Financial Statements of

KINGSTON HYDRO CORPORATION

Year ended December 31, 2017

KPMG LLP
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INDEPENDENT AUDITORS' REPORT

To the Shareholder of Kingston Hydro Corporation

We have audited the accompanying financial statements of Kingston Hydro Corporation, which comprise the balance sheets as at December 31, 2017, the statement of comprehensive income, changes in shareholders' equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Financial Reporting Standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Kingston Hydro Corporation as at December 31, 2017, and its results of operations and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Kingston, Canada

April 23, 2018

KINGSTON HYDRO CORPORATION

Financial Statements

Year ended December 31, 2017

Financial Statements

KINGSTON HYDRO CORPORATION

Balance Sheets

December 31, 2017, with comparative information for December 31, 2016

	2017	2016
Assets		
Current assets:		
Cash	$ 6,928	$ 9,387
Due from City of Kingston (note 10(b))	2,188,858	4,495,253
Miscellaneous accounts receivable	7,759,586	815,984
Billed revenue receivable	5,149,693	6,784,652
Unbilled revenue	7,900,303	9,152,908
Inventory	2,094,349	2,082,191
Prepaid expenses	148,792	145,617
Payments in lieu of taxes recoverable (note 15)	250,920	–
	25,499,429	23,485,992
Non-current assets:		
Property, plant and equipment (note 5)	54,342,863	48,755,067
Deferred tax asset (note 15)	–	252,751
Derivative asset (note 17(b))	102,830	–
Total assets	79,945,122	72,493,810
Regulatory balances (note 9)	3,038,350	11,093,487
Total assets and regulatory balances	$ 82,983,472	$ 83,587,297

	2017	2016

Liabilities and Shareholder's Equity

	2017	2016
Current liabilities:		
Bank loans (note 7(a))	$ 8,984,111	$ 6,133,437
Accounts payable and accrued liabilities	4,723,066	14,791,253
Due to retailers	112,657	100,406
Payments in lieu of taxes payable (note 15)	–	303,674
	13,819,834	21,328,770
Non-current liabilities:		
Derivative liability (note 17(b))	–	393,617
Note payable to City of Kingston (note 6)	10,880,619	10,880,619
Employee future benefit liabilities (note 11(d))	1,223,171	1,178,823
Long-term debt (note 7(b))	19,891,630	19,875,741
Deferred revenue	5,467,882	801,226
Deferred tax liability (note 15)	191,798	–
Total liabilities	51,474,934	54,458,796
Shareholder's equity:		
Share capital (note 12)	12,380,617	12,380,617
Contributed surplus	3,893,103	3,893,103
Accumulated other comprehensive loss	75,578	(289,309)
Retained earnings	11,876,385	11,150,936
	28,225,683	27,135,347
Commitments and contingencies (notes 13 and 14)		
Total liabilities and shareholder's equity	79,700,617	81,594,143
Regulatory balances (note 9)	3,105,882	1,933,265
Deferred tax associated with regulatory balances	176,973	59,889
Total equity, liabilities and regulatory balances	$ 82,983,472	$ 83,587,297

See accompanying notes to financial statements.

On behalf of the Board:

Bryan Paterson,
Chair

Arthur Jordan,
Chair, Audit and Risk Committee

KINGSTON HYDRO CORPORATION

Statements of Comprehensive Income

Year ended December 31, 2017, with comparative information for 2016

	2017	2016
Energy sales	$ 79,994,340	$ 87,688,890
Cost of energy	78,126,049	94,506,180
	1,868,291	(6,817,290)
Other income	1,863,010	1,137,726
Distribution revenue (notes 3(b) and 4)	11,612,597	12,331,630
Net operating revenue	15,343,898	6,652,066
Operating expenses:		
Distribution expenses, operation	1,897,387	2,044,736
Distribution expenses, maintenance	1,445,414	1,540,545
Billing and collecting	1,167,426	1,203,364
Community relations	1,384,214	549,891
General and administrative	2,460,331	2,234,594
Depreciation and amortization	2,095,293	1,793,831
	10,450,065	9,366,961
Earnings (loss) before finance costs, taxation and net movement in regulatory account balances	4,893,833	(2,714,895)
Finance income	207,629	27,074
Finance costs	(1,406,039)	(1,299,581)
Earnings (loss) before taxation and movements in regulatory deferral account balances	3,695,423	(3,987,402)
Current tax expense (note 15)	171,608	449,182
Deferred tax expense (note 15)	430,075	379,824
	601,683	829,006
Net earnings (loss) before movements in regulatory deferral account balances	3,093,740	(4,816,408)
Net movement in regulatory deferral account balances related to profit or loss	(1,868,291)	6,817,290
Net earnings and net movements in regulatory deferral account balances	1,225,449	2,000,882
Other comprehensive income:		
Change in fair value of cash flow hedge	364,887	130,854
Total comprehensive income	$ 1,590,336	$ 2,131,736

See accompanying notes to financial statements.

