# NEWFOUNDLAND AND LABRADOR HYDRO
# CONSOLIDATED FINANCIAL STATEMENTS
# December 31, 2021

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# Independent Auditor's Report

To the Lieutenant-Governor in Council
Province of Newfoundland and Labrador

**Opinion**
We have audited the consolidated financial statements of Newfoundland and Labrador Hydro (the "Company"), which comprise the consolidated statement of financial position as at December 31, 2021, and the consolidated statements of profit and comprehensive income, changes in equity and cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2021, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

**Basis for Opinion**
We conducted our audit in accordance with Canadian generally accepted auditing standards ("Canadian GAAS"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Responsibilities of Management and Those Charged with Governance for the Financial Statements**
Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Those charged with governance are responsible for overseeing the Company's financial reporting process.

**Auditor's Responsibilities for the Audit of the Financial Statements**
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian GAAS will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually

or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Deloitte LLP

Chartered Professional Accountants
March 21, 2022

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

| *As at December 31 (millions of Canadian dollars)* | Notes | **2021** | 2020 |
|---|---|---|---|
| **ASSETS** | | | |
| Current assets | | | |
| Cash | | **107** | 92 |
| Trade and other receivables | 5 | **137** | 108 |
| Inventories | 6 | **97** | 104 |
| Current portion of other long-term assets | 10 | **6** | 3 |
| Prepayments | | **9** | 9 |
| Deferred asset | 7 | **56** | 23 |
| Related party loan receivable | 23 | **53** | - |
| Total current assets | | **465** | 339 |
| Non-current assets | | | |
| Property, plant and equipment | 8 | **2,806** | 2,757 |
| Intangible assets | 9 | **7** | 8 |
| Other long-term assets | 10 | **232** | 222 |
| Total assets | | **3,510** | 3,326 |
| Regulatory deferrals | 11 | **184** | 172 |
| Total assets and regulatory deferrals | | **3,694** | 3,498 |
| **LIABILITIES AND EQUITY** | | | |
| Current liabilities | | | |
| Short-term borrowings | 13 | **55** | 262 |
| Trade and other payables | 12 | **135** | 154 |
| Contract payable | 23 | **18** | - |
| Current portion of long-term debt | 13 | **7** | 7 |
| Derivative liability | 22 | **56** | 23 |
| Other current liabilities | | **6** | 3 |
| Total current liabilities | | **277** | 449 |
| Non-current liabilities | | | |
| Long-term debt | 13 | **2,041** | 1,765 |
| Deferred contributions | 14 | **30** | 26 |
| Decommissioning liabilities | 15 | **13** | 16 |
| Employee future benefits | 17 | **120** | 130 |
| Other long-term liabilities | | **4** | 4 |
| Total liabilities | | **2,485** | 2,390 |
| Shareholder’s equity | | | |
| Share capital | 18 | **23** | 23 |
| Contributed capital | 18 | **150** | 151 |
| Reserves | | **(6)** | (22) |
| Retained earnings | | **1,015** | 939 |
| Total equity | | **1,182** | 1,091 |
| Total liabilities and equity | | **3,667** | 3,481 |
| Regulatory deferrals | 11 | **27** | 17 |
| Total liabilities, equity and regulatory deferrals | | **3,694** | 3,498 |

Commitments and contingencies (Note 24)

*See accompanying notes*

On behalf of the Board:

DIRECTOR

DIRECTOR

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

| *For the year ended December 31 (millions of Canadian dollars)* | Notes | **2021** | 2020 |
|---|---|---|---|
| Energy sales | | **656** | 673 |
| Other revenue | | **57** | 29 |
| Revenue | | **713** | 702 |
| Fuels | | **122** | 158 |
| Power purchased | | **138** | 90 |
| Operating costs | 19 | **169** | 175 |
| Transmission rental | | **21** | 21 |
| Depreciation and amortization | | **105** | 101 |
| Net finance expense | 20 | **90** | 88 |
| Other expense | 21 | **9** | 9 |
| Expenses | | **654** | 642 |
| Share of loss of joint arrangement | | **1** | - |
| Profit before regulatory adjustments | | **58** | 60 |
| Regulatory adjustments | 11 | **(33)** | (15) |
| Profit for the year | | **91** | 75 |
| Other comprehensive income | | | |
| Items related to employee future benefits | | **17** | (1) |
| Net fair value (loss) gain on financial instruments | | **(1)** | 1 |
| Other comprehensive income for the year | | **16** | - |
| Total comprehensive income for the year | | **107** | 75 |

