ANNUAL FINANCIAL REPORT
DECEMBER 31, 2013

TORONTO HYDRO CORPORATION

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Toronto Hydro Corporation

GLOSSARY

AFUDC – Allowance for funds used during construction

ARO – Asset retirement obligation

ASC – Accounting Standards Codification

ASU – Accounting Standards Update

CDM – Conservation and demand management

City – City of Toronto

Copeland Station – The Clare R. Copeland transformer station, formerly called "Bremner Station"

Corporation – Toronto Hydro Corporation

CUPE One – Canadian Union of Public Employees, Local One

Electricity Act – *Electricity Act, 1998* (Ontario)

ERM – Enterprise risk management

FASB – Financial Accounting Standards Board

GWh – Gigawatt-Hours

Green Energy Act – *Green Energy Act, 2009* (Ontario)

HST – Harmonized sales tax

IAS – International Accounting Standards

IASB – International Accounting Standards Board

ICM – Incremental Capital Module

Ice Storm – Refers to an extreme winter storm involving freezing rain, ice pellets and snow that impacted Toronto in December 2013.

IESO – Independent Electricity System Operator

IFRIC – International Financial Reporting Interpretations Committee

IFRS – International Financial Reporting Standards

IRM – Incentive Regulation Mechanism

ITA – *Income Tax Act* (Canada)

ITC – Investment tax credit

KPIs – Key performance indicators

kW – Kilowatt

LDC – Toronto Hydro-Electric System Limited

MD&A – Management's Discussion and Analysis

MED – Refers to major event days as defined by the Institute of Electrical & Electronic Engineers Inc. specification 1366.

MEU – Municipal electricity utility

MW – Megawatt

OCI – Other comprehensive income

OEB – Ontario Energy Board

OEB Act – *Ontario Energy Board Act, 1998* (Ontario)

OMERS – Ontario Municipal Employees Retirement System

OPA – Ontario Power Authority

OSC – Ontario Securities Commission

PILs – Payments in lieu of corporate taxes

PP&E – Property, plant and equipment

RARA – Regulatory assets recovery account

ROC – Risk Oversight Committee

RRA – Rate-regulated accounting

RRFE – Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach

TA – *Taxation Act, 2007* (Ontario)

TH Energy – Toronto Hydro Energy Services Inc.

US GAAP – United States Generally Accepted Accounting Principles

WMS – Wholesale Market Service

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE MONTHS AND YEARS ENDED DECEMBER 31, 2013 AND 2012

Executive Summary

- Net income for the three months and year ended December 31, 2013 was $29.2 million and $121.2 million, compared to net income of $22.8 million and $86.0 million for the comparable periods in 2012;
- capital expenditures were primarily related to the renewal of the electricity infrastructure of LDC and were $151.6 million and $450.3 million for the three months and year ended December 31, 2013, compared to $108.5 million and $292.4 million for the comparable periods in 2012;
- on December 19, 2013, the OEB approved a settlement agreement filed by LDC to allow for the entirety of LDC's requested 2014 capital program;
- on January 16, 2014, the OEB approved LDC's requested disposition of the smart meter deferral account balances, permitting the recovery of $23.9 million and $9.6 million through two separate rate riders effective May 1, 2014;
- in December 2013, the Ice Storm caused damage to the above-ground infrastructure of the Corporation's electricity distribution system resulting in power outages throughout the City;
- on May 22, 2013, the Corporation celebrated the official groundbreaking at Copeland Station, and construction continued during the year;
- on December 17, 2013, the Corporation launched a commercial paper program allowing up to $400.0 million of unsecured short-term promissory notes to be issued in various maturities of no more than one year; and
- on April 9, 2013, the Corporation issued $250.0 million of 2.91% senior unsecured debentures due April 10, 2023 ("Series 8") and $200.0 million of 3.96% senior unsecured debentures due April 9, 2063 ("Series 9"). The net proceeds of the above debentures, together with borrowings under the Corporation's revolving credit facility, were used to repay the Corporation's $225.0 million of 6.11% senior unsecured debentures ("Series 1") and $245.1 million of 6.11% senior unsecured debentures ("Series 5") which matured on May 7, 2013 and May 6, 2013, respectively.

Introduction

The following MD&A should be read in conjunction with:

- the audited consolidated financial statements and accompanying notes of the Corporation as at and for the years ended December 31, 2013 and 2012 (the "Consolidated Financial Statements"); and

- the audited consolidated financial statements and accompanying notes of the Corporation as at and for the years ended December 31, 2012 and 2011.

Copies of these documents are available on the System for Electronic Document Analysis and Retrieval website at www.sedar.com.

The Corporation's above noted annual consolidated financial statements have been prepared in accordance with US GAAP and are presented in Canadian dollars (see "Significant Accounting Policies" below). The OSC granted an exemption to allow the Corporation to file financial statements under US GAAP for the years commencing on or after January 1, 2012 but before January 1, 2015.

Business of Toronto Hydro Corporation

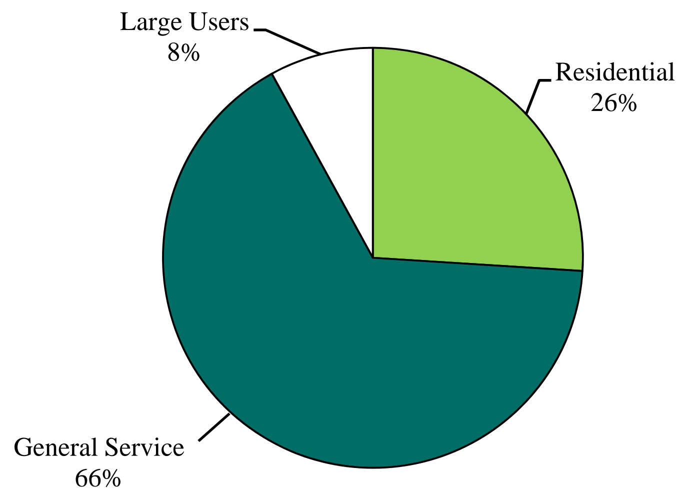
The Corporation is a holding company which wholly owns two subsidiaries:

- LDC - which distributes electricity and engages in CDM activities; and
- TH Energy - which provides street lighting services.

The principal business of the Corporation and its subsidiaries is the distribution of electricity by LDC. LDC owns and operates an electricity distribution system, which delivers electricity to approximately 730,000 customers located in the City. The City is the sole shareholder of the Corporation. LDC is the largest municipal electricity distribution company in Canada and distributes approximately 18% of the electricity consumed in Ontario. The business of LDC is regulated by the OEB, which has broad powers relating to licensing, standards of conduct and service, and the regulation of electricity distribution rates charged by LDC and other electricity distributors in Ontario. For the year ended December 31, 2013, LDC earned electricity revenues of $3,145.5 million. As illustrated in the accompanying chart, 66% of the revenues were earned from general service users[1], 26% from residential service users[2], and 8% from large users[3].

LDC Electricity Revenues by Class %

Year Ended December 31, 2013



[1] "General Service" means a service supplied to premises other than those receiving "Residential Service" and "Large Users" and typically includes small businesses and bulk-metered multi-unit residential establishments. This service is provided to customers with a monthly peak demand of 5,000 kW or less averaged over a twelve-month period.

[2] "Residential Service" means a service that is for domestic or household purposes, including single family or individually metered multi-family units and seasonal occupancy.

[3] "Large Users" means a service provided to a customer with a monthly peak demand of 5,000 kW or more averaged over a twelve-month period.

Electricity Distribution – Industry Overview

In April 1999, the Government of Ontario began restructuring Ontario's electricity industry. Under regulations passed pursuant to the restructuring, LDC and other electricity distributors purchase electricity from the wholesale market administered by the IESO and recover the costs of electricity and certain other costs at a later date in accordance with procedures mandated by the OEB.

The OEB has regulatory oversight of electricity matters in Ontario. The OEB Act sets out the OEB's authority to issue a distribution licence that must be obtained by owners or operators of an electricity distribution system in Ontario. The OEB prescribes licence requirements and conditions including, among other things, specified accounting records, regulatory accounting principles, separation of accounts for distribution and other activities, and requirements for rate-setting and other legal filings.

The OEB's authority and responsibilities include the power to approve and fix rates for the transmission and distribution of electricity, the responsibility to provide rate protection for rural or remote electricity customers, and the responsibility for ensuring that electricity distribution companies fulfill their obligations to connect and service customers.

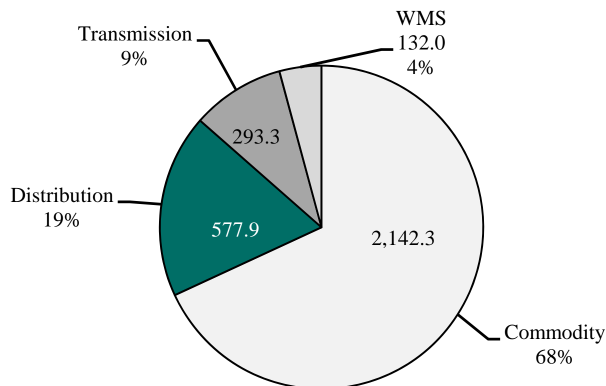
LDC is required to charge its customers for the following amounts (all of which, other than distribution rates, represent a pass-through of amounts payable to third parties):

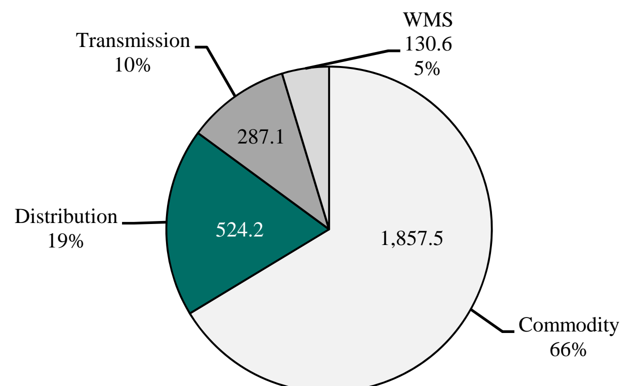
- *Commodity Charge* – The commodity charge represents the market price of electricity consumed by customers and is passed through the IESO to operators of generating stations. It includes the global adjustment, which represents the difference between the market price of electricity and the rates paid to regulated and contracted generators.

- *Retail Transmission Rate* – The retail transmission rate represents the costs incurred in respect of the transmission of electricity from generating stations to local distribution networks. Retail transmission rates are passed through to operators of transmission facilities.

- *WMS Charge* – The WMS charge represents various wholesale market support costs, such as the cost of the IESO to administer the wholesale electricity system, operate the electricity market, and maintain reliable operation of the provincial grid. Wholesale charges are passed through to the IESO.

- *Distribution Rate* – The distribution rate is designed to recover the costs incurred by LDC in delivering electricity to customers, including the OEB-allowed cost of capital. Distribution rates are regulated by the OEB and are comprised of fixed and variable (usage-based) components, based on a forecast of LDC's customers and load.





The electricity revenues for the year ended December 31, 2013 were $3,145.5 million compared to $2,799.4 million for the comparable period in 2012. The increase in electricity revenues for the year ended December 31, 2013 was primarily due to an increase in the commodity charges by the IESO related to higher global adjustment and average energy prices in 2013 compared to 2012 ($284.8 million) and an increase in LDC's distribution revenue for 2013 ($53.7 million) (see "Net Revenues" below in the section entitled "Results of Operations – 2013 compared to 2012").

LDC is required to satisfy and maintain prudential requirements with the IESO, which include credit support with respect to outstanding market obligations in the form of letters of credit, cash deposits or guarantees from third parties with prescribed credit ratings.

The Corporation is exempt from tax under the ITA if not less than 90% of the capital of the Corporation is owned by the City and not more than 10% of the income of the Corporation is derived from activities carried on outside the municipal geographical boundaries of the City. In addition, the Corporation's subsidiaries are also exempt from tax under the ITA provided that all of their capital is owned by the Corporation and not more than 10% of their respective income is from activities carried on outside the municipal geographical boundaries of the City. A corporation exempt from tax under the ITA is also exempt from tax under the TA.

The Corporation and each of its subsidiaries are MEUs for purposes of the PILs regime contained in the Electricity Act. The Electricity Act provides that a MEU that is exempt from tax under the ITA and the TA is required to make, for each taxation year, a PILs payment to the Ontario Electricity Financial Corporation in an amount equal to the tax that it would be liable to pay under the ITA and the TA if it were not exempt from tax. The PILs regime came into effect on October 1, 2001, at which time the Corporation and each of its subsidiaries were deemed to have commenced a new taxation year for purposes of determining their respective liabilities for PILs payments.

Corporate Strategy

The Corporation's vision is to "continuously maximize customer and stakeholders' satisfaction by being safe, reliable and environmentally responsible at optimal costs". The Corporation has an ERM framework that helps determine whether the Corporation is well positioned to achieve its strategic objectives. The ERM framework provides a consistent, disciplined methodology for controlling risk by identifying, assessing, managing, monitoring and reporting risks for the Corporation.

The Corporation is focused on the following four strategic pillars:

People – the Corporation aims to maintain an engaged, healthy, productive, and safe workforce to meet changing business requirements, as it strives to:

- Provide a healthy and safe workplace
- Develop a skilled and knowledgeable workforce
- Keep its workforce engaged

The Corporation will continue to strengthen its already strong safety culture through various internal initiatives in order to achieve world-class results. The Corporation is committed to employee safety and will remain persistent in its efforts to mitigate the risk of injury to its workforce. This will be accomplished through ongoing safety inspections, audits, annual policy review and the continuation of the safety programs and standards. The Corporation will continue to use the internal responsibility system to reinforce the importance of safety in the workplace.

Financial – the Corporation aims to meet the financial objectives of its shareholder, as it strives to:

- Provide a fair return to the shareholder
- Continue to increase shareholder value

The Corporation has provided its shareholder with an annual increase in economic value over the last decade. To meet financial objectives of the shareholder, the Corporation seeks to increase shareholder value and is committed to provide a fair return to its shareholder in the future. Along with excellence in corporate financing and financial management, the Corporation will strive to maintain an investment grade credit rating.

Operations – the Corporation aims to improve reliability through sustainable system management, as it strives to:

- Keep the lights on
- Keep the system safe
- Build a grid that supports a modern Toronto

The Corporation is engaging in resource and capital-intensive programs to improve capacity, reliability and quality. The capital program will replace aging assets and accommodate next generation technology to suit the regulatory trends that incent the increased use of distributed generation.

Customer – the Corporation aims to provide value to customers, as it strives to:

- Make it easy to work with
- Help conserve energy
- Provide innovative tools and technology

The Corporation is looking at ways to improve the level of satisfaction that customers experience, whether it is through education and awareness programs, interaction with call centre representatives, their account managers or over the internet. The Corporation continues to undertake initiatives and invest in technology and processes to improve the customer experience. In turn, this focus on customer service will provide long-term value for money.

Performance Measurement

The Corporation measures its performance in relation to the achievement of its strategic objectives by using a balanced scorecard approach. KPIs are monitored throughout the year and appropriate actions are taken as required. The definitions of the 2013 KPIs associated with the previously mentioned four strategic pillars are as follows:

Strategic Pillars	Performance Measure	Definition
People	Safety	• Number of recordable injuries x 200,000 / exposure hours.
	Employee Engagement	• Average number of employee engagement sessions per employee per year, including corporate-wide, divisional and departmental.
Financial	Net Income	• Net income per the Corporation's consolidated financial statements.
Operations	System Average Interruption Duration Index	• Measure of the annual system average interruption duration per customers served, not including MED.
	System Average Interruption Frequency Index	• Measure of the frequency of service interruptions per customers served, not including MED.
	Worst Performing Feeders	• Total number of feeders experiencing seven or more sustained outages in a year, with outages defined as interruptions greater than one minute.
	LDC Regulated Capital	• Achievement of LDC capital work program as approved by the Board of Directors.
Customer	Conservation Demand Management	• Annual summer peak demand savings through year over year megawatt reduction.
	Enhanced Customer Engagement	• Increase in customer self-serve transactions / engagements using various self-serve options.
	Call Centre Service Response	• Average of call centre responses within thirty seconds.

Capability to Deliver Results

The Corporation strives to manage its performance and deliver results. In 2013, the Corporation exceeded all of its corporate and divisional objectives represented by its KPIs. The Corporation's ability to deliver results in each of its strategic pillars is limited by risks inherent in its regulatory environment, business, workforce and in the economic environment. These risks are discussed under the section "Risk Management and Risk Factors" in this MD&A.

Selected Consolidated Financial Data

Consolidated Statements of Net Income and Comprehensive Income
Three months ended December 31
(in thousands of Canadian dollars, except for per share amounts, unaudited)

	2013 $	2012 $	Change $	2011[1] $
Revenues	819,669	691,847	127,822	694,284
Costs				
Purchased power	627,015	551,267	75,748	542,510
Operating expenses	79,319	65,107	14,212	66,880
Depreciation and amortization	66,631	35,900	30,731	43,984
	772,965	652,274	120,691	653,374
Income before the following:	46,704	39,573	7,131	40,910
Net financing charges	(15,074)	(18,640)	3,566	(19,506)
Gain on disposals of PP&E	162	1,805	(1,643)	(1,135)
Income before income taxes	31,792	22,738	9,054	20,269
Income tax expense (recovery)	2,572	(104)	2,676	3,041
Net income and comprehensive income	29,220	22,842	6,378	17,228
Basic and fully diluted net income per share	29,220	22,842	6,378	17,228

[1] The Corporation's consolidated financial statements were prepared in accordance with Part V of Canadian GAAP until December 31, 2011. Selected financial information from comparative consolidated financial statements for 2011 have been adjusted retroactively from the consolidated financial statements previously filed to conform to the presentation of the Corporation's 2012 and 2013 consolidated financial statements prepared in accordance with US GAAP.

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Consolidated Statements of Net Income and Comprehensive Income
Year ended December 31
(in thousands of Canadian dollars, except for per share amounts)

	2013 $	2012 $	Change $	2011[1] $
Revenues	3,202,793	2,852,477	350,316	2,823,470
Costs				
Purchased power	2,567,512	2,275,209	292,303	2,236,541
Operating expenses	271,958	245,173	26,785	262,241
Depreciation and amortization	172,756	141,572	31,184	151,022
	3,012,226	2,661,954	350,272	2,649,804
Income before the following:	190,567	190,523	44	173,666
Net financing charges	(66,273)	(73,977)	7,704	(75,324)
Gain on disposals of PP&E	1,280	1,805	(525)	3,885
Restructuring costs	-	(27,796)	27,796	-
Income before income taxes	125,574	90,555	35,019	102,227
Income tax expense	4,333	4,565	(232)	6,295
Net income and comprehensive income	121,241	85,990	35,251	95,932
Basic and fully diluted net income per share	121,241	85,990	35,251	95,932

[1] The Corporation's consolidated financial statements were prepared in accordance with Part V of Canadian GAAP until December 31, 2011. Selected financial information from comparative consolidated financial statements for 2011 have been adjusted retroactively from the consolidated financial statements previously filed to conform to the presentation of the Corporation's 2012 and 2013 consolidated financial statements prepared in accordance with US GAAP.

Condensed Consolidated Balance Sheet Data
(in thousands of Canadian dollars)

	As at December 31 2013 $	As at December 31 2012 $
Current assets	555,314	552,292
Non-current assets	3,242,217	2,987,062
Total assets	3,797,531	3,539,354
Current liabilities	696,417	937,514
Non-current liabilities	1,882,596	1,461,568
Total liabilities	2,579,013	2,399,082
Shareholder's equity	1,218,518	1,140,272
Total liabilities and shareholder's equity	3,797,531	3,539,354

Results of Operations – 2013 compared to 2012

Net Income

Net income for the three months and year ended December 31, 2013 was $29.2 million and $121.2 million compared to $22.8 million and $86.0 million for the comparable periods in 2012.

The increase in net income for the three months ended December 31, 2013 was primarily due to higher net revenues ($52.1 million) and lower net financing charges ($3.6 million). These favourable variances were partially offset by a higher depreciation expense ($30.7 million), higher operating expenses ($14.2 million), a higher income tax expense ($2.7 million), and lower gains on disposals of surplus properties ($1.6 million).

The increase in net income for the year ended December 31, 2013 was primarily due to higher net revenues ($58.0 million), restructuring costs recognized in the first quarter of 2012 ($27.8 million) related to the cost reduction initiatives at LDC (see "Restructuring Costs" below), lower net financing charges ($7.7 million), and lower income tax expense ($0.2 million). These favourable variances were partially offset by a higher depreciation expense ($31.2 million), higher operating expenses ($26.8 million), and lower gains on disposals of surplus properties ($0.5 million).

Ice Storm

In December 2013, the Ice Storm caused damage to the above-ground infrastructure of the Corporation's electricity distribution system. Approximately 300,000 customers lost power for periods of up to eight days, though strenuous efforts resulted in 75% power restoration within 48 hours. As a result, the Corporation incurred incremental costs consisting of overtime of its own employees, time and equipment costs of other utilities that provided mutual aid, tree clearing services and the replacement of damaged assets. The total costs incurred amounted to $13.8 million, of which $3.6 million were capitalized to PP&E and $10.2 million were charged to operating expenses. In addition, potential distribution revenue of approximately $0.9 million was lost due to the power outage. The Corporation decided not to file a special application with the OEB to seek recovery of incremental operating expenses for the Ice Storm as it was able to absorb the impact from other favourable variances.