KINGSTON HYDRO CORPORATION

Statements of Changes in Shareholder's Equity

Year ended December 31, 2017, with comparative information for 2016

	Share capital	Contributed surplus	Accumulated other comprehensive income (loss)	Retained earnings (deficit)	Total
Balance, January 1, 2016	$ 12,380,617	$ 3,893,103	$ (420,163)	$ 9,951,054	$ 25,804,611
Net earnings	–	–	–	2,000,882	2,000,882
Other comprehensive income	–	–	130,854	–	130,854
Dividends	–	–	–	(801,000)	(801,000)
Balance, December 31, 2016	12,380,617	3,893,103	(289,309)	11,150,936	27,135,347
Net earnings	–	–	–	1,225,449	1,225,449
Other comprehensive income	–	–	364,887	–	364,887
Dividends	–	–	–	(500,000)	(500,000)
Balance, at December 31, 2017	$ 12,380,617	$ 3,893,103	$ 75,578	$ 11,876,385	$ 28,225,683

See accompanying notes to financial statements.

KINGSTON HYDRO CORPORATION

Statements of Cash Flows

Year ended December 31, 2017, with comparative information for 2016

	2017	2016
Cash provided by (used in):		
Operations:		
Net earnings	$ 1,225,449	$ 2,000,882
Items not involving cash:		
Depreciation and amortization	2,095,293	1,793,831
Tax expenses	601,683	829,006
Change in employee future benefit liabilities	44,348	(43,053)
Income taxes paid	(726,204)	30,465
Change in non-cash operating balances (note 16)	(2,593,158)	(1,326,088)
	647,411	3,285,043
Financing:		
Increase in deferred revenue	4,666,656	515,675
Dividends paid	(500,000)	(801,000)
Repayment of long-term debt payable	(933,437)	(829,819)
Proceeds of long-term loan payable	1,000,000	3,000,000
Repayment of bank loan	–	–
Proceeds of bank loan	2,800,000	3,500,000
	7,033,219	5,384,856
Investments:		
Purchase of property, plant and equipment	(7,683,089)	(8,679,277)
Decrease in cash	(2,459)	(9,378)
Cash, beginning of year	9,387	18,765
Cash, end of year	$ 6,928	$ 9,387

See accompanying notes to financial statements.

KINGSTON HYDRO CORPORATION
Table of Contents to Notes to Financial Statements

Years ended December 31, 2017 and 2016

Notes to Financial Statements

1. Reporting entity:

Kingston Hydro Corporation (the "Corporation") is a rate-regulated, municipally-owned hydro distribution company incorporated under the laws of Ontario Canada. The Corporation is located in Kingston. The address of the Corporation's registered office is 85 Lappans Lane, Kingston, Ontario. The Corporation delivers electricity and related energy services to residential and commercial customers in Kingston. The Corporation is wholly-owned by the Corporation of the City of Kingston.

The financial statements are for the Corporation as at and for the year ended December 31, 2017.

2. Basis of preparation:

(a) Statement of compliance:

The Corporation’s financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as adopted by the International Financial Reporting Interpretations Committee (“IFRIC”) of the IASB.

The financial statements were approved by the Board of Directors on April 23, 2018.

(b) Basis of measurement:

The financial statements have been prepared on the historical cost basis except for the following:

(i) Where held, financial instruments at fair value through profit or loss, including those held for trading, are measured at fair value; and

(ii) Contributed assets are initially measured at fair value.

(c) Functional and presentation currency:

These financial statements are presented in Canadian dollars, which is the Corporation's functional currency.

(d) Use of estimates and judgments:

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses and disclosure of contingent assets and liabilities. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future periods affected.

2. Basis of preparation (continued):

(d) Use of estimates and judgments (continued):

Information about critical accounting judgments in applying accounting policies that have the most significant effect on the amounts recognized in these financial statements is included in the following notes:

(i) note 5 - Property, plant and equipment;

(ii) note 11 - Employee future benefits;

(iii) note 14 - Contingent liabilities.

(e) Rate regulation:

The Corporation is regulated by the Ontario Energy Board ("OEB"), under the authority granted by the *Ontario Energy Board Act, 1998*. Among other things, the OEB has the power and responsibility to approve or set rates for the transmission and distribution of electricity, providing continued rate protection for electricity consumers in Ontario, and ensuring that transmission and distribution companies fulfill obligations to connect and service customers. The OEB may also prescribe license requirements and conditions of service to local distribution companies ("LDCs"), such as the Corporation, which may include, among other things, record keeping, regulatory accounting principles, separation of accounts for distinct businesses, and filing and process requirements for rate setting purposes.

The Corporation is required to bill customers for the debt retirement charge set by the province. The Corporation may file to recover uncollected debt retirement charges from Ontario Electricity Financial Corporation ("OEFC") once each year.

