments thereto, Churchill Falls is required to pay the Province an annual rental of 8% of the consolidated net profits before income taxes, as defined in the Lease, and an annual royalty of \$0.50 per horsepower year generated, as defined in the Lease. At December 31, 2014, \$4.7 million (2013 - \$5.6 million) was payable to the Province.
- (i) 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 incurred in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. To date, \$4.8 million (2013 - \$3.8 million) has been received and \$0.2 million (2013 - \$0.8 million) has been accrued receivable from the Trust.
- (j) As a result of a sub-lease between Churchill Falls and Twin Falls, certain rights were suspended by Churchill Falls effective June 30, 1974 with the result that Churchill Falls diverted the flow of water from the Twin Falls plant and used the facilities of Twin Falls as required. In consideration for this suspension of rights, Churchill Falls was required to deliver to Twin Falls, during the unexpired term of the sub-lease, horsepower equivalent to the installed horsepower of the Twin Falls plant. Twin Falls was obliged to purchase this power for an amount equal to the average annual cost of operating the Twin Falls plant for the five year period ended March 31, 1974. In addition, Twin Falls was required to pay annually Churchill Falls a rental amounting to \$305,000 and \$1.40 per installed horsepower. Twin Falls also paid to Churchill Falls an annual royalty of \$0.50 per horsepower year generated, as defined, all calculated as though the power delivered by Churchill Falls to Twin Falls had been generated in the Twin Falls plant. The sub-lease expired December 31, 2014.

**20.1 Key Management Personnel Compensation**

Compensation for key management personnel, which Hydro defines as its executives who have the primary authority and responsibility for planning, directing and controlling the activities of the entity, includes compensation for senior executives. Salaries and employee benefits include base salaries, performance contract payments, vehicle allowances and contributions to employee benefit plans. Post-employment benefits include contributions to the Province's Public Service Pension Plan.

<i>(millions of Canadian dollars)</i>	<b>2014</b>	2013
Salaries and short-term employee benefits	<b>1.5</b>	0.9
Post-employment benefits	<b>0.1</b>	-
	<b>1.6</b>	0.9

**21. COMMITMENTS AND CONTINGENCIES**

- (a) Hydro has received claims instituted by various companies and individuals with respect to power delivery claims and other miscellaneous matters. Although such matters cannot be predicted with certainty, Management believes that Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, is not expected to materially affect its financial position.
- (b) Outstanding commitments for capital projects total approximately \$29.6 million as at December 31, 2014 (2013 - \$25.4 million).

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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(c) 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
Hydroelectric	300 MW	1998	43 years
Hydroelectric	225 MW	2015	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	300 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:

<i>(millions of dollars)</i>	2015	2016	2017	2018	2019
Power purchases	70.5	71.0	71.0	72.0	72.8

(d) 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.

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

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

2015	\$19.8 million
2016	\$20.0 million
2017	\$20.2 million
2018	\$20.4 million
2019	\$20.6 million

(f) Hydro has received Phase I 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. In 2014, Hydro entered into a new funding agreement for Phase II of the project for \$2.3 million. This funding is repayable in annual installments of \$25,000 per commercial implementation of the resulting product. As at December 31, 2014 there have been no commercial implementations.

(a) In 2013, Hydro entered into a Power Purchase Agreement with Muskrat Falls Corporation (Muskrat Falls) for the purchase of energy and capacity from the Muskrat Falls Plant. The supply period under the agreement is 50 years and commences at the date of commissioning of the Muskrat Falls plant.

(g) 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.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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- (h) In 2014, Hydro entered into three Capacity Assistance Agreements, one with Vale Newfoundland & Labrador Limited (Vale) and two with Corner Brook Pulp and Paper Limited (CBPP) for the purchase of relief power up to 15.8 MW, 60 MW and 30 MW, respectively, during the winter period. The supply period defined in the agreements is from December 1 to March 31 of each year, concluding March 2018. Payment for services will be dependent on the successful provision of capacity assistance for the winter period by Vale and CBPP.
- (i) The arrangements under which Churchill Falls supplies the 225 MW Twinco Block to Twin Falls expired on December 31, 2014. As a result, a new power purchase agreement (PPA) between Churchill Falls and Hydro for the sale of up to 225 MW of power produced by the Churchill Falls Generating Station was signed by Churchill Falls and Hydro, and is effective January 1, 2015.