Smart Meters

On August 1, 2013, LDC filed an application with the OEB requesting approval for the disposition of balances in its smart meter deferral account related to smart meter installations in 2008, 2009 and 2010, and incremental revenue related to these assets. On January 16, 2014, the OEB approved LDC's request for incremental revenue and disposition of the smart meter deferral account balances.

The OEB ruling on smart meters also permitted the recovery in principle of LDC's allowed cost of capital on smart meters since 2008, with a rate order issued to this effect. Accordingly, a new regulatory asset of $25.2 million has been created to reflect the future amount to be recovered through rates, with a related amount recorded in revenue. For the year ended December 31, 2013, LDC ceased to defer operating and depreciation expenses related to the deployment of the 2008 to 2010 smart meters and recognized revenues as approved by the OEB, resulting in a decrease in the smart meters regulatory asset of $25.0 million, an increase in PP&E of $45.7 million, an increase in intangible assets of $1.1 million, an increase in revenues of $57.5 million, an increase in operating expenses of $7.1 million, and an increase in depreciation and amortization expenses of $28.7 million. See note 9 (c) to the Consolidated Financial Statements for further details.

Net Revenues

Net revenues for the three months and year ended December 31, 2013 were $192.7 million and $635.3 million compared to $140.6 million and $577.3 million for the comparable periods in 2012 (see "Non-GAAP Financial Measures" below).

The increase in net revenues for the three months ended December 31, 2013 was primarily due to higher regulated distribution revenue at LDC ($47.9 million) and higher other income ($4.2 million). The increase in distribution revenue was primarily due to revenue recognition related to the disposition of the 2008-2010 smart meter deferral account balances ($57.5 million) (see "Smart Meters" above), revenue recognition related to the IRM adjustment and the eligible in-service capital expenditures under ICM ($5.1 million), and higher consumption in the fourth quarter of 2013 ($3.7 million). These variances were partially offset by a reduction in distribution revenue related to

the revision of prior year tax positions based on reassessments received and in process, not reflected in applications for electricity distribution rates resulting in an over-recovery of PILs from customers ($19.4 million). The increase in other income for the three months ended December 31, 2013 was primarily due to higher revenue in connection with disposal of scrap material, solar panel installation, and duct rental fees.

The increase in net revenues for the year ended December 31, 2013 was primarily due to higher regulated distribution revenue at LDC ($53.7 million) and higher other income ($4.3 million). The increase in distribution revenue was primarily due to revenue recognition related to the disposition of the 2008-2010 smart meter deferral account balances ($57.5 million) (see "Smart Meters" above), revenue recognition related to the IRM adjustment and the eligible in-service capital expenditures under ICM ($8.2 million), and an unfavourable revenue adjustment recorded in 2012 for PILs variances accumulated in regulatory variance accounts ($4.8 million). These variances were partially offset by a reduction in distribution revenue related to the revision of prior year tax positions based on reassessments received and in process, not reflected in applications for electricity distribution rates resulting in an over-recovery of PILs from customers ($19.4 million). The increase in other income for the year ended December 31, 2013 was primarily due to higher revenue in connection with disposal of scrap material, solar panel installation, and duct rental fees.

Expenses

Operating expenses for the three months and year ended December 31, 2013 were $79.3 million and $272.0 million compared to $65.1 million and $245.2 million for the comparable periods in 2012.

The increase in operating expenses for the three months ended December 31, 2013 was primarily due to the cost of power restoration incurred in 2013 as a result of the Ice Storm that adversely affected the City ($10.2 million) and the recognition of operating expenses related to the disposition of the 2008-2010 smart meter deferral account balances ($7.1 million) (see "Smart Meters" above). These variances were partially offset by lower costs associated with street lighting maintenance and customer demand billable work ($2.7 million).

The increase in operating expenses for the year ended December 31, 2013 was primarily due to the cost of power restoration incurred in 2013 as a result of the Ice Storm that adversely affected the City ($10.2 million), a favourable reassessment for payments in lieu of property taxes to the Ministry of Finance of Ontario recorded in the second quarter of 2012 ($8.7 million), and the recognition of operating expenses related to the disposition of the 2008-2010 smart meter deferral account balances ($7.1 million) (see "Smart Meters" above).

Depreciation and amortization expense for the three months and year ended December 31, 2013 was $66.6 million and $172.8 million compared to $35.9 million and $141.6 million for the comparable periods in 2012.

The increase in depreciation and amortization expense for the three months and year ended December 31, 2013 was primarily due to the recognition of depreciation and amortization expenses related to the disposition of the 2008-2010 smart meter deferral account balances ($28.7 million) (see "Smart Meters" above).

Net Financing Charges

Net financing charges for the three months and year ended December 31, 2013 were $15.1 million and $66.3 million compared to $18.6 million and $74.0 million for the comparable periods in 2012.

The decrease in net financing charges for the three months and year ended December 31, 2013 was primarily due to the refinancing of maturing debentures at a lower interest rate in the second quarter of 2013.

Gain on Disposals of PP&E

Gain on disposals of PP&E for the three months and year ended December 31, 2013 were $0.2 million and $1.3 million compared to $1.8 million and $1.8 million for the comparable periods in 2012.

The decrease in gain on disposals of PP&E for the three months and year ended December 31, 2013 was primarily due to a lower gain realized in connection with the disposals of surplus properties at LDC in 2013.

Restructuring Costs

In the first quarter of 2012, the Corporation's Board of Directors approved a workforce restructuring program aimed at reducing operating expenditures for LDC. The program was approved following the decision by the OEB to deny

the request of LDC to set its electricity distribution rates for 2012, 2013 and 2014 under the cost of service framework. In preparing its revised application using the IRM framework, LDC concluded that significant cost reductions were necessary to manage its business within the confines of the expected allowed electricity distribution rates provided by the IRM framework. The main component of these operating cost reduction initiatives was a workforce restructuring program, which included the severance of management employees and a voluntary exit incentive program for targeted unionized positions.

Restructuring costs for the year ended December 31, 2013 were $nil compared to $27.8 million for the comparable period in 2012.

Income Tax Expense (Recovery)

Income tax expense for the three months and year ended December 31, 2013 was $2.6 million and $4.3 million compared to an income tax recovery of $0.1 million and an income tax expense of $4.6 million for the comparable periods in 2012.

The increase in income tax expense for the three months ended December 31, 2013 was due to higher income before taxes.

The decrease in income tax expense for the year ended December 31, 2013 was due to higher deductions for permanent and temporary differences between accounting and tax treatments ($4.6 million) and favourable resolution of issues identified in prior periods and related reassessments by the Ministry of Finance of Ontario ($4.9 million). These variances were partially offset by higher income before taxes ($9.3 million).

Results of Operations – 2012 compared to 2011

Net income was $86.0 million in 2012 compared to $95.9 million in 2011. The decrease in net income was primarily due to restructuring costs recognized in the first quarter of 2012 ($27.8 million) related to the cost reduction initiatives at LDC, lower net revenues ($9.7 million), and lower gains on disposals of surplus properties ($2.1 million). These unfavourable variances were partially offset by lower operating expenses ($17.1 million), lower depreciation expense ($9.5 million), lower income tax expense ($1.7 million), and lower net financing charges ($1.3 million). For further details, see "Selected Consolidated Financial Data" above and the Corporation's 2012 annual MD&A as filed on the System for Electronic Document Analysis and Retrieval website at www.sedar.com.

Quarterly Results of Operations

The table below presents unaudited quarterly consolidated financial information of the Corporation for 2013 and 2012, which has been prepared in accordance with US GAAP.

Quarterly Results of Operations
(in thousands of Canadian dollars, unaudited)

	December 31 2013 $	September 30 2013 $	June 30 2013 $	March 31 2013 $
Revenues	819,669	833,339	792,905	756,880
Costs	772,965	778,240	743,934	717,087
Net income	29,220	35,885	37,555	18,581
	December 31 2012 $	**September 30 2012 $**	**June 30 2012 $**	**March 31 2012 $**
Revenues	691,847	751,270	709,700	699,660
Costs	652,274	693,809	649,831	666,040
Net income (loss)	22,842	34,436	41,538	(12,826)

The Corporation's quarterly results are impacted by changes in revenues resulting from variations in seasonal weather conditions, the fluctuations in electricity prices, and the timing and recognition of regulatory decisions. Consequently, the Corporation's revenues, all other things being equal, would tend to be higher in the first quarter as a result of higher energy consumption for winter heating, and in the third quarter due to air conditioning/cooling. A variation in the above trend was noted in 2013 and 2012, evidenced by higher revenue and cost of purchased power in the second quarters of both years, compared to the first quarters of both years. This variation was primarily due to an increase in commodity costs (see "Electricity Distribution – Industry Overview" above).

Financial Position

The following table outlines the significant changes in the consolidated balance sheets as at December 31, 2013 as compared to the consolidated balance sheets as at December 31, 2012.

Consolidated Balance Sheet Data
(in thousands of Canadian dollars)

Balance Sheet Account	Increase (Decrease) $	Explanation of Significant Change
Assets		
Cash and cash equivalents	(76,592)	See "Liquidity and Capital Resources" below.
Accounts receivable, net of allowance for doubtful accounts	27,555	The increase was primarily due to the timing of billing and collection activities from electricity customers.
Unbilled revenue	48,786	The increase was primarily due to higher pass-through electricity commodity costs and higher consumption in December 2013 compared to December 2012.
Income tax receivable	(7,315)	The decrease was due to a favourable change in prior year reassessments received and in process.
PP&E and intangible assets, net	175,107	The increase was primarily due to the 2013 capital program expenditures and the disposition of the 2008-2010 smart meter deferral account balances (see "Smart Meters" above in the section entitled "Results of Operations – 2013 compared to 2012"), partially offset by depreciation during the period and net eligible in-service capital expenditures under ICM reclassified to regulatory assets per the direction from the OEB.
Regulatory assets	120,270	The increase was primarily due to the reclassification of ICM-related net eligible in-service capital expenditures, partially offset by the net impact of the disposition of the 2008-2010 smart meter deferral account balances (see "Smart Meters" above in the section entitled "Results of Operations – 2013 compared to 2012").

Consolidated Balance Sheet Data
(in thousands of Canadian dollars)

Balance Sheet Account	Increase (Decrease) $	Explanation of Significant Change
Deferred income tax assets	(36,713)	The decrease was due to lower net deductible temporary differences between tax and accounting values of PP&E.
Liabilities and Shareholder's Equity		
Working capital facility	19,084	The increase was due to funds drawn under the Corporation's working capital facility (see "Liquidity and Capital Resources" below).
Commercial paper	150,000	The increase was due to funds drawn under the Corporation's commercial paper program (see "Liquidity and Capital Resources" below).
Accounts payable and accrued liabilities	73,379	The increase was primarily due to higher electricity commodity costs payable to the IESO, higher capital programs, and the costs related to the Ice Storm (see "Ice Storm" above in the section entitled "Results of Operations – 2013 compared to 2012").
Restructuring accrual	(11,954)	The decrease was due to payments made against the restructuring accrual related to the workforce restructuring program initiated by the Corporation in the first quarter of 2012.
Debentures	(20,258)	The decrease was due to the repayment of $470.1 million senior unsecured debentures, offset by the issuance of $450.0 million senior unsecured debentures during the second quarter of 2013 (see "Liquidity and Capital Resources" below).
Post-retirement benefits	(15,098)	The decrease was primarily due to the actuarial gain recorded in 2013.
Regulatory liabilities	(13,676)	The decrease was primarily due to lower income tax payable to customers in the future.
Retained earnings	78,246	The increase in retained earnings was due to net income for the year ($121.2 million), partially offset by dividends paid ($43.0 million).

Liquidity and Capital Resources

Sources of Liquidity and Capital Resources

The Corporation's current assets and current liabilities amounted to $555.3 million and $696.4 million, respectively, as at December 31, 2013, resulting in a working capital deficit of $141.1 million. The deficit is due to the

Corporation's decision to utilize its commercial paper program and revolving credit facility in lieu of issuing additional debentures to fulfill the Corporation's liquidity requirements, including funding significant capital spending in the current year.

The Corporation's primary sources of liquidity and capital resources are cash provided by operating activities, issuances of commercial paper, amounts available to be drawn against its credit facilities, and borrowings from debt capital markets. The Corporation's liquidity and capital resource requirements are mainly for capital expenditures to maintain and improve the electricity distribution system of LDC, to purchase power, to meet financing obligations and for prudential requirements.

The Corporation does not believe that equity contributions from the City, its sole shareholder, will constitute a source of capital.

The City has authorized the Corporation to provide financial assistance to its subsidiaries, and LDC to provide financial assistance to other subsidiaries of the Corporation, in the form of guarantees, letters of credit, direct loans or otherwise, for the purpose of enabling them to carry on their businesses, with financial assistance provided to subsidiaries other than LDC not to exceed an aggregate amount of $500.0 million.

On December 17, 2013, the Corporation launched a commercial paper program allowing up to $400.0 million of unsecured short-term promissory notes to be issued in various maturities of no more than one year. The commercial paper program is supported by liquidity facilities available under the Corporation's revolving credit facility; hence, available borrowing under its revolving credit facility is reduced by the amount of commercial paper outstanding at any point in time. Proceeds from the commercial paper program are being used for general corporate purposes. For the three months ended December 31, 2013, the average outstanding borrowing under the commercial paper program was $33.5 million with a weighted average interest rate of 1.21%. Borrowings under the commercial paper program bear interest based on the prevailing market conditions at the time of issuance.

On September 6, 2013, the Corporation extended the maturity date of its $600.0 million revolving credit facility from October 10, 2017 to October 10, 2018. Borrowings under the revolving credit facility bear interest at short-term floating rates with reference to the Corporation's credit rating.

As at December 31, 2013, no amounts had been drawn under the revolving credit facility and $19.1 million had been drawn under the $20.0 million working capital facility. As at December 31, 2013, $50.1 million of letters of credit had been issued against the $75.0 million prudential facility. For the three months and the year ended December 31, 2013, the average outstanding borrowings on the Corporation's credit facilities, excluding the prudential facility and commercial paper, were $69.2 million and $59.2 million with weighted average interest rates of 1.81% and 2.09 %, respectively. The revolving credit facility, the working capital facility, and the prudential credit facility are summarized in note 11 to the Consolidated Financial Statements.

The Corporation filed a base shelf prospectus dated December 10, 2012 with the securities commissions or similar regulatory authorities in each of the provinces of Canada. These filings allow the Corporation to make offerings of unsecured debt securities of up to $1,500.0 million during the 25-month period following the date of the prospectus.

On April 9, 2013, the Corporation issued Series 8 ($250.0 million) and Series 9 ($200.0 million) debentures, which bear interest payable semi-annually in arrears and contain covenants which, subject to certain exceptions, restrict the ability of the Corporation and LDC to create security interests, incur additional indebtedness or dispose of all or substantially all of their assets. The Corporation may redeem all or part of the Series 8 and Series 9 debentures at any time prior to maturity at a price equal to the greater of the Canada Yield Price (determined in accordance with the terms of the debentures) and par, plus accrued and unpaid interest up to and excluding the date fixed for redemption. The net proceeds of the debentures, together with borrowings under the Corporation's revolving credit facility, were used to repay the Corporation's Series 1 and Series 5 debentures which matured on May 7, 2013 and May 6, 2013, respectively. Debt issuance costs of $2.7 million relating to the Series 8 and Series 9 debentures were deferred as other assets in the second quarter of 2013.

As at December 31, 2013, the Corporation had long-term debentures outstanding in the principal amount of $1,450.0 million. These debentures mature between 2017 and 2063. The Corporation may issue up to $1,050.0 million of additional debentures under the existing base shelf prospectus.

Credit Ratings
As at December 31, 2013

	Debentures	Commercial Paper
DBRS	A (high)	R-1 (low)
Standard & Poor's	A	-

The Corporation believes that it has sufficient available sources of liquidity and capital to satisfy working capital requirements for the next 12 months.

Consolidated Statements of Cash Flows
(in thousands of Canadian dollars)

	Three months Ended December 31		Year Ended December 31	
	2013 $	2012 $	2013 $	2012 $
Cash and cash equivalents, beginning of period	-	137,323	76,592	154,256
Net cash provided by operating activities	79,602	54,925	236,123	246,729
Net cash used in investing activities	(126,857)	(104,949)	(411,652)	(265,432)
Net cash provided by (used in) financing activities	47,255	(10,707)	98,937	(58,961)
Cash and cash equivalents, end of period	-	76,592	-	76,592

Net Cash Provided by Operating Activities

Net cash provided by operating activities for the three months and year ended December 31, 2013 was $79.6 and $236.1 million compared to $54.9 million and $246.7 million for the comparable periods in 2012.

The increase in net cash provided by operating activities for the three months ended December 31, 2013 was primarily due to lower working capital and an increase in net income.

The decrease in net cash provided by operating activities for the year ended December 31, 2013 was primarily due to higher working capital, partially offset by an increase in net income.

Net Cash Used in Investing Activities

Net cash used in investing activities for the three months and year ended December 31, 2013 was $126.9 million and $411.7 million compared to $104.9 million and $265.4 million for the comparable periods in 2012.

The increase in net cash used in investing activities for the three months ended December 31, 2013 was primarily due to higher capital expenditures in 2013.

The increase in net cash used in investing activities for the year ended December 31, 2013 was primarily due to higher capital expenditures in 2013 and the sale and maturity of investments in 2012.

Electricity distribution is a capital-intensive business. As the largest municipal electricity distribution company in Canada, LDC continues to invest in rebuilding existing aging infrastructure to address safety, reliability and customer service requirements.

LDC estimates that approximately one-third of its electricity distribution assets are past their expected useful lives. As a strategic response to meet the objective of maximizing customer and stakeholder satisfaction through providing safe and reliable service, LDC is committed to maintenance and capital expenditure requirements for distribution plant refurbishment and replacement.

The following table summarizes the Corporation's capital expenditures for the periods indicated.

Capital Expenditures
(in thousands of Canadian dollars)

	Three months Ended December 31		Year Ended December 31	
	2013 **$**	**2012** **$**	**2013** **$**	**2012** **$**
Regulated LDC				
Distribution system				
Planned	114,060	84,545	340,347	226,609
Reactive	14,132	11,529	35,002	28,775
Copeland Station	9,515	1,834	45,320	4,065
Technology assets	7,074	7,472	17,118	23,204
Other [1]	5,676	1,788	7,874	5,922
	150,457	107,168	445,661	288,575
Other [2]	1,176	1,362	4,653	3,800
Total Capital Expenditures	151,633	108,530	450,314	292,375

[1] Includes fleet capital and buildings.

[2] Includes unregulated capital expenditures primarily related to TH Energy equipment.

The total regulated capital expenditures were $150.5 million and $445.7 million for the three months and year ended December 31, 2013 compared to $107.2 million and $288.6 million for the comparable periods in 2012. For the year ended December 31, 2013, the increase in regulated capital expenditures was primarily related to planned spending on overhead infrastructure ($52.2 million), Copeland Station ($41.3 million), underground infrastructure ($24.4 million), customer connections ($22.4 million), and network infrastructure and equipment ($13.5 million).

The largest capital initiatives in 2013 include the replacement of overhead infrastructure, the replacement of underground infrastructure, the delivery of customer connections, and the construction of Copeland Station in response to the developing need for distribution solutions in the downtown core of the City.

The replacement of overhead infrastructure includes replacing poles, overhead transformers, overhead switches and other aging overhead infrastructure and equipment. The replacement of underground infrastructure includes replacing direct buried cables, transformers, handwells, and other aging underground infrastructure. Both initiatives will allow LDC to continue to provide ongoing safe and reliable service to its customers. As at December 31, 2013, the year-to-date capital expenditures for the overhead and the underground infrastructure initiatives were $78.2 million and $65.9 million, respectively.

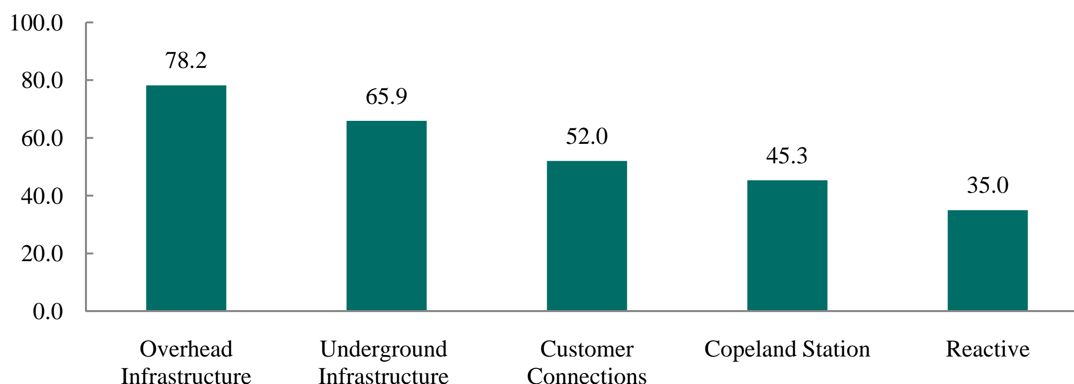
The delivery of customer connections includes spending related to new services and upgrades to existing services for specific commercial customers. For 2013, capital expenditures for the delivery of customer connections were $52.0 million, net of related capital contributions received of $23.6 million.