Rate setting:

Distribution revenue:

For the distribution revenue included in electricity sales, the Corporation files a "Cost of Service" ("COS") rate application with the OEB every five years where rates are determined through a review of the forecasted annual amount of operating and capital expenses, debt and shareholder's equity required to support the Corporation’s business. The Corporation estimates electricity usage and the costs to service each customer class to determine the appropriate rates to be charged to each customer class. The COS application is reviewed by the OEB and intervenors and rates are approved based upon this review, including any revisions resulting from that review.

As a licensed distributor, the Corporation is responsible for billing customers for electricity generated by third parties and the related costs of providing electricity service, such as transmission services and other services provided by third parties. The Corporation is required, pursuant to regulation, to remit such amounts to these third parties, irrespective of whether the Corporation ultimately collects these amounts from customers.

2. Basis of preparation (continued):

(e) Rate regulation (continued):

Rate setting (continued):

Distribution revenue (continued):

The Corporation last filed a COS application in 2015 for rates effective January 1, 2016 to December 31, 2020.

Electricity rates:

The OEB sets electricity prices for low-volume consumers twice each year based on an estimate of how much it will cost to supply the province with electricity for the next year. All remaining consumers pay the market price for electricity. The Corporation is billed for the cost of the electricity that its customers use and passes this cost on to the customer at cost without a mark-up.

3. Significant accounting policies:

The significant accounting policies set out below have been applied consistently to all years presented in these financial statements.

(a) Financial instruments:

All financial assets are classified as loans and receivables and all financial liabilities are classified as other liabilities. These financial instruments are recognized initially at fair value plus any directly attributable transaction costs. Subsequently, they are measured at amortized cost using the effective interest method less any impairment for the financial assets as described in note 3(e). The Corporation does enter into derivative instruments for long-term financing.

Hedging items and hedged items are presented in the financial statements in the same manner as other assets and liabilities. For derivative instruments that qualify for hedge accounting and which are designated as cash flow hedges, the effective portion of any gain or loss, net of tax, is reported as a component of accumulated other comprehensive income. Any gains or losses that represent either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in results of operations.

Cash equivalents include short-term investments with maturities of three months or less when purchased.

3. Significant accounting policies (continued):

(b) Revenue recognition:

Electricity sales:

Electricity sales are recognized as the electricity is delivered to customers and includes the amounts billed to customers for electricity, including the cost of electricity supplied, distribution, and any other regulatory charges. Electricity revenue is recorded on the basis of regular meter readings and estimated customer usage since the last meter reading date to the end of the year. The related cost of power is recorded on the basis of power used.

For customer billings related to electricity generated by third parties and the related costs of providing electricity service, such as transmission services and other services provided by third parties, the Corporation has determined that it is acting as a principal for these electricity charges and, therefore, has presented electricity revenue on a gross basis.

Customer billings for debt retirement charges are recorded on a net basis as the Corporation is acting as an agent for this revenue stream.

Revenue from contracts with customers:

Certain customers and developers are required to contribute towards the capital cost of construction of distribution assets in order to provide ongoing service. Cash contributions are initially recorded as deferred revenue. When an asset other than cash is received as a capital contribution, the asset is initially recognized at its fair value, with a corresponding amount recognized as deferred revenue. The deferred revenue, which represents the Corporation's obligation to continue to provide the customers access to the supply of electricity, is amortized to income on a straight-line basis over the economic useful life of the constructed or contributed asset, which represents the period of ongoing service to the customer.

Rendering of services:

Revenue earned from the provision of services is recognized as the service is rendered.

Government grants:

Incentive payments to which the Corporation is entitled from the Independent Electricity System Operator ("IESO") are recognized as revenue in the period when they are determined by the IESO and the amount is communicated to the Corporation.

(c) Inventory:

Inventory, comprising material and supplies, the majority of which is consumed by the Corporation in the provision of its services, is valued at the lower of cost and net realizable value, with cost being determined on an average cost basis and includes expenditures incurred in acquiring the material and supplies and other costs incurred in bringing them to their existing location and condition.

Net realizable value is the estimated selling price in the ordinary course of business, less estimated selling expenses.

3. Significant accounting policies (continued):

(d) Property, plant and equipment:

Items of property, plant and equipment (“PP&E”) used in rate-regulated activities and acquired prior to January 1, 2014 are measured at deemed cost established on the transition date, less accumulated depreciation. All other items of PP&E are measured at cost, or, where the item is transferred from customers, its fair value, less accumulated depreciation. Consistent with IFRS 1, the Corporation elected to use the carrying amount as previously determined under Canadian GAAP as the deemed cost at January 1, 2014, the transition date to IFRS.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labour, and any other costs directly attributable to bringing the asset to a working condition for its intended use.

Borrowing costs on qualifying assets are capitalized as part of the cost of the asset based upon the weighted average cost of debt incurred on the Corporation's borrowings. Qualifying assets are considered to be those that take in excess of 12 months to construct.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on the disposal of an item of PP&E are determined by comparing the proceeds from disposal, if any, with the carrying amount of the item of PP&E and are recognized net within other income in profit or loss.