The Sub-lease between Twinco and Churchill Falls dated November 15, 1961 giving Twinco the right to develop hydroelectric power on the Unknown River (the Sub-lease) expired on December 31, 2014. A sub-lease was signed between Hydro, Churchill Falls and Twin Falls naming Hydro as the sublessee of the transmission lines and related assets from Churchill Falls to Labrador West, covering the period of January 1 to June 30, 2015. In addition, Hydro entered into a six-month lease with Twin Falls Power Corporation Limited and Wabush Resources Inc. to access a terminal station located on land owned by Wabush Mines. This lease was for a six-month period beginning in January 2015.

Discussions continue between Churchill Falls, Twin Falls and Hydro regarding the commercial matters arising from the expiration of the Sub-lease, including the ownership of assets and the assumption of liabilities (including any environmental liabilities). The consolidated financial statements for the year ended December 31, 2014 do not include adjustments to the carrying values and classification of assets and liabilities as they are undeterminable at this time. These adjustments could be material.

- (j) On February 23, 2010, Churchill Falls filed a motion against Hydro-Québec in Québec Superior Court. The motion was seeking a modification to the pricing terms of the 1969 Power Contract as of November 30, 2009. On July 24, 2014, Churchill Falls received judgment from the Québec Superior Court which ruled against Churchill Falls. Churchill Falls is appealing the decision and on August 26, 2014 filed an Inscription in Appeal with the Québec Court of Appeal.
- (k) In July 2013, Hydro-Québec filed a Motion for Declaratory Judgment (the Motion) in Québec Superior Court relating to the interpretation of the 1969 Power Contract between Churchill Falls and Hydro-Québec and the clarification of certain terms and obligations of the parties under the Renewed Power Contract with Hydro-Québec, which commences in 2016. Churchill Falls has filed a Defense to the Motion and the trial is scheduled to take place in the fall of 2015.
- (l) In 2014, Hydro entered into a six-month lease with Twin Falls Power Corporation Limited and Wabush Resources Inc. to access a terminal station located on land owned by Wabush Mines. This lease is for a six-month period beginning in January 2015.

## **22. CAPITAL MANAGEMENT**

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, reserves and retained earnings).

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

A summary of the capital structure is outlined below:

<i>(millions of dollars)</i>	<b>December 31 2014</b>	December 31 2013	December 31 2013	January 1 2013
<b>Debt</b>				
Long-term debt	<b>1,239.3</b>	1,046.6		1,125.9
Short-term borrowings	<b>53.0</b>	41.0		52.0
Current portion of long-term debt	<b>8.4</b>	82.2		8.2
Sinking funds	<b>(228.4)</b>	(267.6)		(263.3)
	<b>1,072.3</b>	902.2	54.2%	922.8
	<b>57.5%</b>			55.2%
<b>Equity</b>				
Share capital	<b>22.5</b>	22.5		22.5
Contributed capital	<b>118.6</b>	118.4		116.7
Reserves	<b>(4.8)</b>	(5.5)		3.3
Retained earnings	<b>655.9</b>	625.7		607.5
	<b>792.2</b>	761.1	45.8%	750.0
	<b>42.5%</b>			44.8%
<b>Total Debt and Equity</b>	<b>1,864.5</b>	1,663.3	100.0%	1,672.8
	<b>100.0%</b>			100.0%

**22.1 Hydro**

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, Management targets a capital structure comprised of 75% debt and 25% equity, 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 \$53.0 million outstanding as at December 31, 2014 (2013 - \$41.0 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.

**22.2 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.



**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**23. SUPPLEMENTARY CASH FLOW INFORMATION**

<i>(millions of Canadian dollars)</i>	<b>2014</b>	<b>2013</b>
Trade and other receivables	<b>(1.4)</b>	(1.6)
Prepayments	<b>(1.3)</b>	(0.6)
Inventories	<b>(21.9)</b>	(13.2)
Trade and other payables	<b>32.9</b>	26.2
Changes in non-cash working capital balances	<b>8.3</b>	10.8
Interest received	<b>19.8</b>	2.4
Interest paid	<b>88.8</b>	91.1

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**24. SEGMENT INFORMATION**

Hydro operates in four business segments. Hydro regulated activities encompasses sales of electricity to customers within the Province, Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Québec, energy marketing activities which include the sale of electricity to markets outside the Province and other non-regulated energy activities which primarily consist of the investment in a joint arrangement. 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.

