



ANNUAL FINANCIAL REPORT  
DECEMBER 31, 2014

## TORONTO HYDRO CORPORATION

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## GLOSSARY

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**AFUDC** – Allowance for funds used during construction

**ASC** – Accounting Standards Codification

**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

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

**ERM** – Enterprise risk management

**FASB** – Financial Accounting Standards Board

**GAAP** – Generally Accepted Accounting Principles

**GWh** – Gigawatt hour

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

**HST** – Harmonized sales tax

**IAS** – International Accounting Standard

**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. The IESO and the OPA were merged under the name Independent Electricity System Operator on January 1, 2015.

**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

**kWh** – Kilowatt hour

**LDC** – Toronto Hydro-Electric System Limited

**MD&A** – Management's Discussion and Analysis

**MED** – 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. The IESO and the OPA were merged under the name Independent Electricity System Operator on January 1, 2015.

**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

**RDA** – Regulatory deferral account

**RRA** – Rate-regulated accounting

**TA** – *Taxation Act, 2007* (Ontario)

**TH Energy** – Toronto Hydro Energy Services Inc.

**US GAAP** – United States Generally Accepted Accounting Principles

**WMS** – Wholesale Market Service

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MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE  
THREE MONTHS AND YEARS ENDED  
DECEMBER 31, 2014 AND 2013

## Executive Summary

- Net income for the three months and year ended December 31, 2014 was \$23.7 million and \$112.5 million, compared to net income of \$29.3 million and \$121.2 million for the comparable periods in 2013;
- capital expenditures were primarily related to the renewal of the electricity infrastructure of LDC and were \$168.0 million and \$588.4 million for the three months and year ended December 31, 2014, compared to \$151.9 million and \$450.4 million for the comparable periods in 2013;
- on July 31, 2014, LDC filed a rate application with the OEB under the Custom Incentive Rate-setting mechanism, seeking approval of LDC's 2015 test year revenue requirement and corresponding electricity distribution rates effective May 1, 2015, and subsequent annual rate adjustments based on a custom index for the period commencing on January 1, 2016 and ending on December 31, 2019;
- 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;
- during the second quarter of 2014, the gas-insulated transformers and the high and medium voltage switchgear were manufactured and delivered for Copeland Station. During the third quarter of 2014, the tunnel boring was completed as required to connect the new infrastructure to the transmission grid. During the fourth quarter of 2014, the transformer floor in the new building was completed;
- on September 16, 2014, the Corporation issued \$200.0 million of 4.08% senior unsecured debentures due September 16, 2044; and
- on January 9, 2015, the Corporation filed a base shelf prospectus with the securities commissions or similar regulatory authorities in each of the provinces of Canada providing for the issuance of up to \$1.0 billion of unsecured debentures.

## Introduction

The MD&A should be read in conjunction with:

- the Corporation's audited consolidated financial statements and accompanying notes as at and for the years ended December 31, 2014 and 2013 (the "Consolidated Financial Statements"); and
- the Corporation's audited consolidated financial statements and accompanying notes as at and for the years ended December 31, 2013 and 2012.

Copies of these documents are available on the System for Electronic Document Analysis and Retrieval website at [www.sedar.com](http://www.sedar.com).

The Corporation's above noted 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 (see "Future Accounting Pronouncements and IFRS Conversion Project" below).

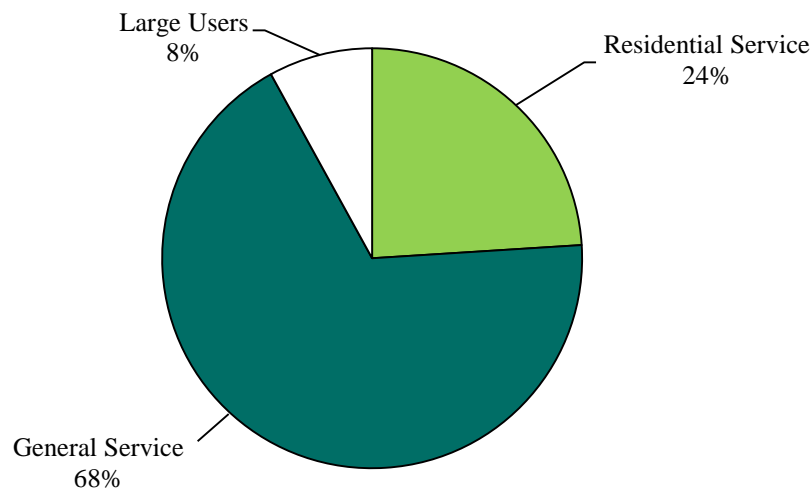
## Business of Toronto Hydro Corporation

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, delivering electricity to approximately 740,000 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, 2014, LDC earned energy sales and distribution revenues of \$3,254.6 million. As illustrated in the accompanying chart, 68% of the energy sales and distribution revenues were earned from general service users<sup>1</sup>, 24% from residential service users<sup>2</sup>, and 8% from large users<sup>3</sup>.

**LDC Energy Sales and Distribution Revenues by Class**  
Year ended December 31, 2014



<sup>1</sup> "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.

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

<sup>3</sup> "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 power to approve the amounts paid to non-contracted generators, 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 include 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.

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 reviews and the continuation of 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 the 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 a strong 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, or 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 2014 KPIs associated with the previously mentioned four strategic pillars are as follows:

Strategic Pillars	Performance Measure	Definition
People	Safety	<ul style="list-style-type: none"> <li>Number of recordable injuries x 200,000 / exposure hours.</li> </ul>
	Attendance	<ul style="list-style-type: none"> <li>Average days absent per employee.</li> </ul>
Financial	Net income	<ul style="list-style-type: none"> <li>Net income per the Corporation's Consolidated Financial Statements.</li> </ul>
	Productivity - operating expenses and other productivity related metrics	<ul style="list-style-type: none"> <li>Consolidated operating expenses (excluding some defined costs) and other productivity related metrics.</li> </ul>
Operations	System average interruption duration index	<ul style="list-style-type: none"> <li>Measure of the annual system average interruption duration per customers served, not including MED.</li> </ul>
	System average interruption frequency index	<ul style="list-style-type: none"> <li>Measure of the frequency of service interruptions per customers served, not including MED.</li> </ul>
	Key account worst performing feeders	<ul style="list-style-type: none"> <li>Total number of feeders experiencing seven or more outages affecting key account customers, including momentary and sustained interruptions, in a 12-month rolling time period.</li> </ul>
	LDC regulated capital	<ul style="list-style-type: none"> <li>Achievement of LDC's capital work program.</li> </ul>
Customer	First call resolution	<ul style="list-style-type: none"> <li>Percentage of telephone enquiries resolved within one call, within a 21-day time period.</li> </ul>
	Enhanced online customer engagement	<ul style="list-style-type: none"> <li>Increase in customer self-serve transactions / engagements using various self-serve options and media channels.</li> </ul>

## Capability to Deliver Results

The Corporation strives to manage its performance and deliver results. In 2014, the Corporation exceeded all of its corporate targets represented by its KPIs except the key accounts worst performing feeders, primarily due to an under estimation of the impact of uncontrollable momentary outages. Each of the corporate targets were reasonably difficult to attain and served to encourage success in the Corporation's financial and operational results. The Corporation's ability to deliver results in each of its strategic pillars is managed through good governance around the balanced scorecard, short interval control and enterprise risk management. However it is also limited by inherent risks as 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 millions of Canadian dollars, unaudited)**

	<b>2014</b>	<b>2013</b>	<b>Change</b>	<b>2012</b>
	\$	\$	\$	\$
Energy sales	703.1	627.0	76.1	551.3
Distribution revenue	134.0	175.5	(41.5)	127.6
Other revenue	20.7	17.1	3.6	13.0
	857.8	819.6	38.2	691.9
Energy purchases	703.1	627.0	76.1	551.3
Operating expenses	68.0	79.3	(11.3)	65.0
Depreciation and amortization	41.8	66.7	(24.9)	35.9
<b>Operating income</b>	44.9	46.6	(1.7)	39.7
Net financing charges	(17.0)	(15.0)	(2.0)	(18.7)
Gain on disposals of PP&E	-	0.2	(0.2)	1.8
<b>Income before income taxes</b>	27.9	31.8	(3.9)	22.8
Income tax expense (recovery)	4.2	2.5	1.7	(0.1)
<b>Net income and comprehensive income</b>	23.7	29.3	(5.6)	22.9

**Consolidated Statements of Net Income and Comprehensive Income**  
**Year ended December 31**  
(in millions of Canadian dollars)

	2014 \$	2013 \$	Change \$	2012 \$
Energy sales	2,700.4	2,567.5	132.9	2,275.2
Distribution revenue	554.2	577.9	(23.7)	524.2
Other revenue	61.6	57.3	4.3	53.1
	3,316.2	3,202.7	113.5	2,852.5
Energy purchases	2,700.4	2,567.5	132.9	2,275.2
Operating expenses	267.6	272.0	(4.4)	245.1
Depreciation and amortization	160.8	172.8	(12.0)	141.6
<b>Operating income</b>	187.4	190.4	(3.0)	190.6
Net financing charges	(63.8)	(66.2)	2.4	(74.0)
Gain on disposals of PP&E	1.5	1.3	0.2	1.8
Restructuring costs	-	-	-	(27.8)
<b>Income before income taxes</b>	125.1	125.5	(0.4)	90.6
Income tax expense	12.6	4.3	8.3	4.6
<b>Net income and comprehensive income</b>	112.5	121.2	(8.7)	86.0

**Condensed Consolidated Balance Sheet Data**  
(in millions of Canadian dollars)

	As at December 31 2014 \$	As at December 31 2013 \$
Current assets	550.3	555.3
Non-current assets	3,726.0	3,242.2
<b>Total assets</b>	4,276.3	3,797.5
Current liabilities	902.6	696.4
Non-current liabilities	2,103.3	1,882.6
<b>Total liabilities</b>	3,005.9	2,579.0
Shareholder's equity	1,270.4	1,218.5
<b>Total liabilities and shareholder's equity</b>	4,276.3	3,797.5

## Results of Operations – 2014 compared to 2013

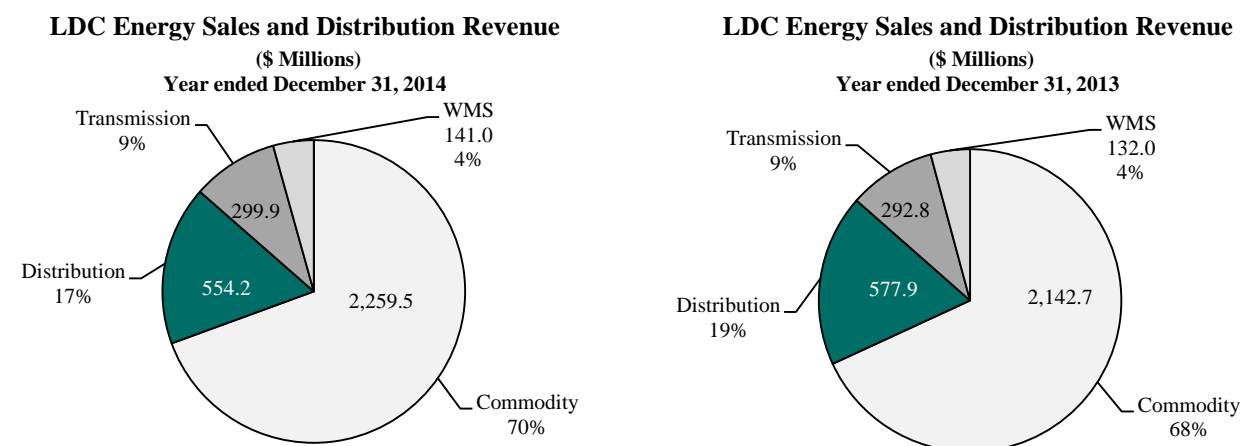
### Net Income

Net income for the three months and year ended December 31, 2014 was \$23.7 million and \$112.5 million compared to \$29.3 million and \$121.2 million for the comparable periods in 2013.

The decrease in net income for the three months ended December 31, 2014 was primarily due to lower distribution revenue (\$41.5 million), higher net financing charges (\$2.0 million), and higher income tax expense (\$1.7 million). These variances were partially offset by lower depreciation and amortization expense (\$24.9 million), lower operating expenses (\$11.3 million), and higher other revenue (\$3.6 million).

The decrease in net income for the year ended December 31, 2014 was primarily due to lower distribution revenue (\$23.7 million) and higher income tax expense (\$8.3 million). These variances were partially offset by lower depreciation and amortization expense (\$12.0 million), lower operating expenses (\$4.4 million), higher other revenue (\$4.3 million), and lower net financing charges (\$2.4 million).

### Revenues



### Energy Sales

LDC's energy sales arise from charges to customers for electricity generated by third parties and the related costs of purchased power, which are passed through to the customers at the cost paid. Energy sales include commodity charges, retail transmission charges and WMS charges. These pass-through charges are considered revenue by LDC due to the collection risk of the related balances. In connection with these charges, LDC records an equivalent cost of energy purchases in its consolidated statements of net income and comprehensive income as these charges are paid by LDC to the respective third parties.

The energy sales for the year ended December 31, 2014 were \$2,700.4 million compared to \$2,567.5 million for the comparable period in 2013. The increase in energy sales for the year ended December 31, 2014 was primarily due to higher commodity and WMS charges. Commodity charges were higher due to increased market price of electricity consumed by customers, and WMS charges were higher due to greater various wholesale market support costs. Both charges were passed through by the IESO.

### Distribution Revenue and Other Revenue

Distribution revenue is recorded based on OEB-approved distribution rates to recover the costs incurred by LDC in delivering electricity to customers, which includes revenue related to eligible capital expenditures under the ICM framework. Other revenue includes revenue from services ancillary to the distribution of electricity, revenue from the delivery of street lighting services, revenue from demand billable activities, and CDM cost efficiency incentives (see "Revenue Recognition" below).

Distribution revenue for the three months and year ended December 31, 2014 was \$134.0 million and \$554.2 million compared to \$175.5 million and \$577.9 million for the comparable periods in 2013.

The decrease in distribution revenue for the three months ended December 31, 2014 was primarily due to revenue recognition in 2013 related to the disposition of the 2008-2010 smart meter deferral account balances (\$57.5 million), an adjustment to unbilled revenue based on new technology implemented to enhance the revenue estimation process (\$10.7 million) (see “Revenue Recognition” below), and lower electricity consumption in the fourth quarter of 2014 (1,794.4 GWh compared to 1,831.2 GWh) (\$2.3 million). These variances were partially offset by a reduction in the distribution revenue recorded in the fourth quarter 2013 related to an over-recovery of PILs from customers (\$18.5 million) in connection with the revision of prior year tax positions (see note 9(f) to the Consolidated Financial Statements), higher revenue recognition related to the eligible in-service capital expenditures under ICM, including the IRM annual adjustment (\$7.9 million), and revenue recognition related to the implementation of the 2014 smart meter incremental revenue requirement (\$2.4 million).