The cost of replacing a part of an item of property, plant and equipment is recognized in the net book value of the item if it is probable that the future economic benefits embodied within the part will flow to the Corporation and its cost can be measured reliably. In this event, the replaced part of property, plant and equipment is written off, and the related gain or loss is included in profit or loss. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

Depreciation is calculated over the depreciable amount and is recognized in profit or loss on a straight-line basis over the estimated useful life of each part or component of an item of property, plant and equipment. The depreciable amount is cost. Land is not depreciated. Construction-in-progress assets are not amortized until the project is complete and in service.

3. Significant accounting policies (continued):

(d) Property, plant and equipment:

Depreciation is provided on a straight-line basis using the following annual rates:

Asset	Rates
Buildings and fixtures	1.67% to 3.33%
Substation equipment	1.67% to 5.00%
Distribution system	1.67% to 2.86%
Meters	2.50% to 6.67%
Tools and equipment	10.00% to 20.00%
System supervisory equipment	5.00%
Vehicle	8.33% to 12.50%
Application software	20.00%
Miscellaneous intangible plant	2.50%
Leasehold improvements	Over the term of the lease

Depreciation methods, useful lives, and residual values are reviewed at each reporting date and adjusted prospectively if appropriate.

(e) Impairment:

(i) Financial assets:

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its current carrying amount (using prevailing interest rates), and the present value of the estimated future cash flows discounted at the original effective interest rate. Interest on the impaired assets continues to be recognized through the unwinding of the discount.

All impairment losses are recognized in profit or loss. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost, the reversal is recognized in profit or loss.

(ii) Non-financial assets:

The carrying amounts of the Corporation's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

3. Significant accounting policies (continued):

(e) Impairment (continued):

(ii) Non-financial assets (continued):

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit"). The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognized if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss.

An impairment loss in respect of goodwill is not reversed. For assets other than goodwill, impairment recognized in prior periods is assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(f) Provisions:

A provision is recognized if, as a result of a past event, the Corporation has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

(g) Regulatory deferral accounts:

Regulatory deferral account debit balances represent costs incurred in excess of amounts billed to the customer at OEB approved rates. These amounts have been accumulated and deferred in anticipation of their future recovery in electricity distribution rates. Regulatory deferral account credit balances represent amounts billed to the customer at OEB approved rates in excess of costs incurred by the Corporation.

Regulatory deferral account debit balances are recognized if it is probable that future billings in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes. The offsetting amount is recognized in profit and loss. The debit balance is reduced by the amount of customer billings as electricity is delivered to the customer and the customer is billed at rates approved by the OEB for the recovery of the capitalized costs.

3. Significant accounting policies (continued):

(g) Regulatory deferral accounts (continued):

Regulatory deferral account credit balances are recognized if it is probable that future billings in an amount at least equal to the credit balance will be reduced as a result of rate-making activities. The offsetting amount is recognized in profit and loss. The credit balance is reduced by the amounts returned to customers as electricity is delivered to the customer at rates approved by the OEB for the return of the regulatory account credit balance.

The probability of recovery or repayment of the regulatory account balances are assessed annually based upon the likelihood that the OEB will approve the change in rates to recover or repay the balance. Any resulting impairment loss is recognized in profit and loss in the year incurred.

Regulatory deferral accounts attract interest at OEB prescribed rates. In 2017, the rates were 1.10% from January 1, 2017 to September 30, 2017, increasing to 1.50% from October 1, 2017 to December 31, 2017.

(h) Employee future benefit liabilities:

The Corporation's employee future benefit liabilities represent its accumulated obligation to Utilities Kingston under a service agreement.

The Corporation accrues its obligations to Utilities Kingston for employee benefit plans. The cost of non-pension post-retirement and post-employment benefits earned is actuarially determined using the projected benefit method pro-rated on service and management's best estimate of salary escalation, retirement ages of Utilities Kingston's employees and expected health care costs.

Utilities Kingston's employees participate in the Ontario Municipal Employees Retirement Fund (OMERS), a multi-employer public sector pension fund, as a defined benefit plan.

(i) Deferred revenue and assets transferred from customers:

Certain customers and developers are required to contribute towards the capital cost of construction in order to provide ongoing service. When an asset is received as a capital contribution, the asset is initially recognized at its fair value, with the corresponding amount recognized as deferred revenue. Deferred revenue represents the Corporation's obligation to continue to provide customers access to the supply of electricity, and is amortized to income on a straight-line basis over the economic useful life of the acquired or contributed asset, which represents the period of ongoing service to the customer.

(j) Leased assets:

Leases, where the terms cause the Corporation to assume substantially all the risks and rewards of ownership, are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

3. Significant accounting policies (continued):

(j) Leased assets (continued):

All other leases are classified as operating leases and the leased assets are not recognized on the Corporation’s balance sheet. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

(k) Finance income and finance costs:

Finance income is recognized as it accrues in profit or loss, using the effective interest method. Finance income comprises interest earned on cash and cash equivalents and on regulatory assets.