<i>(millions of Canadian dollars)</i>	Hydro Regulated	Churchill Falls	Energy Marketing	Other	Inter- Segment	Total
<b>2014</b>						
<b>Energy sales</b>	549.4	71.9	73.9	-	(4.0)	691.2
<b>Other revenue</b>	2.2	1.0	-	-	2.7	5.9
<b>Revenue</b>	551.6	72.9	73.9	-	(1.3)	697.1
<b>Fuels</b>	(268.1)	-	-	-	-	(268.1)
<b>Power purchased</b>	(63.8)	-	(8.5)	-	4.0	(68.3)
<b>Operating costs</b>	(139.1)	(41.4)	(27.3)	(2.3)	-	(210.1)
<b>Depreciation</b>	(56.0)	(13.8)	-	-	-	(69.8)
<b>Net finance income and expense</b>	(74.2)	1.2	(1.0)	-	-	(74.0)
<b>Other income and expense</b>	0.9	(1.8)	0.5	(0.1)	-	(0.5)
<b>Share of profit of joint venture</b>	-	0.4	-	-	-	0.4
<b>Preferred dividends</b>	-	2.7	-	-	(2.7)	-
<b>(Loss) profit before regulatory adjustments</b>	(48.7)	20.2	37.6	(2.4)	-	6.7
<b>Regulatory adjustments</b>	66.3	-	-	-	-	66.3
<b>Profit (loss) for the year</b>	17.6	20.2	37.6	(2.4)	-	73.0
<b>Capital expenditures</b>	208.5	33.0	1.4	-	-	242.9
<b>Total assets</b>	2,159.3	498.2	8.3	-	-	2,665.8
<b>2013</b>						
<i>(millions of Canadian dollars)</i>	Hydro Regulated	Churchill Falls	Energy Marketing	Other	Inter- Segment	Total
<b>Energy sales</b>	543.1	75.6	66.7	-	(4.1)	681.3
<b>Other revenue</b>	2.5	1.0	-	(0.1)	3.2	6.6
<b>Revenue</b>	545.6	76.6	66.7	(0.1)	(0.9)	687.9
<b>Fuels</b>	(190.9)	-	-	-	-	(190.9)
<b>Power purchased</b>	(59.4)	-	(7.7)	-	4.1	(63.0)
<b>Operating costs</b>	(113.0)	(41.3)	(27.1)	(0.8)	-	(182.2)
<b>Depreciation</b>	(51.3)	(13.0)	-	-	-	(64.3)
<b>Net finance income and expense</b>	(74.3)	1.5	(0.3)	-	-	(73.1)
<b>Other income and expense</b>	0.9	(1.3)	(0.2)	(0.1)	-	(0.7)
<b>Share in profit of joint venture</b>	-	0.4	-	-	-	0.4
<b>Preferred dividends</b>	-	3.2	-	-	(3.2)	-
<b>Profit (loss) before regulatory adjustments</b>	57.6	26.1	31.4	(1.0)	-	114.1
<b>Regulatory adjustments</b>	(57.1)	-	-	-	-	(57.1)
<b>Profit (loss) for the year</b>	0.5	26.1	31.4	(1.0)	-	57.0
<b>Capital expenditures</b>	86.6	32.5	0.1	-	-	119.2
<b>Total assets</b>	1,959.6	486.0	6.6	-	-	2,452.2

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**25. EXPLANATION OF TRANSITION TO IFRS**

Hydro adopted IFRS as of January 1, 2014, with a date of transition effective January 1, 2013. Prior to the adoption of IFRS, Hydro prepared its financial statements in accordance with Canadian Generally Accepted Accounting Principles (GAAP).

These annual consolidated financial statements have been prepared with the accounting policies described in Note 2 and in accordance with the existing IFRS in effect at December 31, 2014. Related comparatives have also been prepared under IFRS effective at January 1, 2013. In preparing its opening IFRS Statement of Financial Position, Hydro has adjusted amounts reported previously in financial statements prepared in accordance with GAAP. An explanation of how the transition from GAAP to IFRS has affected Hydro's financial position, financial performance and cash flow is set out in the following tables and the notes that accompany the tables.

IFRS 1 sets out the guidance for first time adoption of IFRS. Under IFRS 1, the standards are applied retrospectively at the date of transition unless certain exemptions are applied.

The following mandatory IFRS exemptions were applied at the transition date:

Estimates

Hindsight was not used to create or revise estimates. The estimates previously made by Hydro under GAAP are consistent with their applications under IFRS.

Classification and Measurement of Financial Assets

Hydro has not retroactively applied the derecognition requirements in IFRS 9 occurring on or after the transition date.