The decrease in distribution revenue for the year ended December 31, 2014 was primarily due to revenue recognition in 2013 related to the disposition of the 2008-2010 smart meter deferral account balances (\$57.5 million), an adjustment to unbilled revenue based on new technology implemented to enhance the revenue estimation process (\$10.7 million) (see “Revenue Recognition” below), and lower electricity consumption in 2014 (7,249.6 GWh compared to 7,278.3 GWh) (\$3.1 million). These variances were partially offset by higher revenue recognition related to the eligible in-service capital expenditures under ICM, including the IRM annual adjustment (\$22.9 million), a reduction in the distribution revenue recorded in 2013 related to an over-recovery of PILs from customers (\$16.5 million) in connection with the revision of prior year tax positions (see note 9(f) to the Consolidated Financial Statements), and revenue recognition related to the implementation of the 2014 smart meter incremental revenue requirement (\$9.6 million).

Other revenue for the three months and year ended December 31, 2014 was \$20.7 million and \$61.6 million compared to \$17.1 million and \$57.3 million for the comparable periods in 2013.

The increase in other revenue for the three months ended December 31, 2014 was primarily due to the cost efficiency incentive recorded in 2014 related to the completion of the 2011-2014 CDM programs (see “CDM Activities” below), partially offset by lower revenue in connection with duct rental fees and solar panel installations.

The increase in other revenue for the year ended December 31, 2014 was primarily due to the cost efficiency incentive recorded in 2014 related to the completion of the 2011-2014 CDM programs (see “CDM Activities” below), partially offset by lower demand billable work and lower revenue related to solar panel installations.

### ***Expenses***

Operating expenses for the three months and year ended December 31, 2014 were \$68.0 million and \$267.6 million compared to \$79.3 million and \$272.0 million for the comparable periods in 2013.

The decrease in operating expenses for the three months ended December 31, 2014 was primarily due to cost of power restoration incurred in the fourth quarter of 2013 as a result of the Ice Storm that adversely affected the City (\$10.2 million) and the recognition of operating expenses in 2013 related to the disposition of the 2008-2010 smart meter deferral account balances (\$7.1 million). These variances were partially offset by higher spending related to the tree-trimming program (\$2.0 million) and higher system maintenance costs (\$1.0 million).

The decrease in operating expenses for the year ended December 31, 2014 was primarily due to the recognition of operating expenses in 2013 related to the disposition of the 2008-2010 smart meter deferral account balances (\$7.1 million) and lower cost of power restoration incurred in the first quarter of 2014 compared to 2013 as a result of the Ice Storm that adversely affected the City (\$6.8 million). These variances were partially offset by higher system maintenance costs (\$6.9 million) and higher spending related to the tree-trimming program in 2014 (\$3.2 million).

Depreciation and amortization expense for the three months and year ended December 31, 2014 was \$41.8 million and \$160.8 million compared to \$66.7 million and \$172.8 million for the comparable periods in 2013.

The decrease in depreciation and amortization expense for the three months and year ended December 31, 2014 was primarily due to the recognition of depreciation and amortization expense related to the disposition of the 2008-2010

smart meter deferral account balances in 2013, partially offset by in-service asset additions stemming from the increase in capital expenditures.

### ***Net Financing Charges***

Net financing charges for the three months and year ended December 31, 2014 were \$17.0 million and \$63.8 million compared to \$15.0 million and \$66.2 million for the comparable periods in 2013.

The increase in net financing charges for the three months ended December 31, 2014 was primarily due to the issuance of \$200.0 million senior unsecured debentures during the third quarter of 2014 (see “Liquidity and Capital Resources” below).

The decrease in net financing charges for the year ended December 31, 2014 was primarily due to the refinancing of maturing debentures at a lower interest rate in the second quarter of 2013, partially offset by higher interest expense related to the issuance of \$200.0 million senior unsecured debentures during the third quarter of 2014.

### ***Income Tax Expense***

Income tax expense for the three months and year ended December 31, 2014 was \$4.2 million and \$12.6 million compared to \$2.5 million and \$4.3 million for the comparable periods in 2013.

The unfavourable variance in income tax expense for the three months ended December 31, 2014 was due to lower deductions for permanent and temporary differences between accounting and tax treatments.

The unfavourable variance in income tax expense for the year ended December 31, 2014 was primarily due to the favourable resolution of certain tax positions identified in prior periods and related reassessments by the Ontario Ministry of Finance in 2013 (\$4.9 million) and lower deductions for permanent and temporary differences between accounting and tax treatments in 2014 (\$3.4 million).

### **Results of Operations – 2013 compared to 2012**

Net income was \$121.2 million in 2013 compared to \$86.0 million in 2012. The increase in net income was primarily due to higher distribution revenue (\$53.7 million), restructuring costs recognized in the first quarter of 2012 (\$27.8 million) related to the cost reduction initiatives at LDC, lower net financing charges (\$7.8 million), and higher other revenue (\$4.2 million). These favourable variances were partially offset by higher depreciation expense (\$31.2 million) and higher operating expenses (\$26.9 million). For further details, see “Selected Consolidated Financial Data” above and the Corporation’s 2013 annual MD&A as filed on the System for Electronic Document Analysis and Retrieval website at [www.sedar.com](http://www.sedar.com).

## Quarterly Results of Operations

The table below presents the Corporation's unaudited quarterly consolidated financial information for 2014 and 2013, which has been prepared in accordance with US GAAP. The number of issued and outstanding shares of the Corporation during the eight quarters noted below was 1,000.

<b>Quarterly Results of Operations</b> (in millions of Canadian dollars, unaudited)				
	<b>December 31</b> <b>2014</b> \$	<b>September 30</b> <b>2014</b> \$	<b>June 30</b> <b>2014</b> \$	<b>March 31</b> <b>2014</b> \$
Revenues	857.8	825.5	769.5	863.4
Net income	23.7	35.1	31.2	22.5
	<b>December 31</b> <b>2013</b> \$	<b>September 30</b> <b>2013</b> \$	<b>June 30</b> <b>2013</b> \$	<b>March 31</b> <b>2013</b> \$
Revenues	819.6	833.3	792.9	756.9
Net income	29.3	35.8	37.6	18.5

The Corporation's revenues, all other things being equal, are impacted by changes in temperature. Revenues 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.

The Corporation's quarterly results are also impacted by fluctuations in electricity prices and the timing and recognition of regulatory decisions. This resulted in a variation from the trend noted above for 2014 and 2013. Commodity costs increased throughout the year as a result of global adjustments (see "Electricity Distribution – Industry Overview" above) in both years, and higher distribution revenue was recognized in the fourth quarter of 2013 as a result of the disposition of the 2008-2010 smart meter deferral account balances.

## Financial Position

The following table outlines the significant changes in the consolidated balance sheet as at December 31, 2014 as compared to the consolidated balance sheet as at December 31, 2013.

<b>Consolidated Balance Sheet Data</b> (in millions of Canadian dollars)		
<b>Balance Sheet Account</b>	<b>Increase</b> <b>(Decrease)</b> \$	<b>Explanation of Significant Change</b>
<b>Assets</b>		
Accounts receivable (net of allowance for doubtful accounts) and unbilled revenue	(15.1)	The decrease was primarily due to lower electricity consumption and an adjustment in unbilled revenue based on new technology implemented (see "Revenue Recognition" below), partially offset by timing variances of billing and collection activities from electricity customers.

**Consolidated Balance Sheet Data  
(in millions of Canadian dollars)**

Balance Sheet Account	Increase (Decrease) \$	Explanation of Significant Change
PP&E and intangible assets, net	179.9	The increase was primarily due to capital expenditures, partially offset by net eligible in-service capital expenditures under ICM reclassified to regulatory assets per the direction from the OEB and depreciation during the period.
Regulatory assets	334.7	The increase was primarily due to the reclassification of ICM-related net eligible in-service capital expenditures (see note 9(a) to the Consolidated Financial Statements), the recognition of actuarial losses of post-retirement benefits, and the retail settlement variance between IESO charges and approved customer charges.
Deferred income tax assets	(27.2)	The decrease was due to lower net deductible temporary differences between tax and accounting values of PP&E.
<b>Liabilities and Shareholder's Equity</b>		
Working capital facility and commercial paper	145.0	The increase was primarily due to funding required for the Corporation's significant capital program.
Accounts payable and accrued liabilities	79.4	The increase was primarily due to higher capital activity and higher electricity commodity costs payable to the IESO.
Deferred conservation credit and deferred revenue	(19.0)	The decrease was primarily due to the actual spend related to CDM activities in 2014, reclassification of a payable due to the IESO, and cost efficiency incentives related to the 2011-2014 CDM programs (see "CDM Activities" below).
Debentures	200.0	The increase was due to the issuance of \$200.0 million senior unsecured debentures during the third quarter of 2014, which was required to support the Corporation's significant capital program.
Post-retirement benefits	54.8	The increase was primarily due to the actuarial loss recorded in 2014 driven by changes in actuarial assumptions and discount rate.
Regulatory liabilities	(25.3)	The decrease was primarily due to a reduction of deferred income tax assets, the benefit of which will be payable to customers.



**Consolidated Balance Sheet Data**  
(in millions of Canadian dollars)

Balance Sheet Account	Increase (Decrease) \$	Explanation of Significant Change
Retained earnings	51.9	The increase in retained earnings was due to net income for the year (\$112.5 million), offset by dividends paid (\$60.6 million).

## Liquidity and Capital Resources

### *Sources of Liquidity and Capital Resources*

The Corporation's current assets and current liabilities amounted to \$550.3 million and \$902.6 million, respectively, as at December 31, 2014, resulting in a working capital deficit of \$352.3 million. The deficit is attributable to the Corporation's preference for utilizing its Commercial Paper Program and Working Capital Facility before issuing additional debentures to fulfill the Corporation's liquidity requirements, including significant capital spending in the current year. The Corporation seeks to maintain an optimal mix of short-term and long-term debt in order to lower financing costs and enhance borrowing flexibility.

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, and to meet financing obligations. See "Liquidity Risk" under note 15 (b) to the Consolidated Financial Statements.

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

The Corporation is a party to a credit agreement with a syndicate of Canadian chartered banks which established a revolving credit facility expiring on October 10, 2019 ("Revolving Credit Facility"), pursuant to which it may borrow up to \$700.0 million, of which up to \$210.0 million is available in the form of letters of credit. On June 13, 2014, the borrowing capacity under the Revolving Credit Facility was increased from \$600.0 million to \$700.0 million and the expiry date extended from October 10, 2018 to October 10, 2019. 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 Corporation's debt to capitalization ratio not exceed 75%. As at December 31, 2014, the Corporation was in compliance with all covenants included in its Revolving Credit Facility.

The Corporation has a commercial paper program allowing up to \$500.0 million of unsecured short-term promissory notes ("Commercial Paper Program") to be issued in various maturities of no more than one year. On June 13, 2014, the amount the Corporation may issue under this program was increased from \$400.0 million to \$500.0 million. The Commercial Paper Program is supported by liquidity facilities available under the Revolving Credit Facility; hence, available borrowing under the 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. 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 \$75.0 million 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 \$20.0 million for the purpose of working capital management ("Working Capital Facility").

The outstanding borrowings under the Revolving Credit Facility and Commercial Paper Program are as follows:

	Facility Limit	Facility Borrowings	Commercial Paper	Facility Availability
	\$	\$	\$	\$
December 31, 2014	700.0	—	308.0	392.0
December 31, 2013	600.0	—	150.0	450.0

As at December 31, 2014, \$6.1 million had been drawn under the Working Capital Facility and \$29.7 million of letters of credit had been issued against the Prudential Facility.

For the three months and year ended December 31, 2014, the average outstanding borrowings under the Corporation's credit facilities and commercial paper, excluding the Prudential Facility, were \$265.9 million and \$250.3 million with weighted average interest rates of 1.19% and 1.18%, respectively.

The Corporation filed a base shelf prospectus dated January 9, 2015 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 \$1.0 billion during the 25-month period following the date of the prospectus.

On September 16, 2014, the Corporation issued \$200.0 million of 4.08% senior unsecured debentures at a price of \$999.48 per \$1,000 principal amount due September 16, 2044 ("Series 10"). The Series 10 debentures bear interest payable semi-annually in arrears. The net proceeds of the debentures were used to repay certain existing indebtedness of the Corporation and for general corporate purposes. Debt issuance costs of \$1.6 million relating to the Series 10 debentures were deferred as other assets in the third quarter of 2014 and are amortized to net financing charges using the effective interest method.

The Corporation may redeem all or part of its outstanding 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, 2014, the Corporation was in compliance with all covenants included in its trust indenture and supplemental trust indentures.

As at December 31, 2014, the Corporation had long-term debentures outstanding in the principal amount of \$1.65 billion. These debentures mature between 2017 and 2063.

The Corporation's commercial paper and debentures were rated as follows:

**Credit Ratings**  
**As at December 31, 2014**

	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 millions of Canadian dollars)

	Three months		Year	
	Ended December 31		Ended December 31	
	2014	2013	2014	2013
	\$	\$	\$	\$
Cash and cash equivalents, beginning of period	-	-	-	76.6
Net cash provided by operating activities	55.7	79.7	254.9	236.3
Net cash used in investing activities	(147.7)	(126.9)	(533.9)	(411.7)
Net cash provided by financing activities	92.0	47.2	279.0	98.8
Cash and cash equivalents, end of period	-	-	-	-

***Net Cash Provided by Operating Activities***

Net cash provided by operating activities for the three months and year ended December 31, 2014 was \$55.7 million and \$254.9 million compared to \$79.7 million and \$236.3 million for the comparable periods in 2013.

The decrease in net cash provided by operating activities for the three months ended December 31, 2014 was primarily due to lower net income after adjustments for non-cash items.

The increase in net cash provided by operating activities for the year ended December 31, 2014 was primarily due to the movement in non-cash working capital balances (see note 19 to the Consolidated Financial Statements), partially offset by net changes in regulatory assets and liabilities and lower net income after adjustments for non-cash items.

***Net Cash Used in Investing Activities***

Net cash used in investing activities for the three months and year ended December 31, 2014 was \$147.7 million and \$533.9 million compared to \$126.9 million and \$411.7 million for the comparable periods in 2013.