Finance charges comprise interest expense on borrowings, finance lease obligations, regulatory liabilities and unwinding of the discount on provisions and impairment losses on financial assets. Finance costs are recognized as an expense unless they are capitalized as part of the cost of qualifying assets.

(l) Income taxes:

The income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case, it is recognized in equity.

The Corporation is currently exempt from taxes under the Income Tax Act (Canada) and the Ontario Corporations Tax Act (collectively, the "Tax Acts"). Under the Electricity Act, 1998, the Corporation makes payments in lieu of corporate taxes to the Ontario Electricity Financial Corporation ("OEFC"). These payments are calculated in accordance with the rules for computing taxable income and taxable capital and other relevant amounts contained in the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) as modified by the Electricity Act, 1998, and related regulations. Prior to October 1, 2001, the Corporation was not subject to income or capital taxes. Payments in lieu of taxes are referred to as income taxes.

Current tax is the tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method. Under this method, deferred income taxes reflect the net tax effects of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes, as well as for tax losses available to be carried forward to future years that are likely to be realized. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates, at the reporting date, expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of enactment or substantive enactment.

4. Electricity industry regulation:

The Ontario Energy Board Act, 1998 (Ontario) ("OEBA") conferred on the Ontario Energy Board ("OEB") powers and responsibilities to regulate the electricity industry in Ontario. These powers and responsibilities include approving or fixing rates for the transmission and distribution of electricity, providing continued rate protection for rural and remote electricity consumers, and ensuring that distribution companies fulfill obligations to connect and service customers. The OEB may also prescribe license requirements and conditions of service to electricity distributors which may include, among other things, record keeping, regulatory accounting principles, separation of accounts for distinct businesses, and filing and process requirements for rate setting purposes. In its capacity to approve or set rates, the OEB has the authority to specify regulatory accounting treatments that may differ from IFRS for enterprises operating in a non-rate regulated environment.

On November 26, 2015, the OEB approved the tariff or rates and charges, effective January 1, 2016, for electricity consumed or estimated to be consumed on or after January 1, 2016. In addition, the OEB ordered the Company to establish certain deferral and variance accounts to track revenues and expenses for years 2016 to 2020 that may become subject to disposition in the future.

On December 29, 2016, the OEB approved new distribution rates, effective January 1, 2017.

On December 20, 2017, the OEB approved new distribution rates, effective January 1, 2018.

5. Property, plant and equipment:

(a) Cost or deemed cost:

	Land and buildings	Distribution equipment	Other fixed assets	Construction -in-Progress	Total
Balance at January 1, 2017	$1,033,425	$ 52,116,776	$ 349,143	$ 503,132	$ 54,002,476
Additions	62,356	7,895,365	214,340	170,227	8,342,288
Disposals/retirements	–	(208,725)	–	(468,657)	(677,382)
Balance at December 31, 2017	$1,095,781	$ 59,803,416	$ 563,483	$ 204,702	$ 61,667,382

	Land and buildings	Distribution equipment	Other fixed assets	Construction -in-Progress	Total
Balance at January 1, 2016	$ 909,461	$ 43,586,807	$ 349,143	$ 268,503	$ 45,113,914
Adjustments	–	2,801,414	–	–	2,801,414
Additions	123,964	5,728,555	–	234,629	6,087,148
Disposals/retirements	–	–	–	–	–
Balance at December 31, 2016	$1,033,425	$ 52,116,776	$ 349,143	$ 503,132	$ 54,002,476

5. Property, plant and equipment (continued):

(b) Accumulated depreciation:

	Land and buildings	Distribution equipment	Other fixed assets	Construction -in- Progress	Total
Balance, January 1, 2017	$ 51,271	$ 4,987,237	$ 208,901	$ –	$ 5,247,409
Depreciation charge	23,107	2,012,548	59,638	–	2,095,293
Disposals/retirements	–	(18,183)	–	–	(18,183)
Balance at December 31, 2017	$ 74,378	$ 6,981,602	$ 268,539	$ –	$ 7,324,519

	Land and buildings	Distribution equipment	Other fixed assets	Construction -in- Progress	Total
Balance, January 1, 2016	$ 30,751	$ 3,049,377	$ 164,165	$ –	$ 3,244,293
Adjustments	–	209,285	–	–	209,285
Depreciation charge	20,520	1,728,575	44,736	–	1,793,831
Balance at December 31, 2016	$ 51,271	$ 4,987,237	$ 208,901	$ –	$ 5,247,409

(c) Carrying amounts:

	Land and buildings	Distribution equipment	Other fixed assets	Construction -in- Progress	Total
At December 31, 2017	$1,021,403	$ 52,821,814	$ 294,944	$ 204,702	$ 54,342,863
At December 31, 2016	982,154	47,129,539	140,242	503,132	48,755,067

6. Note payable to City of Kingston:

In consideration for transfer of the City of Kingston's electricity distribution business, the City of Kingston took back a note payable on January 1, 2000, for an amount equivalent to 50% of the value of net assets transferred. The note payable amounts to $10,880,619 (2016 - $10,880,619). As part of the 2011 Kingston Hydro distribution rate rebasing application, the Ontario Energy Board ordered that Kingston Hydro use a deemed debt rate of 5.87% per annum. This rate became effective May 1, 2011. The note payable has no fixed terms of repayment and is unsecured. It is not the intent of the City of Kingston to demand repayment before January 1, 2019. Interest charges on the note payable for the 2017 fiscal year were $638,692 (2016 - $638,892).