The following optional IFRS exceptions were applied at the transition date:

Property, plant and equipment – deemed cost

Prior to transition to IFRS, the carrying amount of property, plant and equipment included amounts that were determined through rate regulated guidance. On transition to IFRS, Hydro elected to use the carrying amount of property, plant and equipment under GAAP as the deemed cost at January 1, 2013. The decommissioning liabilities are not exempt from IFRS 1 and were adjusted to reflect their IFRS cost.

Borrowing Costs

Hydro has elected to apply the transitional exemption allowing borrowing costs to be capitalized prospectively from the date of transition.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**25.1 Reconciliation of Equity**

<i>(millions of Canadian dollars)</i>	<b>Notes</b>	<b>Previous GAAP</b>	<b>Effect of Transition to IFRS</b>	<b>IFRS</b>	<b>Previous GAAP</b>	<b>Effect of Transition to IFRS</b>	<b>IFRS</b>
		January 1, 2013			December 31, 2013		
<b>ASSETS</b>							
<b>Current assets</b>							
Cash and cash equivalents	a	11.8	(0.2)	11.6	18.3	(0.3)	18.0
Short-term investments	a	0.5	(0.5)	-	0.7	(0.7)	-
Trade and other receivables	a	102.3	(0.3)	102.0	104.0	(0.4)	103.6
Current portion of regulatory assets	f	2.2	(2.2)	-	2.2	(2.2)	-
Current portion of sinking funds		-	-	-	65.4	-	65.4
Prepayments		3.9	-	3.9	4.5	-	4.5
Inventories	f	62.1	(0.1)	62.0	75.2	-	75.2
Derivative assets		-	-	-	0.2	-	0.2
<b>Total current assets</b>		<b>182.8</b>	<b>(3.3)</b>	<b>179.5</b>	<b>270.5</b>	<b>(3.6)</b>	<b>266.9</b>
<b>Non-current assets</b>							
Property, plant and equipment	a,b,c,d,f	1,805.5	14.9	1,820.4	1,845.0	20.4	1,865.4
Regulatory assets	f	62.8	(62.8)	-	62.2	(62.2)	-
Other long-term assets		315.0	-	315.0	254.4	-	254.4
Investments in joint arrangement	a	-	0.7	0.7	-	1.1	1.1
<b>Total non-current assets</b>		<b>2,183.3</b>	<b>(47.2)</b>	<b>2,136.1</b>	<b>2,161.6</b>	<b>(40.7)</b>	<b>2,120.9</b>
<b>Total assets</b>		<b>2,366.1</b>	<b>(50.5)</b>	<b>2,315.6</b>	<b>2,432.1</b>	<b>(44.3)</b>	<b>2,387.8</b>
Regulatory deferrals	f	-	65.1	65.1	-	64.4	64.4
<b>Total assets and regulatory deferrals</b>		<b>2,366.1</b>	<b>14.6</b>	<b>2,380.7</b>	<b>2,432.1</b>	<b>20.1</b>	<b>2,452.2</b>