The increase in net cash used in investing activities for the three months and year ended December 31, 2014 was primarily due to higher capital expenditures in 2014.

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. As well, Toronto continues to have one of the highest number of high-rise buildings under construction in North America, resulting in increased capital programs by LDC.

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

	<b>Capital Expenditures</b> (in millions of Canadian dollars, unaudited)			
	<b>Three months</b>		<b>Year</b>	
	<b>Ended December 31</b>		<b>Ended December 31</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Regulated LDC				
Distribution system				
Planned	97.3	108.4	357.6	330.7
Reactive	10.6	15.2	39.0	36.1
Copeland Station	26.1	9.5	82.1	45.3
Facilities consolidation	12.7	4.9	70.8	8.6
Technology assets	7.5	6.8	18.6	17.1
Other <sup>1</sup>	13.0	5.8	17.4	7.9
	167.2	150.6	585.5	445.7
Other <sup>2</sup>	0.8	1.3	2.9	4.7
<b>Total Capital Expenditures</b>	<b>168.0</b>	<b>151.9</b>	<b>588.4</b>	<b>450.4</b>

<sup>1</sup> Includes fleet capital and buildings.

<sup>2</sup> Includes unregulated capital expenditures primarily related to TH Energy equipment.

The total regulated capital expenditures were \$167.2 million and \$585.5 million for the three months and year ended December 31, 2014 compared to \$150.6 million and \$445.7 million for the comparable periods in 2013. For the year ended December 31, 2014, the increase in regulated capital expenditures was primarily related to spending on underground infrastructure (\$64.5 million), the facilities consolidation program (\$62.2 million), Copeland Station (\$36.8 million), and overhead infrastructure (\$35.4 million). These variances were partially offset by a decrease in Hydro One capital contributions included in planned expenditures (\$14.5 million), network infrastructure and equipment spending (\$13.4 million), customer connections (\$12.0 million), externally-initiated plant relocations and expansions (\$7.9 million), and feeder automation (\$6.4 million).

The largest capital initiatives in 2014 included the replacement of underground infrastructure, the replacement of overhead infrastructure, the construction of Copeland Station in response to the growing need for distribution options in the downtown core of the City, the facilities consolidation program, and the delivery of customer connections.

The replacement of underground infrastructure includes replacing direct buried cables, transformer switches, handwells, and other aging underground infrastructure. The replacement of overhead infrastructure includes replacing poles, overhead transformers, conductors, overhead switches and other aging overhead infrastructure and equipment. Both initiatives will allow LDC to continue to provide ongoing safe and reliable service to its customers. For the year ended December 31, 2014, capital expenditures for the underground infrastructure and the overhead initiatives were \$134.3 million and \$115.6 million, respectively.

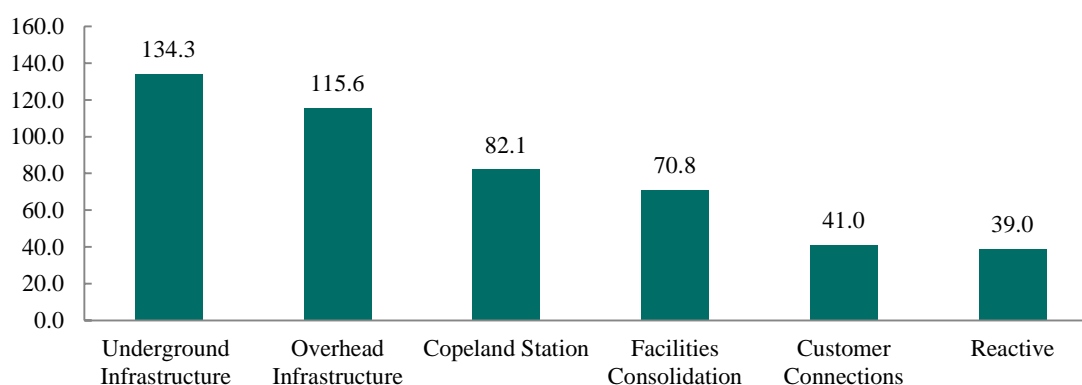
On May 22, 2013, the Corporation celebrated the official ground-breaking at Copeland Station. During the second quarter of 2014, the gas-insulated transformers and the high and medium voltage switchgear were manufactured and delivered. During the third quarter of 2014, the tunnel boring was completed as required to connect the new infrastructure to the transmission grid. During the fourth quarter of 2014, the transformer floor in the new building was completed. As at December 31, 2014, the cumulative capital expenditures on the Copeland Station project amounted to \$142.6 million, of which \$82.1 million was recorded in 2014. The \$142.6 million in costs incurred relates to land and building (\$47.8 million), capital contributions to Hydro One (\$41.1 million), tunnel and other (\$27.3 million), and equipment (\$26.4 million). All capital expenditures related to Copeland Station are recorded to PP&E. Copeland Station is one of the most complex projects ever undertaken by the Corporation and unforeseen delays have extended the expected completion date from 2015 to 2016. The delays are attributable to a variety of factors, including the effect of unusually adverse weather events, challenging site conditions and contractor performance. Other causes of delay include unforeseen obstructions found on site, and delays in securing appropriate permits for certain on-site

activities. Despite the delays, the total capital expenditures required to complete Copeland Station are expected to remain at approximately \$195.0 million, plus AFUDC as applicable.

The facilities consolidation program relates to the consolidation of operating centres to lower operating centre costs and simplify long-term planning. The facilities consolidation program will decrease the total number of operating centres by two upon completion. In 2014, the Corporation began relocating staff, equipment and operations as well as performing the required capital investment on specific properties as part of this program and incurred \$57.0 million in costs. Expected net proceeds on the sale of two surplus properties have been included in the rate application to mitigate electricity distribution rate increases. In the second quarter of 2014, the Corporation also purchased a property in the west end of the City for \$13.1 million, which will become an operating centre. On March 3, 2015, the Corporation sold one of the surplus properties owned by LDC for \$10.5 million. The expected gain of \$5.9 million, subject to finalization of the costs related to the sale, will be paid to customers in the future as part of the benefits of the facilities consolidation program (see note 11 to the Consolidated Financial Statements).

The delivery of customer connections includes spending related to new services and upgrades to existing services for specific commercial customers. For the year ended December 31, 2014, capital expenditures for the delivery of customer connections were \$41.0 million, net of related capital contributions received of \$28.7 million.

**Most Significant Regulated Capital Initiatives**  
(\$ Millions)  
Year ended December 31, 2014



***Net Cash Provided by Financing Activities***

Net cash provided by financing activities for the three months and year ended December 31, 2014 was \$92.0 million and \$279.0 million compared to \$47.2 million and \$98.8 million for the comparable periods in 2013.

The increase in net cash provided by financing activities for the three months ended December 31, 2014 was primarily due to increased short-term borrowings for general corporate purposes.

The increase in net cash provided by financing activities for the year ended December 31, 2014 was primarily due to increased borrowings required to fund the Corporation’s larger capital program compared to the prior year. In the third quarter of 2014, net proceeds from the issuance of \$200.0 million of senior unsecured debentures due on September 16, 2044 were utilized to reduce the balance of outstanding commercial paper and for general corporate purposes.

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 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:

- \$6.3 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, 2014, the Board of Directors of the Corporation declared and paid dividends totalling \$60.6 million to the City.

On March 5, 2015, the Board of Directors of the Corporation declared dividends in the amount of \$37.5 million. The dividends consisted of \$31.2 million with respect to net income for the year ended December 31, 2014, payable to the City on March 13, 2015, and \$6.3 million with respect to the first quarter of 2015, payable to the City on March 31, 2015.

### ***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, 2014**  
**(in millions of Canadian dollars, unaudited)**

	Total \$	2015 \$	2016/2017 \$	2018/2019 \$	After 2019 \$
Working capital facility	6.1	6.1	-	-	-
Commercial paper <sup>1</sup>	308.0	308.0	-	-	-
Debentures – principal repayment	1,650.0	-	250.0	250.0	1,150.0
Debentures – interest payments	1,142.4	69.2	138.4	112.4	822.4
Operating leases	13.8	6.1	7.7	-	-
Capital projects <sup>2</sup> and other	50.1	37.7	12.4	-	-
Capital leases	10.2	3.0	5.8	1.4	-
<b>Total contractual obligations and other commitments</b>	<b>3,180.6</b>	<b>430.1</b>	<b>414.3</b>	<b>363.8</b>	<b>1,972.4</b>

<sup>1</sup> The notes under the Commercial Paper Program were issued at a discount and are repaid at their principal amount.

<sup>2</sup> Reflects capital project commitments for construction services and estimated capital contributions, with the majority related to Copeland Station.

### **Corporate Developments**

#### ***Changes to the Corporation's Board of Directors and Audit Committee***

Effective September 1, 2014, Vince Brescia resigned as an independent director of the Corporation and as a member of the Audit Committee. Effective September 2, 2014, Brian Chu, who is a director of LDC, was appointed to the Audit Committee.

Effective December 3, 2014, the City, as the sole shareholder of the Corporation, appointed councillor Stephen Holyday, councillor Denzil Minnan-Wong and councillor Vincent Crisanti to the Board of Directors to replace councillor Shelley Carroll, councillor Josh Colle and councillor Gloria Lindsay Luby. Effective December 15, 2014, councillor Vincent Crisanti resigned from the Board of Directors. Effective February 10, 2015, the City appointed councillor Paul Ainslie to the Board of Directors. The appointments of councillors Holyday, Minnan-Wong and Ainslie are effective for a term ending December 31, 2016, or until their successors are appointed.

#### ***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. On April 2, 2013, the OEB approved new rates for LDC effective June 1, 2013, which reflected approved capital expenditures amounting to \$203.3 million for 2012 and \$484.2 million for 2013. In a separate decision rendered on December 19, 2013, the OEB approved capital expenditures amounting to \$398.8 million for 2014.

On January 16, 2014, the OEB approved LDC's request for disposition of the smart meter deferral account balances related to smart meter installations in 2008, 2009 and 2010 through two separate rate riders effective May 1, 2014 (see note 9(d) to the Consolidated Financial Statements). The first rate rider relates to the recovery of \$23.9 million, representing the cumulative revenue requirement net of recoveries from an existing smart meter rate rider. This existing smart meter rate rider was discontinued when the new rate riders became effective. The second rate rider relates to the recovery of \$9.6 million, representing the forecasted 2014 incremental revenue requirement.

On July 31, 2014, LDC filed a rate application with the OEB under the Custom Incentive Rate-setting mechanism, seeking approval of LDC's 2015 test year revenue requirement and corresponding electricity distribution rates effective May 1, 2015, and subsequent annual rate adjustments based on a custom index for the period commencing on January 1, 2016 and ending on December 31, 2019. The rate application includes requests for approval of capital expenditures of approximately \$2.5 billion over the 2015-2019 period. The rate application also seeks approval to include in LDC's rate base capital amounts that were prudently incurred prior to 2015 which are subject to review by the OEB. In addition, LDC seeks approval to recover the net book value of stranded meters (see note 9(d) to the Consolidated Financial Statements). LDC's revenues over the period will be based on the existing rate base, capital expenditures and operating expenses ultimately approved by the OEB in the rate application plus cost of capital allowed by the OEB.

On August 3, 2011, the OEB issued its final decision allowing the transfer of a portion of the street lighting assets to the new wholly-owned legal entity (1798594 Ontario Inc.), and for LDC to amalgamate with the new legal entity. The OEB decided that the rate base, revenue requirement and rate consequences of the transfer would be decided at LDC's next cost of service or rebasing rate application. On January 1, 2012, the Corporation completed the asset transfer and amalgamation. The purchase price for such assets, including a post-closing adjustment, was \$42.5 million, subject to transaction costs. On July 31, 2014, LDC filed the above noted rate application with the OEB seeking a final determination of the rate base, revenue requirement and rate consequences of the street lighting transfer.

### ***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 to support achievement of the mandatory CDM targets described above. LDC applied to the OPA in March 2014 to revise the program administration budget to \$45.8 million for the delivery of CDM programs from 2011 to 2014. 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 and deferred revenue. 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. As at December 31, 2014, LDC has estimated that approximately \$5.7 million qualified as cost efficiency incentives, and approximately \$4.9 million is repayable to the OPA for the remaining program administration budget and included within accounts payable and accrued liabilities.

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. Funding and respective targets for CDM programs approved pursuant to the 2011-2014 OPA agreement that have in-service dates in 2015 will be allocated toward the 2011-2014 program. LDC has requested separate funding from the OPA relating to these transitional CDM programs for 2015.

On March 26, 2014, the Minister of Energy of Ontario, under the guidance of sections 27.1 and 27.2 of the OEB Act, directed the OEB to amend the licence of each licensed electricity distributor to require the electricity distributor, as a condition of its licence, to make CDM programs available to customers in its licensed service area and to do so in relation to each customer segment in its service area, over the period beginning January 1, 2015 through December 31, 2020. On March 31, 2014, the Minister of Energy of Ontario issued a direction to require the OPA to coordinate, support and fund the delivery of CDM programs through electricity distributors. The OPA’s objective is to reduce electricity consumption by a total of 7 terawatt hours between January 1, 2015 and December 31, 2020, of which LDC’s share is approximately 1,576 GWh of energy savings.

On November 13, 2014, LDC entered into an energy conservation agreement with the OPA for the delivery of these CDM programs over the 2015-2020 period with funding of approximately \$400.0 million, which includes participant incentives and LDC program administration costs. LDC is required to provide to the IESO its plan for achieving its CDM target by May 1, 2015. LDC also has the option to submit a joint CDM plan with one or more distribution companies. LDC can choose between full cost recovery funding, pay-for-performance funding, or a combination of both, for each CDM program. Under the full cost recovery funding method, the IESO reimburses LDC for all adequately documented costs incurred with an option to receive a portion of its funding in advance. Cost efficiency incentives may be awarded if LDC’s electricity savings meet or exceed certain CDM plan targets for programs under the full cost recovery funding method, with a mid-term review to be performed by the IESO for the 2015-2017 periods. Under the pay-for-performance funding method, LDC receives payment in arrears based on verified electricity savings achieved with various options for frequency of payment.

**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 any applicable liability insurance policies which the Corporation believes would cover any damages which may become payable by the Corporation and its subsidiaries in connection with these actions, subject to such claim not being disputed by the insurer. See note 22 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. All issued shares were fully paid.