Copeland Station will be the first transformer station built in downtown Toronto since the 1960's and will be the second underground transformer station in Canada. When in service, the new station will provide electricity to buildings and neighbourhoods in the central-southwest region of Toronto. Between 2006 and 2011, the population in the City's downtown increased by over 50%, and Toronto is now the fourth largest metropolitan area[4], by population, in North America. Copeland Station will provide much needed additional capacity to serve current and future load requirements in this high-density, high-growth area of Toronto.

On May 22, 2013, the Corporation celebrated the official groundbreaking at the station. On February 1, 2014, the tunnel boring machine arrived on-site and was being prepared to begin tunnelling north to connect the new infrastructure to the grid. As at December 31, 2013, the capital expenditures on the Copeland Station project

[4] http://www.toronto.ca/legdocs/mmis/2013/ed/bgrd/backgroundfile-56336.pdf

amounted to $60.5 million of which $45.3 million was recorded in 2013. The total capital expenditures required to complete Copeland Station are expected to be approximately $194.9 million. All capital expenditures related to Copeland Station are recorded to PP&E.



Net Cash Provided by (Used in) Financing Activities

Net cash provided by financing activities for the three months and year ended December 31, 2013 was $47.3 million and $98.9 million compared to net cash used in financing activities of $10.7 million and $59.0 million for the comparable periods in 2012.

The increase in net cash provided by financing activities for the three months ended December 31, 2013 was primarily due to an increase in funds drawn under the Corporation's commercial paper program and working capital facility related to higher capital expenditures in 2013, partially offset by a decrease in funds drawn under the Corporation's revolving credit facility.

The increase in net cash provided by financing activities for the year ended December 31, 2013 was primarily due to funds drawn under the Corporation's commercial paper program and working capital facility related to higher capital expenditures, a decrease in customer deposits in 2012 in compliance with OEB rules and regulations, and lower dividends paid in 2013 compared to 2012. These variances were partially offset by the net effect of the payment in connection with the retirement of $470.1 million of senior unsecured debentures and the issuance of $450.0 million of senior unsecured debentures in the second quarter of 2013.

The shareholder direction adopted by the City with respect to the Corporation provides that the Board of Directors of the Corporation will use its best efforts to ensure that the Corporation meets certain financial performance standards, including those relating to the credit rating and dividends. Subject to applicable law, the shareholder direction provides that the Corporation will pay dividends to the City each year amounting to the greater of $25.0 million or 50% of the Corporation's consolidated net income for the prior fiscal year. The dividends are not cumulative and are payable as follows:

- $6.25 million on the last day of each fiscal quarter of the year; and
- the amount, if any, by which 50% of the Corporation's annual consolidated net income for the year exceeds $25.0 million, within ten days after the approval of the Corporation's audited consolidated financial statements for the year by the Board of Directors of the Corporation.

For the year ended December 31, 2013, the Board of Directors of the Corporation declared and paid dividends totalling $43.0 million to the City.

On March 19, 2014, the Board of Directors of the Corporation declared dividends in the amount of $41.87 million. The dividends are comprised of $35.62 million with respect to net income for the year ended December 31, 2013,

payable to the City on March 28, 2014, and $6.25 million with respect to the first quarter of 2014, payable to the City on March 31, 2014.

Summary of Contractual Obligations and Other Commitments

The following table presents a summary of the Corporation's debentures, major contractual obligations and other commitments.

Summary of Contractual Obligations and Other Commitments
As at December 31, 2013
(in thousands of Canadian dollars)

	Total $	2014 $	2015/2016 $	2017/2018 $	After 2018 $
Working capital facility	19,084	19,084	-	-	-
Commercial paper	150,000	150,000	-	-	-
Debentures – principal repayment	1,450,000	-	-	250,000	1,200,000
Debentures – interest payments	958,583	60,995	121,990	109,115	666,483
Operating lease obligations	20,268	6,175	11,970	2,123	-
Capital project and other commitments [1,2]	82,569	79,797	2,772	-	-
Capital lease obligations	11,418	2,537	5,074	3,807	-
AROs	7,147	2,417	377	376	3,977
Total contractual obligations and other commitments	2,699,069	321,005	142,183	365,421	1,870,460

[1] Reflect capital project commitments for construction services and estimated capital contributions, with the majority related to Copeland Station.

[2] Subsequent to December 31, 2013, the Corporation entered into capital commitments of approximately $21.0 million for capital contributions payable to Hydro One Networks Inc. over the next year in respect of Copeland Station.

Corporate Developments

Distribution Rates for LDC

Regulatory developments in Ontario's electricity industry, including current and possible future consultations between the OEB and interested stakeholders, may affect LDC's electricity distribution rates and other permitted recoveries in the future.

On May 10, 2012, LDC filed an application for electricity distribution rates for 2012, 2013, and 2014 using the IRM framework, including the filing of an ICM application (the "IRM/ICM Application").

On October 31, 2012, LDC submitted an update to its IRM/ICM Application modifying the requested capital expenditures for 2012 and 2013 to $283.0 million and $579.1 million, respectively, and requesting that consideration for 2014 be deferred to a second phase of the proceeding, once LDC had received a decision from the OEB in respect of phase one. On November 3, 2012, the OEB accepted LDC's request for a two-phase proceeding: phase one comprising LDC's 2012 and 2013 work program proposals and phase two comprising LDC's 2014 work program proposal.

On April 2, 2013, the OEB issued a partial decision and order for phase one of the proceeding comprising LDC's 2012 and 2013 work program proposals. The OEB's decision determined that eligible capital funding under the ICM framework was to be calculated on an in-service basis. This correlates to the approval of capital expenditures amounting to $203.3 million for 2012 and $484.2 million for 2013. New rates became effective June 1, 2013. In 2015, LDC will be allowed to seek recovery for capital spent in 2012 and 2013 that has not yet been approved by the OEB in the current ICM decision due to the standard operation of the regulatory model.

On August 1, 2013, LDC filed an application with the OEB requesting approval for the disposition of balances in its smart meter deferral account related to smart meter installations in 2008, 2009 and 2010. In the application, LDC requested two new rate riders effective May 1, 2014. The first rate rider relates to the recovery of $23.9 million, which represents the cumulative revenue requirement net of recoveries from an existing smart meter rate rider. This

existing smart meter rate rider would be discontinued when the new rate riders become effective. The second rate rider relates to the recovery of $9.6 million, which represents the forecasted 2014 incremental revenue requirement until LDC may be permitted to transfer the smart meter assets into rate base.

On August 19, 2013, LDC submitted an update to its IRM/ICM Application regarding its 2014 work program proposal. The filed update incorporates the OEB's guidance on the ICM methodology provided in the April 2, 2013 partial decision and order with respect to phase one of this proceeding. In phase two, LDC sought approval for total capital expenditures amounting to $398.8 million for 2014.

On December 18, 2013, LDC filed a settlement agreement with the OEB, which allowed for the entirety of LDC's requested 2014 capital program. On December 19, 2013, the OEB approved this settlement agreement. Consistent with the April 2, 2013 partial decision and order with respect to phase one, eligible capital funding under the ICM framework is to be calculated on an in-service basis. This correlates to the approval of capital expenditures amounting to $398.8 million for 2014.

On January 16, 2014, the OEB approved LDC's requested disposition of the smart meter deferral account balances, permitting the recovery of $23.9 million and $9.6 million through two separate rate riders effective May 1, 2014.

CDM Activities

On March 31, 2010, the Minister of Energy and Infrastructure of Ontario, under the guidance of sections 27.1 and 27.2 of the OEB Act, directed the OEB to establish CDM targets to be met by electricity distributors. Accordingly, on November 12, 2010, the OEB amended LDC's distribution licence to require LDC, as a condition of its licence, to achieve 1,304 GWh of energy savings and 286 MW of summer peak demand savings, over the period beginning January 1, 2011 through December 31, 2014.

Effective January 1, 2011, LDC entered into an agreement with the OPA in the amount of approximately $50.0 million to deliver CDM programs extending from January 1, 2011 to December 31, 2014. As at December 31, 2013, LDC received approximately $45.9 million from the OPA for the delivery of CDM programs. All programs to be delivered are fully funded and paid in advance by the OPA. Amounts received but not yet spent are presented under current liabilities as deferred conservation credit. Upon the expiration of the agreement, LDC is required to repay to the OPA any excess funding received for program administration less any cost efficiency incentives. These programs are expected to support the achievement of the mandatory CDM targets described above.

On December 21, 2012, the Minister of Energy of Ontario issued a direction to the OPA under subsection 25.32(4.1) of the Electricity Act to extend the funding time period for OPA-contracted province-wide CDM initiatives under the Green Energy Act framework to December 31, 2015.

OEB PILs Proceeding

The OEB conducted a review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for certain MEUs. On June 24, 2011, the OEB issued its decision for these MEUs and provided guidelines for the calculation and further disposition of the balances accumulated in the PILs regulatory variance accounts.

LDC reviewed the balance of its PILs regulatory variance accounts and applied the guidelines provided by the OEB. LDC applied for disposition of the balance as part of its IRM/ICM Application filed on May 10, 2012. The OEB issued its decision and order on April 2, 2013 approving the disposition of the balance. The impact was recorded previously in the Corporation's consolidated financial statements.

Changes to the Corporation's Board of Directors

On April 3, 2013, the City, as the sole shareholder of the Corporation, appointed David Williams, Colum Bastable, Vincent Brescia, Glenna Carr, Derek Cowbourne, Sara Gelgor, Paulette Kennedy and Isabel Meharry to the Board of Directors as independent directors of the Corporation. Their appointments were effective April 15, 2013 for a term ending April 14, 2015 or until their successors are appointed. On April 3, 2013, the City also nominated David Williams as Chairman of the Corporation. Mr. Williams was appointed Chairman by the Corporation's Board of Directors effective April 15, 2013 for a term ending April 14, 2015 or until his successor is appointed.

Effective January 1, 2013, the City, as the sole shareholder of the Corporation, appointed councillor Gloria Lindsay Luby to the Board of Directors of the Corporation to replace councillor Ron Moeser and also re-appointed each of councillor Josh Colle, as the Mayor's designate, and councillor Shelley Carroll to the Board of Directors of the Corporation. Their appointments are effective for a term ending November 30, 2014 or until their successors are appointed.

Labour Agreement

On February 13, 2014, CUPE One ratified collective agreements governing inside and outside employees for a four-year period expiring January 31, 2018. The collective agreements implemented a wage increase of 1.5% on February 1, 2014 and provide for general wage increases of 1.75% effective February 1, 2015, 1.75% effective February 1 2016, and 2% effective February 1, 2017. The collective agreements also contain cost of living escalator clauses that provide for wage adjustments corresponding to the percentage change in the consumer price index. The escalator clauses only become effective if certain prescribed thresholds are exceeded.

Legal Proceedings

In the ordinary course of business, the Corporation is subject to various legal actions and claims with customers, suppliers, former employees and other parties. On an ongoing basis, the Corporation assesses the likelihood of any adverse judgments or outcomes as well as potential ranges of probable costs and losses. A determination of the provision required, if any, for these contingencies is made after an analysis of each individual issue. The provision may change in the future due to new developments in each matter or changes in approach, such as a change in settlement strategy. If damages were awarded under these actions, the Corporation and its subsidiaries would make a claim under their liability insurance which the Corporation believes would cover any damages which may become payable by the Corporation and its subsidiaries in connection with these actions. See note 22 (a) to the Consolidated Financial Statements for a discussion of material legal proceedings.

Share Capital

The authorized share capital of the Corporation consists of an unlimited number of common shares without par value, of which 1,000 common shares are issued and outstanding as at the date hereof.

Transactions with Related Parties

As a wholly-owned subsidiary of the City, the Corporation and the City are considered related parties. All transactions with the City are conducted on terms similar to those offered to unrelated parties.

Summary of Transactions with Related Parties
(in thousands of Canadian dollars)

	Year Ended December 31	
	2013 **$**	**2012** **$**
Revenues	246,894	222,032
Operating expenses and capital expenditures	31,861	26,259
Dividends	42,995	47,966

Summary of Amounts Due to/from Related Parties
(in thousands of Canadian dollars)

	As at December 31	
	2013 $	2012 $
Accounts receivable	5,579	7,810
Unbilled revenue	19,425	17,018
Accounts payable and accrued liabilities	45,472	38,020
Advance deposits	8,816	8,926

Revenues represent amounts charged to the City primarily for electricity, street lighting and ancillary services. Operating expenses and capital expenditures represent amounts charged by the City for purchased road cut repairs, property taxes and other services. Dividends are paid to the City.

Accounts receivable represent receivables from the City primarily for electricity, street lighting and ancillary services. Unbilled revenue represents receivables from the City related to electricity and other services provided and not yet billed. Accounts payable and accrued liabilities represent amounts payable to the City related to road cut repairs and other services, as well as amounts received from the City for the construction of electricity distribution assets. Advance deposits represent amounts received from the City for future expansion projects.

Controls and Procedures

For purposes of certain Canadian securities regulations, the Corporation is a "Venture Issuer". As such, it is exempt from certain of the requirements of National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings. Accordingly, the Chief Executive Officer and Chief Financial Officer have reviewed the Consolidated Financial Statements and the MD&A for the three months and year ended December 31, 2013. Based on their knowledge and exercise of reasonable diligence, they have concluded that these documents fairly present in all material respects the financial condition, results of operations and cash flows of the Corporation for the periods presented.

Risk Management and Risk Factors

The Corporation faces various risks that could impact the achievement of its strategic objectives. It adopts an enterprise wide approach to risk management, achieved through a process of consolidating and aligning the various views of risk across the enterprise via a risk governance structure. The Corporation executes its ERM activities via an ERM framework that is aligned to industry best practices and international guidelines. The Corporation views ERM as a management activity undertaken to add value and improve overall operations. It helps the Corporation by enabling the attainment of its strategic goals and objectives through a systematic, disciplined approach towards identifying, evaluating, treating, monitoring and reporting of risks. Accordingly, ERM is an integral part of the strategic management of the Corporation and is routinely considered in forecasting, planning and executing all aspects of the business.

The ERM framework is operationalized by a consistent, disciplined methodology that clearly defines the risk management process which incorporates subjective elements, risk quantification and risk interdependencies.

While the Corporation's philosophy is that ERM is the responsibility of all business units, at all levels, in matters strategic and operational, the ERM governance structure is comprised of three key levels.

At the top level is the Board of Directors, who works to maintain a general understanding of the risk categories, the types of risks to which the Corporation may be exposed and the practices used to identify, assess, measure and manage those risks. Quarterly, the Board of Directors reviews the Corporation's risk profile, a list of key risks together with treatment activities that represents the greatest threats to meeting the Corporation's strategic objectives.

The second level is the ROC, a lead body to ensure systems are in place to identify, manage, and monitor risks. Through its review of reports from the business and other areas, the ROC assesses the appropriateness and consistent application of systems to manage risks within the Corporation. The ROC also ensures that key risks are brought forward to the attention of the Board and for action by executive management.

Finally, the third level is the Risk Forum. The Risk Forum supports the ROC and is a collection of subject matter experts from across the Corporation who actively engage in the day to day management of risks. Working with the ROC, the Risk Forum oversees the Corporation's risk profile, its performance against the defined risk appetite and determines appropriate risk responses. They also work to ensure effective, efficient, complete and transparent risk reporting to the ROC.

The Corporation is subject to a variety of risks including those described below:

Regulatory Developments

Ontario's electricity industry regulatory developments and policy changes may affect the electricity distribution rates charged by LDC and the costs LDC is permitted to recover. This may in turn have a material adverse effect on the financial performance of the Corporation and/or its ability to provide reliable service to its customers. In particular, there can be no assurance that:

- the OEB will approve LDC's electricity distribution rates under the RRFE, at levels that will permit LDC to carry out its planned capital work programs required to maintain safe and reliable service to its customers and earn the allowed rate of return on the investment in the business;
- the regulatory instruments that arise from the RRFE will be sufficient to address LDC's operations, needs and circumstances in respect of future applications for electricity distribution rates;
- the OEB will not set a lower recovery for LDC's cost of capital;
- the full cost of providing service to distribution customers will be permitted to be recovered through LDC's electricity distribution rates;
- the OEB will not permit competitors to provide distribution services in LDC's licensed area, or permit loads within LDC's service area to become electrically served by a means other than through LDC's electricity distribution system;
- the OEB will allow recovery for revenue lost as a consequence of unanticipated effects of CDM;
- parts of LDC's services will not be separated from LDC and opened to competition; or
- regulatory or other changes will not be made to the PILs regime.

Changes to any of the laws, rules, regulations and policies applicable to the businesses carried on by the Corporation could also have a significant impact on the Corporation. There can be no assurance that the Corporation will be able to comply with applicable future laws, rules, regulations and policies. Failure by the Corporation to comply with applicable laws, rules, regulations and policies may subject the Corporation to civil or regulatory proceedings that may have a material adverse effect on the Corporation.

Any future regulatory decision to disallow or limit the recovery of costs could lead to potential asset impairment and charges to results from operations, which could have a material adverse effect.

Condition of Distribution Assets

LDC estimates that approximately one-third of its electricity distribution assets are past their expected useful lives. LDC's ability to continue to provide a safe work environment for its employees and a reliable and safe distribution service to its customers and the general public will depend on, among other things, the OEB allowing recovery of costs in respect of LDC's maintenance program and capital expenditure requirements for distribution plant refurbishment and replacement.

LDC is focused on overcoming the above challenges and executing its maintenance program. However, if LDC is unable to carry out these plans in a timely and optimal manner, equipment performance will degrade which may compromise the reliability of distribution assets, the ability to deliver sufficient electricity and/or customer supply security and increase the costs of operating and maintaining these assets.

Information Technology Infrastructure

LDC's ability to operate effectively is in part dependent on the development, maintenance and management of complex information technology systems. Computer systems are employed to operate LDC's electricity distribution system and financial, billing and business systems to capture data and to produce timely and accurate information. Failures of any one of the financial, business and operating systems could have a material adverse effect on the Corporation's business, operating results, financial condition and prospects. The Corporation mitigates this risk through various methods including the use of security event management tools on its distribution and business systems, by separating the electricity distribution system from the business systems and by providing company-wide awareness training to personnel.

LDC's electricity distribution infrastructure and technology systems are also potentially vulnerable to damage or interruption from cyber attacks, which could have an adverse impact on its operations, financial conditions, brand and reputation. While LDC has implemented preventative measures to monitor and protect against cyber attacks and mitigate their effects, there can be no assurance that such measures will be completely effective in protecting LDC's electricity distribution infrastructure or assets from a cyber attack or the effects thereof.

Natural and Other Unexpected Occurrences

LDC's operations are exposed to the effects of natural and other unexpected occurrences, such as severe or unexpected weather conditions, terrorism and pandemics. In the current year, the City experienced two severe weather events, one of which (see "Ice Storm" above in the section entitled "Results of Operations – 2013 compared to 2012") had a significant financial impact. Although LDC's facilities and operations are constructed, operated and maintained to withstand such occurrences, there can be no assurance that they will successfully do so in all circumstances. Any major damage to LDC's facilities or interruption of LDC's operations arising from these occurrences could result in lost revenues and repair costs that can be substantial. Although the Corporation has insurance, if it sustained a large uninsured loss caused by natural or other unexpected occurrences, LDC would apply to the OEB for the recovery of the loss related to the electricity distribution system. There can be no assurance that the OEB would approve, in whole or in part, such an application.

Electricity Consumption

LDC's electricity distribution rates are comprised of a fixed charge and a usage-based (consumption) charge. The volume of electricity consumed by LDC's customers during any period is governed by events largely outside LDC's control (e.g., principally sustained periods of hot or cold weather could increase the consumption of electricity, sustained periods of mild weather could decrease the consumption of electricity and general economic conditions could affect overall electricity consumption). Accordingly, there can be no assurance that LDC will earn the revenue requirement approved by the OEB.

Economic conditions could also lead to lower overall electricity consumption, particularly in the commercial customer segment, which is estimated to be the most sensitive to economic changes. Lower electricity consumption from customers could negatively impact LDC's revenue. On an annual basis, the Corporation estimates that a decrease of 1% in electricity consumption would reduce net revenue by approximately $3.5 million.

Market and Credit Risk

LDC is subject to credit risk with respect to customer non-payment of electricity bills. LDC is permitted to mitigate the risk of customer non-payment using any means permitted by law, including security deposits (including letters of credit, surety bonds, cash deposits or lock-box arrangements, under terms prescribed by the OEB), late payment penalties, pre-payment, pre-authorized payment, load limiters or disconnection. In the event of an actual payment default and a corresponding bad debt expense incurred by LDC, approximately 80% of the expense would be related to commodity and transmission costs and the remainder to LDC's distribution revenue. While LDC would be liable for the full amount of the default, there can be no assurance that the OEB would allow recovery of the bad debt expense from remaining customers. Established practice in such cases is that the OEB would examine any electricity distributor's application for recovery of extraordinary bad debt expenses on a case-by-case basis.

The Corporation is exposed to fluctuations in interest rates for the valuation of its post-retirement benefit obligations. The Corporation estimates that a 1% (100 basis point) increase in the discount rate used to value these obligations would decrease the accrued benefit obligation, as at December 31, 2013, by approximately $37.0 million, and a 1% (100 basis point) decrease in the discount rate would increase the accrued benefit obligation, as at December 31, 2013, by approximately $45.5 million.

