Financial Statements of

KINGSTON HYDRO CORPORATION

Year ended December 31, 2018

KPMG LLP
863 Princess Street, Suite 400
Kingston ON K7L 5N4
Canada
Telephone 613-549-1550
Fax 613-549-6349

INDEPENDENT AUDITORS' REPORT

To the Shareholder of Kingston Hydro Corporation

Opinion

We have audited the financial statements of Kingston Hydro Corporation (the Corporation), which comprise:

- the balance sheets as at December 31, 2018
- the statement of comprehensive income for the year then ended
- the statement of changes in shareholder's equity for the year then ended
- the statement of cash flows for the year then ended
- and notes to the financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the ''financial statements'').

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2018, and its results of operations and its cash flows year then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the ***''Auditors' Responsibilities for the Audit of the Financial Statements''*** section of our auditors' report.

We are independent of the Corporation in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Responsibilities of Management 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.

In preparing the financial statements, management is responsible for assessing the Corporation's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Corporation or to cease operations, or has no realistic alternative but to do so.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Corporation's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Corporation's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Corporation's to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Kingston, Canada

April 15, 2019

KINGSTON HYDRO CORPORATION

Financial Statements

Year ended December 31, 2018

Financial Statements

KINGSTON HYDRO CORPORATION

Balance Sheet

December 31, 2018, with comparative information for December 31, 2017

	2018	2017
		(Restated - note 21)
Assets		
Current assets:		
Cash	$ 177,620	$ 6,928
Due from City of Kingston (note 10(b))	3,843,011	2,188,858
Miscellaneous accounts receivable	1,247,711	7,759,586
Billed revenue receivable	4,970,648	5,149,693
Unbilled revenue	7,824,373	7,900,303
Inventory	1,944,715	2,094,349
Prepaid expenses	168,518	148,792
Payments in lieu of taxes recoverable (note 15)	77,067	250,920
	20,253,663	25,499,429
Non-current assets:		
Property, plant and equipment (note 5)	57,516,436	54,342,863
Derivative asset (note 17(b))	96,098	102,830
Total assets	77,866,197	79,945,122
Regulatory debit balances (note 9)	5,160,928	3,704,010
Total assets and regulatory balances	$ 83,027,125	$ 83,649,132

	2018	2017 (Restated - note 21)
Liabilities and Shareholder's Equity		
Current liabilities:		
Bank loans (note 7(a))	$ 4,401,370	$ 8,984,111
Accounts payable and accrued liabilities	8,087,084	4,723,066
Due to retailers	95,395	112,657
Deposits payable	193,695	–
	12,777,544	13,819,834
Non-current liabilities:		
Note payable to City of Kingston (note 6)	10,880,619	10,880,619
Employee future benefit liabilities (note 11(d))	1,304,332	1,223,171
Long-term debt (note 7(b))	17,986,812	19,891,630
Deferred revenue	6,867,906	5,467,882
Deferred tax liability (note 15)	552,075	191,798
Total liabilities	50,369,288	51,474,934
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	70,630	75,578
Retained earnings	13,932,979	12,978,141
	30,277,329	29,327,439
Commitments and contingencies (notes 13 and 14)		
Total liabilities and shareholder's equity	80,646,617	80,802,373
Regulatory credit balances (note 9)	2,065,241	2,669,786
Deferred tax associated with regulatory balances	315,267	176,973
Total equity, liabilities and regulatory balances	$ 83,027,125	$ 83,649,132

See accompanying notes to financial statements.

On behalf of the Board:

Bryan Paterson,
Chair

Arthur Jordan,
Chair, Audit and Risk Committee

KINGSTON HYDRO CORPORATION

Statement of Comprehensive Income

Year ended December 31, 2018, with comparative information for 2017

	2018	2017 (Restated - note 21)
Energy sales	$ 75,612,797	$ 79,994,340
Cost of energy	77,107,145	78,126,049
	(1,494,348)	1,868,291
Other income	607,909	635,072
IESO Conservation Program revenue	1,109,828	1,227,938
Distribution revenue (notes 3(b) and 4)	12,203,097	11,612,597
Net operating revenue	12,426,486	15,343,898
Operating expenses:		
IESO Conservation Program expenses	1,109,828	1,229,827
Distribution expenses, operation	1,405,432	1,121,235
Distribution expenses, maintenance	1,885,621	1,745,774
Billing and collecting	762,393	1,019,800
Community relations	601,236	502,999
General and administrative	2,989,805	2,735,137
Depreciation and amortization	2,193,987	2,095,293
	10,948,302	10,450,065
Earnings before finance costs, taxation and net movement in regulatory account balances	1,478,184	4,893,833
Finance income	90,230	207,629
Finance costs	(1,332,953)	(1,406,039)
Earnings before taxation and movements in regulatory deferral account balances	235,461	3,695,423
Current tax expense (note 15)	96,479	171,608
Deferred tax expense (note 15)	362,061	312,991
	458,540	484,599
Net earnings before movements in regulatory deferral account balances	(223,079)	3,210,824
Net movement in regulatory deferral account balances related to profit or loss	1,877,917	(1,543,548)
Net earnings and net movements in regulatory deferral account balances	1,654,838	1,667,276
Other comprehensive income:		
Change in fair value of cash flow hedge	(4,948)	364,887
Total comprehensive income	$ 1,649,890	$ 2,032,163

See accompanying notes to financial statements.

KINGSTON HYDRO CORPORATION
Statement of Changes in Shareholder's Equity

Year ended December 31, 2018, with comparative information for 2017

	Share capital	Contributed surplus	Accumulated other comprehensive income (loss)	Retained earnings (deficit)	Total
Balance, January 1, 2017 (Restated – note 21)	$ 12,380,617	$ 3,893,103	$ (289,309)	$ 11,810,865	$ 27,795,276
Net earnings	–	–	–	1,667,276	1,667,276
Other comprehensive income	–	–	364,887	–	364,887
Dividends	–	–	–	(500,000)	(500,000)
Balance, December 31, 2017	12,380,617	3,893,103	75,578	12,978,141	29,327,439
Net earnings	–	–	–	1,654,838	1,654,838
Other comprehensive income	–	–	(4,948)	–	(4,948)
Dividends	–	–	–	(700,000)	(700,000)
Balance, December 31, 2018	$ 12,380,617	$ 3,893,103	$ 70,630	$ 13,932,979	$ 30,277,329

See accompanying notes to financial statements.

KINGSTON HYDRO CORPORATION

Statement of Cash Flows

Year ended December 31, 2018, with comparative information for 2017

	2018	2017 (Restated - note 21)
Cash provided by (used in):		
Operations:		
Net earnings	$ 1,654,838	$ 1,667,276
Items not involving cash:		
Depreciation and amortization	2,193,987	2,095,293
Tax expenses	458,540	484,599
Tax expenses included in net movement in regulatory deferral account balances	138,294	117,084
Change in employee future benefit liabilities	81,161	44,348
Income taxes paid	77,374	(726,204)
Change in non-cash operating balances (note 16)	6,721,593	(3,034,985)
	11,325,787	647,411
Financing:		
Increase in deferred revenue	1,400,024	4,666,656
Dividends paid	(700,000)	(500,000)
Repayment of long-term debt payable	(987,559)	(933,437)
Proceeds of long-term loan payable	2,500,000	1,000,000
Repayment of bank loan	(8,000,000)	–
Proceeds of bank loan	–	2,800,000
	(5,787,535)	7,033,219
Investments:		
Purchase of property, plant and equipment	(5,367,560)	(7,683,089)
Increase (decrease) in cash	170,692	(2,459)
Cash, beginning of year	6,928	9,387
Cash, end of year	$ 177,620	$ 6,928

See accompanying notes to financial statements.

KINGSTON HYDRO CORPORATION

Table of Contents to Notes to Financial Statements

Years ended December 31, 2018 and 2017

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, 2018.

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 15, 2019.

(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:

At initial recognition, the Corporation measures its financial assets at fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at fair value through profit or loss are expensed in profit or loss.

Subsequent measurement of the financial asset depends on the classification determined on initial recognition. Financial assets are classified as either amortized cost, fair value through other comprehensive income or fair value through profit or loss, depending on its business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. Financial assets are not reclassified subsequent to their initial recognition, unless the Corporation changes its business model for managing financial assets.

Financial liabilities are initially measured at fair value, net of transaction costs incurred. They are subsequently carried at amortized cost using the effective interest rate method; any difference between the proceeds (net of transaction costs) and the redemption value is recognized as an adjustment to interest expense over the period of the borrowings.