**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 millions of Canadian dollars)**

	Year	
	Ended December 31	
	2014	2013
	\$	\$
Revenues	238.6	246.9
Operating expenses and capital expenditures	20.8	31.9
Dividends	60.6	43.0



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

	<b>As at December 31</b>	
	<b>2014</b>	<b>2013</b>
	<b>\$</b>	<b>\$</b>
Accounts receivable	9.4	5.6
Unbilled revenue	22.3	19.4
Accounts payable and accrued liabilities	43.2	45.5
Advance deposits	8.2	8.8

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 represents receivables from the City primarily for electricity, street lighting and ancillary services. Unbilled revenue represents receivables from the City related mainly to electricity 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 year ended December 31, 2014. Based on their knowledge and exercise of reasonable diligence, they have concluded that these documents fairly present in all material respects the financial condition, financial performance and cash flows of the Corporation as at the date of and for the period 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:

### ***Condition of Distribution Assets***

LDC estimates that approximately one-third of its electricity distribution assets have already exceeded or will reach their expected useful lives within the next 5-year period. 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 capital and maintenance programs. 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.

### ***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. Among other things, there can be no assurance that:

- the OEB will approve LDC's electricity distribution rates, 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 are made available to LDC 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.

### ***Information Technology Infrastructure***

The Corporation'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 the Corporation's 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 implementation of high availability and redundancy in its core infrastructure and application components. Electricity distribution systems are isolated from business systems and operate independently.

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. LDC has implemented security controls aligned with industry best practices and standards including the National Institute of Standards and Technology Cybersecurity Framework. Preventative controls are employed to protect information and technology assets against cyber-attacks and mitigate their effects. Detective controls are employed to continuously monitor information systems so that LDC can respond appropriately to minimize the damage in the event of a cyber-attack. Even with these measures in place, there can be no assurance that such measures will be 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. 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). Additionally, consumption may be decreased in the future due to the impact of CDM programs, distributed generation, renewable energy, and advances in technology. The current pace of technological advancement in distributed generation, renewable energy, and energy efficiency in both appliances and equipment could reduce consumption as costs for new technology decrease and usage becomes widespread. 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 (i.e., 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. 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. 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, 2014, by \$45.7 million, and a 1% (100 basis point) decrease in the discount rate would increase the accrued benefit obligation, as at December 31, 2014, by \$59.4 million.

As at December 31, 2014, aside from the valuation of its post-retirement benefit obligations, the Corporation was exposed to short-term interest rate risk on the short-term borrowings under its Commercial Paper Program and Working Capital Facility, and customers' advance deposits, 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 manages interest rate risk by monitoring its mix of fixed and floating rate instruments, and taking action as necessary to maintain an appropriate balance. 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 \$3.6 million to annual net financing charges.

### ***Additional Debt Financing and Credit Rating***

Cash generated from operations, after the payment of dividends, is not expected to be sufficient to repay existing indebtedness, fund capital expenditures and meet other liquidity requirements over the next 12 months. The Corporation relies on debt financing through its medium-term note program, Commercial Paper Program or existing credit facilities to finance the Corporation's daily operations, repay existing indebtedness, 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 ratings assigned to short-term borrowings under the Corporation's Commercial Paper Program, and the availability of the commercial paper market. See notes 12 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.

### ***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, physical damage to certain automobiles, and deductibles). 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.

### ***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.

### ***Conflicts of Interest***

The City owns all of the outstanding shares of the Corporation and has the power through the Shareholder Direction 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.

### ***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.

### ***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 regulated electricity distributors authorized to serve a single area are likely to result in the continuation of the practice of having a single regulated 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.

### ***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 for 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***

Revenues from energy sales and distribution are recorded on the basis of cyclical billings and include an estimated amount for electricity delivered and not yet billed, 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, included as part of distribution revenue, is recognized on the basis of in-service assets. Other revenue, which includes revenue from services ancillary to the distribution of electricity, revenue from the delivery of street lighting services and revenue from demand billable activities, is recognized as the services are rendered. Revenue not yet recognized from demand billable activities is included within deferred conservation credit and deferred revenue.

Revenues and costs associated with CDM programs are presented using the net basis of accounting. Cost efficiency incentives related to the CDM programs, included as part of other revenue, are recognized when they are considered earned and the amount realizable can be reasonably estimated.

In December 2014, the Corporation revised its estimate of unbilled revenue based on new technology implemented to enhance the revenue estimation process. This change has been accounted for on a prospective basis in the Consolidated Financial Statements as at December 31, 2014. For the three months and year ended December 31, 2014, the change in estimate reduced unbilled revenue by \$7.7 million, settlement variances by \$3.0 million, and distribution revenue by \$10.7 million.

### ***Regulatory Assets and Liabilities***

As at December 31, 2014, regulatory assets amounted to \$576.2 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 of post-retirement benefits. As at December 31, 2014, regulatory liabilities amounted to \$157.8 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 can be no assurance that actual employee future benefits cost will not differ significantly from the estimates calculated using management's assumptions.

### **Significant Accounting Policies**

The Corporation's Consolidated Financial Statements have been prepared in accordance with US GAAP with respect to the preparation of financial information. These Consolidated Financial Statements are presented in Canadian dollars, which is the Corporation's functional currency. 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 IESO, the Ontario Ministry of Energy, or the Ontario Ministry of Finance. The significant accounting policies of the Corporation are summarized in notes 2 and 4 to the Consolidated Financial Statements.

### **Future Accounting Pronouncements and IFRS Conversion Project**

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 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 will be prepared in accordance with IFRS with a transition date of January

1, 2014. The Corporation will apply the provisions of IFRS 14 – “Regulatory Deferral Accounts” (“IFRS 14”) in its first annual IFRS financial statements.

In May 2014, the FASB and IASB issued their converged standard, “Revenue from Contracts with Customers”, which replaces existing revenue recognition guidance with a single model for recognizing revenue from contracts with customers except for leases, financial instruments and insurance contracts. The new IFRS standard is effective for annual reporting periods beginning on or after January 1, 2017. The Corporation is currently evaluating the impact of the new standard.

**Rate-Regulated Accounting**

On September 17, 2014, the IASB issued a Discussion Paper – Reporting the Financial Effects of Rate Regulation (“DP”) as part of its active research programme to assess whether to develop proposals for a permanent standard for reporting specified financial effects of rate-regulation. This project is separate from the issuance of IFRS 14 which allowed first-time adopters to continue to apply their previous GAAP recognition and measurement policies for RDAs until the IASB concludes on the outcome of the DP. The comment period on the DP ended on January 15, 2015. The Corporation issued a separate and a joint letter with the Canadian Electricity Association in support of the DP.

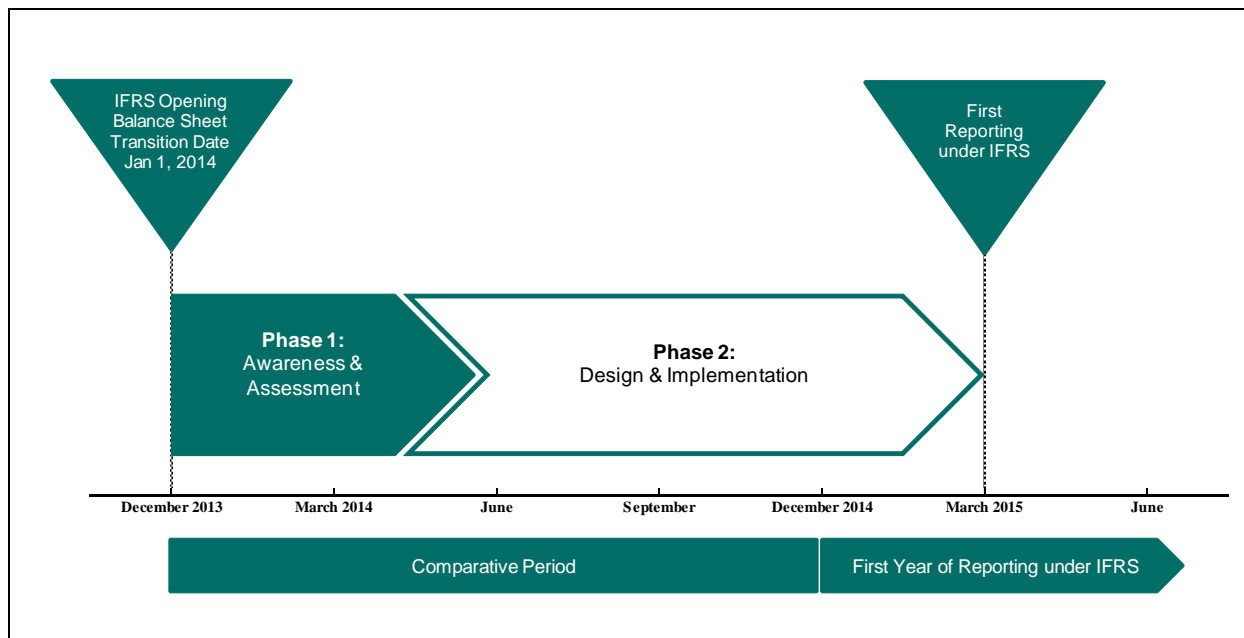
**IFRS Conversion Project**

The information below is provided for a better understanding of the Corporation’s IFRS changeover plan and the resulting possible impacts. The differences identified to date should not be regarded as an exhaustive list and other changes may result from the conversion to IFRS. Furthermore, the disclosed impacts of the conversion reflect the Corporation’s most recent assumptions, estimates and expectations. Circumstance may arise, such as changes in IFRS, regulations or economic conditions, which combined with the inherent uncertainty from the use of assumptions, could change the actual impacts of the conversion from those presented below.

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 has completed the awareness and assessment phase, which involved determining the areas with the highest potential impact to the Corporation’s accounting and disclosures, assessing the impact of the IFRS conversion on the Corporation’s systems, processes and controls, as well as regulatory, tax and other business processes, and establishing a communication plan and staff-training plan.

The Corporation has completed the design phase of the project, which involved establishing issue-specific working groups in each of the identified areas. The working groups established key milestones, which included developing recommendations, analyzing financial system and internal control impact, developing significant accounting policies, and carrying out ongoing discussions with external auditors, in each area.

The roll-out of the changes developed in the design phase takes place during the implementation phase which is currently in progress. The implementation phase involves 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, and assessing the ongoing impact on the IFRS financial statements and related disclosures.

The following section provides certain key activities of the changeover plan and an assessment of the Corporation’s progress at this time.

Key Activities	Status
<b>Accounting policies &amp; procedures:</b>	
<ul style="list-style-type: none"> <li>High level review of major differences between US GAAP and IFRS</li> <li>Establish issue-specific working groups in the identified areas</li> <li>Detailed assessment of accounting and disclosure differences, accounting policy choices and IFRS 1 – “First-time Adoption of IFRS” (“IFRS 1”) elections available</li> <li>Develop recommendations and accounting policies through ongoing discussions with external auditors</li> <li>Finalize new accounting policies and accounting manuals</li> </ul>	<ul style="list-style-type: none"> <li>All accounting policy positions have been developed and approved by senior management, the Audit Committee, and the Board of Directors</li> <li>Continue to monitor ongoing IASB projects and assess potential impact</li> <li>Accounting policies and procedure manuals continue to be updated based on the IASB project developments</li> </ul>
<b>Financial statement preparation:</b>	
<ul style="list-style-type: none"> <li>Identify US GAAP to IFRS financial statement presentation differences and design interim and annual financial statement formats and related notes disclosures</li> <li>Simulate the financial reporting process under IFRS</li> <li>Prepare the opening balance sheet on the date of transition and IFRS 1 related reconciliations and disclosures</li> <li>Assess ongoing impact on the IFRS financial statements and related disclosures</li> </ul>	<ul style="list-style-type: none"> <li>Developed draft financial statement formats</li> <li>Completed testing of system related modifications to IFRS generated financial statements</li> <li>Preparation of the opening balance sheet on transition date has been completed and the audit is currently in progress</li> <li>Calculation of quarterly comparative IFRS amounts for 2014 continues to be in progress</li> </ul>
<b>Training &amp; communication:</b>	
<ul style="list-style-type: none"> <li>Provide training to affected finance and operational teams, management and the Audit Committee of the Board of Directors</li> <li>Develop and execute staff training plan, and roll out communication initiatives</li> <li>Continue to update the Audit Committee and senior management on a quarterly basis for key developments in IFRS and the potential impact to the Corporation’s financial statements</li> </ul>	<ul style="list-style-type: none"> <li>Completed detailed training for resources directly engaged in the changeover and general awareness training to broader group of finance employees. Specific IFRS training for the Audit Committee has been completed</li> <li>Continue to provide topic-specific and relevant training to finance and operational teams on all finalized positions. Key areas include RDAs, PP&amp;E, employee future benefits, capital contributions, and financial statement presentation.</li> <li>Continue ongoing, periodic internal and external communications on the Corporation’s progress on the IFRS project and direction</li> </ul>
<b>Business impact:</b>	
<ul style="list-style-type: none"> <li>Evaluate impact and implement necessary changes to debt covenants, internal performance measures, contracts and processes</li> </ul>	<ul style="list-style-type: none"> <li>Impact to debt covenants, regulatory and other business processes has been assessed and modifications to processes is in progress</li> <li>Determined that the transition to IFRS will have no significant impact to the Corporation’s debt covenants and the Corporation should remain in compliance with its financial covenants using IFRS financial information</li> </ul>



Key Activities	Status
Information technology systems:	
<ul style="list-style-type: none"> <li>Analysis of financial system to identify required modifications</li> <li>Test the effectiveness of the changes made to systems</li> <li>Ensure solution captures financial information under US GAAP and IFRS during the year of transition for comparative reporting purposes</li> </ul>	<ul style="list-style-type: none"> <li>Completed system changes for reporting purposes including subledger configurations for derecognition and depreciation at a component level. System changes to reflect new financial statement presentation required under the RDA standard have also been completed</li> <li>Completed modifications to the system to accommodate the January 1, 2014 transition date and continue to accumulate IFRS data for reporting comparative information</li> <li>Continue to implement remaining required modifications to financial systems</li> </ul>
Control environment:	
<ul style="list-style-type: none"> <li>Detailed assessment of the impact of IFRS conversion on people, systems, processes and internal controls</li> <li>Analyze and update internal control processes and documentation</li> <li>Implement related controls and procedures to ensure the integrity and effectiveness of internal controls over financial reporting (“ICFR”) and disclosure controls and procedures (“DC&amp;P”)</li> </ul>	<ul style="list-style-type: none"> <li>Based on the accounting policies and procedures developed, the Corporation continues to evaluate and document the impact on new and existing controls to ensure the integrity and effectiveness of ICFR and DC&amp;P</li> <li>Additional controls have been implemented to address first-time IFRS adoption and new processes implemented to support ongoing IFRS reporting requirements, including key areas such as derecognition, PP&amp;E and RDAs. These controls have been implemented and tested on a timely basis for reporting under IFRS in 2015</li> </ul>

### IFRS 1 Exemptions

In general, a first-time adopter is required to apply IFRS 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 exceptions and optional exemptions to the retrospective application are available. The Corporation has made an assessment of the IFRS 1 optional exemptions and will make the following elections upon transition.