As at December 31, 2013, aside from the valuation of its post-retirement benefit obligations, the Corporation was exposed to interest rate risk predominately from short-term borrowings under its commercial paper program, while most of its remaining obligations were either non-interest bearing or bear fixed interest rates, and its financial assets were predominately short-term in nature and mostly non-interest bearing. The Corporation estimates that a 100 basis point increase (decrease) in short-term interest rates, with all other variables held constant, would result in an increase (decrease) of approximately $2.1 million to annual net financing charges.

Additional Debt Financing and Credit Rating

Cash generated from operations, after the payment of expected dividends, is not expected to be sufficient to repay existing indebtedness, fund capital expenditures and meet other obligations. The Corporation relies on debt financing through its medium-term note program, commercial paper program or existing credit facilities to repay existing indebtedness, finance the Corporation's daily operations, and fund capital expenditures. The Corporation's ability to arrange sufficient and cost-effective debt financing could be adversely affected by a number of factors, including financial market conditions, the regulatory environment in Ontario, the Corporation's results of operations and financial condition, the ratings assigned to the debentures issued under the Corporation's medium-term note program by credit rating agencies, the current timing to maturity of the Corporation's debentures, the availability of the commercial paper market, and general economic conditions. See notes 11 and 13 to the Consolidated Financial Statements.

Should the Corporation's credit rating from both credit rating agencies fall below "A (minus)" with stable outlook (S&P) and "A (low)" with stable trend (DBRS), the Corporation and its subsidiaries may be required to post additional collateral with the IESO.

Work Force Renewal

Over the next decade, a significant portion of LDC's employees will become eligible for retirement, including potential retirements occurring in supervisory, trades and technical positions. Accordingly, LDC will be required to attract, train and retain skilled employees. There can be no assurance that LDC will be able to attract and retain the required workforce.

Labour Relations

The Corporation's ability to operate successfully in the electricity industry in Ontario will continue to depend in part on its ability to make changes to existing work processes and conditions to adapt to changing circumstances. The Corporation's ability to make such changes, in turn, will continue to depend in part on its relationship with its labour unions and its ability to develop plans and approaches that are acceptable to its labour unions. There can be no assurance that the Corporation will be able to secure the support of its labour unions.

Insurance

Although the Corporation maintains insurance, there can be no assurance that the Corporation will be able to obtain or maintain adequate insurance in the future at rates it considers reasonable or that insurance will continue to be available. In addition, there can be no assurance that available insurance will cover all losses or liabilities that might arise in the conduct of the Corporation's business. The Corporation self-insures against risks (e.g., business interruption and physical damage to certain automobiles). The occurrence of a significant uninsured claim or a claim in excess of the insurance coverage limits maintained by the Corporation could have a material adverse effect on the Corporation's results of operations and financial position.

Conflicts of Interest

The City owns all of the outstanding shares of the Corporation and has the power to determine the composition of the Board of Directors of the Corporation and influence the Corporation's major business and corporate decisions, including its financing programs and dividend payments. A conflict may arise between the City's role as the sole

shareholder of the Corporation and its role as the administrator of the City's budget and other matters for the residents of the City.

Change of Ownership

The City may decide to sell all or part of the Corporation. In the case of such event, depending on the nature of the transaction, the Corporation's credit ratings could be negatively affected.

Real Property Rights

Certain terminal stations and municipal sub-stations of LDC are located on lands owned by the Province, the City and others. In some cases, LDC does not have and may not be able to obtain formal access agreements with respect to such facilities. Failure to obtain or maintain access agreements could adversely affect LDC's operations.

LDC Competition

In the past, there had been one electricity distributor in each region of Ontario. Under the current regulatory regime, a person must obtain a licence from the OEB in order to own and operate an electricity distribution system. LDC has the right to distribute electricity in the City. Although the distribution licence specifies the area in which the distributor is authorized to distribute electricity, unless otherwise provided, the licence does not provide exclusive distribution rights for such area.

The Corporation believes that the complexities and potential inefficiencies that would be created by having multiple electricity distributors authorized to serve a single area are likely to result in the continuation of the practice of having a single electricity distributor authorized to serve a single area. In addition, the Corporation believes that there are significant barriers to entry with respect to the business of electricity distribution in Ontario, including the cost of maintaining an electricity distribution system, OEB regulation of electricity distribution rates and the level of regulatory compliance required to operate an electricity distribution system. However, the Corporation recognizes that more than one distribution licence could be issued for the same area and there is a possibility that in the future some business functions or activities could be separated from LDC and made open to competition from non-regulated business entities, or that defined geographical areas within LDC's service area may be electrically supplied by a means other than through LDC's electricity distribution system.

Non-GAAP Financial Measures

The Corporation's MD&A includes references to "net revenues", which is a non-GAAP financial measure. The definition of net revenues is revenue minus the cost of purchased power. This measure does not have any standard meaning prescribed by US GAAP and is not necessarily comparable to similarly titled measures of other companies. The Corporation uses this measure to assess its performance and to further make operating decisions. Users of the MD&A utilize this measure to assess the Corporation's financial performance from ongoing operations.

Critical Accounting Estimates

The preparation of the Corporation's Consolidated Financial Statements in accordance with US GAAP requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses for the year. The estimates are based on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. Actual results may differ from these estimates and judgments under different assumptions or conditions.

The following critical accounting estimates involve significant estimates and judgments used in the preparation of the Consolidated Financial Statements:

Revenue Recognition

Revenue from the sale of electricity is recorded on the basis of cyclical billings and includes an estimated amount for electricity delivered and not yet billed, the amount of which is impacted by energy demand, customer class usage patterns and composition, and weather conditions. Revenue related to eligible capital expenditures under the ICM

framework is recognized on the basis of in-service assets. Other revenues, which include revenues from electricity distribution related services, revenues from the delivery of street lighting services and revenues from demand billable activities, are recognized as the services are rendered.

Regulatory Assets and Liabilities

As at December 31, 2013, regulatory assets amounted to $241.5 million and were primarily related to the reclassification of ICM-related net eligible in-service capital expenditures and timing differences in the recognition of actuarial losses and prior service costs of post-retirement benefits. As at December 31, 2013, regulatory liabilities amounted to $183.1 million and were primarily related to deferred income tax assets payable to customers. These assets and liabilities can be recognized for rate-setting and financial reporting purposes only if the OEB directs the relevant regulatory treatment or if future OEB direction is judged to be probable. In the event that the disposition of these balances was assessed to no longer be probable, the balances would be recorded in the Corporation's consolidated statements of net income and comprehensive income in the period that the assessment is made. The measurement of regulatory assets and liabilities is subject to certain estimates and assumptions, including assumptions made in the interpretation of the OEB's regulations and decisions.

Employee Future Benefits

Employee future benefits other than pension provided by the Corporation include medical, dental and life insurance benefits, and accumulated sick leave credits. These plans provide benefits to employees when they are no longer providing active service. The accrued benefit obligation and net periodic benefit cost are calculated by independent actuaries using the projected unit credit method and based on assumptions that reflect management's best estimate. The assumptions were determined by management recognizing the recommendations of the Corporation's actuaries. There could be no assurance that actual employee future benefits cost will not differ significantly from the estimates calculated using management's assumptions.

Asset Retirement Obligations

The Corporation recognizes a liability for the future removal and handling costs for contamination in distribution equipment and for the future environmental remediation of certain properties. The liability is recognized when an ARO is incurred and when the fair value can be reasonably estimated. AROs amounted to $6.3 million as at December 31, 2013 compared to $5.1 million as at December 31, 2012. See notes 4 (n) and 15 to the Consolidated Financial Statements.

Significant Accounting Policies

The Consolidated Financial Statements of the Corporation have been prepared in accordance with US GAAP and are presented in Canadian dollars. In preparing the Consolidated Financial Statements, management makes estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements, and the reported amounts of revenues and expenses for the year. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Ministry of Energy of Ontario, or the Ministry of Finance of Ontario. The significant accounting policies of the Corporation are summarized in notes 2 and 4 to the Consolidated Financial Statements.

Adoption of New Accounting Pronouncements

In December 2011, the FASB issued ASU No. 2011-11, "Balance Sheet (Topic 210): *Disclosures about Offsetting Assets and Liabilities*". The amendments require an entity to disclose both gross and net information about financial instruments and transactions eligible for offset in the consolidated balance sheets. ASU No. 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. Retrospective application is required. The ASU No. 2013-01, "Balance Sheet (Topic 210): *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*", was issued in January 2013 to amend the scope of ASU No. 2011-11 to clarify that the disclosure requirements are limited to derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions that are either offset in the consolidated balance sheets or subject to enforceable master netting arrangements or similar agreements. The adoption of these amendments did not have an impact on the Corporation's consolidated balance sheets and related disclosures.

Future Accounting Pronouncements

On July 21, 2011, the OSC granted an exemption to allow the Corporation to prepare its consolidated financial statements in accordance with US GAAP for its fiscal years beginning on or after January 1, 2012 but before January 1, 2015. In the absence of the exemption, the Corporation would have previously been required to adopt IFRS on January 1, 2012. On March 19, 2014, the Board of Directors of the Corporation approved the adoption of IFRS for the year beginning on January 1, 2015 due to the pending expiration of the exemption. Accordingly, the Corporation's consolidated financial statements for 2015 are expected to be prepared in accordance with IFRS and applied retrospectively to the Corporation's opening IFRS consolidated statement of financial position as at January 1, 2014.

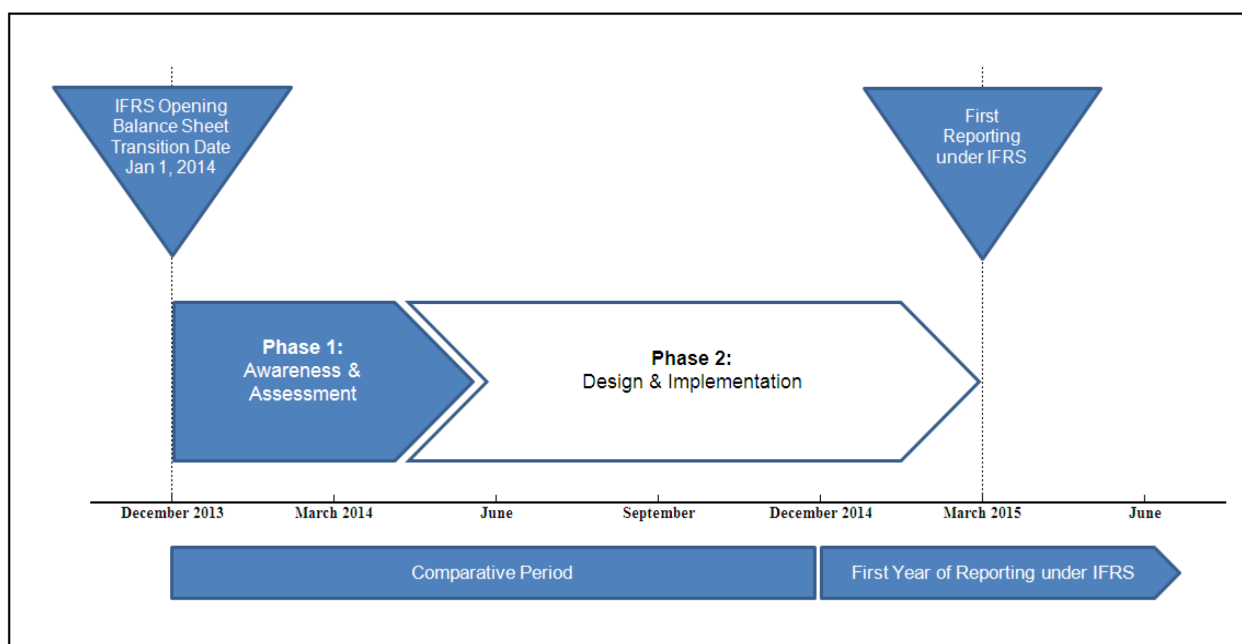
The Corporation has an internal initiative to govern the conversion process and is currently in the process of evaluating the potential impact of the conversion to IFRS on its consolidated financial statements. The Corporation believes that the impact on its financial statements could be material.

IFRS Conversion Project

As a result of above decision, the Corporation has re-initiated its IFRS conversion project, which was previously suspended as a result of the Corporation's decision to adopt US GAAP. The Corporation established a formal project governance structure. This structure includes a steering committee consisting of senior levels of management from finance, information technology and operations, among others. Regular progress reports are provided to senior executive management.

The Corporation's project consists of two phases:

1) the awareness and assessment phase; and
2) the design and implementation phase.



The Corporation updated its awareness and initial assessment during the fourth quarter of 2013. During the initial assessment it was determined that the areas of accounting differences with the highest potential impact to the Corporation are accounting for PP&E, PILs, employee future benefits, regulatory deferral accounts, as well as initial adoption of IFRS under the provisions of IFRS 1, First-time Adoption of IFRS ("IFRS 1"). The Corporation next updated the detailed assessment of accounting and disclosure differences which is expected to be completed in the first quarter of 2014. In parallel, a detailed assessment of the impact of the IFRS conversion on the Corporation's systems, processes and controls as well as other business, regulatory and tax impacts is also in process. During the awareness and assessment phase, the Corporation established a communication plan and a staff-training plan.

The Corporation has not yet started the design and implementation phase of the project. The design phase will involve establishing issue-specific working groups in each of the identified risk areas. The working groups will establish key milestones which include developing recommendations, analyzing financial system and internal control impacts, developing significant accounting policies, and carrying out ongoing discussions with external auditors, in each area. Based on the outcomes of each working group, the Corporation is currently determining the projected impacts of adopting IFRS on its financial statements after considering the options available under IFRS 1.

The roll-out of the changes developed in the design phase will take place during the implementation phase and involve the development of new accounting policies and accounting manuals and the associated training for the finance and operational teams, testing the effectiveness of the changes made to systems, a simulation of the financial reporting process, preparation of opening balance sheet on transition date and related reconciliations, assessing the ongoing impacts on the IFRS financial statements and related disclosures.

The Corporation has revised its project plan to reflect the necessary work involved in determining the impacts of adopting IFRS at the new adoption date of January 1, 2015. The following table provides certain key activities of the changeover plan and an assessment of the Corporation's progress at this time. This information reflects the Corporation's most recent assumptions and expectations. Circumstances may arise such as changes in IFRS, regulations, or economic conditions, which would affect these assumptions or expectations.

Key Activities	Status
Accounting policies & procedures:	
• High level review of major differences between US GAAP and IFRS • Establish issue-specific working groups in the identified risk areas • Detailed assessment of accounting and disclosure differences, accounting policy choices and IFRS 1 elections available • Develop recommendations and accounting policies through ongoing discussions with external auditors • Finalize new accounting policies and accounting manuals	• All accounting policy positions are in process • Final approval of the policies will be finalized in 2014 • Continue to monitor ongoing IASB projects and assess potential impacts • Accounting policies and procedure manuals continue to be updated based on the IASB project developments
Financial statements preparation:	
• Identify US GAAP to IFRS financial statements presentation differences and design interim and annual financial statements formats and related notes disclosures • Simulate the financial reporting process under IFRS • Prepare the opening balance sheet on the date of transition and IFRS 1 related reconciliations and disclosures • Assess ongoing impacts on the IFRS financial statements and related disclosures	• Developed drafted financial statements formats • Started testing of system related modifications to IFRS generated financial statements • Preparation of the opening balance sheet on transition date is in progress
Training & communication:	
• Provide training to affected finance and operational teams, management and the Board of Directors, and relevant committees thereof, including the audit committee • Develop and execute staff training plan, and roll out communication initiatives • Continue to update audit committee and senior management on a quarterly basis for key developments in IFRS and the potential impacts to the Corporation's financial statements	• Completed detailed training for resources directly engaged in the changeover and general awareness training to broader group of finance employees • Started topic-specific and relevant training to finance and operational teams on all finalized positions. Key areas include PP&E, PILs, employee benefits, provisions, capital contributions, borrowing costs and financial statement presentation • Continue ongoing, periodic internal and external communications on the Corporation's progress on the IFRS project and direction • Develop staff training plans with respect to regulatory deferral accounts

Key Activities	Status
Business impacts:	
• Evaluate impacts and implement necessary changes to debt covenants, internal performance measures, contracts and processes	• Impacts to debt covenants, regulatory and other business processes are being assessed
Information technology systems:	
• Analysis of financial system to identify required modifications • Test the effectiveness of the changes made to systems • Ensure solution captures financial information under US GAAP and IFRS during the year of transition for comparative reporting purposes	• Completed system changes for reporting purposes including subledger configurations for derecognition and depreciation on a component level. Further changes to information systems are to be made based upon the changes required to meet the regulatory deferral account standard • Complete the modifications to the system to accommodate the new transition date of January 1, 2014 and begin to accumulate IFRS data for reporting comparative information • Continue to implement remaining required modifications to financial systems
Control environment:	
• Detailed assessment of the impact of IFRS conversion on people, systems, processes and internal controls • Analyze and update internal control processes and documentation • Implement related controls and procedures to ensure the integrity and effectiveness of internal controls over financial reporting (“ICFR”) and disclosure controls and procedures (“DC&P”)	• Based on the accounting policies and procedures developed, the Corporation continues to evaluate and document the impacts on new and existing controls to ensure the integrity and effectiveness of ICFR and DC&P • Additional controls may be required to address first-time IFRS adoption and new processes implemented to support ongoing IFRS reporting requirements. These controls will be implemented and tested on a timely basis for reporting under IFRS in 2015.

In general, a first-time adopter is required to apply the IFRS standards retrospectively and recognize any consequential adjustments in retained earnings. IFRS 1 contains all of the transitional requirements applicable for the first-time adoption of IFRS. Several mandatory and optional exemptions to the retrospective application are available. The Corporation has considered the impacts of IFRS 1 and an initial assessment has been made as to which exemptions would be elected upon transition. At this time, the impact on the Corporation’s future financial position and results of operations is not reasonably determinable. In addition, during the year of 2014 until the transition, changes to IFRS may impact exemptions available for first-time adopters, and in turn, may change the Corporation’s original assessments and policy selections.

The Corporation has completed a detailed assessment of the accounting and disclosure differences between US GAAP and IFRS and identified the following areas as having the potential to materially impact the consolidated financial statements on the date of transition to IFRS and post-IFRS implementation.

Risk Areas	Key Differences IFRS vs. US GAAP	Potential Key Impacts
IAS 12 - Income Taxes	IAS 12 requires that a deferred tax asset is recognized to the extent it is probable that it will be realized - i.e. a net approach, whereas US GAAP allows all deferred tax assets being recognized and a valuation allowance being recognized to the extent that it is more likely than not that the deferred tax assets will not be realized - i.e. a gross approach.	Currently a valuation allowance has been established for certain capital loss carry forwards and allowed tax depreciation under US GAAP. All other deferred tax assets are considered more likely than not to be realized. The impact of adopting IAS 12 is one of disclosure only as the net deferred tax assets recorded would be similar under both standards.
IAS 16 - PP&E	IAS 16 requires that the estimates of useful life and residual value, and the method of depreciation, are reviewed at a minimum at each annual reporting period. Any changes are accounted for prospectively as a change in estimate. The carrying amount of an item of PP&E shall be derecognized upon disposal or when no future economic benefits are expected. The gain or loss arising from the derecognition of an item of PP&E shall be included in profit or loss (unless IAS 17 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.	As a result of adoption of IAS 16, useful lives and residual value will need to be reviewed annually. The Corporation will be derecognizing all items of PP&E as soon as they are taken out of service. PP&E will decrease with a corresponding increase to depreciation expense.

Risk Areas	Key Differences IFRS vs. US GAAP	Potential Key Impacts
IAS 19 - Employee Benefits	IAS 19 does not specify whether an entity should distinguish current and non-current portions related to post-employment benefits. Under US GAAP, the amount of the actuarial present value of benefits included in the benefit obligation which is expected to be paid in the next 12 months is classified as current. Actuarial gains or losses of defined benefit plans are recognized immediately in OCI and cannot be recycled into profit or loss. The corridor method, which is permitted under US GAAP has been eliminated under IFRS. For other long-term benefits other than post-employment benefits, IAS 19 requires benefits that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service to be classified as current. Under IFRS, short-term benefits that accumulate are recognized even when the benefit is non-vested, as opposed to US GAAP, in which recognition of such benefits is permitted but not mandatory.	Based on preliminary assessments, the Corporation will elect to account for all post-employment benefits as non-current under IFRS. All actuarial gains and losses related to post-employment benefits will be recognized immediately into OCI under IFRS and will not be allowed to be recycled to profit or loss. The Corporation's long-term benefits are not expected to be wholly settled within 12 months and therefore will remain as non-current under IFRS. As a result of adoption of IAS 19, the Corporation will need to accrue for the required employee benefits liability.
IAS 23- Borrowing Costs	The core principle of IAS 23 is that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as an expense in the period in which they are incurred. Borrowing costs under IFRS are calculated using the weighted average interest rate of the Corporation's general borrowings, including borrowing costs previously capitalized, as opposed to the OEB prescribed rate on a simple interest basis permitted under US GAAP. Borrowing costs should also be capitalized as soon as the asset meets the conditions of commencement date as opposed to the current practice, in which costs can be capitalized after the 6 month mark.	Based on preliminary assessments, it is expected that additional borrowing costs would be capitalized as a result of the adoption of IAS 23.
IAS 37 - Provisions, Contingent Assets and Liabilities	IAS 37 requires a discount rate that reflects current market assessments of the time value of money and risks specific to the liability, whereas US GAAP requires the use of a credit-adjusted risk-free rate.	Based on preliminary assessments, the impact on the date of transition when using the IFRS 1 optional exemption is an increase to decommissioning provisions, a decrease to PP&E, and a decrease to opening retained earnings.
IFRIC 18 - Transfer Assets from Customers (Capital Contributions)	IFRIC 18 does not allow for the netting of capital contributions received against items of PP&E.	Based on preliminary assessments, there will be a reclassification between PP&E, and unearned revenue liability. The capital contribution will be amortized, and recognized into revenue opposed to against depreciation under US GAAP. Presentation differences will have no impact on the net income reported.
IFRS 14 – Regulatory Deferral Accounts	The Corporation is in the process of determining key differences.	The Corporation is in the process of determining key differences.