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.

3. Significant accounting policies (continued):

(a) Financial instruments (continued):

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

(b) Revenue recognition:

Sale and distribution of electricity

The performance obligations for the sale and distribution of electricity are recognized over time using an output method to measure the satisfaction of the performance obligation. The value of the electricity services transferred to the customer is determined on the basis of cyclical meter readings plus estimated customer usage since the last meter reading date to the end of the year and represents the amount that the Corporation has the right to bill. Revenue includes the cost of electricity supplied, distribution, and any other regulatory charges. 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 billing stream.

Capital contributions

Developers are required to contribute towards the capital cost of construction of distribution assets in order to provide ongoing service. The developer is not a customer and therefore the contributions are scoped out of IFRS 15 *Revenue from Contracts with Customers*. Cash contributions, received from developers are 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 useful life of the related asset.

Certain customers are also required to contribute towards the capital cost of construction of distribution assets in order to provide ongoing service. These contributions fall within the scope of IFRS 15 *Revenue from Contracts with Customers*. The contributions are received to obtain a connection to the distribution system in order receive ongoing access to electricity. The Corporation has concluded that the performance obligation is the supply of electricity over the life of the relationship with the customer which is satisfied over time as the customer receives and consumes the electricity. Revenue is recognized on a straight-line basis over the useful life of the related asset.

3. Significant accounting policies (continued):

(b) Revenue recognition (continued):

Other revenue

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

Government grants and the related performance incentive payments under CDM programs are recognized as revenue in the year when there is reasonable assurance that the program conditions have been satisfied and the payment will be received.

(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.

(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.

3. Significant accounting policies (continued):

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

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.

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 loss allowance for expected credit losses on financial assets measured at amortized cost is recognized at the reporting date. The loss allowance is measured at an amount equal to the lifetime expected credit losses for the asset.

(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.

3. Significant accounting policies (continued):

(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.

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 2018, the rates were 1.50% from January 1, 2018 to March 31, 2018, increasing to 1.89% from April 1, 2018 to September 30, 2018, and increasing to 2.17% from October 1, 2018 to December 31, 2018.

(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.

3. Significant accounting policies (continued):

(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.

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.

3. Significant accounting policies (continued):

(l) Income taxes (continued):

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

On December 13, 2018, the OEB approved new distribution rates, effective January 1, 2019,

5. Property, plant and equipment:

(a) Cost or deemed cost:

	Land and buildings	Distribution equipment	Other fixed assets	Construction -in- Progress	Total
Balance, January 1, 2018	$ 1,095,781	$ 59,803,416	$ 563,483	$ 204,702	$ 61,667,382
Additions	–	5,029,804	281,511	216,557	5,527,872
Disposals/retirements	–	–	–	(160,312)	(160,312)
Balance, December 31, 2018	$ 1,095,781	$ 64,833,220	$ 844,994	$ 260,947	$ 67,034,942

	Land and buildings	Distribution equipment	Other fixed assets	Construction -in- Progress	Total
Balance, 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, December 31, 2017	$ 1,095,781	$ 59,803,416	$ 563,483	$ 204,702	$ 61,667,382

(b) Accumulated depreciation:

	Land and buildings	Distribution equipment	Other fixed assets	Construction -in- Progress	Total
Balance, January 1, 2018	$ 74,378	$ 6,981,602	$ 268,539	$ –	$ 7,324,519
Depreciation charge	23,626	2,071,622	98,739	–	2,193,987
Disposals/retirements	–	–	–	–	–
Balance, December 31, 2018	$ 98,004	$ 9,053,224	$ 367,278	$ –	$ 9,518,506

5. Property, plant and equipment (continued):

(b) Accumulated depreciation (continued):

	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, December 31, 2017	$ 74,378	$ 6,981,602	$ 268,539	$ –	$ 7,324,519

(c) Carrying amounts:

	Land and buildings	Distribution equipment	Other fixed assets	Construction -in-Progress	Total
At December 31, 2018	$ 997,777	$ 55,779,996	$ 477,716	$ 260,947	$ 57,516,436
At December 31, 2017	1,021,403	52,821,814	294,944	204,702	54,342,863

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 (2017 - $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, 2020. Interest charges on the note payable for the 2018 fiscal year were $638,692 (2017 - $638,692).