IFRS Optional Exemption	Description	Policy Selection
Rate-regulated deemed cost	An entity that is subject to rate regulation may elect to use the previous GAAP carrying amount of PP&E or intangible assets at the date of transition to IFRS as deemed cost.	The Corporation will elect this exemption except for construction in progress items for which capital contributions have been received. This will result in a decrease of \$2,625.8 million to both cost and accumulated depreciation of PP&E and intangible assets as at January 1, 2014.
Borrowing Costs	IAS 23 – “Borrowing Costs” (“IAS 23”) requires the capitalization of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. IFRS 1 provides an optional exemption that permits application of the requirements of IAS 23 prospectively from the date of transition.	The Corporation will elect this exemption and consequently, will not have an adjustment to its opening balance sheet as at January 1, 2014.
Decommissioning liabilities included in the cost of PP&E	IFRS 1 provides an optional exemption that permits a first-time adopter to use a simplified method to recalculate its decommissioning provisions in accordance with IFRS at the transition date.	The Corporation will elect this exemption, which will result in an increase to the RDAs and a decrease to PP&E of \$0.9 million as at January 1, 2014.
Leases	IFRIC 4 – “Determining whether an Arrangement contains a Lease” (“IFRIC 4”) requires the assessment of whether an arrangement contains a lease to be based on the facts and circumstances existing at the date of the inception of the arrangement. IFRS 1 provides an optional exemption that permits an entity that made the same determination of whether an arrangement contains a lease under its previous GAAP as that required by IFRIC 4, but at a date other than that required by IFRIC 4, not to reassess that determination when it adopts IFRS.	The Corporation will elect this exemption and thus will not be required to make any additional assessments at the date of transition.

IFRS Optional Exemption	Description	Policy Selection
Business Combinations	IFRS 1 provides an optional exemption for a first-time adopter not to apply IFRS 3 – “Business Combinations” retrospectively to past business combinations occurred prior to the date of transition.	The Corporation will elect this exemption and thus will not restate any such business combinations.
Transfer of Assets from Customers (Capital Contributions)	IFRS 1 provides an optional exemption for a first-time adopter to apply IFRIC 18 – “Transfer from Customers” (“IFRIC 18”) prospectively to transfers of assets from customers received on or after the date of transition.	The Corporation will not elect this exemption and will instead apply IFRIC 18 retrospectively to all customer contributions received prior to the date of transition. However, the use of the rate-regulated deemed cost exemption noted above means that no adjustment will be made to the contributions included in the PP&E deemed cost.

### IFRS 14 – RDAs

In January 2014, the IASB issued IFRS 14 as an interim standard giving entities conducting rate regulated activities the option of continuing to recognize RDAs according to their previous GAAP. RDAs provide useful information about the Corporation’s financial position, activities, and future cash flows and as such, the Corporation has elected to adopt the provisions of IFRS 14 as part of the conversion from US GAAP to IFRS. IFRS 14 will remain in force until either repealed or replaced by permanent guidance on rate regulated accounting from the IASB.

### IFRS Accounting Impacts and Financial Statement Adjustment at Transition Date

The Corporation completed a detailed assessment of the accounting and disclosure differences between US GAAP and IFRS. The following reconciliation presents the differences between US GAAP and IFRS for the Corporation’s unaudited opening consolidated balance sheet as at January 1, 2014. The notes below the table explain the significant differences and financial statement adjustments that will be recorded at the date of transition. The retrospective adjustment to the January 1, 2014 shareholder’s equity balance is \$0.9 million.

**Consolidated Balance Sheet**  
(in millions of Canadian dollars)

As at January 1, 2014	Notes	US GAAP \$	Transitional Adjustments \$	IFRS \$
<b>ASSETS</b>				
<b>Current</b>				
Accounts receivable, net of impairment		202.6	—	202.6
Unbilled revenue		326.9	—	326.9
Income tax receivable		0.5	—	0.5
Inventories		8.6	—	8.6
Regulatory assets	A	7.1	(7.1)	—
Other assets	B, C	9.6	(0.7)	8.9
<b>Total current assets</b>		<b>555.3</b>	<b>(7.8)</b>	<b>547.5</b>
Property, plant and equipment, net	A, C, E	2,664.4	180.7	2,845.1
Intangible assets, net		171.5	—	171.5
Regulatory assets	A	234.4	(234.4)	—
Other assets	B, C	14.3	(13.4)	0.9
Deferred income tax assets	A	157.6	(23.8)	133.8
<b>Total assets</b>		<b>3,797.5</b>	<b>(98.7)</b>	<b>3,698.8</b>
Regulatory deferral account debit balances and related tax asset	A, D	—	113.5	113.5
<b>Total assets and regulatory deferral account debit balances</b>		<b>3,797.5</b>	<b>14.8</b>	<b>3,812.3</b>
<b>LIABILITIES AND EQUITY</b>				
<b>Current</b>				
Working capital facility		19.1	—	19.1
Commercial paper		150.0	—	150.0
Accounts payable and accrued liabilities	E	456.7	(29.2)	427.5
Customers' advance deposits		37.3	—	37.3
Deferred conservation credit and deferred revenue		20.7	—	20.7
Post-employment benefits	D	8.0	(8.0)	—
Other liabilities		2.1	—	2.1
Regulatory liabilities	A	2.5	(2.5)	—
<b>Total current liabilities</b>		<b>696.4</b>	<b>(39.7)</b>	<b>656.7</b>
Customers' advance deposits		7.4	—	7.4
Debentures	B	1,449.3	(6.9)	1,442.4
Deferred revenues	E	—	45.7	45.7
Post-employment benefits	D	230.8	5.2	236.0
Other liabilities		14.5	—	14.5
Regulatory liabilities	A	180.6	(180.6)	—
<b>Total liabilities</b>		<b>2,579.0</b>	<b>(176.3)</b>	<b>2,402.7</b>
<b>Equity</b>				
Share capital		567.8	—	567.8
Retained earnings	D	650.7	0.9	651.6
<b>Total equity</b>		<b>1,218.5</b>	<b>0.9</b>	<b>1,219.4</b>
<b>Total liabilities and equity</b>		<b>3,797.5</b>	<b>(175.4)</b>	<b>3,622.1</b>
Regulatory deferral account credit balances	A	—	190.2	190.2
<b>Total liabilities, equity and regulatory deferral account credit balances</b>		<b>3,797.5</b>	<b>14.8</b>	<b>3,812.3</b>

**Notes to the table:**

**A. Regulatory deferral accounts**

IFRS 14 requires that all RDA balances and related deferred tax amounts be reclassified to a new and separate section of the consolidated balance sheet. As well, the profit or loss effect of all changes in RDAs must be segregated in a new separate section of the consolidated statement of profit or loss. Amounts that are permitted or required to be

recognized under another IFRS standard are excluded from the RDAs. The effect of the reclassifications will be to enhance comparability of IFRS 14 compliant financial statements with those of entities not applying IFRS 14. IFRS 14 also requires disclosure regarding the movements in the period, risks, and expected period of recovery/amortization of individual RDAs.

For the Corporation, the impact of IFRS 14 as at January 1, 2014 will be to reduce current regulatory assets by \$7.1 million, long-term regulatory assets by \$234.4 million, deferred income tax assets by \$23.8 million, current regulatory liabilities by \$2.5 million and long-term regulatory liabilities by \$180.6 million, and increase PP&E by \$157.0 million, regulatory deferral account debit balances and related tax asset by \$115.4 million, and regulatory deferral account credit balances by \$190.2 million.

#### ***B. Debt issuance costs***

Under US GAAP, debt issuance costs are recognized as deferred charges in other non-current assets. Under IFRS, debt issuance costs will be netted against the principal balance of the related debenture. As at January 1, 2014, this presentation difference will result in a decrease in other current assets by \$0.6 million and other non-current assets by \$6.3 million and a corresponding decrease to debentures of \$6.9 million.

#### ***C. Prepaid lease***

Under US GAAP, a prepaid land lease is included in other assets. Under IFRS, the prepaid land lease will be included in PP&E as a finance lease as substantially all of the risks and rewards incidental to ownership of the land are transferred to the Corporation. As at January 1, 2014, this presentation difference will decrease current other assets by \$0.1 million, decrease other non-current assets by \$7.1 million, and increase PP&E by \$7.2 million.

#### ***D. Employee benefits***

The attribution period and attribution methods are different between IFRS and US GAAP and result in a minor measurement difference of the post-employment liability. In addition, under IFRS, a liability is recognized for both non-vested and vested sick leave benefits, unlike US GAAP, which only requires a liability for the vested sick leave component. As at January 1, 2014, the impact of these recognition and measurement differences will be to reduce the balance of the post-employment benefits by \$2.8 million, decrease regulatory deferral account debit balances by \$1.9 million, and increase retained earnings by \$0.9 million.

The Corporation will elect under IFRS, which was not permitted under US GAAP, to classify all post-employment benefit obligations as non-current, since they are not expected to be settled wholly within twelve months. As at January 1, 2014, the impact of this election will be to decrease current post-employment benefits and increase long-term post-employment benefits by \$8.0 million.

#### ***E. Capital contributions***

Under US GAAP, capital contributions received and used to finance additions to PP&E are offset against the cost of the constructed asset and depreciated at an equivalent rate as the related PP&E, as a reduction in depreciation expense. Under IFRIC 18, contributions received in order to construct an item of PP&E are treated as deferred revenues and recognized as revenue over the useful lives of the related PP&E. The Corporation will apply IFRIC 18 to capital contributions received for projects not yet in service, excluding PP&E items to which the deemed cost election was applied. As at January 1, 2014, the impact of the conversion to IFRS will be to increase PP&E by \$16.5 million, decrease accounts payable and accrued liabilities by \$29.2 million, and increase deferred revenues by \$45.7 million.

## 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", "believes", "can", "committed", "could", "estimates", "expected", "focus", "forecast", "may", "might", "plans", "projected", "seek", "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 effect of changes in energy consumption on future revenue as described in the sections entitled "Quarterly Results of Operations" and "Risk Management and Risk Factors", the Corporation's plans 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 section entitled "Liquidity and Capital Resources", the anticipated capacity to be provided by Copeland Station, the expected capital expenditures required to complete Copeland Station, and the anticipated completion date for Copeland Station as described in the section entitled "Liquidity and Capital Resources", the planned and proposed capital initiatives and the expected results of such initiatives as described in the section entitled "Liquidity and Capital Resources", the expected net proceeds and gains on the sale of surplus properties as described in the section entitled "Liquidity and Capital Resources", the anticipated contractual obligations and other commitments of the Corporation over the next five years as set out in the section entitled "Liquidity and Capital Resources", the outcomes regarding the current rate application under the Custom Incentive Rate-setting mechanism, and plans to meet CDM targets as described in the section entitled "Corporate Developments", the ability to pay any damages in connection with legal actions and claims as described in the section entitled "Legal Proceedings", and the plans and expected effects in connection with the IFRS conversion project and the anticipated effects of the transition to IFRS as described in the section entitled "Future Accounting Pronouncements and IFRS Conversion Project". 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 the 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, and legislative, judicial and regulatory developments that could affect revenues and the results of borrowing efforts.

Additional factors which could cause actual results or outcomes to differ materially from the results expressed or implied by forward-looking information include, among other things, the risk factors listed under the section entitled "Risk Management and Risk Factors" in this MD&A. Please review the section "Risk Management and Risk Factors" in detail. The Corporation cautions that the above list of risk factors is not exhaustive.

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.

## Selected Annual Information

The following table sets forth selected annual financial information of the Corporation for the three years ended December 31, 2014, 2013 and 2012, which has been prepared in accordance with US GAAP. This information has been derived from the Consolidated Financial Statements.

<b>Selected Annual Consolidated Financial Information</b> (in millions of Canadian dollars)			
	<b>2014</b>	<b>2013</b>	<b>2012</b>
	\$	\$	\$
<b>Year Ended December 31</b>			
Distribution revenue and other revenue <sup>1</sup>	615.8	635.2	577.3
Operating expenses <sup>1</sup>	267.6	272.0	245.1
Net income <sup>1</sup>	112.5	121.2	86.0
Capital expenditures <sup>2</sup>	588.4	450.4	292.4
<b>As at December 31</b>			
Total assets <sup>3</sup>	4,276.3	3,797.5	3,539.4
Total debentures <sup>3,4</sup>	1,649.3	1,449.3	1,469.6
Other non-current financial liabilities <sup>5</sup>	12.2	15.5	16.2
Shareholder's equity <sup>3</sup>	1,270.4	1,218.5	1,140.3
Dividends <sup>2</sup>	60.6	43.0	48.0
Total debt to capitalization ratio <sup>6</sup>	60.7%	57.0%	56.3%
Return on equity <sup>7</sup>	9.0%	10.3%	7.7%

<sup>1</sup> See "Results of Operations" for further details on distribution revenue, other revenue, operating expenses and net income.

<sup>2</sup> See "Liquidity and Capital Resources" for further details on capital expenditures and dividends

<sup>3</sup> See "Financial Position" for further details of significant changes in assets, debentures and shareholder's equity.

<sup>4</sup> Total debentures include current and long-term debentures.

<sup>5</sup> Other non-current financial liabilities include primarily 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.

<sup>6</sup> 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).

<sup>7</sup> 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](http://www.sedar.com).

Toronto, Canada

March 5, 2015



CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2014 and 2013

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 5, 2015.

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"

Anthony Haines

President and Chief Executive Officer

"Jean-Sebastien Couillard"

Jean-Sebastien Couillard

Executive Vice-President and Chief  
Financial Officer





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

Telephone (416) 777-8500  
Fax (416) 777-8818  
Internet [www.kpmg.ca](http://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, 2014 and December 31, 2013, the consolidated statements of net income and comprehensive income, changes in shareholder's equity and cash flows for the years then ended, 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, 2014 and December 31, 2013, and its consolidated statements of net income and comprehensive income, changes in shareholder's equity and cash flows for the years then ended in accordance with United States Generally Accepted Accounting Principles.