Forward-Looking Information

The Corporation includes forward-looking information in its MD&A within the meaning of applicable securities laws in Canada. The purpose of the forward-looking information is to provide management's expectations regarding the Corporation's future results of operations, performance, business prospects and opportunities and may not be appropriate for other purposes. All forward-looking information is given pursuant to the "safe harbour" provisions of applicable Canadian securities legislation. The words "aims", "anticipates", "believes", "budgets", "committed", "could", "estimates", "expects", "focus", "forecasts", "intends", "may", "might", "plans", "projects", "schedule", "should", "strives", "will", "would" and similar expressions are often intended to identify forward-looking information, although not all forward-looking information contains these identifying words. The forward-looking information reflects management's current beliefs and is based on information currently available to the Corporation's management.

The forward-looking information in the MD&A includes, but is not limited to, statements regarding the Corporation's achievement of its strategic pillars as described in the section entitled "Corporate Strategy", the Corporation's plans to borrow funds to repay maturing debentures and to finance the investment in LDC's infrastructure and the Corporation's available sources of liquidity and capital resources and the sufficiency thereof to satisfy working capital requirements for the next 12 months as described in the sections entitled "Liquidity and Capital Resources" and "Additional Debt Financing and Credit Rating", the anticipated capacity to be provided by Copeland Station and the expected capital expenditures required to complete Copeland Station as described in the section entitled "Liquidity and Capital Resources", the ability to pay any damages in connection with legal actions and claims as described in the section entitled "Legal Proceedings", the impact of market volatility on the Corporation's consolidated results of operations, performance, business prospects and opportunities as described in the section entitled "Quarterly Results of Operations", the effect of changes in energy consumption on future revenue as described in the section entitled "Electricity Consumption", the effect of changes in interest rates and discount rates on future revenue requirements and future post-retirement benefit obligations, respectively, as described in the section entitled "Market and Credit Risk", the changes in accounting estimates as described in the section entitled "Significant Accounting Policies", and the plans in connection with the IFRS conversion project and progress of the regulatory deferral account project as described in the section entitled "Future Accounting Pronouncements". The statements that make up the forward-looking information are based on assumptions that include, but are not limited to, the future course of the economy and financial markets, the receipt of applicable regulatory approvals and requested rate orders, the receipt of favourable judgments, the level of interest rates and the Corporation's ability to borrow, and the effectiveness of a potential future transition to IFRS by the Corporation.

The forward-looking information is subject to risks, uncertainties and other factors that could cause actual results to differ materially from historical results or results anticipated by the forward-looking information. The factors which could cause results or events to differ from current expectations include, but are not limited to, market liquidity and the quality of the underlying assets and financial instruments, the timing and extent of changes in prevailing interest rates, inflation levels, legislative, judicial and regulatory developments that could affect revenues and the results of borrowing efforts.

All forward-looking information in the MD&A is qualified in its entirety by the above cautionary statements and, except as required by law, the Corporation undertakes no obligation to revise or update any forward-looking information as a result of new information, future events or otherwise after the date hereof.

TORONTO HYDRO Corporation

Selected Annual Information

The following table sets forth selected annual financial information of the Corporation for the three years ended December 31, 2013, 2012 and 2011. This information has been derived from the Consolidated Financial Statements.

Selected Annual Consolidated Financial Information
(in thousands of Canadian dollars)

	2013 $	2012 $	2011[1] $
Year Ended December 31,			
Net revenues [2]	635,281	577,268	586,929
Operating expenses [2]	271,958	245,173	262,241
Net income [2]	121,241	85,990	95,932
Capital expenditures [3]	450,314	292,375	437,067
As at December 31,			
Total assets [4]	3,797,531	3,539,354	3,527,507
Total debentures [4,5]	1,449,332	1,469,590	1,469,527
Other non-current financial liabilities [6]	15,531	16,175	27,101
Shareholder's equity [4]	1,218,518	1,140,272	1,102,248
Dividends [3]	42,995	47,966	33,063
Total debt to capitalization ratio [7]	57.0%	56.3%	57.1%
Return on equity [8]	10.3%	7.7%	9.0%

1 The Corporation's consolidated financial statements were prepared in accordance with Part V of Canadian GAAP until December 31, 2011. Selected financial information from comparative consolidated financial statements for 2011 have been adjusted retroactively from the consolidated financial statements previously filed to conform to the presentation of the Corporation's 2012 and 2013 consolidated financial statements prepared in accordance with US GAAP.

2 See "Results of Operations" for further details on net revenues, operating expenses and net income.

3 See "Liquidity and Capital Resources" for further details on capital expenditures and dividends.

4 See "Financial Position" for further details of significant changes in assets, debentures and shareholder's equity.

5 Total debentures include current and long-term debentures.

6 Other non-current financial liabilities include non-current obligations under capital lease and non-current customers' advance deposits. Under US GAAP, deposits that are due or will be due on demand within one year from the end of the reporting period have been reclassified to other current financial liabilities.

7 Total debt to capitalization ratio = (total debt) / (total debt + total shareholder's equity), where total debt = (working capital facility + commercial paper + revolving credit facility + current portion of debentures + long-term portion of debentures).

8 Return on equity = net income / average total shareholder's equity. Return on equity is measured over a 12-month period.

Additional Information

Additional information with respect to the Corporation (including its annual information form) is available on the System for Electronic Document Analysis and Retrieval website at www.sedar.com.

Toronto, Canada

March 19, 2014

CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013 and 2012

See Annual Financial Report for abbreviations used in the audited consolidated financial statements.

MANAGEMENT'S REPORT

The accompanying Consolidated Financial Statements have been prepared by management of Toronto Hydro Corporation (the "Corporation"), who are responsible for the integrity, consistency and reliability of the information presented. The Consolidated Financial Statements have been prepared in accordance with United States Generally Accepted Accounting Principles and applicable securities legislation.

The preparation of the Consolidated Financial Statements necessarily involves the use of estimates and assumptions based on management's judgments, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. Estimates and assumptions are based on historical experience, current conditions and various other assumptions believed to be reasonable in the circumstances, with critical analysis of the significant accounting policies followed by the Corporation as described in Note 4 to the Consolidated Financial Statements. The preparation of the Consolidated Financial Statements includes information regarding the estimated impact of future events and transactions. Actual results in the future may differ materially from the present assessment of this information because future events and circumstances may not occur as expected. The Consolidated Financial Statements have been prepared within reasonable limits of materiality in light of information available up to March 19, 2014.

In meeting its responsibility for the reliability of financial information, management maintains and relies on a comprehensive system of internal control and internal audit, which is designed to provide reasonable assurance that the financial information is relevant, reliable and accurate, and that the Corporation's assets are safeguarded and transactions are properly authorized and executed. The system includes formal policies and procedures and appropriate delegation of authority and segregation of responsibilities within the organization. An internal audit function evaluates the effectiveness of these internal controls and reports its findings to management and the Audit Committee of the Corporation, as required.

The Board of Directors, through its Audit Committee, is responsible for overseeing management in the performance of its financial reporting and internal controls. The Audit Committee is composed of independent directors and meets periodically with management, the internal auditors and the external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that each group has properly discharged its respective responsibility and to review the Consolidated Financial Statements before recommending approval by the Board of Directors. The Audit Committee also considers, for review by the Board of Directors and approval by the shareholder, the appointment of the external auditors. The external auditors have direct and full access to the Audit Committee, with and without the presence of management, to discuss their audit and their findings as to the integrity of the financial reporting and the effectiveness of the system of internal controls.

The Consolidated Financial Statements were reviewed by the Audit Committee, and on their recommendation, were approved by the Board of Directors. The Consolidated Financial Statements have been examined by KPMG LLP, independent external auditors appointed by the Corporation's shareholder. The external auditors' responsibility is to express their opinion on whether the Consolidated Financial Statements are fairly presented in accordance with United States Generally Accepted Accounting Principles. The attached Independent Auditors' Report outlines the scope of their examination and their opinion.

On behalf of Toronto Hydro Corporation's management:

"Anthony Haines"	*"Jean-Sebastien Couillard"*
Anthony Haines	Jean-Sebastien Couillard
President and Chief Executive Officer	Chief Financial Officer

KPMG LLP
Chartered Accountants
Bay Adelaide Centre
333 Bay Street Suite 4600
Toronto ON M5H 2S5

Telephone (416) 777-8500
Fax (416) 777-8818
Internet www.kpmg.ca

INDEPENDENT AUDITORS' REPORT

To the Shareholder of Toronto Hydro Corporation

We have audited the accompanying consolidated financial statements of Toronto Hydro Corporation, which comprise the consolidated balance sheets as at December 31, 2013 and December 31, 2012, the consolidated statements of net income and comprehensive income, shareholder's equity and cash flows for the years ended December 31, 2013 and December 31, 2012, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with United States Generally Accepted Accounting Principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Toronto Hydro Corporation as at December 31, 2013 and December 31, 2012 and its consolidated statements of net income and comprehensive income, shareholder's equity and cash flows for the years ended December 31, 2013 and December 31, 2012 in accordance with United States Generally Accepted Accounting Principles.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Canada

March 19, 2014

TORONTO HYDRO Corporation

CONSOLIDATED BALANCE SHEETS

[in thousands of Canadian dollars]

As at December 31	2013 $	2012 $
ASSETS		
Current		
Cash and cash equivalents	**-**	76,592
Accounts receivable, net of allowance for doubtful accounts *[note 16[b]]*	**202,714**	175,159
Unbilled revenue *[note 16[b]]*	**326,872**	278,086
Income tax receivable	**564**	7,879
Inventories *[note 5]*	**8,566**	7,555
Regulatory assets *[note 9]*	**7,060**	1,658
Other assets *[note 6]*	**9,538**	5,363
Total current assets	**555,314**	552,292
Property, plant and equipment, net *[note 7]*	**2,664,364**	2,526,666
Intangible assets, net *[note 8]*	**171,489**	134,080
Regulatory assets *[note 9]*	**234,424**	119,556
Other assets *[note 10]*	**14,335**	12,442
Deferred income tax assets *[note 18]*	**157,605**	194,318
Total assets	**3,797,531**	3,539,354
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Working capital facility *[note 11]*	**19,084**	-
Commercial paper *[note 11]*	**150,000**	-
Accounts payable and accrued liabilities *[note 16[b]]*	**456,750**	383,371
Restructuring accrual *[note 12]*	**-**	11,954
Customers' advance deposits	**37,293**	40,048
Deferred conservation credit	**20,671**	20,316
Debentures *[note 13]*	**-**	470,050
Post-retirement benefits *[note 14]*	**8,003**	9,925
Other liabilities *[note 21]*	**2,100**	1,850
Regulatory liabilities *[note 9]*	**2,516**	-
Total current liabilities	**696,417**	937,514
Customers' advance deposits	**7,356**	6,790
Debentures *[note 13]*	**1,449,332**	999,540
Post-retirement benefits *[note 14]*	**230,789**	243,965
Other liabilities *[note 21]*	**8,175**	9,385
Regulatory liabilities *[note 9]*	**180,617**	196,809
Asset retirement obligations *[note 15]*	**6,327**	5,079
Total liabilities	**2,579,013**	2,399,082
Commitments, contingencies and subsequent events *[notes 2, 21 and 22]*		
Shareholder's equity		
Share capital *[note 19]*	**567,817**	567,817
Retained earnings	**650,701**	572,455
Total shareholder's equity	**1,218,518**	1,140,272
Total liabilities and shareholder's equity	**3,797,531**	3,539,354

ON BEHALF OF THE BOARD:

"David Williams"
David Williams, Director

"Paulette Kennedy"
Paulette Kennedy, Director

The accompanying notes are an integral part of the consolidated financial statements.

TORONTO HYDRO Corporation

CONSOLIDATED STATEMENTS OF NET INCOME AND COMPREHENSIVE INCOME

[in thousands of Canadian dollars, except for per share amounts]

Year ended December 31	**2013 $**	**2012 $**
Revenues	**3,202,793**	2,852,477
Costs		
Purchased power	**2,567,512**	2,275,209
Operating expenses	**271,958**	245,173
Depreciation and amortization *[notes 7, 8 and 9]*	**172,756**	141,572
	3,012,226	2,661,954
Income before the following:	**190,567**	190,523
Net financing charges *[note 23]*	**(66,273)**	(73,977)
Gain on disposals of property, plant and equipment	**1,280**	1,805
Restructuring costs *[note 12]*	**-**	(27,796)
Income before income taxes	**125,574**	90,555
Income tax expense *[note 18]*	**4,333**	4,565
Net income and comprehensive income	**121,241**	85,990
Basic and fully diluted net income per share *[note 19]*	**121,241**	85,990

CONSOLIDATED STATEMENTS OF SHAREHOLDER'S EQUITY

[in thousands of Canadian dollars]

Year ended December 31	**2013 $**	**2012 $**
Share capital ***[note 19]***	**567,817**	567,817
Retained earnings, beginning of year	**572,455**	534,431
Net income	**121,241**	85,990
Dividends *[notes 19 and 20]*	**(42,995)**	(47,966)
Retained earnings, end of year	**650,701**	572,455
Total shareholder's equity	**1,218,518**	1,140,272

The accompanying notes are an integral part of the consolidated financial statements.

TORONTO HYDRO Corporation

CONSOLIDATED STATEMENTS OF CASH FLOWS

[in thousands of Canadian dollars]

Year ended December 31	**2013** **$**	**2012** $
OPERATING ACTIVITIES		
Net income	**121,241**	85,990
Adjustments for non-cash items		
Depreciation and amortization *[notes 7, 8 and 9]*	**172,756**	141,572
Post-retirement benefits	**7,620**	12,850
Deferred income taxes *[note 18]*	**(710)**	889
Gain on disposals of property, plant and equipment	**(1,280)**	(1,805)
Other	**821**	1,002
Net change in regulatory assets and liabilities *[note 9]*	**(19,518)**	11,295
Net change in other non-current assets and liabilities	**140**	(1,221)
Changes in non-cash working capital balances *[note 24]*	**(44,947)**	(3,843)
Net cash provided by operating activities	**236,123**	246,729
INVESTING ACTIVITIES		
Purchase of property, plant and equipment *[note 24]*	**(358,860)**	(260,040)
Purchase of intangible assets *[note 8]*	**(54,455)**	(42,057)
Proceeds from investments	**-**	34,000
Proceeds on disposals of property, plant and equipment	**1,663**	2,665
Net cash used in investing activities	**(411,652)**	(265,432)
FINANCING ACTIVITIES		
Increase in working capital facility *[note 11]*	**19,084**	-
Increase in commercial paper *[note 11]*	**150,000**	-
Dividends paid *[notes 19 and 20]*	**(42,995)**	(47,966)
Decrease in customers' advance deposits	**(2,189)**	(9,200)
Proceeds from debentures *[note 13]*	**449,741**	-
Debt issuance costs paid *[note 13]*	**(2,694)**	-
Repayment of debentures *[note 13]*	**(470,057)**	-
Repayment of capital lease liability	**(1,953)**	(1,795)
Net cash provided by (used in) financing activities	**98,937**	(58,961)
Net decrease in cash and cash equivalents during the year	**(76,592)**	(77,664)
Cash and cash equivalents, beginning of year	**76,592**	154,256
Cash and cash equivalents, end of year	**-**	76,592
Supplementary cash flow information		
Total interest paid	**69,908**	75,520
Total income taxes recovered	**(3,106)**	(598)

The accompanying notes are an integral part of the consolidated financial statements.

1. INCORPORATION

On June 23, 1999, the Corporation was incorporated under the *Business Corporations Act* (Ontario), and is wholly-owned by the City. The incorporation was required in accordance with the provincial government's Electricity Act.

The Corporation supervises the operations and provides corporate, management services and strategic direction to two subsidiaries incorporated under the *Business Corporations Act* (Ontario) and wholly-owned by the Corporation:

[i] LDC (incorporated June 23, 1999) – distributes electricity to customers located in the City and is subject to rate regulation. LDC is also engaged in the delivery of CDM activities; and

[ii] TH Energy (incorporated June 23, 1999) – provides street lighting services.

The principal business of the Corporation and its subsidiaries is the distribution of electricity by LDC.

2. BASIS OF PRESENTATION

These audited consolidated financial statements of the Corporation have been prepared in accordance with US GAAP with respect to the preparation of annual financial information, and are presented in Canadian dollars. The OSC granted an exemption to allow the Corporation to file financial statements under US GAAP for the years commencing on or after January 1, 2012 but before January 1, 2015.

The Corporation has evaluated the events and transactions occurring after the consolidated balance sheet date through March 19, 2014 when the Corporation's consolidated financial statements were available to be issued after the approval by the Corporation's Board of Directors, and identified the events and transactions which required recognition in the consolidated financial statements and/or disclosure in the notes to the consolidated financial statements *[notes 3, 4, 9, 14, 19, 21 and 22]*.

3. REGULATION

In April 1999, the Government of Ontario began restructuring Ontario's electricity industry. Under regulations passed pursuant to the restructuring, LDC and other electricity distributors purchase electricity from the wholesale market administered by the IESO and recover the costs of electricity and certain other costs at a later date in accordance with procedures mandated by the OEB.

The OEB has regulatory oversight of electricity matters in Ontario. The OEB Act sets out the OEB's authority to issue a distribution licence that must be obtained by owners or operators of an electricity distribution system in Ontario. The OEB prescribes licence requirements and conditions including, among other things, specified accounting records, regulatory accounting principles, separation of accounts for distribution and other activities, and requirements for rate-setting and other legal filings.

The OEB's authority and responsibilities include the power to approve and fix rates for the transmission and distribution of electricity, the responsibility to provide rate protection for rural or remote electricity customers, and the responsibility for ensuring that electricity distribution companies fulfill their obligations to connect and service customers.

LDC is required to charge its customers for the following amounts (all of which, other than distribution rates, represent a pass-through of amounts payable to third parties):

- *Commodity Charge* – The commodity charge represents the market price of electricity consumed by customers and is passed through the IESO to operators of generating stations. It includes the global adjustment, which represents the difference between the market price of electricity and the rates paid to regulated and contracted generators.

- *Retail Transmission Rate* – The retail transmission rate represents the costs incurred in respect of the transmission of electricity from generating stations to local distribution networks. Retail transmission rates are passed through to operators of transmission facilities.

- *WMS Charge* – The WMS charge represents various wholesale market support costs, such as the cost of the IESO to administer the wholesale electricity system, operate the electricity market, and maintain reliable operation of the provincial grid. Wholesale charges are passed through to the IESO.

- *Distribution Rate* – The distribution rate is designed to recover the costs incurred by LDC in delivering electricity to customers, including the OEB-allowed cost of capital. Distribution rates are regulated by the OEB and are comprised of fixed and variable (usage-based) components, based on a forecast of LDC's customers and load.

LDC is required to satisfy and maintain prudential requirements with the IESO, which include credit support with respect to outstanding market obligations in the form of letters of credit, cash deposits or guarantees from third parties with prescribed credit ratings.

a) Electricity Distribution Rates

Regulatory developments in Ontario's electricity industry, including current and possible future consultations between the OEB and interested stakeholders, may affect LDC's electricity distribution rates and other permitted recoveries in the future.

On May 10, 2012, LDC filed an application for electricity distribution rates for 2012, 2013, and 2014 using the IRM framework, including the filing of an ICM application [the "IRM/ICM Application"].

On October 31, 2012, LDC submitted an update to its IRM/ICM Application modifying the requested capital expenditures for 2012 and 2013 to $283,000,000 and $579,100,000, respectively, and requesting that consideration for 2014 be deferred to a second phase of the proceeding, once LDC had received a decision from the OEB in respect of phase one. On November 3, 2012, the OEB accepted LDC's request for a two-phase proceeding: phase one comprising LDC's 2012 and 2013 work program proposals and phase two comprising LDC's 2014 work program proposal.

On April 2, 2013, the OEB issued a partial decision and order for phase one of the proceeding comprising LDC's 2012 and 2013 work program proposals. The OEB's decision determined that eligible capital funding under the ICM framework was to be calculated on an in-service basis. This correlates to the approval of capital expenditures amounting to $203,330,000 for 2012 and $484,220,000 for 2013. New rates became effective June 1, 2013. In 2015, LDC will be allowed to seek recovery for capital spent in 2012 and 2013 that has not yet been approved by the OEB in the current ICM decision due to the standard operation of the regulatory model.

On August 1, 2013, LDC filed an application with the OEB requesting approval for the disposition of balances in its smart meter deferral account related to smart meter installations in 2008, 2009 and 2010. In the application, LDC requested two new rate riders effective May 1, 2014. The first rate rider relates to the recovery of $23,927,000, which represents the cumulative revenue requirement net of recoveries from an existing smart meter rate rider. This existing smart meter rate rider would be discontinued when the new rate riders become effective. The second rate

rider relates to the recovery of $9,631,000, which represents the forecasted 2014 incremental revenue requirement until LDC may be permitted to transfer the smart meter assets into rate base.