7. Bank loans and long-term debt:

(a) Bank loans:

	2018	2017
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
Current portion of long-term debt (note 7(b))	4,401,370	984,111
	$ 4,401,370	$ 8,984,111

(b) Long-term debt:

	2018	2017
Committed reduced term facility (single draw), fixed rate of 3.67%, due December 18, 2020 (facility 3)	$ 2,248,918	$ 2,302,881
Committed reduced term facility (single draw), fixed rate of 3.25%, due May 2019 (facility 4)	145,394	486,423
Committed reduced term facility (single draw), fixed rate of 3.03% due February 2019 (facility 6)	1,628,518	1,727,686
Committed reduced term facility (single draw), fixed rate of 3.25% due January 2022 (facility 5)	2,898,379	3,073,340
Committed reduced term facility (single draw), fixed rate of 3.92% due December 2042 (Infrastructure Ontario)	3,083,619	3,159,921
Interest rate swap loan, fixed rate of 3.24%, due December 9, 2021 (facility 3)	1,373,603	1,406,752
Interest rate swap loan, fixed rate of 3.01%, due December 4, 2024 (facility 3)	2,083,990	2,140,508
Interest rate swap loan, fixed rate of 2.13%, due December 4, 2019 (facility 3)	2,104,971	2,154,774
Interest rate swap loan, fixed rate of 2.72%, due December 12, 2023 (facility 3)	3,344,803	3,423,456
Interest rate swap loan, fixed rate of 3.92%, due November 15, 2025 (facility 3)	2,496,346	–
Capital loan, fixed rate of 3.15%, due December 18, 2024 (facility 3)	979,641	1,000,000
	22,388,182	20,875,741
Less: current portion of long-term debt	4,401,370	984,111
	$ 17,986,812	$ 19,891,630

7. Bank loans and long-term debt:

(b) Long-term debt (continued):

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

2019	$ 4,401,370
2020	2,706,999
2021	4,131,507
2022	306,605
2023	3,234,831
2024 and thereafter	7,606,870
	$ 22,388,182

(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, 2018 (2017 - $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 2018 were $1,895,129 (2017 - $1,862,208).

9. Regulatory deferral account balance:

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

	2017	Balances arising in the period	Recovery/ reversal	2018	Remaining recovery period (years)
Regulatory deferral account debit balances					
Group 1 deferred accounts	$ 3,011,834	$ 972,130	$ –	$ 3,983,964	1
Regulatory asset recovery account	(131,210)	(9,388)	(23,590)	(164,188)	–
Other regulatory accounts	157,726	(4,097)	–	153,629	–
Deferred income taxes	665,660	521,863	–	1,187,523	–
Total amount related to regulatory deferral account debit balances	$ 3,704,010	$ 1,480,508	$ (23,590)	$ 5,160,928	1

	2017	Balances arising in the period	Recovery/ reversal	2018	Remaining recovery period (years)
Regulatory deferral account credit balances					
Group 1 deferred accounts	$ (2,669,786)	$ 604,545	$ –	$ (2,065,241)	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 2019 Custom IR Year Four update rate application (EB-2018-0047) included a request to the OEB for disposition of the Corporation's deferral and variance account Group 1 balances. As part of the decision and rate order issued by the OEB on December 13, 2018, the Corporation received approval from the Ontario Energy Board on an interim basis for the disposition of Group 1 Deferral and Variance accounts in the amount of a net credit to customers in the amount of $107,387.

10. Related party transactions:

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

During the year, the Corporation paid $13,930,444 (2017 - $12,541,915) 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, 2018 with respect to these transactions.

(b) City of Kingston:

During the year, the Corporation contracted for certain financial services from the City of Kingston. As at December 31, 2018, 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 $3,843,011 (2017 - $2,188,858). 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, 2018 is $189,033 (2017 - $194,545).

(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, 2018. 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:

	2018	2017
Accrued benefit liabilities, January 1	$ 796,964	$ 740,997
Service cost (reduction)	89,955	55,967
Accrued benefit liabilities, December 31	$ 886,919	$ 796,964

11. Employee future benefit liabilities (continued):

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

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.

(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, 2018 and is $228,380 (2017 - $231,662).