Chartered Professional Accountants, Licensed Public Accountants  
March 5, 2015  
Toronto, Canada

## CONSOLIDATED BALANCE SHEETS

[in millions of Canadian dollars]

As at December 31	2014 \$	2013 \$
<b>ASSETS</b>		
<b>Current</b>		
Accounts receivable, net of allowance for doubtful accounts <i>[note 15[b]]</i>	206.9	202.6
Unbilled revenue <i>[note 15[b]]</i>	307.5	326.9
Income tax receivable	0.8	0.6
Inventories <i>[note 5]</i>	8.6	8.6
Regulatory assets <i>[note 9]</i>	11.8	7.1
Other assets <i>[note 6]</i>	10.7	9.5
Assets held for sale <i>[note 11]</i>	4.0	-
<b>Total current assets</b>	<b>550.3</b>	<b>555.3</b>
Property, plant and equipment, net <i>[note 7]</i>	2,817.9	2,664.4
Intangible assets, net <i>[note 8]</i>	197.9	171.5
Regulatory assets <i>[note 9]</i>	564.4	234.4
Other assets <i>[note 10]</i>	15.4	14.3
Deferred income tax assets <i>[note 16]</i>	130.4	157.6
<b>Total assets</b>	<b>4,276.3</b>	<b>3,797.5</b>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
<b>Current</b>		
Working capital facility <i>[note 12]</i>	6.1	19.1
Commercial paper <i>[note 12]</i>	308.0	150.0
Accounts payable and accrued liabilities <i>[note 15[b]]</i>	536.1	456.7
Customers' advance deposits	38.5	37.3
Deferred conservation credit and deferred revenue <i>[note 3[b]]</i>	1.7	20.7
Post-retirement benefits <i>[note 14]</i>	8.0	8.0
Other liabilities <i>[note 21]</i>	2.6	2.1
Regulatory liabilities <i>[note 9]</i>	1.6	2.5
<b>Total current liabilities</b>	<b>902.6</b>	<b>696.4</b>
Customers' advance deposits	4.7	7.4
Debentures <i>[note 13]</i>	1,649.3	1,449.3
Post-retirement benefits <i>[note 14]</i>	285.6	230.8
Other liabilities <i>[note 21]</i>	7.5	14.5
Regulatory liabilities <i>[note 9]</i>	156.2	180.6
<b>Total liabilities</b>	<b>3,005.9</b>	<b>2,579.0</b>
Commitments, contingencies and subsequent events <i>[notes 2, 21 and 22]</i>		
<b>Shareholder's equity</b>		
Share capital <i>[note 17]</i>	567.8	567.8
Retained earnings	702.6	650.7
<b>Total shareholder's equity</b>	<b>1,270.4</b>	<b>1,218.5</b>
<b>Total liabilities and shareholder's equity</b>	<b>4,276.3</b>	<b>3,797.5</b>

### 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.

## CONSOLIDATED STATEMENTS OF NET INCOME AND COMPREHENSIVE INCOME

[in millions of Canadian dollars]

Year ended December 31	2014 \$	2013 \$
Energy sales	2,700.4	2,567.5
Distribution revenue	554.2	577.9
Other revenue	61.6	57.3
	<b>3,316.2</b>	<b>3,202.7</b>
Energy purchases	2,700.4	2,567.5
Operating expenses	267.6	272.0
Depreciation and amortization [notes 7, 8 and 9]	160.8	172.8
<b>Operating income</b>	<b>187.4</b>	<b>190.4</b>
Net financing charges [note 18]	(63.8)	(66.2)
Gain on disposals of property, plant and equipment	1.5	1.3
<b>Income before income taxes</b>	<b>125.1</b>	<b>125.5</b>
Income tax expense [note 16]	12.6	4.3
<b>Net income and comprehensive income</b>	<b>112.5</b>	<b>121.2</b>

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY

[in millions of Canadian dollars]

Year ended December 31	2014 \$	2013 \$
<b>Share capital [note 17]</b>	<b>567.8</b>	<b>567.8</b>
<b>Retained earnings, beginning of year</b>	<b>650.7</b>	<b>572.5</b>
Net income	112.5	121.2
Dividends [notes 17 and 20]	(60.6)	(43.0)
<b>Retained earnings, end of year</b>	<b>702.6</b>	<b>650.7</b>
<b>Total shareholder's equity</b>	<b>1,270.4</b>	<b>1,218.5</b>

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

[in millions of Canadian dollars]

Year ended December 31	2014 \$	2013 \$
<b>OPERATING ACTIVITIES</b>		
Net income	112.5	121.2
Adjustments for non-cash items		
Depreciation and amortization [notes 7, 8 and 9]	160.8	172.8
Post-retirement benefits	6.3	7.6
Deferred income taxes [note 16]	1.5	(0.7)
Gain on disposals of property, plant and equipment	(1.5)	(1.3)
Other	(1.2)	1.0
Net change in regulatory assets and liabilities [note 9]	(47.2)	(19.5)
Net change in other non-current assets and liabilities	(5.3)	0.1
Changes in non-cash working capital balances [note 19]	29.0	(44.9)
<b>Net cash provided by operating activities</b>	<b>254.9</b>	<b>236.3</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of property, plant and equipment [note 19]	(489.4)	(358.9)
Purchase of intangible assets [note 19]	(46.3)	(54.5)
Proceeds on disposals of property, plant and equipment	1.8	1.7
<b>Net cash used in investing activities</b>	<b>(533.9)</b>	<b>(411.7)</b>
<b>FINANCING ACTIVITIES</b>		
Increase (decrease) in working capital facility [note 12]	(13.0)	19.1
Increase in commercial paper [note 12]	158.0	150.0
Dividends paid [notes 17 and 20]	(60.6)	(43.0)
Decrease in customers' advance deposits	(1.5)	(2.2)
Proceeds from debentures [note 13]	199.9	449.7
Debt issuance costs paid [note 13]	(1.6)	(2.7)
Repayment of debentures	-	(470.1)
Repayment of capital lease liability	(2.2)	(2.0)
<b>Net cash provided by financing activities</b>	<b>279.0</b>	<b>98.8</b>
<b>Net decrease in cash and cash equivalents during the year</b>	<b>-</b>	<b>(76.6)</b>
Cash and cash equivalents, beginning of year	-	76.6
<b>Cash and cash equivalents, end of year</b>	<b>-</b>	<b>-</b>
<b>Supplementary disclosure of operating cash flows</b>		
Total interest paid	65.2	69.9
Total income taxes paid (recovered)	10.3	(3.1)

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2014 and 2013

[all tabular amounts in millions of Canadian dollars]

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### 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 is domiciled in Canada and its registered office is located at 14 Carlton Street, Toronto, Ontario, M5B 1K5.

The Corporation supervises the operations of, 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

The Corporation's audited consolidated financial statements have been prepared in accordance with US GAAP with respect to the preparation of annual financial information. These consolidated financial statements are presented in Canadian dollars, which is the Corporation's functional currency. 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 5, 2015 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 11, 12 and 17].

### 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 power to approve the amounts paid to non-contracted generators, 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2014 and 2013

[all tabular amounts in millions of Canadian dollars]

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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 include 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. On April 2, 2013, the OEB approved new rates for LDC effective June 1, 2013, which reflected approved capital expenditures amounting to \$203.3 million for 2012 and \$484.2 million for 2013. In a separate decision rendered on December 19, 2013, the OEB approved capital expenditures amounting to \$398.8 million for 2014.

On January 16, 2014, the OEB approved LDC's request for disposition of the smart meter deferral account balances related to smart meter installations in 2008, 2009 and 2010 through two separate rate riders effective May 1, 2014 [note 9[d]]. The first rate rider relates to the recovery of \$23.9 million, representing the cumulative revenue requirement net of recoveries from an existing smart meter rate rider. This existing smart meter rate rider was discontinued when the new rate riders became effective. The second rate rider relates to the recovery of \$9.6 million, representing the forecasted 2014 incremental revenue requirement.

On July 31, 2014, LDC filed a rate application with the OEB under the Custom Incentive Rate-setting mechanism, seeking approval of LDC's 2015 test year revenue requirement and corresponding electricity distribution rates effective May 1, 2015, and subsequent annual rate adjustments based on a custom index for the period commencing on January 1, 2016 and ending on December 31, 2019. The rate application includes requests for approval of capital expenditures of approximately \$2.5 billion over the 2015-2019 period. The rate application also seeks approval to include in LDC's rate base capital amounts that were prudently incurred prior to 2015 which are subject to review by the OEB. In addition, LDC seeks approval to recover the net book value of stranded meters [note 9[d]]. LDC's

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2014 and 2013

[all tabular amounts in millions of Canadian dollars]

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revenues over the period will be based on the existing rate base, capital expenditures and operating expenses ultimately approved by the OEB in the rate application plus cost of capital allowed by the OEB.

On August 3, 2011, the OEB issued its final decision allowing the transfer of a portion of the street lighting assets to the new wholly-owned legal entity (1798594 Ontario Inc.), and for LDC to amalgamate with the new legal entity. The OEB decided that the rate base, revenue requirement and rate consequences of the transfer would be decided at LDC's next cost of service or rebasing rate application. On January 1, 2012, the Corporation completed the asset transfer and amalgamation. The purchase price for such assets, including a post-closing adjustment, was \$42.5 million, subject to transaction costs. On July 31, 2014, LDC filed the above noted rate application with the OEB seeking a final determination of the rate base, revenue requirement and rate consequences of the street lighting transfer.

### ***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 \$50.0 million to deliver CDM programs extending from January 1, 2011 to December 31, 2014 to support achievement of the mandatory CDM targets described above. LDC applied to the OPA in March 2014 to revise the program administration budget to \$45.8 million for the delivery of CDM programs from 2011 to 2014. 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 and deferred revenue. 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. As at December 31, 2014, LDC has estimated that approximately \$5.7 million qualified as cost efficiency incentives, and approximately \$4.9 million is repayable to the OPA for the remaining program administration budget and included within accounts payable and accrued liabilities [note 4[i]].

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. Funding and respective targets for CDM programs approved pursuant to the 2011-2014 OPA agreement that have in-service dates in 2015 will be allocated toward the 2011-2014 program. LDC has requested separate funding from the OPA relating to these transitional CDM programs for 2015.

On March 26, 2014, the Minister of Energy of Ontario, under the guidance of sections 27.1 and 27.2 of the OEB Act, directed the OEB to amend the licence of each licensed electricity distributor to require the electricity distributor, as a condition of its licence, to make CDM programs available to customers in its licensed service area and to do so in relation to each customer segment in its service area, over the period beginning January 1, 2015 through December 31, 2020. On March 31, 2014, the Minister of Energy of Ontario issued a direction to require the OPA to coordinate, support and fund the delivery of CDM programs through electricity distributors. The OPA's objective is to reduce electricity consumption by a total of 7 terawatt hours between January 1, 2015 and December 31, 2020, of which LDC's share is approximately 1,576 GWh of energy savings.

On November 13, 2014, LDC entered into an energy conservation agreement with the OPA for the delivery of these CDM programs over the 2015-2020 period with funding of approximately \$400.0 million, which includes participant incentives and LDC program administration costs. LDC is required to provide to the IESO its plan for achieving its CDM target by May 1, 2015. LDC also has the option to submit a joint CDM plan with one or more



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distribution companies. LDC can choose between full cost recovery funding, pay-for-performance funding, or a combination of both, for each CDM program. Under the full cost recovery funding method, the IESO reimburses LDC for all adequately documented costs incurred with an option to receive a portion of its funding in advance. Cost efficiency incentives may be awarded if LDC's electricity savings meet or exceed certain CDM plan targets for programs under the full cost recovery funding method, with a mid-term review to be performed by the IESO for the 2015-2017 periods. Under the pay-for-performance funding method, LDC receives payment in arrears based on verified electricity savings achieved with various options for frequency of payment.

### 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, 2014 to March 31, 2014 was 3.70%, and from April 1, 2014 to December 31, 2014 was 3.17% [January 1, 2013 to September 30, 2013 - 3.23%; October 1, 2013 to December 31, 2013 - 3.70%]. AFUDC is included in PP&E and intangible assets for financial reporting purposes,

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charged to operations through depreciation and amortization expense over the useful lives of the related assets and recovered through future distribution 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 capitalized. 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, 2013 and 2014 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 in accordance with the PP&E depreciation rates. 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 certain capital projects of LDC. According to US GAAP and 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.

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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 25.0%
Equipment and tools	10.0% to 16.7%
Computer hardware	16.7% to 25.0%
Assets under capital lease	9.0% to 14.3%
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*

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.

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### *i) Revenue recognition*

Effective January 1, 2014, the Corporation has disaggregated the components of revenues into energy sales, distribution revenue and other revenue in the consolidated statements of net income and comprehensive income, with no change to the method of revenue recognition. Revenues from energy sales and distribution are recorded on the basis of cyclical billings and include an estimated amount for electricity delivered and not yet billed, which is impacted by energy demand, customer class usage patterns and composition, and weather conditions.

In December 2014, the Corporation revised its estimate of unbilled revenue based on new technology implemented to enhance the revenue estimation process. This change has been accounted for on a prospective basis in the consolidated financial statements as at December 31, 2014. For the three months and year ended December 31, 2014, the change in estimate reduced unbilled revenue by \$7.7 million, settlement variances by \$3.0 million, and distribution revenue by \$10.7 million.

Energy sales arise from charges to customers for electricity generated by third parties and the related costs of purchased power, which are passed through to the customers at the cost paid. Under RRA, energy sales are equal to the cost of energy purchased in the period as settlement variances are recorded for the difference between the amounts charged by LDC to customers, based on regulated rates, and the corresponding cost of non-competitive electricity service incurred by LDC charged by the IESO.

Distribution revenue is recorded based on OEB-approved distribution rates to recover the costs incurred by LDC in delivering electricity to customers. Revenue related to eligible capital expenditures under the ICM framework, included as part of distribution revenue, is recognized on the basis of in-service assets.

Other revenue, which includes revenue from services ancillary to the distribution of electricity, revenue from the delivery of street lighting services and revenue from demand billable activities, is recognized as the services are rendered. Revenue not yet recognized from demand billable activities is included within deferred conservation credit and deferred revenue.

Revenues and costs associated with CDM programs are presented using the net basis of accounting. Cost efficiency incentives related to the CDM programs, included as part of other revenue, are recognized when they are considered earned and the amount realizable can be reasonably estimated.

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 HST applied 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 HST charged on 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.

### *j) 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.

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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 due to 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 due to 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 due to 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 due to 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 due to 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 15[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.

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### *k) 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.

### *l) 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, 2014.

The cost of providing benefits under the defined benefit plans is determined using the projected unit credit method and is 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%



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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.