*See accompanying notes*

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

| *(millions of Canadian dollars)* | Note | Share Capital | Contributed Capital | Reserves | Retained Earnings | Total |
|---|---|---|---|---|---|---|
| **Balance at January 1, 2021** | | **23** | **151** | **(22)** | **939** | **1,091** |
| **Profit for the year** | | **-** | **-** | **-** | **91** | **91** |
| **Other comprehensive income for the year** | | **-** | **-** | **16** | **-** | **16** |
| **Total comprehensive income for the year** | | **-** | **-** | **16** | **91** | **107** |
| **Regulatory adjustment** | **18** | **-** | **(1)** | **-** | **-** | **(1)** |
| **Dividends** | **18** | **-** | **-** | **-** | **(15)** | **(15)** |
| **Balance at December 31, 2021** | | **23** | **150** | **(6)** | **1,015** | **1,182** |
| | | | | | | |
| Balance at January 1, 2020 | | 23 | 152 | (22) | 877 | 1,030 |
| Profit for the year | | - | - | - | 75 | 75 |
| Total comprehensive income for the year | | - | - | - | 75 | 75 |
| Regulatory adjustment | 18 | - | (1) | - | - | (1) |
| Dividends | 18 | - | - | - | (13) | (13) |
| Balance at December 31, 2020 | | 23 | 151 | (22) | 939 | 1,091 |

*See accompanying notes*

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

| *For the year ended December 31 (millions of Canadian dollars)* | Notes | **2021** | 2020 |
|---|---|---|---|
| Operating activities | | | |
| Profit for the year | | **91** | 75 |
| Adjustments to reconcile profit to cash provided from operating activities: | | | |
| Depreciation and amortization | | **105** | 101 |
| Regulatory adjustments | 11 | **(33)** | (15) |
| Amortization of rate stabilization plan fuel credit | | **33** | 24 |
| Finance income | 20 | **(15)** | (14) |
| Finance expense | 20 | **105** | 102 |
| Other | | **13** | 7 |
| | | **299** | 280 |
| Changes in non-cash working capital balances | 26 | **(22)** | 31 |
| Interest received | | **3** | 3 |
| Interest paid | | **(107)** | (104) |
| Net cash provided from operating activities | | **173** | 210 |
| Investing activities | | | |
| Additions to property, plant and equipment and intangibles | | **(161)** | (131) |
| Contributions to sinking funds | 10 | **(7)** | (7) |
| Increase in related party loan receivable | 23 | **(53)** | - |
| Increase in reserve fund | 10 | **(5)** | (13) |
| Changes in non-cash working capital balances | 26 | **1** | 2 |
| Net cash used in investing activities | | **(225)** | (149) |
| Financing activities | | | |
| Proceeds from long-term debt | 13 | **287** | - |
| Dividends paid | 18 | **(15)** | (13) |
| (Decrease) increase in short-term borrowings | | **(207)** | 29 |
| Rate stabilization plan fuel credit | | **(3)** | (55) |
| Other | | **5** | 4 |
| Net cash provided from (used in) financing activities | | **67** | (35) |
| Net increase in cash | | **15** | 26 |
| Cash, beginning of the year | | **92** | 66 |
| Cash, end of the year | | **107** | 92 |

*See accompanying notes*

## 1. DESCRIPTION OF BUSINESS

Newfoundland and Labrador Hydro (Hydro or the Company) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (the Province). The principal activity of Hydro is the generation, transmission and sale of electricity. Hydro's operations include both regulated and non-regulated activities. Hydro is a 100% owned subsidiary of Nalcor Energy (Nalcor). Hydro's head office is located at 500 Columbus Drive in St. John's, Newfoundland and Labrador, A1B 0C9, Canada.

Hydro holds interests in the following entities:

A 65.8% interest in Churchill Falls (Labrador) Corporation Limited (Churchill Falls). Churchill Falls is incorporated under the laws of Canada and owns and operates a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (MW).