7. Bank loans and long-term debt:

(a) Bank loans:

	2017	2016
Operating facility of $12,000,000, available by way of a Prime Rate Based Loan or Banker's Acceptance with interest at the bank's rate on Banker's Acceptances plus a 0.50% stamping fee, drawn at a rate of 1.7% (facility 1)	$ 8,000,000	$ 5,200,000
Current portion of long-term debt (note 7(b))	984,111	933,437
	$ 8,984,111	$ 6,133,437

7. Bank loans and long-term debt (continued):

(b) Long-term debt:

	2017	2016
Committed reduced term facility (single draw), fixed rate of 3.67%, due December 18, 2020 (facility 3)	$ 2,302,881	$ 2,354,901
Committed reduced term facility (single draw), fixed rate of 3.25%, due May 2019 (facility 4)	486,423	816,562
Committed reduced term facility (single draw), fixed rate of 3.03% due February 2019 (facility 6)	1,727,686	1,823,898
Committed reduced term facility (single draw), fixed rate of 3.25% due January 2022 (facility 5)	3,073,340	3,242,714
Committed reduced term facility (single draw), fixed rate of 3.92% due December 2042 (Infrastructure Ontario)	3,159,921	3,233,317
Interest rate swap loan, fixed rate of 3.24%, due December 9, 2021 (facility 3)	1,406,752	1,438,846
Interest rate swap loan, fixed rate of 3.01%, due December 4, 2024 (facility 3)	2,140,508	2,195,831
Interest rate swap loan, fixed rate of 2.13%, due December 4, 2019 (facility 3)	2,154,774	2,203,103
Interest rate swap loan, fixed rate of 2.72%, due December 12, 2023 (facility 3)	3,423,456	3,500,000
Capital loan, fixed rate of 3.15%, due December 18, 2024 (facility 3)	1,000,000	–
	20,875,741	20,809,172
Less: current portion of long-term debt	984,111	933,431
	$ 19,891,630	$ 19,875,741

Principal payments on long-term debt based on scheduled repayments are as follows:

2018	$ 984,111
2019	4,361,523
2020	2,655,274
2021	4,083,071
2022	256,236
2023 and thereafter	8,535,526
	$ 20,875,741

KINGSTON HYDRO CORPORATION

7. Bank loans and long-term debt (continued):

(c) To comply with requirements of the IESO, as a supplier of energy to the wholesale electricity market, the Corporation is required to post security determined in relation to the Corporation's credit rating. A letter of credit has been provided in the amount of $5,301,839 as at December 31, 2017 (2016 - $5,301,839).

Bank indebtedness is secured by a general security agreement representing a first charge on all the Corporation's assets.

8. Pension agreements:

On behalf of their employees who provide services to the Corporation, 1425445 Ontario Limited (operating as Utilities Kingston), a related corporation, makes contributions to the Ontario Municipal Employees Retirement Fund (OMERS), which is a multi-employer plan. The plan is a defined benefit plan which specifies the amount of the retirement benefit to be received by the employees based on the length of service and rates of pay. Total contributions by that Corporation to OMERS for 2017 were $1,862,208 (2016 - $1,832,832).

9. Regulatory deferral account balance:

The following is a reconciliation of the carrying amount for each class of regulatory deferral account balances:

	2016	Balances arising in the period	Recovery/ reversal	2017	Remaining recovery period (years)
Regulatory deferral account debit balances					
Group 1 deferred accounts	$ 10,631,926	$ (5,568,598)	$ (2,051,494)	$ 3,011,834	1
Regulatory asset recovery account	214,889	(429,223)	83,124	(131,210)	–
Other regulatory accounts	246,672	(88,946)	–	157,726	–
Total amount related to regulatory deferral account debit balances	$ 11,093,487	$ (6,086,767)	$ (1,968,370)	$ 3,038,350	1

9. Regulatory deferral account balance (continued):

	2016	Balances arising in the period	Recovery/ reversal	2017	Remaining recovery period (years)
Regulatory deferral account credit balances					
Group 1 deferred accounts	$ (1,497,169)	$ (1,108,939)	$ (63,678)	$ (2,669,786)	1
Income tax	(436,096)	–	–	(436,096)	–
Total amount related to regulatory deferral account credit balances	$ (1,933,265)	$ (1,108,939)	$ (63,678)	$ (3,105,882)	1

The regulatory deferral account balances are recovered or settled through rates set by the OEB which are determined using estimates of future consumption of electricity by its customers. Future consumption is impacted by various factors including the economy and weather. The Corporation has received approval from the OEB to establish its regulatory deferral account balances.