On August 19, 2013, LDC submitted an update to its IRM/ICM Application regarding its 2014 work program proposal. The filed update incorporates the OEB's guidance on the ICM methodology provided in the April 2, 2013 partial decision and order with respect to phase one of this proceeding. In phase two, LDC sought approval for total capital expenditures amounting to $398,780,000 for 2014.

On December 18, 2013, LDC filed a settlement agreement with the OEB, which allowed for the entirety of LDC's requested 2014 capital program. On December 19, 2013, the OEB approved this settlement agreement. Consistent with the April 2, 2013 partial decision and order with respect to phase one, eligible capital funding under the ICM framework is to be calculated on an in-service basis. This correlates to the approval of capital expenditures amounting to $398,780,000 for 2014.

On January 16, 2014, the OEB approved LDC's requested disposition of the smart meter deferral account balances, permitting the recovery of $23,927,000 and $9,631,000 through two separate rate riders effective May 1, 2014 *[note 9[c]]*.

b) CDM Activities

On March 31, 2010, the Minister of Energy and Infrastructure of Ontario, under the guidance of sections 27.1 and 27.2 of the OEB Act, directed the OEB to establish CDM targets to be met by electricity distributors. Accordingly, on November 12, 2010, the OEB amended LDC's distribution licence to require LDC, as a condition of its licence, to achieve 1,304 GWh of energy savings and 286 MW of summer peak demand savings, over the period beginning January 1, 2011 through December 31, 2014.

Effective January 1, 2011, LDC entered into an agreement with the OPA in the amount of approximately $50,000,000 to deliver CDM programs extending from January 1, 2011 to December 31, 2014. As at December 31, 2013, LDC received approximately $45,919,000 [December 31, 2012 - $35,366,000] from the OPA for the delivery of CDM programs. All programs to be delivered are fully funded and paid in advance by the OPA. Amounts received but not yet spent are presented under current liabilities as deferred conservation credit. Upon the expiration of the agreement, LDC is required to repay to the OPA any excess funding received for program administration less any cost efficiency incentives. These programs are expected to support the achievement of the mandatory CDM targets described above.

On December 21, 2012, the Minister of Energy of Ontario issued a direction to the OPA under subsection 25.32(4.1) of the Electricity Act to extend the funding time period for OPA-contracted province-wide CDM initiatives under the Green Energy Act framework to December 31, 2015.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Basis of consolidation

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

b) Regulation

The following regulatory treatments have resulted in accounting treatments which differ from US GAAP for enterprises operating in an unregulated environment:

Regulatory Assets and Liabilities

The Corporation has determined that its assets and liabilities arising from rate-regulated activities qualify for the application of regulatory accounting treatment in accordance with FASB ASC 980 – "Regulated Operations", which includes accounting principles prescribed by the OEB in the "Accounting Procedures Handbook for Electricity Distributors". Under RRA, the timing and recognition of certain expenses and revenues may differ from those otherwise expected under US GAAP in order to appropriately reflect the economic impact of regulatory decisions regarding the Corporation's regulated revenues and expenditures. These timing differences are recorded as regulatory assets and regulatory liabilities on the Corporation's consolidated balance sheets and represent existing rights and obligations regarding cash flows expected to be recovered from or refunded to customers, based on decisions and approvals by the OEB. Regulatory assets and liabilities can be recognized for rate-setting and financial reporting purposes only if the OEB directs the relevant regulatory treatment or if future OEB direction is judged to be probable. In the event that the disposition of these balances was assessed to no longer be probable, the balances would be recorded in the Corporation's consolidated statements of net income and comprehensive income in the period that the assessment is made. The measurement of regulatory assets and liabilities is subject to certain estimates and assumptions, including assumptions made in the interpretation of the OEB's regulations and decisions.

Regulatory assets and liabilities are classified as current if they are expected to be recovered from, or refunded to, customers within 12 months after each reporting period. All other regulatory asset and liability balances are classified as long-term on the consolidated balance sheets.

Allowance for funds used during construction

The OEB provides for the inclusion of an AFUDC when capitalizing construction-in-progress assets, until such time as the asset is substantially complete. A concurrent credit of the same amount is made to net financing charges when the allowance is capitalized. The interest rate for capitalization is prescribed by the OEB and modified on a periodic basis, and is applied to the balance of the construction-in-progress assets on a simple interest basis. The interest rate for capitalization for the period from January 1, 2013 to September 30, 2013 was 3.23%, and from October 1, 2013 to December 31, 2013 was 3.70% [January 1, 2012 to March 31, 2012 - 3.92%; April 1, 2012 to September 30, 2012 - 3.51%; October 1, 2012 to December 31, 2012 - 3.23%]. AFUDC is included in PP&E and intangible assets for financial reporting purposes, charged to operations through depreciation and amortization expense over the useful lives of the related assets and recovered through future revenue.

c) Cash and cash equivalents

Cash and cash equivalents include cash in bank accounts and short-term investments with terms to maturity of 90 days or less from their date of acquisition.

d) Accounts receivable

Accounts receivable are recorded at the invoiced amount and overdue amounts bear interest at OEB-approved rates. The carrying amount of accounts receivable is reduced through an allowance for doubtful accounts and the amount of the related impairment loss is recognized in the consolidated statements of net income and comprehensive income. Subsequent recoveries of receivables previously provisioned and written off are credited to the

consolidated statements of net income and comprehensive income. Management estimates uncollectible accounts receivable after considering historical loss experience and the characteristics of existing accounts.

e) Inventories

Inventories consist primarily of small consumable materials mainly related to the maintenance of the electricity distribution infrastructure. The Corporation classifies all major construction related components of its electricity distribution system infrastructure to PP&E. As prescribed by the OEB, these items are depreciated when they are acquired. Inventories are carried at the lower of cost and market, with cost determined on an average cost basis net of a provision for obsolescence.

f) Property, plant and equipment

PP&E are stated at cost. In accordance with group depreciation practices, assets in a group are not removed from the accounts on disposition and instead depreciation continues to be recorded until the asset group is fully depreciated. Readily identifiable assets are removed from the accounts at retirement or disposition. The cost of PP&E represents the original cost, consisting of direct materials and labour, contracted services, AFUDC, and overhead directly attributable to the capital project.

PP&E relating to eligible capital expenditures approved under the ICM framework for the 2012 and 2013 work program proposals are reclassified from construction in progress to regulatory assets once an asset is determined to be in-service, as directed by the OEB. The assets are then depreciated in the regulatory asset account over the estimated useful lives previously specified for PP&E. Upon final approval by the OEB and inclusion in LDC's rate base, the assets will be transferred back to PP&E.

Capital contributions received are used to finance additions to PP&E of LDC. According to the accounting principles prescribed by the OEB, capital contributions received are treated as a credit to PP&E. The amount is subsequently depreciated by a charge to accumulated depreciation and a credit to depreciation expense at an equivalent rate to that used for the depreciation of the related PP&E.

Depreciation is provided on a straight-line basis over the estimated useful lives at the following annual rates:

Distribution lines	1.7% to 5.0%
Transformers	3.3% to 5.0%
Meters	2.5% to 6.7%
Stations	2.5% to 10.0%
Buildings	1.3% to 5.0%
Rolling stock	12.5% to 25.0%
Other capital assets	4.0% to 20.0%
Equipment and tools	10.0% to 16.7%
Computer hardware	16.7% to 25.0%
Assets under capital lease	14.3% to 25.0%
Communications	10.0% to 20.0%

Construction in progress relates to assets not currently in use and therefore is not depreciated.

In the event that facts and circumstances indicate that PP&E may be impaired, an evaluation of recoverability is performed. For purposes of such an evaluation, the estimated future undiscounted cash flows associated with the asset are compared to the carrying amount of the asset to determine if a write-down is required. The impairment loss is measured as the amount by which the carrying amount of the asset exceeds its fair value, which is determined by the estimated future discounted cash flows.

g) *Intangible assets*

Effective January 1, 2012, the Corporation revised its estimate of useful life of its Customer Care and Billing Customer Information System from five years to ten years as a result of an analysis completed related to the useful life assessment. This change has been accounted for on a prospective basis in the consolidated financial statements effective January 1, 2012. The change in estimate reduced amortization expense by approximately $4,000,000 for the year ended December 31, 2012 with an offsetting increase in the carrying value of intangible assets. The change in estimate will decrease future amortization expense by $4,000,000 per year over the term of the original useful life with no impact to the final year of the original useful life, and thereafter increase future amortization expense by $4,000,000 per year.

Intangible assets are stated at cost. Amortization is provided on a straight-line basis over the estimated useful lives at the following annual rates:

Computer software	10.0% to 25.0%
Contributions	4.0%

Software in development and contributions for work in progress relate to assets not currently available for use and therefore are not amortized. Contributions represent payments made to Hydro One Networks Inc. for dedicated infrastructure in order to receive connections to transmission facilities.

In the event that facts and circumstances indicate that intangible assets may be impaired, an evaluation of recoverability is performed. For purposes of such an evaluation, the estimated future undiscounted cash flows associated with the asset are compared to the carrying amount of the asset to determine if a write-down is required. The impairment loss is measured as the amount by which the carrying amount of the asset exceeds its fair value, which is determined by the estimated future discounted cash flows.

h) *Deferred financing costs*

One-time costs incurred in relation to the Corporation's debenture offerings and costs of arranging the Corporation's revolving credit facilities are capitalized within other assets on the consolidated balance sheets. Debt issuance costs are amortized over the term of the related debentures, using the effective interest method of amortization, and are included in net financing charges. Financing costs relating to revolving credit facilities are amortized on a straight-line basis over the term of the facility, and are included in net financing charges. Transaction costs are expensed as incurred for financial instruments classified as held for trading.

i) *Restructuring*

Restructuring charges are recorded based upon planned employee termination dates, site closure and consolidation plans, and contract terminations. Restructuring charges can include severance costs to eliminate a specified number of employee positions, infrastructure charges to vacate facilities and consolidate operations, and contract cancellation costs. The timing of associated cash payments is dependent upon the type of restructuring charge and can extend over a multi-year period.

j) *Revenue recognition*

Revenue from the sale of electricity is recorded on the basis of cyclical billings and includes an estimated amount for electricity delivered and not yet billed, the amount of which is impacted by energy demand, customer class usage patterns and composition, and weather conditions. Revenue related to eligible capital expenditures under the ICM framework is recognized on the basis of in-service assets.

Other revenues, which include revenues from electricity distribution related services, revenues from the delivery of street lighting services and revenues from demand billable activities, are recognized as the services are rendered.

In the course of its operations, the Corporation collects HST from its customers. When customers are billed, a current liability for HST is recognized which corresponds to the revenue derived from the services provided by the Corporation. When expenses are incurred by the Corporation, a current asset for HST is recorded which corresponds to the expenditures derived from the goods or services received by the Corporation. The Corporation's revenues and expenses exclude HST. This net asset or liability is settled with the appropriate government authority.

k) Financial instruments

At inception, all financial instruments which meet the definition of a financial asset or financial liability are recorded at fair value, unless fair value cannot be reliably determined. Gains and losses related to the measurement of financial instruments are reported in the consolidated statements of net income and comprehensive income. Subsequent measurement of each financial instrument will depend on the consolidated balance sheet classification elected by the Corporation. The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between willing parties.

The following summarizes the accounting classification the Corporation has elected to apply to each of its significant categories of financial instruments:

Cash equivalents and short-term investments	Held for Trading
Accounts receivable and unbilled revenue	Loans and Receivables
Working capital facility, revolving credit facility and commercial paper	Other Financial Liabilities
Accounts payable and accrued liabilities	Other Financial Liabilities
Obligations under capital lease	Other Financial Liabilities
Customers' advance deposits	Other Financial Liabilities
Debentures	Other Financial Liabilities

The Corporation uses the following methods and assumptions to estimate the fair value of each class of financial instruments for which carrying amounts are included in the consolidated balance sheets:

- Cash equivalents, comprising short-term investments, are classified as "Held for Trading" and are measured at fair value. The carrying amounts approximate fair value because of the short maturity of these instruments.

- Accounts receivable and unbilled revenue are classified as "Loans and Receivables" and are measured at amortized cost, which, upon initial recognition, is considered equivalent to fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.

- Working capital facility, revolving credit facility and commercial paper are classified as "Other Financial Liabilities" and are initially measured at fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.

- Accounts payable and accrued liabilities are classified as "Other Financial Liabilities" and are initially measured at fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.

- Obligations under capital lease are classified as "Other Financial Liabilities" and are initially measured at fair value. Subsequent measurements are based on a discounted cash flow analysis and approximate the carrying value as management believes that the fixed interest rates are representative of current market rates.

- Customers' advance deposits are classified as "Other Financial Liabilities" and are initially measured at fair value. Subsequent measurements are recorded at cost plus accrued interest. The carrying amounts approximate fair value because of the short maturity of the current portion, and the long-term portion approximates the carrying value, taking into account interest accrued on the outstanding balance.

- Debentures are classified as "Other Financial Liabilities" and are initially measured at fair value. The carrying amounts of the debentures are carried at amortized cost, based on an initial fair value as determined at the time using a quoted market price for similar debt instruments. The fair value of the debentures is calculated by discounting the related cash flows at the estimated yield to maturity of similar debt instruments *[note 16[a]]*. While the Corporation has the option to redeem some or all of the debentures at its discretion, this option has no value and has not been recorded in the consolidated financial statements.

l) Fair value measurements

The Corporation utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A fair value hierarchy exists that prioritizes observable and unobservable inputs used to measure fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Corporation's assumptions with respect to how market participants would price an asset or liability. The fair value hierarchy includes three levels of inputs that may be used to measure fair value:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis;

- Level 2: Other than quoted prices included within Level 1 that are observable for the assets or liabilities, either directly or indirectly; and

- Level 3: Unobservable inputs, supported by little or no market activity, used to measure the fair value of the assets or liabilities to the extent that observable inputs are not available.

m) Employee future benefits

Multi-employer pension plan

The Corporation's full-time employees participate in a pension plan through OMERS. OMERS is a multi-employer, contributory, defined benefit pension plan established in 1962 by Ontario for employees of municipalities, local boards and school boards. Both participating employers and employees are required to make plan contributions based on participating employees' contributory earnings. The OMERS plan is accounted for as a defined contribution plan where the Corporation recognizes the expense related to this plan as contributions are made, since it is not practicable to determine the Corporation's portion of pension obligations or the fair value of plan assets. The Corporation is not responsible for any other contractual obligations other than the contributions.

Post-retirement benefits other than pension

The Corporation has a number of unfunded benefit plans providing post-retirement benefits (other than pension) to its employees. The Corporation pays certain medical, dental and life insurance benefits under unfunded defined benefit plans on behalf of its retired employees. The Corporation pays accumulated sick leave credits, up to certain established limits based on service, in the event of retirement, termination or death of certain employees.

The Corporation periodically measures its accumulated benefit obligation for accounting purposes as at December 31 of the applicable year. The latest actuarial valuation was performed as at January 1, 2012.

The cost of providing benefits under the defined benefit plans is determined using the projected unit credit method and based on assumptions that reflect management's best estimate. All actuarial gains and losses and prior service costs are recognized in OCI as they arise and subsequently reclassified to a regulatory asset on the consolidated balance sheets. This results in the full recognition of the benefit obligation as a liability on the consolidated balance sheets.

Actuarial gains and losses are amortized into net periodic benefit cost for the current period when the net cumulative unrecognized actuarial gains or losses in the regulatory asset at the end of the previous reporting period exceed 10% of the accumulated benefit obligation at that date. These gains or losses are recognized over the expected average remaining service period of active employees participating in the plans.

The prior service costs in the regulatory asset are recognized as an expense on a straight-line basis over the average remaining service period of employees active at the date of amendment.

The effects of a curtailment loss are recognized in the consolidated statements of net income and comprehensive income when its occurrence is probable and reasonably estimable. The effects of a curtailment gain are recognized in the consolidated statements of net income and comprehensive income when the related employees terminate or the plan suspension or amendment is adopted. The effects of a settlement gain or loss are recognized in the consolidated statements of net income and comprehensive income in the period in which a settlement occurs.

n) Asset retirement obligations

The Corporation recognizes a liability for the future removal and handling costs for contamination in distribution equipment and for the future environmental remediation of certain properties. Initially, the liability is measured at present value and the amount of the liability is added to the carrying amount of the related asset. In subsequent periods, the capitalized amount is depreciated over the useful life of the related asset and the liability is adjusted quarterly for the discount applied upon initial recognition of the liability ["accretion expense"] and for changes in the underlying assumptions. The liability is recognized when the ARO is incurred and when the fair value can be reasonably estimated.

The Corporation has not recorded a liability related to certain AROs as a reasonable estimate of fair value could not be made. The Corporation does not recognize an ARO for active properties that support LDC's distribution operations since it cannot reasonably determine the amount of any remediation costs related to possible contamination, and a reliable estimate cannot be made until environmental site assessments have been completed. The Corporation expects to use the majority of its installed assets in perpetuity. If, at some future date, a particular asset is shown not to meet the perpetuity assumption, it will be reviewed to determine if an ARO exists.

o) Customers' advance deposits

Security deposits from electricity customers are cash collections to guarantee the payment of electricity bills. The electricity customer security deposits liability includes related interest amounts owed to the customers with the debit charged to net financing charges. Deposits that are refundable upon demand are classified as a current liability.

Security deposits on Offers to Connect are cash collections from specific customers to guarantee the payment of additional costs relating to expansion projects. This liability includes related interest amounts owed to the customers with the debit charged to net financing charges. Deposits are classified as a current liability when the Corporation no longer has an unconditional right to defer payment of the liability for at least 12 months after the reporting period.

p) Income taxes

Under the Electricity Act, the Corporation is required to make PILs to the Ontario Electricity Financial Corporation. These payments are calculated in accordance with the ITA and the TA as modified by regulations made under the Electricity Act and related regulations. This effectively results in the Corporation paying taxes similar to what would be imposed under the Federal and Ontario Tax Acts.

The Corporation uses the liability method of accounting for income taxes. Under the liability method, current income taxes payable are recorded based on taxable income. The Corporation recognizes deferred income tax assets and liabilities for the future tax consequences of events that have been included in the consolidated financial statements or income tax returns. Deferred income tax assets and liabilities are determined based on the difference between the carrying value of assets and liabilities on the consolidated balance sheets and their respective tax basis, using the tax rates enacted by the consolidated balance sheet date that are in effect for the year in which the differences are expected to reverse. Tax benefits associated with income tax positions taken, or expected to be taken, in a tax return are recorded only when it is more likely than not that they will be realized, and are measured at the largest amount of the benefit that has a likelihood greater than 50 percent of being realized upon settlement. Deferred income tax assets are evaluated and unless realization is considered more likely than not, a valuation allowance is established.

ASC 980 requires the recognition of deferred income tax assets and liabilities and related regulatory liabilities and assets for the amount of deferred income taxes expected to be refunded to, or recovered from, customers in future electricity distribution rates. These amounts include a gross up to reflect the income tax benefits associated with reduced revenues resulting from the realization of deferred income tax assets. Deferred income taxes that are not included in the rate-setting process are charged or credited to the consolidated statements of net income and comprehensive income.

The benefits of the refundable apprenticeship and co-operative ITCs are credited against the related expense in the consolidated statements of net income and comprehensive income. All other types of ITCs are recorded as a reduction to income tax expense in the current period to the extent that realization of such benefit is more likely than not.

q) Use of estimates

The preparation of the Corporation's consolidated financial statements in accordance with US GAAP requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses for the year. The estimates are based on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities as well as identifying and assessing

the accounting treatment with respect to commitments and contingencies. Significant areas requiring the use of management estimates relate to unbilled revenue, regulatory assets and liabilities, AROs, post-retirement benefits, income taxes (including deferred income taxes), and revenue recognition. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Ministry of Energy of Ontario, or the Ministry of Finance of Ontario.

r) Adoption of New Accounting Pronouncements

In December 2011, the FASB issued ASU No. 2011-11, "Balance Sheet (Topic 210): *Disclosures about Offsetting Assets and Liabilities*". The amendments require an entity to disclose both gross and net information about financial instruments and transactions eligible for offset in the consolidated balance sheets. ASU No. 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. Retrospective application is required. The ASU No. 2013-01, "Balance Sheet (Topic 210): *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*", was issued in January 2013 to amend the scope of ASU No. 2011-11 to clarify that the disclosure requirements are limited to derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions that are either offset in the consolidated balance sheets or subject to enforceable master netting arrangements or similar agreements. The adoption of these amendments did not have an impact on the Corporation's consolidated balance sheets and related disclosures.

s) Future Accounting Pronouncements

On July 21, 2011, the OSC granted an exemption to allow the Corporation to prepare its consolidated financial statements in accordance with US GAAP for its fiscal years beginning on or after January 1, 2012 but before January 1, 2015. In the absence of the exemption, the Corporation would have previously been required to adopt IFRS on January 1, 2012. On March 19, 2014, the Board of Directors of the Corporation approved the adoption of IFRS for the year beginning on January 1, 2015 due to the pending expiration of the exemption. Accordingly, the Corporation's consolidated financial statements for 2015 are expected to be prepared in accordance with IFRS and applied retrospectively to the Corporation's opening IFRS consolidated statement of financial position as at January 1, 2014.

The Corporation has an internal initiative to govern the conversion process and is currently in the process of evaluating the potential impact of the conversion to IFRS on its consolidated financial statements. The Corporation believes that the impact on its financial statements could be material.