A 51.0% interest in Lower Churchill Development Corporation (LCDC), an inactive subsidiary. LCDC is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### 2.1 Statement of Compliance and Basis of Measurement

These annual audited consolidated financial statements (financial statements) have been prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB).

These financial statements have been prepared on a historical cost basis, except for financial instruments at fair value through profit or loss (FVTPL) which have been measured at fair value. The financial statements are presented in Canadian Dollars (CAD) and all values rounded to the nearest million, except when otherwise noted. The financial statements were approved by Hydro's Board of Directors (the Board) on March 4, 2022.

### 2.2 Basis of Consolidation

The financial statements include the financial statements of Hydro, its subsidiary companies, its proportionate share of investments in joint arrangements and its share of investments over which Hydro exercises significant influence using the equity method of accounting. In addition, the financial statements of all structured entities, for which Hydro has been determined the primary beneficiary, are included in these financial statements. Intercompany transactions and balances have been eliminated upon consolidation.

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

Cash and cash equivalents consist of amounts on deposit with Schedule 1 Canadian Chartered banks, as well as highly liquid investments with maturities of three months or less. Investments with maturities greater than three months and less than twelve months are classified as short-term investments.

### 2.4 Inventories

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

### 2.5 Property, Plant and Equipment

Items of property, plant and equipment are recognized at cost less accumulated depreciation and accumulated impairment losses. Cost includes materials, labour, contracted services, professional fees and, for qualifying assets, borrowing costs capitalized in accordance with Hydro's accounting policy outlined in Note 2.7. Costs capitalized with the related asset include all those costs directly attributable to bringing the asset into operation.

When significant parts of property, plant and equipment are required to be replaced at intervals, Hydro recognizes such parts as individual assets with specific useful lives and depreciation rates. Likewise, when a major inspection is performed, its cost is recognized in the carrying amount of the asset as a replacement if the recognition criteria are satisfied. All other repairs and maintenance costs are recognized in profit or loss as incurred.

Depreciation commences when the assets are ready for their intended use. Residual values and useful lives are reviewed at the end of each year and adjusted prospectively, if appropriate. As per Board Order P.U. 30 (2019), Hydro was approved to recover gains and losses through accumulated amortization and to record removal costs through depreciation. To comply with International Accounting Standard (IAS) - 16, the adjustments related to the recovery of gains and losses through accumulated amortization and removal depreciation are presented as a regulatory adjustment in Note 11. The depreciation rates used are as follows:

| | |
|---|---|
| Generation plant | |
| Hydroelectric | 25 to 110 years |
| Thermal | 20 to 70 years |
| Diesel | 3 to 70 years |
| Transmission | |
| Lines | 26 to 65 years |
| Terminal stations | 20 to 60 years |
| Distribution system | 20 to 60 years |
| Other assets | 3 to 70 years |

Hydroelectric generation plant includes the powerhouse, turbines, governors and generators, as well as water conveying and control structures, including dams, dikes, tailraces, penstocks and intake structures. Thermal generation plant is comprised of the powerhouse, turbines and generators, boilers, oil storage tanks, stacks, and auxiliary systems. Diesel generation plant includes the buildings, engines, generators, switchgear, fuel storage and transfer systems, dikes and liners and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Terminal station assets are used to step up voltages of electricity for transmission and to step down voltages for distribution. Distribution system assets include poles, transformers, insulators, and conductors.

Other assets include telecontrol, buildings, vehicles, furniture, tools and equipment.

The carrying amount of a replaced asset is derecognized when replaced. Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recorded in other expense. Pursuant to Board Order No. P.U. 30 (2019), the gains and losses are deferred on retirement of property, plant and equipment. The deferral will be recovered through future depreciation expense.

<u>Churchill Falls</u>
The depreciation rates used are as follows:

| | |
|---|---|
| Hydroelectric generation plant | 7 to 100 years |
| Transmission and terminal | 7 to 70 years |
| Service facilities and other | 3 to 55 years |

Hydroelectric generation plant includes the powerhouse, turbines and generators, governors and exciters, and auxiliary systems, as well as water conveying and control structures, including dams, dikes, tailraces, surge chambers, penstocks and intake structures.

Transmission and terminal includes transmission lines, terminal stations and distribution systems. Transmission lines include support structures, foundations, conductors, and insulators associated with lines at voltages of 735, 230, and 69 kilovolt. Terminal station assets which are used to step up voltages of electricity for transmission and to step down voltages for distribution, provide switching and protection functions, and include auxiliary systems. Distribution system assets include poles, transformers, insulators, and conductors.