Settlement of the Group 1 deferral and variance accounts is done on an annual basis. Kingston Hydro Corporation's 2017 Custom IR Year Two update rate application (EB-2017-0087) included a request to the OEB for disposition of Kingston Hydro's deferral and variance account Group 1 balances. As part of the decision and rate order issued by the OEB on December 29, 2016, Kingston Hydro Corporation received approval for total recovery of $2,030,680 to dispose of deferral and variance Group 1 accounts amount ($1,425,601), excluding 1589 global adjustment sub-account and Group 1 sub-account 1580 global adjustment amount $3,456,281. The accounts were approved for disposal over a one year period of January 1, 2017 to December 31, 2017. Kingston Hydro Corporation has elected not to dispose of these deferral and variance accounts in 2017. The disposition will be re-evaluated in 2018.

10. Related party transactions:

(a) 1425445 Ontario Limited (operating as Utilities Kingston):

During the year, the Corporation paid $12,541,915 (2016 - $13,434,502) to 1425445 Ontario Limited (operating as Utilities Kingston) ("Utilities Kingston") for support services and capital works. Utilities Kingston is a shared-services business incorporated to provide support services to both the Corporation and to various infrastructure businesses of the City of Kingston. There was no balance owing at December 31, 2017 with respect to these transactions.

10. Related party transactions (continued):

(b) City of Kingston:

During the year, the Corporation contracted for certain financial services from the City of Kingston. As at December 31, 2017, the Corporation had an amount due from the City of Kingston representing the cumulative net balance of cash receipts and disbursements processed by the City of Kingston on behalf of the Corporation, in the amount of $2,188,858 (2016 - $4,495,253). The City of Kingston pays the Corporation interest on the balance at a rate of prime minus 1.65%.

11. Employee future benefit liabilities:

(a) Pension plan:

The former Hydro-Electric Commission of the Corporation of the City of Kingston entered into agreements in 1995 with a number of former employees on non-contributory defined benefit pension plans. An actuarial report of the accrued pension liability indicates that the present value of the accrued pension benefits as at December 31, 2017 is $194,545 (2016 - $190,980).

(b) Extended health care, dental and life insurance benefits:

The Corporation has an obligation with respect to post employment extended health care, dental and life insurance benefits that are provided to employees of Utilities Kingston through the service agreement with Utilities Kingston. An independent actuarial study of the post-retirement and post-employment benefits has been undertaken for Utilities Kingston. The most recent actuarial valuation of the future benefit liability for Utilities Kingston was completed as at December 31, 2015. The Corporation is responsible for approximately 25% of the post-employment benefit liability of Utilities Kingston.

These accrued benefit liabilities at December 31 include the following components:

	2017	2016
Accrued benefit liabilities, January 1	$ 740,997	$ 787,761
Service cost (reduction)	55,967	(46,764)
Accrued benefit liabilities, December 31	$ 796,964	$ 740,997

These benefits will be paid to Utilities Kingston as future benefit obligations are paid by Utilities Kingston to its employees as part of the support services contract with the Corporation.

11. Employee future benefit liabilities (continued):

(c) Accumulated sick leave:

Utilities Kingston provides accumulated sick leave benefits to all its employees. Under the plan, the sick leave days accumulate from year to year but are non-vested. The Corporation is responsible for approximately 25% of the accrued benefit liability of Utilities Kingston. The amount of the Corporation's accrued benefit liability for accumulated sick leave that does not vest has been actuarially determined as at December 31, 2017 and is $231,662 (2016 - $246,846).

(d) Future benefit liabilities:

	2017	2016
Future benefit liabilities are comprised of:		
Pension plan	$ 194,545	$ 190,980
Health, dental and life insurance	796,964	740,997
Accumulated sick leave	231,662	246,846
	$ 1,223,171	$ 1,178,823

12. Share capital:

	2017	2016
Authorized:		
Unlimited Class A common shares		
Issued and outstanding:		
120 Class A common shares	$ 12,380,617	$ 12,380,617

13. General liability insurance:

The Corporation is a member of the Municipal Electric Association Reciprocal Insurance Exchange ("MEARIE") which is a pooling of general liability risks. Members of MEARIE would be assessed, on a pro-rata basis, based on the total of their respective deposit premiums should losses be experienced by MEARIE that are in excess of their reserves and supplemental insurance, for the years in which the Corporation, and the former Hydro-Electric Commission, has been a member. The Corporation has not been made aware of any additional assessments.