(d) Future benefit liabilities:

	2018	2017
Future benefit liabilities are comprised of:		
Pension plan	$ 189,033	$ 194,545
Health, dental and life insurance	886,919	796,964
Accumulated sick leave	228,380	231,662
	$ 1,304,332	$ 1,223,171

12. Share capital:

	2018	2017
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, 2018 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:

	2018	2017
Federal and Ontario statutory income tax rate	26.50%	26.50%
Earnings before provision for PILs	$ 2,113,378	$ 2,151,875
Provision for PILs at statutory rate	$ 560,045	$ 570,247
Change resulting from:		
Tax effect of regulatory assets and liabilities	(101,646)	(86,057)
Tax effect of other miscellaneous adjustments	141	409
Provision for PILs	$ 458,540	$ 484,599
Effective income tax rate	21.7%	22.5%

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

	2018	2017
Shortfall of tax values over accounting values of fixed assets	$ (872,256)	$ (488,687)
Future benefit liabilities	345,647	324,139
Regulatory assets	(315,267)	(176,973)
Derivative asset	(25,466)	(27,250)
	$ (867,342)	$ (368,771)

16. Change in non-cash operating balances:

	2018	2017
Decrease (increase) in due from City of Kingston	$ (1,654,153)	$ 2,306,395
Decrease (increase) in miscellaneous accounts receivable	6,511,875	(6,943,602)
Decrease in billed revenue receivable	179,045	1,634,959
Decrease in unbilled revenue	75,930	1,252,605
Decrease (increase) in inventory	149,634	(12,158)
Increase in prepaid expenses	(19,726)	(3,175)
Increase (decrease) in accounts payable and accrued liabilities	3,364,018	(10,068,187)
Increase (decrease) in due to retailers	(17,262)	12,251
Increase in deposits payable	193,695	–
Change in regulatory deferral account debit balances	(1,456,918)	730,790
Change in regulatory deferral account credit balances	(604,545)	8,055,137
	$ 6,721,593	$ (3,034,985)

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, 2018 is $3,581,932 (2017 - $3,435,187).

17. Financial instruments and risk management (continued):

(b) Financial risks (continued):

(ii) Derivative instruments:

At December 31, 2018, the Corporation has a series of interest rate swap contracts totaling $15,828,576 (2017 - $16,715,820) 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, 2018 equals about 55% (2017 - 54%) 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, 2018, an asset of $96,098 (2017 - $102,830) 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. Change in Accounting Policy

IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments

The Corporation has initially applied IFRS 15 *Revenue from Contracts with Customers* from January 1, 2018 on a retrospective basis. The following practical expedients have been used in the initial application of this new standard:

For completed contracts, the Corporation did not restate contracts that:

(i) Began and ended within the same annual reporting period; or

(ii) Were completed at the beginning of January 1, 2017.

IFRS 15 contains a five step model that applies to contracts with customers that specifies that revenue is recognized when or as an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled.

19. Change in Accounting Policy (continued)

The Corporation has initially applied IFRS 9 *Financial Instruments* from January 1, 2018 on a retrospective basis. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for measuring impairment on financial assets, and new general hedge accounting requirements.

Despite the retrospective adoption, the accounting policy change did not result in a significant impact to the financial statements. As a result, the Corporation was not required to make any adjustments to the comparative figures upon initial adoption.

The updated accounting policies have been discussed further in note 3.

20. Future accounting pronouncements:

The Corporation is evaluating the adoption of the following new and revised standards along with any subsequent amendments.

Leases

In January 2016, IASB issued IFRS 16 to establish principles for the recognition, measurement, presentation, and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that faithfully represents those transactions. IFRS 16 replaces IAS 17 and it is effective for annual periods beginning on or after January 1, 2019. The standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by the lessor. Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided. The Corporation intends to adopt IFRS 16 in its financial statements for the annual period beginning January 1, 2019. The Corporation is assessing the impact of IFRS 16 on its results of operations, financial position and disclosures.

21. Comparative information:

(a) The Corporation has retroactively restated its prior period financial statements to adjust for certain regulatory assets associated with deferred income tax liabilities. The impact of the adjustment was an increase to regulatory debit balances and retained earnings at January 1, 2017 of $659,929 and an increase to total comprehensive income for the year ended December 31, 2017 of $441,827.

(b) 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.