Service facilities and other includes roads, telecontrol, buildings, airport, aircraft, vehicles, furniture, tools and equipment, and the town site, including municipal water and sanitary sewer systems.

### 2.6 Intangible Assets

Intangible assets that are expected to generate future economic benefit and are measurable, including computer software costs, costs of technical services and feasibility studies are capitalized as intangible assets in accordance with IAS 38.

Intangible assets with finite useful lives are carried at cost less accumulated amortization and accumulated impairment losses. The estimated useful life and amortization method are reviewed at the end of each year with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives are carried at cost less accumulated impairment losses.

Amortization is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

| | |
|---|---|
| Feasibility studies | 22 years |
| Computer software | 7 to 10 years |

### 2.7 Borrowing Costs

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

### 2.8 Impairment of Non-Financial Assets

Property, plant and equipment and other non-financial assets are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where it is not possible to estimate the recoverable amount of an individual asset, Hydro estimates the recoverable amount of the cash generating unit (CGU) to which the asset belongs. The recoverable amount is the higher of fair value less costs of disposal and value in use. Value in use is generally computed by reference to the present value of future cash flows expected to be derived from non-financial assets. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset or CGU is estimated to be less than its carrying amount, the carrying amount of the asset or CGU is reduced to its recoverable amount and an impairment loss is recognized immediately in the Consolidated Statement of Profit and Comprehensive Income.

### 2.9 Investment in Joint Arrangement

A joint arrangement is an arrangement in which two or more parties have joint control. Control exists when Hydro has the power, directly or indirectly, to govern the financial and operating policies of another entity, so as to obtain benefits from its activities. A joint arrangement is either classified as a joint operation or a joint venture based on the rights of the parties involved. Hydro's investment in Churchill Falls is classified as a joint operation.

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

Churchill Falls, holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives Churchill Falls joint control of Twin Falls. This investment is accounted for using the equity method. Under the equity method, the interest in the joint venture is carried in the Statement of Financial Position at cost plus post acquisition changes in Churchill Falls' share of net assets of the joint venture. The Consolidated Statement of Profit and Comprehensive Income reflects the share of the profit or loss of the joint venture.

**2.10 Employee Future Benefits**

(i) Pension Plan

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

(ii) Other Benefits

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a retirement allowance.

The cost of providing these benefits is determined using the projected unit credit method, with actuarial valuations being completed on an annual basis based on service and Management's best estimate of salary escalation, retirement ages of employees and expected health care costs.

Actuarial gains and losses on Hydro's defined benefit obligation are recognized in reserves in the period in which they occur. Past service costs are recognized in operating costs as incurred. Pursuant to Board Order No. P.U. 36 (2015), Hydro recognizes the amortization of employee future benefit actuarial gains and losses in the Consolidated Statement of Profit and Comprehensive Income as a regulatory adjustment.

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

**2.11 Provisions**

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

**2.12 Decommissioning, Restoration and Environmental Liabilities**

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

**2.13 Revenue from Contracts with Customers**

Hydro recognizes revenue from contracts with customers related to the sale of electricity to regulated Provincial industrial, utility and direct customers in rural Newfoundland and Labrador and to non-regulated industrial, utility and external market customers. Churchill Falls also recognizes revenue from contracts with customers related to the sale of electricity.

Revenue is measured based on the consideration specified in a contract with a customer and excludes amounts collected on behalf of third parties. Hydro recognizes revenue when they transfer control of a product or service to a customer.

Revenue from the sale of energy is recognized when Hydro satisfies its performance obligation by transferring energy to the customer. Sales within the Province are primarily at rates approved by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB), whereas export sales and sales to other certain major industrial customers are either at rates under the terms of the applicable contracts, or at market rates. Hydro recognizes revenue at the amount to which they have the right to invoice, which corresponds directly to the value of Hydro's performance to date.

**2.14 Leasing**

Lessee Accounting

Hydro assesses whether a contract is or contains a lease, at inception of a contract. Hydro recognizes a right-of-use asset and a corresponding lease liability with respect to all lease agreements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less) and leases of low-value assets. For these leases, Hydro recognizes the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by using the rate implicit in the lease. If this rate cannot be readily determined, Hydro uses its incremental borrowing rate.