5. INVENTORIES

Inventories consist of the following:

	2013 $	2012 $
Fuses	**2,498**	2,137
Consumables, tools and other maintenance items	**2,024**	1,968
Drums and reels	**1,473**	1,115
Other	**2,571**	2,335
	8,566	7,555

For the year ended December 31, 2013, the Corporation recognized operating expenses of $6,936,000 related to inventory used to service electrical distribution assets [2012 - $6,934,000].

6. CURRENT PORTION OF OTHER ASSETS

Current portion of other assets consists of the following:

	2013 $	2012 $
Prepaid expenses	**8,613**	4,382
Deferred financing costs	**925**	981
	9,538	5,363

7. PROPERTY, PLANT AND EQUIPMENT

PP&E consist of the following:

	2013			2012		
	Cost $	Accumulated depreciation $	Net book value $	Cost $	Accumulated depreciation $	Net book value $
Land	**16,740**	**—**	**16,740**	16,747	—	16,747
Distribution lines	**3,115,987**	**1,548,275**	**1,567,712**	2,978,511	1,488,060	1,490,451
Transformers	**702,027**	**396,012**	**306,015**	672,981	377,900	295,081
Meters	**199,634**	**60,506**	**139,128**	243,152	133,789	109,363
Stations	**291,699**	**154,017**	**137,682**	286,229	145,601	140,628
Buildings	**172,306**	**76,793**	**95,513**	160,368	69,248	91,120
Rolling stock	**72,865**	**50,282**	**22,583**	73,239	43,834	29,405
Other capital assets	**74,188**	**52,084**	**22,104**	70,850	47,889	22,961
Equipment and tools	**47,760**	**36,194**	**11,566**	45,613	33,936	11,677
Computer hardware	**56,337**	**45,138**	**11,199**	50,511	40,003	10,508
Assets under capital lease	**13,723**	**4,836**	**8,887**	13,538	2,948	10,590
Communications	**33,092**	**28,498**	**4,594**	32,082	26,597	5,485
Construction in progress	**320,641**	**—**	**320,641**	292,650	—	292,650
	5,116,999	**2,452,635**	**2,664,364**	4,936,471	2,409,805	2,526,666

For the year ended December 31, 2013, AFUDC in the amount of $1,306,000 [2012 - $994,000] was capitalized to PP&E and credited to net financing charges.

For the year ended December 31, 2013, capital contributions in the amount of $27,501,000 [2012 - $21,309,000] were credited to PP&E.

For the year ended December 31, 2013, the Corporation recorded depreciation expense of $145,656,000 [2012 - $120,613,000], of which $1,977,000 [2012 - $1,985,000] related to assets under capital lease and $21,537,000 [2012 - $nil] related to smart meter depreciation that had been deferred *[note 9[c]]*.

8. INTANGIBLE ASSETS

Intangible assets consist of the following:

	2013			2012		
	Cost $	Accumulated amortization $	Net book value $	Cost $	Accumulated amortization $	Net book value $
Computer software	**268,389**	**198,816**	**69,573**	242,254	174,410	67,844
Contributions	**22,181**	**3,077**	**19,104**	19,649	2,175	17,474
Software in development	**11,700**	—	**11,700**	14,210	—	14,210
Contributions for work in progress	**71,112**	—	**71,112**	34,552	—	34,552
	373,382	**201,893**	**171,489**	310,665	176,585	134,080

Contributions for work in progress relate to payments made by the Corporation for connection projects to increase electricity distribution system capacity.

For the year ended December 31, 2013, AFUDC in the amount of $2,016,000 [2012 - $1,331,000] was capitalized to intangible assets and credited to net financing charges.

For the year ended December 31, 2013, the Corporation recorded amortization expense on intangible assets of $25,308,000 [2012 - $20,959,000], of which $7,196,000 [2012 - $nil] related to smart meter software amortization that had been deferred *[note 9[c]]*.

Estimated future amortization expense related to intangible assets recorded as at December 31, 2013 is as follows:

	$
2014	**19,306**
2015	**18,524**
2016	**17,029**
2017	**14,698**
2018	**10,748**

9. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

	2013 $	2012 $
ICM	**151,930**	—
Post-retirement benefits	**38,781**	61,499
Smart meters	**25,230**	55,599
Stranded meters	**16,877**	—
Settlement variances	**8,227**	1,071
RARA	**—**	2,466
Other	**439**	579
Total regulatory assets	**241,484**	121,214
Less: Current portion of regulatory assets	**7,060**	1,658
Long-term portion of regulatory assets	**234,424**	119,556

Regulatory liabilities consist of the following:

	2013 $	2012 $
Deferred income taxes	**155,853**	193,276
Revision of prior year tax position	**19,421**	—
RARA	**4,277**	—
Income and other taxes variance account	**2,432**	2,398
Other	**1,150**	1,135
Total regulatory liabilities	**183,133**	196,809
Less: Current portion of regulatory liabilities	**2,516**	—
Long-term portion of regulatory liabilities	**180,617**	196,809

For the year ended December 31, 2013, LDC disposed of approved net regulatory assets amounting to $153,000 through permitted distribution rate adjustments [2012 – approved net regulatory liabilities of $8,838,000].

The regulatory assets and liabilities of the Corporation consist of the following:

a) Incremental Capital Module

The ICM regulatory asset account relates to the partial decision and order from the OEB for LDC's 2012 and 2013 work program proposals and the associated rate rider, which became effective June 1, 2013 *[note 3[a]]*. As directed by the OEB, this account is comprised of the cost of the eligible in-service capital expenditures under ICM, offset by the amount collected through the rate rider. This account is also adjusted by the amount recognized into revenues related to the eligible in-service capital expenditures and their associated depreciation.

For the year ended December 31, 2013, eligible in-service capital expenditures of $159,672,000 [2012 - $nil] were reclassified from PP&E to regulatory assets. As a non-cash transaction, this has been excluded from the consolidated statements of cash flows. As at December 31, 2013, eligible in-service capital expenditures, net of accumulated depreciation, totalling $157,880,000, were recorded in regulatory assets [December 31, 2012 - $nil]. In

the absence of rate regulation, PP&E would have been $157,880,000 higher as at December 31, 2013 [December 31, 2012 - $nil impact].

For the year ended December 31, 2013, LDC recorded depreciation expenses of $1,792,000 [2012 - $nil] related to the eligible in-service capital expenditures.

For the year ended December 31, 2013, the revenues related to the eligible in-service capital expenditures were $6,707,000 [2012 - $nil]. In the absence of rate regulation, for the year ended December 31, 2013, revenues would have been $5,925,000 higher [2012 - $nil impact].

b) Post-Retirement Benefits

This regulatory asset account relates to the expected future electricity distribution charges to customers arising from timing differences in the recognition of actuarial losses and prior service costs of other post-retirement benefits. In the absence of rate regulation, these amounts would be recorded in OCI and accumulated other comprehensive income. The amount is amortized over the same period as the corresponding actuarial losses and prior service costs. The period in which recovery is expected cannot be determined at this time.

c) Smart Meters and Stranded Meters

The smart meters and stranded meters regulatory asset accounts relate to Ontario's decision to install smart meters throughout Ontario. LDC substantially completed its smart meter project as at December 31, 2010. In connection with this initiative, the OEB ordered LDC to record all expenditures and related revenues from 2008 to 2010 to a regulatory asset account and allowed LDC to keep the net book value of the stranded meters in PP&E. Effective January 1, 2011, LDC has recorded post-2010 smart meter costs in PP&E and intangible assets as a regular distribution activity as directed by the OEB. On August 1, 2013, LDC filed an application with the OEB requesting approval for the disposition of balances in its smart meter deferral account related to smart meter installations in 2008, 2009 and 2010, and incremental revenue related to these assets. On January 16, 2014, the OEB approved LDC's request for incremental revenue and disposition of the smart meter deferral account balances *[note 3[a]]*.

The OEB ruling on smart meters also permitted the recovery in principle of LDC's allowed cost of capital on smart meters since 2008, with a rate order issued to this effect. Accordingly, a new regulatory asset of $25,230,000 has been created to reflect the future amount to be recovered through rates, with a related amount recorded in revenue. For the year ended December 31, 2013, LDC ceased to defer operating and depreciation expenses related to the deployment of the 2008 to 2010 smart meters and recognized revenues as approved by the OEB, resulting in a decrease in the smart meters regulatory asset of $25,025,000, an increase in PP&E of $45,720,000, an increase in intangible assets of $1,066,000, an increase in revenues of $57,482,000, an increase in operating expenses of $7,105,000, an increase in depreciation and amortization expenses of $28,733,000 and a decrease in net financing charges of $117,000.

The net book value of stranded meters related to the deployment of smart meters has been reclassified from PP&E to regulatory assets, resulting in an increase in regulatory assets of $17,362,000 and a decrease in PP&E of $17,362,000 as at December 31, 2013. Salvage proceeds of $485,000 have been applied to reduce the stranded meters regulatory asset account. LDC expects to apply to the OEB for recovery of the remaining stranded meters costs as part of its 2015 electricity distribution rates application.

In the absence of rate regulation, for the year ended December 31, 2013, revenues relating to smart meters and stranded meters would be $51,474,000 lower [2012 - $5,889,000 higher], operating expenses would be $7,105,000 lower [2012 - $nil impact] and depreciation and amortization expenses would be $25,461,000 lower [2012 - $3,518,000 higher].

d) Settlement Variances

This account is comprised of the variances between amounts charged by LDC to customers, based on regulated rates, and the corresponding cost of non-competitive electricity service incurred by LDC. The settlement variances relate primarily to service charges, non-competitive electricity charges and the global adjustment. Accordingly, LDC has deferred the variances between the costs incurred and the related recoveries in accordance with the criteria set out in the accounting principles prescribed by the OEB. The balance for settlement variances continues to be calculated and attracts carrying charges in accordance with the OEB's direction.

For the year ended December 31, 2013, settlement variances included in the RARA of $nil were disposed through rate adjustments [2012 - $12,249,000].

e) Regulatory Assets Recovery Account

The RARA consists of balances of regulatory assets or regulatory liabilities approved for disposition by the OEB through rate riders. The RARA is subject to carrying charges following the OEB-prescribed methodology and related rates.

On February 22, 2011, the OEB approved the disposition of the Late Payment Penalties Settlement regulatory asset of $7,526,000, over a 21-month period commencing on August 1, 2011 and ending on April 30, 2013.

On April 2, 2013, the OEB approved the disposition of net regulatory liabilities of $6,509,000, primarily consisting of PILs regulatory variance accounts, over an 11-month period commencing on June 1, 2013 and ending on April 30, 2014.

f) Deferred Income Taxes

This regulatory liability account relates to the expected future electricity distribution rate reduction for customers arising from timing differences in the recognition of deferred income tax assets *[note 4[p]]*.

As at December 31, 2013, LDC recorded a deferred income tax asset and a corresponding regulatory liability of $155,853,000 [December 31, 2012 - $193,276,000] with respect to its rate-regulated activities that will be included in the rate-setting process.

g) Revision of Prior Year Tax Position

The revision of prior year tax position regulatory liability account relates to a favourable change to certain prior year tax positions based on reassessments received and in process, not reflected in electricity distribution rates charged to customers. As at December 31, 2013, the balance in this account consisted of an over-recovery of PILs from customers of $19,421,000 [December 31, 2012 - $nil].

h) Income and Other Taxes Variance Account

The income and other taxes variance regulatory liability account relates to the differences that have resulted from a legislative or regulatory change to the tax rates or rules assumed in applications for electricity distribution rates. As at December 31, 2013, the balance in this account consisted of an over-recovery of PILs from customers of $2,432,000 [December 31, 2012 - $2,398,000].

10. OTHER ASSETS

Other long-term assets consist of the following:

	2013 $	2012 $
Prepaid expenses	**7,103**	7,191
Deferred financing costs	**7,232**	5,251
	14,335	12,442

11. CREDIT FACILITIES AND SHELF PROSPECTUS

The Corporation is a party to a credit agreement with a syndicate of Canadian chartered banks which establishes a revolving credit facility [“Revolving Credit Facility”], pursuant to which it may borrow up to $600,000,000, of which up to $210,000,000 is available in the form of letters of credit. On September 6, 2013, the Corporation extended the maturity date of its Revolving Credit Facility from October 10, 2017 to October 10, 2018. Borrowings under the Revolving Credit Facility bear interest at short-term floating rates with reference to the Corporation's credit rating.

The Revolving Credit Facility contains certain covenants, the most significant of which is a requirement that the debt to capitalization ratio not exceed 75%. As at December 31, 2013, the Corporation was in compliance with all covenants included in its Revolving Credit Facility.

On December 17, 2013, the Corporation launched a commercial paper program allowing up to $400,000,000 of unsecured short-term promissory notes to be issued in various maturities of no more than one year. The commercial paper program is supported by liquidity facilities available under the Corporation’s Revolving Credit Facility; hence, available borrowing under its Revolving Credit Facility is reduced by the amount of commercial paper outstanding at any point in time. Proceeds from the commercial paper program are being used for general corporate purposes. As at December 31, 2013, $150,000,000 was outstanding under the commercial paper program [December 31, 2012 - $nil]. Borrowings under the commercial paper program bear interest based on the prevailing market conditions at the time of issuance.

Additionally, the Corporation is a party to:

- a demand facility with a Canadian chartered bank for $75,000,000 for the purpose of issuing letters of credit mainly to support LDC’s prudential requirements with the IESO [“Prudential Facility”]; and
- a demand facility with a second Canadian chartered bank for $20,000,000 for the purpose of working capital management [“Working Capital Facility”].

As at December 31, 2013, no amounts had been drawn under the Revolving Credit Facility and $19,084,000 had been drawn under the Working Capital Facility [December 31, 2012 - $nil]. As at December 31, 2013, $50,054,000 of letters of credit had been issued against the Prudential Facility [December 31, 2012 - $49,227,000]. For the year ended December 31, 2013, the average outstanding borrowings on the Corporation’s credit facilities, excluding the Prudential Facility, were $67,679,000 with a weighted average interest rate of 1.98%.

The Corporation filed a base shelf prospectus dated December 10, 2012 with the securities commissions or similar regulatory authorities in each of the provinces of Canada. These filings allow the Corporation to make offerings of

unsecured debt securities of up to $1,500,000,000 during the 25-month period following the date of the prospectus *[note 13]*.

12. RESTRUCTURING

In the first quarter of 2012, the Corporation's Board of Directors approved a workforce restructuring program aimed at reducing operating expenditures for LDC. The program was approved following the decision by the OEB to deny the request of LDC to set its electricity distribution rates for 2012, 2013 and 2014 under the cost of service framework. In preparing its revised application using the IRM framework, LDC concluded that significant cost reductions were necessary to manage its business within the confines of the expected allowed electricity distribution rates provided by the IRM framework *[note 3[a]]*. The main component of these operating cost reduction initiatives was a workforce restructuring program, which included the severance of management employees and a voluntary exit incentive program for targeted unionized positions.

For the year ended December 31, 2013, the costs incurred as a result of these operating cost reduction initiatives amounted to $nil [2012 - $27,796,000] and were comprised of ongoing termination charges of $nil and one-time termination incentive charges of $nil [2012 - $23,668,000 and $4,128,000, respectively], of which $nil remains unpaid as at December 31, 2013 [December 31, 2012 - $11,954,000].

13. DEBENTURES

Debentures consist of the following:

	2013 $	2012 $
Senior unsecured debentures		
Series 1 – 6.11% due May 7, 2013	—	225,000
Series 2 – 5.15% due November 14, 2017	**250,000**	250,000
Series 3 – 4.49% due November 12, 2019	**250,000**	250,000
Series 5 – 6.11% due May 6, 2013	—	245,057
Series 6 – 5.54% due May 21, 2040	**200,000**	200,000
Series 7 – 3.54% due November 18, 2021	**300,000**	300,000
Series 8 – 2.91% due April 10, 2023	**250,000**	—
Series 9 – 3.96% due April 9, 2063	**200,000**	—
Total debentures	**1,450,000**	1,470,057
Less: Unamortized discount/premium	**668**	467
Less: Current portion of debentures	—	470,050
Long-term portion of debentures	**1,449,332**	999,540

All debentures of the Corporation rank equally.

On April 9, 2013, the Corporation issued $250,000,000 of 2.91% senior unsecured debentures due April 10, 2023 ["Series 8"] and $200,000,000 of 3.96% senior unsecured debentures due April 9, 2063 ["Series 9"]. The Series 8 and Series 9 debentures bear interest payable semi-annually in arrears. The net proceeds of the debentures were used to repay the Corporation's Series 1 and Series 5 debentures which matured on May 7, 2013 and May 6, 2013, respectively. Debt issuance costs of $2,694,000 relating to the Series 8 and Series 9 debentures were deferred as other assets in the second quarter of 2013.

The Corporation may redeem all or part of the debentures at any time prior to maturity at a price equal to the greater of the Canada Yield Price (determined in accordance with the terms of the debentures) and par, plus accrued and unpaid interest up to and excluding the date fixed for redemption. Also, the Corporation may, at any time and from time to time, purchase debentures for cancellation, in the open market, by tender or by private contract, at any price. The debentures contain certain covenants which, subject to certain exceptions, restrict the ability of the Corporation and LDC to create security interests, incur additional indebtedness or dispose of all or substantially all of their assets. The Corporation's unsecured debentures limit consolidated funded indebtedness to a maximum of 75% of total consolidated capitalization. As at December 31, 2013, the Corporation was in compliance with its covenants.

14. EMPLOYEE FUTURE BENEFITS

Pension

The Corporation's full-time employees participate in a pension plan through OMERS. The plan assets are pooled together to provide benefits to plan participants and are not segregated in separate accounts for each member entity. As at December 31, 2013, the OMERS plan was 88% funded, with a funding deficit of approximately $8,600,000,000. For the year ended December 31, 2013, the total contributions of all participating employers and employees were approximately $3,500,000,000. For the year ended December 31, 2013, the Corporation's contributions were $18,509,000 [2012 - $16,718,000], representing less than five percent of total contributions to the plan.

For 2013, OMERS contribution rates were 9.0% up to the year's maximum pensionable earnings ["YMPE"] and 14.6% over YMPE for normal retirement age of 65 [2012 - 8.3% up to YMPE and 12.8% over YMPE for normal retirement age of 65].

As at December 31, 2012, OMERS had approximately 266,000 active members. As at December 31, 2013, approximately 1,500 members [December 31, 2012 - 1,700] had a current relationship with the Corporation.

Post-retirement benefits other than pension

a) Benefit Obligations

	2013 $	2012 $
Balance, beginning of year	**253,890**	244,326
Service cost	**5,226**	5,151
Interest cost	**10,792**	11,657
Benefits paid	**(10,432)**	(8,069)
Actuarial (gain) loss	**(20,684)**	825
Balance, end of year	**238,792**	253,890

On February 13, 2014, LDC's unionized workforce ratified a collective agreement to expire at the end of January 2018. The agreement does not contain terms that create a post-retirement benefits liability in respect of past service.

b) Amounts recognized in regulatory assets

	2013 $	2012 $
Net actuarial loss	**38,767**	61,477
Prior service cost	**14**	22
Total recognized in regulatory assets *[note 9]*	**38,781**	61,499

As at December 31, 2013, the estimated net actuarial loss and prior service cost that are expected to be amortized from regulatory asset to net periodic benefit cost in 2014 are $842,000 and $6,000, respectively.

c) Components of net periodic benefit costs

	2013 $	2012 $
Service cost	**5,226**	5,151
Interest cost	**10,792**	11,657
Amortization of net actuarial loss	**2,026**	3,046
Amortization of prior service cost	**8**	1,065
Net periodic benefit cost	**18,052**	20,919
Capitalized as part of PP&E	**6,623**	7,305
Charged to operations	**11,429**	13,614

d) Expected benefit payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid over the next five years, and in the aggregate for the five fiscal years thereafter:

	Post-retirement Benefits $
2014	**8,191**
2015	**8,403**
2016	**9,090**
2017	**9,541**
2018	**10,112**
2019-2023	**59,394**

e) Significant assumptions

	2013 %	2012 %
Accrued benefit obligation as at December 31:		
Discount rate	**4.75**	4.25
Benefit costs for years ended December 31:		
Discount rate	**4.25**	4.75
Assumed health care cost trend rates as at December 31:		
Rate of increase in dental costs assumed for next year	**4.00**	4.00
Rate of increase in medical costs assumed for next year		
For pre July 2000 retirements	**6.00**	6.50
For other retirements	**7.50**	8.00
Rate that medical cost trend rate gradually declines to		
For pre July 2000 retirements	**5.00**	5.00
For other retirements	**5.00**	5.00
Year that the medical cost trend rate reaches the ultimate trend rate		
For pre July 2000 retirements	**2016**	2016
For other retirements	**2019**	2019

f) Sensitivity analysis

Assumed medical and dental care cost trend rates have a significant effect on the amounts reported for medical and dental care plans. A one-percentage-point change in assumed medical and dental care cost trend rates would have the following effects for 2013:

	Increase $	Decrease $
Total of current service and interest cost (at 4.25%)	**2,339**	**(2,063)**
Accrued benefit obligation as at December 31, 2013 (at 4.75%)	**30,388**	**(26,664)**

Assumed interest rates have a significant effect on the amounts reported for the total accrued benefit obligation and expense. A one-percentage-point change in assumed interest rates would have the following effects:

	Increase $	Decrease $
Accrued benefit obligation as at December 31, 2013	**(37,041)**	**45,469**
Estimated net periodic benefit cost for 2014	**(1,818)**	**3,096**

15. ASSET RETIREMENT OBLIGATIONS

The reconciliation between the opening and closing ARO liability balances is as follows:

	2013 $	2012 $
Balance, beginning of year	**5,079**	4,902
ARO liabilities settled in the year	**(573)**	(313)
Accretion expense	**182**	174
Revision in estimated cash flows	**1,639**	316
Balance, end of year	**6,327**	5,079

16. FINANCIAL INSTRUMENTS

a) Recognition and measurement

As at December 31, 2013 and December 31, 2012, the fair values of cash and cash equivalents, net accounts receivable, unbilled revenue, Working Capital Facility, commercial paper, and accounts payable and accrued liabilities approximate their carrying values due to the short maturity of these instruments *[note 4[k]]*. The fair values of customers' advance deposits approximate their carrying values taking into account interest accrued on the outstanding balance. Obligations under capital lease are measured based on a discounted cash flow analysis and approximate the carrying value as management believes that the fixed interest rates are representative of current market rates.