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

<i>(millions of Canadian dollars)</i>	Notes	Previous GAAP	Effect of Transitio to IFRS	IFRS	Previous GAAP	Effect of Transitio to IFRS	IFRS
		January 1, 2013			December 31, 2013		
<b>LIABILITIES AND EQUITY</b>							
<b>Current liabilities</b>							
Short-term borrowings		52.0	-	52.0	41.0	-	41.0
Trade and other payables	a	92.3	(0.1)	92.2	118.4	-	118.4
Current portion of long-term debt		8.2	-	8.2	82.2	-	82.2
Current portion of regulatory liabilities	f	169.0	(169.0)	-	214.0	(214.0)	-
Deferred credits		1.9	-	1.9	0.7	-	0.7
Current portion of decommissioning liabilities	a	0.3	(0.3)	-	0.4	(0.4)	-
Current portion of deferred contributions	b,c	-	0.2	0.2	-	0.6	0.6
Derivative liabilities		-	-	-	0.4	-	0.4
<b>Total current liabilities</b>		<b>323.7</b>	<b>(169.2)</b>	<b>154.5</b>	<b>457.1</b>	<b>(213.8)</b>	<b>243.3</b>
<b>Non-current liabilities</b>							
Long-term debt		1,125.9	-	1,125.9	1,046.6	-	1,046.6
Regulatory liabilities	f	33.2	(33.2)	-	40.3	(40.3)	-
Deferred contributions	b,c	-	9.9	9.9	-	10.7	10.7
Decommissioning liabilities	a,b,d	24.6	2.1	26.7	24.7	0.1	24.8
Employee benefits liability	e	69.3	39.6	108.9	75.3	30.2	105.5
Long-term payables		2.6	-	2.6	1.6	-	1.6
<b>Total non-current liabilities</b>		<b>1,255.6</b>	<b>18.4</b>	<b>1,274.0</b>	<b>1,188.5</b>	<b>0.7</b>	<b>1,189.2</b>
<b>Total liabilities</b>		<b>1,579.3</b>	<b>(150.8)</b>	<b>1,428.5</b>	<b>1,645.6</b>	<b>(213.1)</b>	<b>1,432.5</b>
<b>Shareholder's Equity</b>							
Share capital		22.5	-	22.5	22.5	-	22.5
Shareholder contributions		116.7	-	116.7	118.4	-	118.4
Reserves	e	42.8	(39.5)	3.3	25.5	(31.0)	(5.5)
Retained earnings	a,b,e	604.8	2.7	607.5	620.1	5.6	625.7
<b>Total equity</b>		<b>786.8</b>	<b>(36.8)</b>	<b>750.0</b>	<b>786.5</b>	<b>(25.4)</b>	<b>761.1</b>
<b>Total liabilities and equity</b>		<b>2,366.1</b>	<b>(187.6)</b>	<b>2,178.5</b>	<b>2,432.1</b>	<b>(238.5)</b>	<b>2,193.6</b>
Regulatory deferrals	f	-	202.2	202.2	-	258.6	258.6
<b>Total liabilities, equity and regulatory deferrals</b>		<b>2,366.1</b>	<b>14.6</b>	<b>2,380.7</b>	<b>2,432.1</b>	<b>20.1</b>	<b>2,452.2</b>

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**25.2 Reconciliation of Comprehensive Income for the Year Ended December 31, 2013**

<i>(millions of Canadian dollars)</i>	Notes	Previous GAAP	Effect of Transition to IFRS	IFRS
Energy sales	a	682.3	(1.0)	681.3
Other revenue	a,b,c	5.9	0.7	6.6
<b>Revenue</b>		<b>688.2</b>	<b>(0.3)</b>	<b>687.9</b>
Fuels		(190.9)	-	(190.9)
Power purchased	a	(63.2)	0.2	(63.0)
Operating costs	a,e	(185.0)	2.8	(182.2)
Depreciation	a,b,c,d,f	(65.9)	1.6	(64.3)
Net finance income and expense	a,b,d	(72.3)	(0.8)	(73.1)
Other income and expense	a	(1.1)	0.4	(0.7)
Share of profit of joint arrangement	a	-	0.4	0.4
<b>Profit, before regulatory adjustments</b>		<b>109.8</b>	<b>4.3</b>	<b>114.1</b>
Regulatory adjustments	e,f	(55.6)	(1.5)	(57.1)
<b>Profit for the year</b>		<b>54.2</b>	<b>2.8</b>	<b>57.0</b>
<b>Other comprehensive income:</b>				
Net change in fair value of available for sale financial instruments		(5.0)	-	(5.0)
Net change in fair value of financial instruments reclassified to profit or loss	a	(12.3)	(0.6)	(12.9)
Actuarial gain on employee benefit liability	e	-	9.1	9.1
<b>Total comprehensive income for the year</b>		<b>36.9</b>	<b>11.3</b>	<b>48.2</b>

**25.3 Reconciliation of Cash Flows for the Year Ended December 31, 2013**

<i>(millions of Canadian dollars)</i>	Previous GAAP	Effect of Transition to IFRS	IFRS
Cash provided from (used in):			
Operating activities	194.5	(0.6)	193.9
Investing activities	(136.7)	(1.5)	(138.2)
Financing activities	(51.3)	2.0	(49.3)
Net increase in cash and cash equivalents	6.5	(0.1)	6.4

**25.4 Notes to the Reconciliation**

(a) Accounting for Joint Arrangements

Under GAAP, Hydro accounted for its interests in subsidiaries in which it has joint control using proportionate consolidation. IFRS 11 requires joint arrangements to be classified as either joint operations or joint ventures. Hydro has determined that Churchill Falls is a joint operation and therefore recognizes its share of assets, liabilities and profit or loss in relation to its interest in the joint operation.