Lease payments included in the measurement of the lease liability comprise:

- Fixed (and in-substance) lease payments less any lease incentives;
- variable lease payments that depend on an index or rate; and
- payments expected under residual value guarantees and payments relating to purchase options and renewal option periods that are reasonably certain to be exercised (or periods subject to termination options that are not reasonably certain to be exercised).

The lease liability is subsequently measured at amortized cost using the effective interest rate method. Lease liabilities are remeasured, with a corresponding adjustment to the related right-of-use assets, when there is a change in variable lease payments arising from a change in an index or rate, or when Hydro changes its assessment of whether purchase, renewal or termination options will be exercised. Hydro did not make any such adjustments during the periods presented.

The right-of-use assets comprise the initial measurement of the corresponding lease liability, lease payments made at or before the commencement day and any initial direct costs. They are subsequently measured at cost less accumulated depreciation and accumulated impairment losses.

Whenever Hydro incurs an obligation for costs to dismantle and remove a leased asset, restore the site on which it is located or restore the underlying asset to the condition required by the terms and conditions of the lease, a provision is recognized and measured under *IAS 37 – Provisions, Contingent Liabilities and Contingent Assets*. The costs are included in the related right-of-use asset.

Right-of-use assets are depreciated over the shorter period of the lease term and useful life of the underlying asset. If a lease transfers ownership of the underlying asset or the cost of the right-of-use asset reflects that Hydro expects to exercise a purchase option, the related right-of-use asset is depreciated over the useful life of the underlying asset. Depreciation starts at the commencement date of the lease.

Variable rents that do not depend on an index or rate are not included in the measurement of the lease liability and the right-of-use asset. The related payments are recognized as an expense in operating costs in the period in which the event or condition that triggers those payments occurs.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. Hydro has elected to apply this practical expedient.

**2.15 Foreign Currencies**

Transactions in currencies other than Hydro's functional currency (foreign currencies) are recognized using the exchange rate in effect at the date of transaction, approximated by the prior month end close rate. At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates of exchange in effect at the period end date. Foreign exchange gains and losses not included in regulatory deferrals are recorded in the Consolidated Statement of Profit and Comprehensive Income as other expense.

**2.16 Income Taxes**

Hydro is exempt from paying income taxes under Section 149(1) (d.2) of the Income Tax Act.

**2.17 Financial Instruments**

Classification and Initial Measurement

Financial assets and financial liabilities are recognized in the Consolidated Statement of Financial Position when Hydro becomes a party to the contractual provisions of the instrument and are initially measured at fair value.

Financial assets are classified at amortized cost, fair value through other comprehensive income (FVTOCI), FVTPL or as derivatives designated as hedging instruments in an effective hedge. Financial liabilities are classified at FVTPL, amortized cost or as derivatives designated as hedging instruments in an effective hedge. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at FVTPL) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVTPL are recognized immediately in profit or loss.

Financial Assets at Amortized Cost

Financial assets with contractual cash flows arising on specified dates, consisting solely of principal and interest, and that are held within a business model whose objective is to collect the contractual cash flows are subsequently measured at amortized cost using the effective interest rate method and are subject to impairment. Gains and losses are recognized in profit or loss when the asset is derecognized, modified or impaired.

Hydro's financial assets at amortized cost include cash, trade and other receivables, related party loan receivable and sinking fund investments.

Financial Assets at FVTOCI

Financial assets measured at FVTOCI are those that have contractual cash flows arising on specific dates, consisting solely of principal and interest, and that are held within a business model whose objective is to collect the contractual cash flows and to sell the financial asset. Any changes in the carrying amount of these assets other than foreign exchange gains and losses, impairment gains and losses, and interest income are recognized in other comprehensive income accumulated in the fair value reserve. When these assets are derecognized, the cumulative gains or losses previously recognized in other comprehensive income are reclassified to profit or loss.

Hydro's financial assets measured at FVTOCI include reserve fund investments.

Financial Assets at FVTPL
Financial assets that do not meet the criteria for being measured at amortized cost or FVTOCI are measured at FVTPL. Financial assets at FVTPL are measured at fair value at the end of each reporting period, with any fair value gains or losses recognized in profit or loss to the extent they are not part of a designated hedging relationship. Currently, Hydro has no financial assets measured at FVTPL.