The carrying value and fair value of the Corporation's debentures consist of the following:

	2013 $		2012 $	
	Carrying value	**Fair value [(1)]**	**Carrying value**	**Fair value [(1)]**
Senior unsecured debentures				
Series 1 – 6.11% due May 7, 2013	**—**	**—**	224,993	228,749
Series 2 – 5.15% due November 14, 2017	**249,886**	**275,065**	249,861	283,971
Series 3 – 4.49% due November 12, 2019	**249,962**	**270,565**	249,956	280,381
Series 5 – 6.11% due May 6, 2013	**—**	**—**	245,057	249,108
Series 6 – 5.54% due May 21, 2040	**199,862**	**226,842**	199,859	256,678
Series 7 – 3.54% due November 18, 2021	**299,877**	**302,843**	299,864	316,973
Series 8 – 2.91% due April 10, 2023	**249,960**	**232,849**	—	—
Series 9 – 3.96% due April 9, 2063	**199,785**	**172,647**	—	—

(1) The fair value measurement of financial instruments for which the fair value has been disclosed is included in Level 2 of the fair value hierarchy.

b) Financial Risks

The following is a discussion of financial risks and related mitigation strategies that have been identified by the Corporation for financial instruments. This is not an exhaustive list of all risks, nor will the mitigation strategies eliminate all risks listed.

The Corporation is exposed to a variety of financial risks, particularly credit risk, interest rate risk and liquidity risk.

Credit risk

The Corporation is exposed to credit risk as a result of the risk of counterparties defaulting on their obligations. The Corporation's exposure to credit risk primarily relates to accounts receivable and unbilled revenue. The Corporation monitors and limits its exposure to credit risk on a continuous basis.

The Corporation's credit risk associated with accounts receivable is primarily related to electricity bill payments from LDC customers. LDC has approximately 730,000 customers. LDC obtains security instruments from certain customers in accordance with direction provided by the OEB. As at December 31, 2013, LDC held security deposits in the amount of $44,649,000 [December 31, 2012 - $46,838,000], of which $22,211,000 [December 31, 2012 - $25,666,000] were related to security deposits on Offers to Connect to guarantee the payment of additional costs relating to expansion projects. As at December 31, 2013, there were no significant concentrations of credit risk with respect to any customer.

The Corporation did not have any single customer that generated more than 10% of total consolidated revenues for the years ended December 31, 2013 and December 31, 2012.

Credit risk associated with accounts receivable and unbilled revenue is as follows:

	2013 $	2012 $
Unbilled revenue	**326,872**	278,086
Accounts receivable		
Outstanding for not more than 30 days	**176,936**	153,513
Outstanding for more than 30 days and not more than 120 days	**24,454**	18,231
Outstanding for more than 120 days	**12,225**	14,113
Less: Allowance for doubtful accounts	**(10,901)**	(10,698)
Total accounts receivable, net	**202,714**	175,159
Total accounts receivable and unbilled revenue	**529,586**	453,245

Reconciliation between the opening and closing allowance for doubtful accounts balances is as follows:

	2013 $	2012 $
Balance, beginning of year	**(10,698)**	(12,987)
Provision for doubtful accounts	**(7,805)**	(6,586)
Write-offs	**8,140**	9,285
Recoveries	**(538)**	(410)
Balance, end of year	**(10,901)**	(10,698)

Unbilled revenue represents amounts for which the Corporation has a contractual right to receive cash through future billings and are unbilled at period-end. Unbilled revenue is considered current and no allowance for doubtful accounts had been provided as at December 31, 2013 and December 31, 2012.

The credit risk related to cash, cash equivalents and investments is mitigated by the Corporation's treasury policies on assessing and monitoring the credit exposures of counterparties. The Corporation's maximum exposure to credit risk is approximately equal to the carrying value of its financial assets.

Interest rate risk

The Corporation is exposed to fluctuations in interest rates for the valuation of its post-retirement benefit obligations *[note 14[f]]*. The Corporation is also exposed to short-term interest rate risk on the net of cash and cash equivalents, short-term borrowings under its Revolving Credit Facility, Working Capital Facility and commercial paper program *[note 11]* and customers' advance deposits. The Corporation manages interest rate risk by monitoring the mix of fixed and floating rate instruments, and taking action as necessary to maintain an appropriate balance.

As at December 31, 2013, aside from the valuation of its post-retirement benefit obligations, the Corporation was exposed to interest rate risk predominately from short-term borrowings under its commercial paper program, while most of its remaining obligations were either non-interest bearing or bear fixed interest rates, and its financial assets were predominately short-term in nature and mostly non-interest bearing. The Corporation estimates that a 100 basis point increase (decrease) in short-term interest rates, with all other variables held constant, would result in an increase (decrease) of approximately $2,100,000 to annual net financing charges.

Liquidity risk

The Corporation is exposed to liquidity risk related to its ability to fund its obligations as they become due. The Corporation monitors and manages its liquidity risk to ensure access to sufficient funds to meet operational and investing requirements. The Corporation has access to credit facilities and debt capital markets and monitors cash balances daily. The Corporation's objective is to ensure that sufficient liquidity is on hand to meet obligations as they fall due while minimizing net financing charges.

Liquidity risks associated with financial commitments are as follows:

	December 31, 2013					
	Due within 1 year $	Due within 2 years $	Due within 3 years $	Due within 4 years $	Due within 5 years $	Due after 5 years $
Financial liabilities						
Working Capital Facility	**19,084**	—	—	—	—	—
Commercial paper	**150,000**	—	—	—	—	—
Accounts payable and accrued liabilities	**456,750**	—	—	—	—	—
Obligations under capital lease	**2,537**	**2,537**	**2,537**	**2,537**	**1,270**	—
Senior unsecured debentures						
Series 2 – 5.15% due November 14, 2017	—	—	—	**250,000**	—	—
Series 3 – 4.49% due November 12, 2019	—	—	—	—	—	**250,000**
Series 6 – 5.54% due May 21, 2040	—	—	—	—	—	**200,000**
Series 7 – 3.54% due November 18, 2021	—	—	—	—	—	**300,000**
Series 8 – 2.91% due April 10, 2023	—	—	—	—	—	**250,000**
Series 9 – 3.96% due April 9, 2063	—	—	—	—	—	**200,000**
Interest payments on debentures [(1)]	**51,906**	**60,995**	**60,995**	**60,995**	**48,120**	**666,483**
	680,277	**63,532**	**63,532**	**313,532**	**49,390**	**1,866,483**

[(1)] The “Due within 1 year” column excludes $9,089,000 of interest on debentures that was accrued as at December 31, 2013.

Foreign exchange risk

As at December 31, 2013, the Corporation had limited exposure to the changing values of foreign currencies. While the Corporation purchases goods and services which are payable in US dollars, and purchases US currency to meet the related commitments when required, the impact of these transactions is not material to the consolidated financial statements.

17. FINANCIAL ASSISTANCE

The City has authorized the Corporation to provide financial assistance to its subsidiaries, and LDC to provide financial assistance to other subsidiaries of the Corporation, in the form of guarantees, letters of credit, direct loans or otherwise, for the purpose of enabling them to carry on their businesses, with financial assistance provided to subsidiaries other than LDC not to exceed an aggregate amount of $500,000,000.

As at December 31, 2013, the Corporation had drawn letters of credit in the amount of $50,054,000 [December 31, 2012 - $49,227,000] *[note 11]* on its Prudential Facility in respect of the operations of LDC.

18. INCOME TAXES

The Corporation’s effective tax rate for the year ended December 31, 2013 was 3.45% [2012 – 5.04%]. Income tax expense for the year ended December 31, 2013 was $4,333,000 [2012 - $4,565,000]. The effective tax rate and income tax expense for the year ended December 31, 2013 were lower than those for the year ended December 31, 2012 due to changes in permanent and temporary differences between accounting and tax treatments.

Income tax expense differs from the amount that would have been recorded using the combined statutory Canadian federal and Ontario income tax rate. Reconciliation of income tax expense computed at the statutory income tax rate to the income tax provision is set out below:

Consolidated Statements of Net Income and Comprehensive Income

	2013 $	2012 $
Rate reconciliation		
Income before income taxes	**125,574**	90,555
Statutory Canadian federal and provincial income tax rate	**26.50%**	26.50%
Expected income tax expense	**33,277**	23,997
Temporary differences not benefited in LDC	**(20,186)**	(16,133)
Change in unrecognized tax benefits	**(5,051)**	(1,730)
Impact of change in expected future tax rate on existing deferred income tax balances	**—**	(1,803)
Other	**(3,707)**	234
Income tax expense	**4,333**	4,565
Effective tax rate	**3.45%**	5.04%
Components of income tax expense		
Current tax	**7,137**	6,322
Deferred income tax related to the origination and reversal of temporary differences	**(710)**	889
Non-refundable ITCs	**(2,094)**	(2,646)
Income tax expense	**4,333**	4,565

Consolidated Balance Sheets

Significant components of the Corporation's deferred income tax assets are as follows:

	2013 $	2012 $
PP&E and intangible assets	**73,236**	91,818
Post-retirement benefits liability	**53,003**	50,667
Regulatory adjustments	**41,301**	51,218
Other taxable temporary differences	**(1,871)**	9,932
Capital loss carryforwards	**5,007**	5,220
Non-capital loss carryforwards	**738**	7
Valuation allowance	**(13,809)**	(14,544)
Deferred income tax assets	**157,605**	194,318

Realization of the Corporation's deferred income tax assets is considered more likely than not other than for certain capital loss carryforwards and allowed tax depreciation, for which a valuation allowance has been established.

As at December 31, 2013, the Corporation accumulated non-capital losses for income tax purposes of approximately $2,784,000 [December 31, 2012 - $28,000], which are available to reduce taxable income in future years. As at

December 31, 2013, the Corporation also accumulated taxable capital losses of $18,894,000 [December 31, 2012 - $19,698,000], which are available to offset capital gains in future years.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2013 $	2012 $
Balance, beginning of year	**5,274**	7,004
Increases for tax positions taken in the current year	**18**	248
Decreases for tax positions taken in prior years	**(1,603)**	(39)
Settlements with tax authorities	**(3,466)**	(1,939)
Balance, end of year	**223**	5,274

As at December 31, 2013, $223,000 of unrecognized tax benefits [December 31, 2012 - $5,274,000] would have a favourable effect on the effective tax rate, if recognized. No interest and penalties have been accrued, since the Corporation is of the view that none are expected to be payable. During the next 12 months, unrecognized tax benefits are not expected to significantly change.

As at December 31, 2013, the Corporation’s tax years currently open to examination by tax authorities include 2007 and subsequent years. Other than in respect of the fair market revaluation of the Corporation's assets on October 1, 2001 pursuant to Section 7 of Ontario Regulation 162/01 of the Electricity Act, tax years prior to 2007 are closed to further examination.

19. SHARE CAPITAL

Share capital consists of the following:

	2013 $	2012 $
Authorized		
The authorized share capital of the Corporation consists of an unlimited number of common shares without par value		
Issued and outstanding		
1,000 common shares	**567,817**	567,817

The weighted daily average number of shares outstanding for the year ended December 31, 2013 was 1,000 [2012 - 1,000]. Basic and fully diluted net income per share was determined by dividing the net income for the year by the weighted daily average number of shares outstanding.

Dividends

The shareholder direction adopted by the City with respect to the Corporation provides that the Board of Directors of the Corporation will use its best efforts to ensure that the Corporation meets certain financial performance standards, including those relating to the credit rating and dividends.

Subject to applicable law, the shareholder direction provides that the Corporation will pay dividends to the City each year amounting to the greater of $25,000,000 or 50% of the Corporation's consolidated net income for the prior fiscal year. The dividends are not cumulative and are payable as follows:

[i] $6,250,000 on the last day of each fiscal quarter of the year; and

[ii] the amount, if any, by which 50% of the Corporation's annual consolidated net income for the year exceeds $25,000,000, within ten days after the approval of the Corporation's audited consolidated financial statements for the year by the Board of Directors of the Corporation.

For the year ended December 31, 2013, the Board of Directors of the Corporation declared and paid dividends totalling $42,995,000 [2012 - $47,966,000] to the City.

On March 19, 2014, the Board of Directors of the Corporation declared dividends in the amount of $41,871,000. The dividends are comprised of $35,621,000 with respect to net income for the year ended December 31, 2013, payable to the City on March 28, 2014, and $6,250,000 with respect to the first quarter of 2014, payable to the City on March 31, 2014.

20. RELATED PARTY TRANSACTIONS

As a wholly-owned subsidiary of the City, the Corporation and the City are considered related parties. All transactions with the City are conducted on terms similar to those offered to unrelated parties.

Summary of Transactions with Related Parties	2013 $	2012 $
Revenues	**246,894**	222,032
Operating expenses and capital expenditures	**31,861**	26,259
Dividends	**42,995**	47,966

Summary of Amounts Due to/from Related Parties	2013 $	2012 $
Accounts receivable	**5,579**	7,810
Unbilled revenue	**19,425**	17,018
Accounts payable and accrued liabilities	**45,472**	38,020
Advance deposits	**8,816**	8,926

Revenues represent amounts charged to the City primarily for electricity, street lighting and ancillary services. Operating expenses and capital expenditures represent amounts charged by the City for purchased road cut repairs, property taxes and other services. Dividends are paid to the City *[note 19]*.

Accounts receivable represent receivables from the City primarily for electricity, street lighting and ancillary services. Unbilled revenue represents receivables from the City related to electricity and other services provided and not yet billed. Accounts payable and accrued liabilities represent amounts payable to the City related to road cut repairs and other services, as well as amounts received from the City for the construction of electricity distribution assets. Advance deposits represent amounts received from the City for future expansion projects.

21. COMMITMENTS

Operating leases and capital projects

As at December 31, 2013, the future minimum annual payments under property operating leases, capital projects and other commitments with remaining terms from one to five years and thereafter were as follows:

	Operating leases $	Capital projects [2] and other $
2014	**6,175**	**79,797**
2015	**6,186**	**2,772**
2016	**5,784**	—
2017	**2,123**	—
2018	—	—
Thereafter	—	—
Total amount of future minimum payments [1]	**20,268**	**82,569**

[1] Refer to note 16 for repayments of senior unsecured debentures, Working Capital Facility and commercial paper excluded from the table above.
[2] Reflects capital project commitments for construction services and estimated capital contributions, with the majority related to Copeland Station.

The Corporation has the option to renew its two major property operating leases at the end of the current lease term for an additional five years at the then fair rental value.

Operating lease expense for the year ended December 31, 2013 was $6,132,000 [2012 - $6,547,000].

Subsequent to December 31, 2013, the Corporation entered into capital commitments of approximately $21,000,000 for capital contributions payable to Hydro One Networks Inc. over the next year in respect of Copeland Station.

Capital leases

As at December 31, 2013, the future minimum annual lease payments under capital leases with remaining lease terms from one to five years and thereafter were as follows:

	$
2014	**2,537**
2015	**2,537**
2016	**2,537**
2017	**2,537**
2018	**1,270**
Thereafter	**—**
Total amount of future minimum lease payments	**11,418**
Less: interest and executory costs	**1,143**
	10,275
Current portion included in Other liabilities	**2,100**
Long-term portion included in Other liabilities	**8,175**

22. CONTINGENCIES

a) Legal Proceedings

In the ordinary course of business, the Corporation is subject to various legal actions and claims with customers, suppliers, former employees and other parties. On an ongoing basis, the Corporation assesses the likelihood of any adverse judgments or outcomes as well as potential ranges of probable costs and losses. A determination of the provision required, if any, for these contingencies is made after an analysis of each individual issue. The provision may change in the future due to new developments in each matter or changes in approach, such as a change in settlement strategy. If damages were awarded under these actions, the Corporation and its subsidiaries would make a claim under their liability insurance which the Corporation believes would cover any damages which may become payable by the Corporation and its subsidiaries in connection with these actions.

2 Secord Avenue

An action was commenced against LDC in September 2008 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of $30,000,000 as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, a statement of defence and third party claim have been served by LDC and a third party defence and counterclaim against LDC seeking damages in the amount of $51,000,000 have been filed. A certification order has been issued. Affidavits of documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. A mediation took place on January 15, 2014 and the parties have agreed to settle the action of the class plaintiffs by the payment by LDC of the total amount of $6,527,000, including all taxes and legal fees, subject to approval by the Ontario Superior Court of Justice. LDC will make a claim under its liability insurance which the Corporation believes will cover the settlement payment. A settlement approval hearing will be scheduled. If the settlement is approved by the court, the main actions commenced by the class plaintiffs will be dismissed without costs, however the claims, counterclaims and third party claims amongst the various defendants to the class action will continue. Given the preliminary status of the remaining unsettled actions, it is not possible to reasonably

quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

On December 20, 2010, LDC was served with a statement of claim by the City seeking damages in the amount of $2,000,000 as a result of the fire at 2 Secord Avenue. A statement of defence and a third party claim have been served. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

By order of the court dated January 24, 2012, the above actions and a smaller non-class action commenced in April 2009 involving the same incident will be tried at the same time or consecutively.

2369 Lakeshore Boulevard West

A third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of $30,000,000 as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. Subsequently, in March 2010, the plaintiff in the main action amended its statement of claim to add LDC as a defendant. The plaintiff in the main action seeks general damages in the amount of $10,000,000 and special damages in the amount of $20,000,000 from LDC. The proposed class action is at a preliminary stage. The plaintiff cancelled its certification motion set for November 2013 and advised it intends to reschedule. Cross-examinations for a certification motion have commenced, but have not been completed. Statements of defence to the main action and to the third party claim have not been filed. Given the preliminary status of these actions, it is not possible at this time to reasonably quantify the effect, if any, of these actions on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with these actions.

On August 29, 2011, LDC was served with a statement of claim by the owner of the building and the property management company for the building seeking damages in the amount of $2,000,000 as a result of the fire at 2369 Lakeshore Boulevard West. LDC has filed a statement of defence and counterclaim. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

b) OEB PILs Proceeding

The OEB conducted a review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for certain MEUs. On June 24, 2011, the OEB issued its decision for these MEUs and provided guidelines for the calculation and further disposition of the balances accumulated in the PILs regulatory variance accounts.

LDC reviewed the balance of its PILs regulatory variance accounts and applied the guidelines provided by the OEB. LDC applied for disposition of the balance as part of its IRM/ICM Application filed on May 10, 2012. The OEB issued its decision and order on April 2, 2013 approving the disposition of the balance. The impact was recorded previously in the Corporation's consolidated financial statements.

23. NET FINANCING CHARGES

Net financing charges consist of the following:

	2013 $	2012 $
Interest income	**2,271**	1,845
Interest expense		
Long-term debt [(1)]	**(67,645)**	(75,503)
Other interest	**(4,221)**	(2,644)
AFUDC	**3,322**	2,325
	(66,273)	(73,977)

(1) Includes amortization of debt issuance costs, premiums and discounts.

24. CONSOLIDATED STATEMENTS OF CASH FLOWS

Changes in non-cash working capital provided/(used) cash as follows:

	2013 $	2012 $
Accounts receivable	**(27,555)**	8,113
Unbilled revenue	**(48,786)**	(16,028)
Income tax receivable	**7,315**	3,433
Inventories	**(1,011)**	(664)
Other current assets	**(4,175)**	46
Accounts payable and accrued liabilities	**40,669**	(17,322)
Restructuring accrual	**(11,954)**	11,954
Deferred conservation credit	**355**	6,957
Other current liabilities	**195**	(332)
	(44,947)	(3,843)

The reconciliation between total additions to PP&E and the amount presented on the consolidated statements of cash flows after factoring in the non-cash additions is as follows:

	2013 $	2012 $
Purchase of PP&E, cash basis	**358,860**	260,040
Net change in accruals related to PP&E	**32,710**	(11,719)
Capital lease additions	**305**	—
ARO additions	**1,669**	377
Capitalized overhead costs	**2,315**	1,620
Total additions to PP&E	**395,859**	250,318

25. Comparative Figures

Certain comparative figures have been reclassified from financial statements previously presented to conform to the presentation of the 2013 consolidated financial statements. During the fourth quarter of 2013, the Corporation changed its presentation of the consolidated statements of cash flows for the net change in regulatory assets and liabilities from investing activities to operating activities. Prior year comparatives have been retrospectively reclassified with $14,581,000 previously presented as investing activities for the year ended December 31, 2012 reclassified to operating activities.