14. Contingent liabilities:

The nature of the Corporation's activities is such that there may be litigation pending at any time. With respect to claims at December 31, 2017 against the Corporation, management believes there are valid defenses and appropriate insurance coverage in place. In the event any claims specifically are successful, management believes that such claims are not expected to have a material effect on the financial position of the Corporation.

No provision has been made in these financial statements in respect of any of the above contingent liabilities as management has assessed the risk of loss to be remote.

15. Payments in lieu of corporate income taxes:

The provision for amounts in lieu of corporate income taxes ("PILs") differs from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rates. A reconciliation between the statutory and effective tax rates is provided as follows:

	2017	2016
Federal and Ontario statutory income tax rate	26.50%	26.50%
Earnings before provision for PILs	$ 1,827,132	$ 2,829,888
Provision for PILs at statutory rate	$ 484,190	$ 749,920
Change resulting from:		
Tax effect of regulatory assets and liabilities	117,084	97,630
Tax effect of other miscellaneous adjustments	409	(18,544)
Provision for PILs	$ 601,683	$ 829,006
Effective income tax rate	32.9%	29.3%

Tax effects of temporary difference that give rise to future tax assets and liabilities are as follows:

	2017	2016
Shortfall of tax values over accounting values of fixed assets	$ (488,687)	$ (163,944)
Future benefit liabilities	324,139	312,387
Regulatory liabilities	(176,973)	(59,889)
Derivative liability (asset)	(27,250)	104,308
	$ (368,771)	$ 192,862

16. Change in non-cash operating balances:

	2017	2016
Decrease (increase) in due from City of Kingston	$ 2,306,395	$ (785,842)
Increase in miscellaneous accounts receivable	(6,943,602)	(138,711)
Decrease (increase) in billed revenue receivable	1,634,959	(1,306,276)
Decrease (increase) in unbilled revenue	1,252,605	(953,401)
Increase in inventory	(12,158)	(586,170)
Increase in prepaid expenses	(3,175)	(14,712)
Increase (decrease) in accounts payable and accrued liabilities	(10,068,187)	5,280,799
Increase (decrease) in due to retailers	12,251	(15,292)
Decrease in deposits payable	–	(101,000)
Change in regulatory deferral account credit balances	1,172,617	(6,659,724)
Change in regulatory deferral account debit balances	8,055,137	3,954,241
	$ (2,593,158)	$ (1,326,088)

17. Financial instruments and risk management:

(a) Fair value disclosure:

Cash and cash equivalents are measured at fair value. The carrying values of receivables and accounts payable and accrued charges approximate fair value because of the short maturity of these instruments. The carrying value of the customer deposits approximates fair value because the amounts are payable on demand.

(b) Financial risks:

The Corporation understands the risks inherent in its business and defines them broadly as anything that could impact its ability to achieve its strategic objectives. The Corporation's exposure to a variety of risks such as credit risk, interest rate risk and liquidity risk, as well as related mitigation strategies, are discussed below.

(i) Credit risks:

Financial instruments carry credit risk that a counterparty will fair to discharge an obligation which could result in a financial loss. Financial assets held by the Corporation, such as accounts receivable, expose it to credit risk. The Corporation earns its revenue from a broad base of customers located in the City of Kingston.

The carrying amount of accounts receivable is reduced through the use of an allowance for impairment and the amount of the related impairment loss is recognized in net earnings. Subsequent recoveries of receivables previously provisioned are credited to net earnings. The balance of the allowance for impairment at December 31, 2017 is $3,435,187 (2016 - $3,127,183).

17. Financial instruments and risk management (continued):

(b) Financial risks (continued):

(ii) Derivative instruments:

At December 31, 2017, the Corporation has a series of interest rate swap contracts totaling $16,715,820 (2016 - $17,575,861) that were used to convert floating rate debt to fixed rate debt. These swaps qualify as cash flow hedges. The Corporation's cash flow hedge exposure at December 31, 2017 equals about 68% (2016 - 43%) of total long-term debt.

The unrealized gain or loss on these contracts is included as a component of other comprehensive income (loss) for the period. As of December 31, 2017, an asset of $102,830 (2016 – liability of $393,616) is included on the balance sheet related to these contracts.

18. Capital risk management:

The Corporation's objectives when managing capital are to safeguard its assets while at the same time maintain investor and creditor confidence, and to sustain future development of the business.

The Corporation includes shareholder's equity and long-term debt including the note payable to the City of Kingston in the definition of capital. To maintain or adjust the capital structure, the Corporation may issue new shares, issue new debt with different characteristics, acquire or dispose of assets, or adjust the amount of cash and short-term investment balances held.

There were no changes in the Corporation's approach to capital management during the period. As part of its lending arrangements, the Corporation is subject to various financial covenants, including debt service coverage ratio and debt to capitalization ratio.

In addition, the note payable to the City of Kingston is subordinated to the Corporation's bank in favour of the bank loan.

19. Comparative information:

Certain comparative information has been reclassified to conform to the presentation adopted in the current year. There is no impact to comprehensive income or retained earnings as a result of the reclassification.