Financial Liabilities at Amortized Cost
Hydro subsequently measures all financial liabilities at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the liability is derecognized.

Hydro's financial liabilities at amortized cost include trade and other payables, short-term borrowings, contract payable and long-term debt.

Financial Liabilities at FVTPL
Financial liabilities that do not meet the criteria for being measured at amortized cost or FVTOCI are measured at FVTPL. Financial liabilities at FVTPL are measured at fair value at the end of each reporting period, with any fair value gains or losses recognized in profit or loss to the extent they are not part of a designated hedging relationship.

Hydro's financial liabilities measured at FVTPL include derivative instruments not part of a designated hedging relationship.

Derecognition of Financial Instruments
Hydro derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another party.

Hydro derecognizes financial liabilities when, and only when, its obligations are discharged, cancelled or have expired. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

Impairment of Financial Assets
Hydro recognizes a loss allowance for expected credit losses (ECL) on investments in debt instruments that are measured at amortized cost or at FVTOCI. The amount of ECL is updated at each reporting date to reflect changes in credit risk since initial recognition of the respective financial instrument.

Hydro always recognizes lifetime ECL for trade and other receivables. The ECL on these financial assets are estimated based on Hydro's historical credit loss experience, adjusted for factors that are specific to the debtors, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date, including time value of money where appropriate. Hydro also records 12-month ECL for those financial assets which have low credit risk and where the low credit risk exemption has been applied. The classes of financial assets that have been identified to have low credit risk are cash, sinking funds and the reserve fund.

For all other financial instruments, Hydro recognizes lifetime ECL when there has been a significant increase in credit risk since initial recognition. If, on the other hand, the credit risk on the financial instrument has not increased significantly since initial recognition, Hydro measures the loss allowance for that financial instrument at an amount equal to 12-month ECL. The assessment of whether lifetime ECL should be recognized is based on significant increases in the likelihood or risk of a default occurring since initial recognition instead of on evidence of a financial asset being credit-impaired at the reporting date or an actual default occurring.

Lifetime ECL represents the ECL that will result from all possible default events over the expected life of a financial instrument. In contrast, 12-month ECL represents the portion of lifetime ECL that is expected to result from default events on a financial instrument that are possible within 12 months after the reporting date.

### 2.18 Government Grants

Government grants are recognized when there is reasonable assurance that Hydro will comply with the associated conditions and that the grants will be received.

Government grants are recognized in profit or loss on a systematic basis over the periods in which Hydro recognizes as expenses the related costs for which the grants are intended to compensate. Specifically, government grants whose primary condition is that Hydro should purchase, construct or otherwise acquire non-current assets are recognized as deferred revenue in the Consolidated Statement of Financial Position and transferred to the Consolidated Statement of Profit and Comprehensive Income on a systematic and rational basis over the useful lives of the related assets.

Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to Hydro with no future related costs are recognized in the Consolidated Statement of Profit and Comprehensive Income in the period in which they become receivable.

### 2.19 Regulatory Deferrals

Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service methodology. Hydro's allowed rate of return on rate base based upon Board Order No. P.U. 30 (2019) is 5.4% in 2021 and 5.4% in 2020. Hydro applies various regulator approved accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally, these policies result in the deferral and amortization of costs or credits which are expected to be recovered or refunded in future rates. In the absence of rate regulation, these amounts would be included in the determination of profit or loss in the year the amounts are incurred. The effects of rate regulation on the financial statements are disclosed in Note 11.

## 3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

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

In 2020, the outbreak of the Coronavirus disease (COVID-19) has resulted in governments worldwide enacting emergency measures to combat the spread of the virus. For the year ended December 31, 2021, COVID-19 did not have a significant financial impact on the Company's results of operations, financial position or cash flow. There continues to be uncertainty around the duration and magnitude of the pandemic and therefore the extent of any future effect on the Company is unknown at this time. Management will continue to assess the impact of COVID-19 on the Company's operations and financial results.