### *m) 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.

### *n) 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 equivalent 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.



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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.

### *o) 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 for identifying and assessing the accounting treatment with respect to commitments and contingencies. Significant areas requiring the use of management estimates include unbilled revenue, regulatory assets and liabilities, 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 IESO, the Ontario Ministry of Energy, or the Ontario Ministry of Finance.

### *p) Future Accounting Pronouncements and Adoption of IFRS*

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 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 will be prepared in accordance with IFRS with a transition date of January 1, 2014. The Corporation will apply the provisions of IFRS 14 - "Regulatory deferral accounts" in its first annual IFRS financial statements. Certain forward-looking information disclosed in these consolidated financial statements relate to US GAAP requirements which are not applicable under IFRS [*notes 8, 14[d] and 16*].

The Corporation has an internal initiative to govern the conversion process and is continuing the process of evaluating the potential impact of the conversion to IFRS on its consolidated financial statements. The Corporation has completed a detailed assessment of the accounting and disclosure differences between US GAAP and IFRS and identified the areas that potentially may materially impact the consolidated financial statements on the date of transition to IFRS and post-IFRS implementation, which included RDAs, PP&E, capital contributions, employee benefits and debt issuance costs.

In May 2014, the FASB and IASB issued their converged standard, "Revenue from Contracts with Customers", which replaces existing revenue recognition guidance with a single model for recognizing revenue from contracts with customers except for leases, financial instruments and insurance contracts. The new IFRS standard is effective for annual reporting periods beginning on or after January 1, 2017. The Corporation is currently evaluating the impact of the new standard.

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### 5. INVENTORIES

Inventories consist of the following:

	2014 \$	2013 \$
Fuses	2.1	2.5
Consumables, tools and other maintenance items	2.2	2.0
Drums and reels	1.6	1.5
Other	2.7	2.6
	<b>8.6</b>	8.6

For the year ended December 31, 2014, the Corporation recognized operating expenses of \$5.8 million related to inventory used to service electrical distribution assets [2013 - \$6.9 million].

### 6. CURRENT PORTION OF OTHER ASSETS

Current portion of other assets consists of the following:

	2014 \$	2013 \$
Prepaid expenses	9.7	8.6
Deferred financing costs	1.0	0.9
	<b>10.7</b>	9.5

### 7. PROPERTY, PLANT AND EQUIPMENT

PP&E consist of the following:

	2014			2013		
	Cost \$	Accumulated depreciation \$	Net book value \$	Cost \$	Accumulated depreciation \$	Net book value \$
Distribution assets	4,405.9	2,229.6	2,176.3	4,257.5	2,130.6	2,126.9
Land and buildings	209.7	77.1	132.6	189.1	76.8	112.3
Equipment and other	367.6	267.8	99.8	349.7	245.2	104.5
Construction in progress	409.2	—	409.2	320.7	—	320.7
	<b>5,392.4</b>	<b>2,574.5</b>	<b>2,817.9</b>	5,117.0	2,452.6	2,664.4

As at December 31, 2014, Equipment and other included assets under capital lease with cost of \$15.8 million [December 31, 2013 - \$13.7 million] and accumulated depreciation of \$8.5 million [December 31, 2013 - \$4.8 million].

For the year ended December 31, 2014, AFUDC in the amount of \$2.8 million [2013 - \$1.3 million] was capitalized to PP&E and credited to net financing charges.

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For the year ended December 31, 2014, capital contributions in the amount of \$38.3 million [2013 - \$28.7 million] were credited to PP&E.

For the year ended December 31, 2014, the Corporation recorded depreciation expense on PP&E of \$130.9 million [2013 - \$145.7 million], of which \$3.7 million [2013 - \$2.0 million] related to assets under capital lease.

### 8. INTANGIBLE ASSETS

Intangible assets consist of the following:

	2014			2013		
	Cost \$	Accumulated amortization \$	Net book value \$	Cost \$	Accumulated amortization \$	Net book value \$
Computer software	285.5	217.8	67.7	268.4	198.8	69.6
Contributions	23.0	4.0	19.0	22.1	3.1	19.0
Software in development	13.5	—	13.5	11.7	—	11.7
Contributions for work in progress	97.7	—	97.7	71.2	—	71.2
	<b>419.7</b>	<b>221.8</b>	<b>197.9</b>	373.4	201.9	171.5

For the year ended December 31, 2014, AFUDC in the amount of \$2.7 million [2013 - \$2.0 million] was capitalized to intangible assets and credited to net financing charges.

For the year ended December 31, 2014, the Corporation recorded amortization expense on intangible assets of \$19.9 million [2013 - \$25.3 million].

Estimated future amortization expense related to intangible assets recorded as at December 31, 2014 is as follows:

	\$
2015	20.3
2016	19.2
2017	19.8
2018	15.4
2019	12.7

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### 9. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

	2014 \$	2013 \$
ICM	396.7	151.9
Post-retirement benefits	87.3	38.8
Settlement variances	54.2	8.2
Smart meters	20.9	25.2
Stranded meters	14.4	16.9
Other	2.7	0.5
<b>Total regulatory assets</b>	<b>576.2</b>	<b>241.5</b>
Less: Current portion of regulatory assets	11.8	7.1
<b>Long-term portion of regulatory assets</b>	<b>564.4</b>	<b>234.4</b>

Regulatory liabilities consist of the following:

	2014 \$	2013 \$
Deferred income taxes	130.2	155.9
Revision of prior year tax position	22.3	19.4
Income and other taxes variance account	2.5	2.4
RARA	1.7	4.3
Other	1.1	1.1
<b>Total regulatory liabilities</b>	<b>157.8</b>	<b>183.1</b>
Less: Current portion of regulatory liabilities	1.6	2.5
<b>Long-term portion of regulatory liabilities</b>	<b>156.2</b>	<b>180.6</b>

For the year ended December 31, 2014, LDC disposed of approved regulatory liabilities amounting to \$2.6 million through permitted distribution rate adjustments [2013 – approved net regulatory assets of \$0.2 million].

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

#### a) *Incremental Capital Module*

The ICM regulatory asset account relates to the ICM application approved by the OEB and the associated rate rider, which became effective June 1, 2013 [note 3[a]]. As directed by the OEB, this account includes the cost of the eligible in-service capital expenditures under ICM, offset by the amount collected through the ICM rate riders. This account is also adjusted by the amount recognized into revenues related to the eligible in-service capital expenditures and the associated depreciation.

For the year ended December 31, 2014, eligible in-service capital expenditures of \$248.6 million [2013 - \$159.7 million] were reclassified from PP&E to regulatory assets as prescribed by the OEB. As a non-cash transaction, this reclassification has been excluded from the consolidated statements of cash flows. As at December 31, 2014, eligible in-service capital expenditures, net of accumulated depreciation, totalling \$399.0 million, were recorded in

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regulatory assets [December 31, 2013 - \$157.9 million]. In the absence of rate regulation, PP&E would have been \$399.0 million higher as at December 31, 2014 [December 31, 2013 - \$157.9 million higher].

For the year ended December 31, 2014, LDC recorded depreciation expense of \$7.5 million [2013 - \$1.8 million] related to the eligible in-service capital expenditures.

For the year ended December 31, 2014, the revenues related to the eligible in-service capital expenditures were \$25.1 million [2013 - \$6.7 million]. In the absence of rate regulation, for the year ended December 31, 2014, revenues would have been \$3.7 million lower [2013 - \$5.9 million higher].

### ***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 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. The period in which recovery is expected cannot be determined at this time.

### ***c) Settlement Variances***

This account includes 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.

### ***d) Smart Meters and Stranded Meters***

The smart meters and stranded meters regulatory asset accounts relate to the provincial government'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 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 \$25.2 million was recorded as at December 31, 2013 to reflect the future amount to be recovered through rates over a 36-month period commencing on May 1, 2014 and ending on April 30, 2017, with a related amount recorded in revenue.

In addition, the net book value of stranded meters related to the deployment of smart meters was reclassified from PP&E to regulatory assets as at December 31, 2013. Depreciation expense was recorded on the stranded meters in regulatory assets in 2014. For the year ended December 31, 2014, LDC recorded depreciation expense of \$2.5 million [2013 - \$2.8 million] related to the stranded meters within regulatory assets. In the absence of rate regulation, for the year ended December 31, 2014, depreciation and amortization expenses relating to stranded meters would have been \$2.5 million lower [2013 - \$2.8 million lower]. Included in the 2015-2019 rate application is the recovery of the forecasted net book value of the stranded meters as at December 31, 2014 [note 3[a]].

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For the year ended December 31, 2014, LDC recognized \$9.5 million of the forecasted 2014 smart meter incremental revenue requirement [2013 - \$nil]. In the absence of rate regulation, for the year ended December 31, 2014, revenues relating to smart meters would have been \$4.4 million higher [2013 - \$51.5 million lower], operating expenses would have \$nil impact [2013 - \$7.1 million lower], and depreciation and amortization expenses would have \$nil impact [2013 - \$22.7 million lower].

### *e) 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[n]].

As at December 31, 2014, LDC had a deferred income tax asset and a corresponding regulatory liability of \$130.2 million [December 31, 2013 - \$155.9 million] with respect to its rate-regulated activities that will be included in the rate-setting process.

### *f) Revision of Prior Year Tax Position*

The revision of prior year tax position regulatory liability account relates to changes 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, 2014, the balance in this account consisted of an over-recovery of PILs from customers of \$22.3 million [December 31, 2013 - \$19.4 million]. LDC has requested disposition of this balance in the 2015-2019 rate application over a 36-month period commencing on May 1, 2015.

### *g) 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, 2014, the balance in this account consisted of an over-recovery of PILs from customers of \$2.5 million [December 31, 2013 - \$2.4 million].

### *h) 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 \$7.5 million, 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 \$6.5 million, primarily consisting of PILs regulatory variance accounts, over an 11-month period commencing on June 1, 2013 and ending on April 30, 2014.

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### 10. OTHER ASSETS

Other long-term assets consist of the following:

	2014 \$	2013 \$
Prepaid expenses	7.0	7.1
Deferred financing costs	8.4	7.2
	<b>15.4</b>	<b>14.3</b>

### 11. ASSETS HELD FOR SALE

In December 2014, the Corporation entered into an agreement to sell a property including land and buildings owned by LDC to a third party. The sale is part of the Corporation's plan to consolidate its operating centres to lower costs and simplify long-term planning. Accordingly, the carrying amount of the identified assets of \$4.0 million has been transferred from PP&E to assets held for sale as at December 31, 2014. The Corporation does not record depreciation on assets classified as held for sale. On March 3, 2015, the Corporation sold the property and is expected to recognize a gain of \$5.9 million, subject to finalization of the costs related to the sale, to be deferred as a regulatory liability in the first quarter of 2015 as the amount is expected to reduce future electricity distribution rates for customers.

### 12. SHORT-TERM BORROWINGS AND SHELF PROSPECTUS

The Corporation is a party to a credit agreement with a syndicate of Canadian chartered banks which established a revolving credit facility expiring on October 10, 2019 ["Revolving Credit Facility"], pursuant to which it may borrow up to \$700.0 million, of which up to \$210.0 million is available in the form of letters of credit. On June 13, 2014, the borrowing capacity under the Revolving Credit Facility was increased from \$600.0 million to \$700.0 million and the expiry date extended from October 10, 2018 to October 10, 2019. 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 Corporation's debt to capitalization ratio not exceed 75%. As at December 31, 2014, the Corporation was in compliance with all covenants included in its Revolving Credit Facility.

The Corporation has a commercial paper program allowing up to \$500.0 million of unsecured short-term promissory notes ["Commercial Paper Program"] to be issued in various maturities of no more than one year. On June 13, 2014, the amount the Corporation may issue under this program was increased from \$400.0 million to \$500.0 million. The Commercial Paper Program is supported by liquidity facilities available under the Revolving Credit Facility; hence, available borrowing under the 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. Borrowings under the commercial paper program bear interest based on the prevailing market conditions at the time of issuance.



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Additionally, the Corporation is a party to:

- a demand facility with a Canadian chartered bank for \$75.0 million 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 \$20.0 million for the purpose of working capital management [“Working Capital Facility”].

The outstanding borrowings under the Revolving Credit Facility and Commercial Paper Program are as follows:

	Facility Limit \$	Facility Borrowings \$	Commercial Paper \$	Facility Availability \$
December 31, 2014	700.0	—	308.0	392.0
December 31, 2013	600.0	—	150.0	450.0

As at December 31, 2014, \$6.1 million had been drawn under the Working Capital Facility [December 31, 2013 - \$19.1 million] and \$29.7 million of letters of credit had been issued against the Prudential Facility [December 31, 2013 - \$50.1 million].

For the year ended December 31, 2014, the average outstanding borrowings under the Corporation’s credit facilities and commercial paper, excluding the Prudential Facility, were \$250.3 million [2013 - \$67.7 million] with a weighted average interest rate of 1.18% [2013 - 1.98%].

The Corporation filed a base shelf prospectus dated January 9, 2015 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 \$1.0 billion during the 25-month period following the date of the prospectus [note 13].

### 13. DEBENTURES

Debentures consist of the following:

	2014 \$	2013 \$
Senior unsecured debentures		
Series 2 – 5.15% due November 14, 2017	250.0	250.0
Series 3 – 4.49% due November 12, 2019	250.0	250.0
Series 6 – 5.54% due May 21, 2040	200.0	200.0
Series 7 – 3.54% due November 18, 2021	300.0	300.0
Series 8 – 2.91% due April 10, 2023	250.0	250.0
Series 9 – 3.96% due April 9, 2063	200.0	200.0
Series 10 – 4.08% due September 16, 2044	200.0	—
<b>Total debentures</b>	<b>1,650.0</b>	<b>1,450.0</b>
Less: Unamortized discount/premium	0.7	0.7
Less: Current portion of debentures	—	—
<b>Long-term portion of debentures</b>	<b>1,649.3</b>	<b>1,449.3</b>

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All debentures of the Corporation rank equally.

On September 16, 2014, the Corporation issued \$200.0 million of 4.08% senior unsecured debentures at a price of \$999.48 per \$1,000 principal amount due September 16, 2044 ["Series 10"]. The Series 10 debentures bear interest payable semi-annually in arrears. The net proceeds of the debentures were used to repay certain existing indebtedness of the Corporation and for general corporate purposes. Debt issuance costs of \$1.6 million relating to the Series 10 debentures were deferred as other assets in the third quarter of 2014 and are amortized to net financing charges using the effective interest method.

The Corporation may redeem all or part of its outstanding 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, 2014, the Corporation was in compliance with all covenants included in its trust indenture and supplemental trust indentures.