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 arrangement is a joint venture and is accounted for using the equity method under IFRS 11, but was previously proportionately consolidated under GAAP. Under the equity method, the interest in the joint venture is carried in the Statements of Financial Position at cost plus post acquisition changes in Churchill Falls' share of net assets of the joint venture. The Statements of Profit and Comprehensive Income reflect the share of the profit or loss of the joint venture.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

(b) Property, Plant and Equipment

Regulated Hydro

Prior to transition to IFRS, the carrying amount of property, plant and equipment included amounts that were determined through rate regulated guidance. On transition to IFRS, Hydro has elected to use the carrying amount of property, plant and equipment at its deemed cost at January 1, 2013.

Other Property, Plant and Equipment

Under GAAP, Hydro allocated the cost of an item of property, plant and equipment to significant separable components only when practicable. IAS 16 requires that each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item be depreciated separately. Hydro also reviewed replacement of major components to determine if assets replaced prior to the end of their useful life required derecognition under IFRS.

A reconciliation of the property, plant and equipment is as follows:

<i>(millions of Canadian dollars)</i>	December 31 2013	January 1 2013
Property, plant and equipment as reported under GAAP	1,845.0	1,805.5
Remove Twin Falls' property, plant and equipment	(0.1)	(0.1)
Reclassify Churchill Falls' contributions in aid of construction	9.7	10.1
Reclassify Hydro contributions in aid of construction	1.6	-
Reclassify insurance proceeds to regulatory deferrals	4.3	-
Revision of Hydro decommissioning liabilities	0.1	2.1
<u>Other property, plant and equipment adjustments</u>	<u>4.8</u>	<u>2.8</u>
Property, plant and equipment as reported under IFRS	1,865.4	1,820.4

(c) Contributions in Aid of Construction

Under GAAP, Hydro recorded contributions in aid of construction as a reduction to the carrying value of property, plant and equipment. IFRIC 18 and IAS 18 requires contributions to be recorded as revenue with the unearned portion recorded as deferred contributions and amortized to profit or loss as earned.

(d) Decommissioning Liabilities

Under GAAP, decommissioning liabilities were measured based upon the estimated futures cash flows required to settle the obligation, discounted using the credit-adjusted risk-free rate upon recognition. Subsequent measurement reflected changes to estimated timing and amount of cash flows, but not changes to the discount rate. Under IFRS, decommissioning liabilities are measured using a discount rate reflecting risks specific to the liability. Subsequent measurement reflects changes in the estimated timing and amount of cash flows as well as changes to reflect market interest rates. The change resulted in an increase in decommissioning liabilities of \$2.1 million on transition to IFRS at January 1, 2013. As at December 31, 2013, this resulted in an increase of \$0.1 million in decommissioning liabilities and a corresponding increase in property, plant and equipment.

Under GAAP, \$0.8 million of accretion costs were presented in depreciation expense for the year ended December 31, 2013. Under IFRS, accretion has been reclassified as a finance expense.

(e) Employee Benefits

Adoption of IAS 19, resulted in an increase in the employee benefit liability as at January 1, 2013 of \$39.6 million and a corresponding decrease in reserves of \$39.5 million and retained earnings of \$0.1 million. For the year ended December 31, 2013, adoption of the amended IAS 19 resulted in an increase of \$30.2 million to the employee benefit liability, a decrease in reserves of \$31.0 million and an increase in retained earnings of \$0.8 million.

**NEWFOUNDLAND AND LABRADOR HYDRO**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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In addition, for the year ended December 31, 2013, adoption of the amended IAS 19 also resulted in a decrease in operating costs of \$2.4 million.

(f) Regulatory deferrals

Under GAAP, Hydro included certain regulatory deferrals in inventories and property, plant and equipment. IFRS 14 requires that all regulatory assets and liabilities be disclosed separately in the Statements of Financial Position. As a result, Hydro reclassified \$0.1 million from inventories to regulatory deferrals at January 1, 2013, and reclassified \$4.3 million from property, plant and equipment to regulatory deferrals at December 31, 2013.

Due to uncertainties surrounding the timing of the reversal of regulatory deferral balances, IFRS 14 does not require classification of such balances between current and non-current.

**26. SUBSEQUENT EVENTS**

Nalcor, Hydro and Emera Incorporated (Emera), entered into a Memorandum of Understanding (MOU Agreement) dated March 4, 2013, as was amended by an Extension Agreement dated February 25, 2014 and further amended by an Extension Agreement No. 2 dated November 4, 2014 providing for, among other things, the transfer of the Service Agreement by Emera to Nalcor or an affiliate of Nalcor in accordance with the terms and conditions set out in the MOU Agreement. As of February 1, 2015, transfer of the Service Agreement was finalized and NEM acquired 2MW of long-term transmission service in New Brunswick.