### 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, 2014, the OMERS plan was 90.8% funded [December 31, 2013 - 88.2%]. OMERS has a strategy to return the plan to a fully funded position. The Corporation is not able to assess the implications of this strategy or the withdrawal of other participating entities from the OMERS plan on its future contributions.

For the year ended December 31, 2014, the total contributions of all participating employers and employees were approximately \$3.7 billion [2013 - \$3.5 billion]. For the year ended December 31, 2014, the Corporation's contributions to the plan were \$18.2 million [2013 - \$18.5 million], representing less than five percent of total contributions to the plan.

For 2014 and 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.

As at December 31, 2013, OMERS had approximately 270,000 active members. As at December 31, 2014, approximately 1,500 members [December 31, 2013 - 1,500] had a current relationship with the Corporation.

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### *Post-retirement benefits other than pension*

#### *a) Benefit Obligations*

	2014 \$	2013 \$
Balance, beginning of year	238.8	253.9
Service cost	4.6	5.2
Interest cost	11.4	10.8
Benefits paid	(10.6)	(10.4)
Actuarial (gain) loss	49.4	(20.7)
<b>Balance, end of year</b>	<b>293.6</b>	<b>238.8</b>

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*

As at December 31, 2014, the amount recognized in regulatory assets related to unamortized net actuarial loss was \$87.3 million [2013 - \$38.8 million] [note 9].

The estimated net actuarial loss expected to be amortized from regulatory assets to net periodic benefit cost in 2015 is \$4.2 million.

#### *c) Components of net periodic benefit costs*

	2014 \$	2013 \$
Service cost	4.6	5.2
Interest cost	11.4	10.8
Amortization of net actuarial loss	0.9	2.0
<b>Net periodic benefit cost</b>	<b>16.9</b>	<b>18.0</b>
Capitalized as part of PP&E	6.6	6.6
Charged to operations	10.3	11.4

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### 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 \$
2015	8.1
2016	8.8
2017	9.3
2018	9.9
2019	10.5
2020-2024	59.9

### e) *Significant assumptions*

	2014 %	2013 %
<b>Accrued benefit obligation as at December 31:</b>		
Discount rate	4.00	4.75
<b>Benefit costs for years ended December 31:</b>		
Discount rate	4.75	4.25
<b>Assumed health care cost trend rates as at December 31:</b>		
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	5.00	6.00
For other retirements	6.50	7.50
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	2015	2016
For other retirements	2018	2019

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### 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 2014:

	Increase \$	Decrease \$
Total of current service and interest cost (at 4.75%)	2.4	(2.1)
Accrued benefit obligation as at December 31, 2014 (at 4.00%)	38.4	(34.5)

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, 2014	(45.7)	59.4
Estimated net periodic benefit cost for 2015	(3.5)	4.3

## 15. FINANCIAL INSTRUMENTS

### a) Recognition and measurement

As at December 31, 2014 and December 31, 2013, 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[j)]. 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:

	2014		2013	
	\$		\$	
	Carrying value	Fair value <sup>(1)</sup>	Carrying value	Fair value <sup>(1)</sup>
Senior unsecured debentures				
Series 2 – 5.15% due November 14, 2017	249.9	273.5	249.9	275.1
Series 3 – 4.49% due November 12, 2019	250.0	276.4	249.9	270.6
Series 6 – 5.54% due May 21, 2040	199.9	255.7	199.9	226.8
Series 7 – 3.54% due November 18, 2021	299.9	321.1	299.9	302.8
Series 8 – 2.91% due April 10, 2023	250.0	254.1	249.9	232.9
Series 9 – 3.96% due April 9, 2063	199.8	201.9	199.8	172.6
Series 10 – 4.08% due September 16, 2044	199.8	209.3	—	—

<sup>(1)</sup> 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.

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### 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.

#### *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 740,000 customers. LDC obtains security instruments from certain customers in accordance with direction provided by the OEB. As at December 31, 2014, LDC held security deposits in the amount of \$43.2 million [December 31, 2013 - \$44.7 million], of which \$19.8 million [December 31, 2013 - \$22.2 million] were related to security deposits on Offers to Connect to guarantee the payment of additional costs related to expansion projects. As at December 31, 2014, 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, 2014 and December 31, 2013.

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

	2014 \$	2013 \$
Unbilled revenue	307.5	326.9
Accounts receivable		
Outstanding for not more than 30 days	180.7	176.9
Outstanding for more than 30 days and not more than 120 days	23.4	24.4
Outstanding for more than 120 days	14.7	12.2
Less: Allowance for doubtful accounts	(11.9)	(10.9)
<b>Total accounts receivable, net</b>	<b>206.9</b>	<b>202.6</b>
<b>Total accounts receivable and unbilled revenue</b>	<b>514.4</b>	<b>529.5</b>

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

	2014 \$	2013 \$
Balance, beginning of year	(10.9)	(10.7)
Provision for doubtful accounts	(7.4)	(7.8)
Write-offs	7.1	8.1
Recoveries	(0.7)	(0.5)
<b>Balance, end of year</b>	<b>(11.9)</b>	<b>(10.9)</b>

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, 2014 and December 31, 2013.

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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 12], and customers' advance deposits. The Corporation manages interest rate risk by monitoring its mix of fixed and floating rate instruments, and taking action as necessary to maintain an appropriate balance.

As at December 31, 2014, 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 and Working Capital Facility, 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 \$3.6 million 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 financial 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.



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Liquidity risks associated with financial commitments are as follows:

December 31, 2014						
	Due within 1 year \$	Due within 2 years \$	Due within 3 years \$	Due within 4 years \$	Due within 5 years \$	Due after 5 years \$
Working Capital Facility	6.1	—	—	—	—	—
Commercial paper <sup>(1)</sup>	308.0	—	—	—	—	—
Accounts payable and accrued liabilities <sup>(2)</sup>	524.6	—	—	—	—	—
Obligations under capital lease	3.0	3.0	2.8	1.4	—	—
Senior unsecured debentures						
Series 2 – 5.15% due November 14, 2017	—	—	250.0	—	—	—
Series 3 – 4.49% due November 12, 2019	—	—	—	—	250.0	—
Series 6 – 5.54% due May 21, 2040	—	—	—	—	—	200.0
Series 7 – 3.54% due November 18, 2021	—	—	—	—	—	300.0
Series 8 – 2.91% due April 10, 2023	—	—	—	—	—	250.0
Series 9 – 3.96% due April 9, 2063	—	—	—	—	—	200.0
Series 10 – 4.08% due September 16, 2044	—	—	—	—	—	200.0
Interest payments on debentures	69.2	69.2	69.2	56.2	56.2	822.4
	<b>910.9</b>	<b>72.2</b>	<b>322.0</b>	<b>57.6</b>	<b>306.2</b>	<b>1,972.4</b>

<sup>(1)</sup> The notes under the Commercial Paper Program were issued at a discount and are repaid at their principal amount.

<sup>(2)</sup> Accounts payable and accrued liabilities exclude \$11.5 million of accrued interest on debentures included within “Interest payments on debentures”.

### Foreign exchange risk

As at December 31, 2014, 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.

## 16. INCOME TAXES

The Corporation’s effective tax rate for the year ended December 31, 2014 was 10.06% [2013 – 3.45%]. Income tax expense for the year ended December 31, 2014 was \$12.6 million [2013 - \$4.3 million]. The effective tax rate and income tax expense for the year ended December 31, 2014 were higher than those for the year ended December 31, 2013 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:

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### *Consolidated Statements of Net Income and Comprehensive Income*

	2014 \$	2013 \$
<b>Rate reconciliation</b>		
Income before income taxes	125.1	125.5
Statutory Canadian federal and provincial income tax rate	26.50%	26.50%
Expected income tax expense	33.2	33.3
Temporary differences not benefited in LDC	(18.2)	(20.2)
Change in unrecognized tax benefits	0.1	(5.1)
Other	(2.5)	(3.7)
<b>Income tax expense</b>	<b>12.6</b>	<b>4.3</b>
<b>Effective tax rate</b>	<b>10.06%</b>	<b>3.45%</b>
<b>Components of income tax expense</b>		
Current income tax	12.7	7.1
Deferred income tax related to the origination and reversal of temporary differences	1.5	(0.7)
Non-refundable ITCs	(1.6)	(2.1)
<b>Income tax expense</b>	<b>12.6</b>	<b>4.3</b>

### *Consolidated Balance Sheets*

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

	2014 \$	2013 \$
PP&E and intangible assets	51.8	73.2
Post-retirement benefits liability	54.7	53.0
Regulatory adjustments	34.5	41.3
Other taxable temporary differences	(2.0)	(1.8)
Capital loss carryforwards	5.0	5.0
Non-capital loss carryforwards	—	0.7
Valuation allowance	(13.6)	(13.8)
<b>Deferred income tax assets</b>	<b>130.4</b>	<b>157.6</b>

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, 2014, the Corporation has no accumulated non-capital losses for income tax purposes [December 31, 2013 - \$2.8 million], which are available to reduce taxable income in future years. As at December 31, 2014, the Corporation accumulated net capital losses of \$18.7 million [December 31, 2013 - \$18.9 million], which are available to offset capital gains in future years.

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

	2014 \$	2013 \$
Balance, beginning of year	0.2	5.3
Increases for tax positions taken in the current year	0.1	—
Decreases for tax positions taken in prior years	—	(1.6)
Settlements with tax authorities	—	(3.5)
<b>Balance, end of year</b>	<b>0.3</b>	<b>0.2</b>

As at December 31, 2014, \$0.3 million of unrecognized tax benefits [December 31, 2013 - \$0.2 million] 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, 2014, 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.

## 17. SHARE CAPITAL

Share capital consists of the following:

	2014 \$	2013 \$
<b>Authorized</b>		
The authorized share capital of the Corporation consists of an unlimited number of common shares without par value		
<b>Issued and outstanding</b>		
1,000 common shares, of which all were fully paid.	<b>567.8</b>	567.8

### *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 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:

- [i] \$6.3 million 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 \$25.0 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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[all tabular amounts in millions of Canadian dollars]

For the year ended December 31, 2014, the Board of Directors of the Corporation declared and paid dividends totalling \$60.6 million [2013 - \$43.0 million] to the City.

On March 5, 2015, the Board of Directors of the Corporation declared dividends in the amount of \$37.5 million. The dividends consisted of \$31.2 million with respect to net income for the year ended December 31, 2014, payable to the City on March 13, 2015, and \$6.3 million with respect to the first quarter of 2015, payable to the City on March 31, 2015.

### 18. NET FINANCING CHARGES

Net financing charges consist of the following:

	2014 \$	2013 \$
Interest income	0.7	2.3
Interest expense		
Long-term debt <sup>(1)</sup>	(64.1)	(67.6)
Other interest	(5.9)	(4.2)
AFUDC	5.5	3.3
	<b>(63.8)</b>	<b>(66.2)</b>

<sup>(1)</sup> Includes amortization of debt issuance costs, premiums and discounts.

### 19. CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	2014 \$	2013 \$
Accounts receivable	(4.3)	(27.6)
Unbilled revenue	19.4	(48.8)
Income tax receivable	(0.2)	7.3
Inventories	—	(1.0)
Other current assets	(1.2)	(4.2)
Accounts payable and accrued liabilities	34.1	40.8
Restructuring accrual	—	(12.0)
Deferred conservation credit and deferred revenue	(19.0)	0.4
Other current liabilities	0.2	0.2
	<b>29.0</b>	<b>(44.9)</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	2014 \$	2013 \$
Purchase of PP&E, cash basis	489.4	358.9
Net change in accruals related to PP&E	48.4	32.7
Capital lease additions	2.1	0.3
Asset retirement obligation additions	0.3	1.7
Capitalized overhead costs	1.9	2.3
<b>Total additions to PP&amp;E</b>	<b>542.1</b>	395.9
Purchase of intangible assets, cash basis	46.3	54.5
<b>Total additions to PP&amp;E and intangible assets</b>	<b>588.4</b>	450.4

## 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	2014 \$	2013 \$
Revenues	238.6	246.9
Operating expenses and capital expenditures	20.8	31.9
Dividends	60.6	43.0

Summary of Amounts Due to/from Related Parties	2014 \$	2013 \$
Accounts receivable	9.4	5.6
Unbilled revenue	22.3	19.4
Accounts payable and accrued liabilities	43.2	45.5
Advance deposits	8.2	8.8

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 17].

Accounts receivable represents receivables from the City primarily for electricity, street lighting and ancillary services. Unbilled revenue represents receivables from the City related mainly to electricity 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 21. COMMITMENTS

#### *Operating leases and capital projects*

As at December 31, 2014, 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 <sup>(2)</sup> and other
	\$	\$
2015	6.1	37.7
2016	5.7	12.4
2017	2.0	—
2018	—	—
2019	—	—
Thereafter	—	—
<b>Total amount of future minimum payments <sup>(1)</sup></b>	<b>13.8</b>	<b>50.1</b>

<sup>(1)</sup> Refer to note 15 for future cash outflows excluded from the table above.

<sup>(2)</sup> 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, 2014 was \$6.2 million [2013 - \$6.1 million].

#### *Capital leases*

As at December 31, 2014, the future minimum annual lease payments under capital leases with remaining lease terms from one to five years and thereafter were as follows:

	\$
2015	3.0
2016	3.0
2017	2.8
2018	1.4
2019	—
Thereafter	—
Total amount of future minimum lease payments	10.2
Less: interest and executory costs	0.8
	9.4
Current portion included in Other liabilities	2.6
Long-term portion included in Other liabilities	6.8

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 22. CONTINGENCIES

#### *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 any applicable liability insurance policies which the Corporation believes would cover any damages which may become payable by the Corporation and its subsidiaries in connection with these actions, subject to such claim not being disputed by the insurer.

#### *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) which sought damages in the amount of \$30.0 million 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. On June 16, 2014, a settlement reached by the parties was approved by Order of the Ontario Superior Court of Justice pursuant to which LDC paid the amount of \$6.5 million, including all taxes and legal fees in settlement of the action of the class plaintiffs. LDC's liability insurance covered the settlement payment.

On March 10, 2009, a third party claim was served by LDC related to the above action and on June 15, 2009, a third party defence and counterclaim against LDC seeking damages in the amount of \$51.0 million were served by the owner and manager of 2 Secord Avenue. Given the preliminary status of the 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 \$2.0 million 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 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 \$30.0 million 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 \$10.0 million and special damages in the amount of \$20.0 million from LDC. The plaintiff's motion for certification of the class action was granted on September 11, 2014. 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



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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 \$2.0 million 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.