### 3.1 Use of Judgments

(i) Property, Plant and Equipment

Hydro's accounting policy relating to property, plant and equipment is described in Note 2.5. In applying this policy, judgment is used in determining whether certain costs are additions to the carrying amount of the property, plant and equipment as opposed to repairs and maintenance. If an asset has been developed, judgment is required to identify the point at which the asset is capable of being used as intended and to identify the directly attributable borrowing costs to be included in the carrying value of the development asset. Judgment is also used in determining the appropriate componentization structure for Hydro's property, plant and equipment.

(ii) Revenue

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

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

(iii) Determination of CGUs

Hydro's accounting policy relating to impairment of non-financial assets is described in Note 2.8. In applying this policy, Hydro groups assets into the smallest identifiable group for which cash flows are largely independent of the cash flows from other assets or groups of assets. Judgment is used in determining the level at which cash flows are largely independent of other assets or groups of assets.

(iv) Discount Rates

Certain of Hydro's financial liabilities are discounted using discount rates that are subject to Management's judgment.

(v) Consolidation of Joint Arrangements

Management exercises judgment when applying the criteria outlined in IFRS 11 to determine whether joint arrangements constitute joint ventures or joint operations. Management has determined that its interest in Churchill Falls is considered a joint operation and its interest in Twin Falls is considered a joint venture.

(vi) Leases

Definition of a lease

At inception of a contract, Hydro assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, Hydro assesses whether the contract involves the use of an identified asset, Hydro has the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use and Hydro has the right to direct the use of the asset.

Lease extension and termination options

In determining the lease term, Hydro considers all facts and circumstances that create an economic incentive to exercise an extension option, or not to exercise a termination option. The assessment is reviewed if a significant event or a significant change in circumstances occurs within its control. The assessment requires the consideration of facts and circumstances such as contractual terms and conditions for option periods, significant leasehold improvements undertaken, costs to terminate the lease, the importance of the asset to the lessee's operations and past practice.

(vii) Regulatory adjustments

Regulatory assets and liabilities recorded in Hydro arise due to the rate setting process for regulated utilities governed by the PUB. The amounts relate to costs or credits which Management believes will be recovered or settled through customer rates in future periods, pursuant to the proceedings and outcomes of future PUB orders. Certain estimates are necessary since the regulatory environment often requires amounts to be recognized at estimated values until these amounts are finalized pursuant to regulatory decisions or other regulatory proceedings. The final amounts approved by the PUB for deferral as regulatory assets and liabilities and the approved recovery or settlement periods may differ from those originally expected. Any resulting adjustments to original estimates could have a material impact and are recognized in profit or loss in the period in which they become known.

### 3.2 Use of Estimates

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

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

(iii) Employee Future Benefits
Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee benefits is accounted for on an accrual basis, and has been actuarially determined using the projected unit credit method prorated on service, and Management's best estimate of salary escalation, retirement ages of employees and expected health care costs.

(iv) Leases incremental borrowing rate
Hydro uses its incremental borrowing rates in measuring its lease liabilities. The incremental borrowing rate is the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The determination of the incremental borrowing rate requires the consideration of different components, all of which are to incorporate a number of important lease characteristics.

(v) Deferred Assets and Derivative Liabilities
Effective October 1, 2015, Hydro entered into a power purchase agreement (PPA) with Nalcor Energy Marketing Corporation (Energy Marketing) which allows for the purchase of available Recapture energy from Hydro for resale by Energy Marketing in export markets or through agreements with counterparties. Additionally, the PPA allows for the use of Hydro's transmission service rights by Energy Marketing to deliver electricity, through rights which are provided to Hydro pursuant to a Transmission Service Agreement with Hydro-Québec dated April 1, 2009. The current terms of the PPA require a 60 day termination notice by either party. Management's assumption is that the term of the PPA at December 31, 2021, will continue for at least the next 12 months.

Fair values relating to Hydro's financial instruments and derivatives that have been classified as Level 3 have been determined using inputs for the assets or liabilities that are not readily observable. Certain of these fair values are classified as Level 3 as the transactions do not occur in an active market, or the terms extend beyond the period for which a quoted price is available.

Hydro's PPA with Energy Marketing is accounted for as a derivative instrument, where Hydro determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability, nor based on a valuation technique that uses only data from observable markets. These derivative transactions are initially measured at fair value and the expected difference is deferred. Subsequently, the deferred difference is recognized in other comprehensive income (loss) on an appropriate basis over the life of the related derivative instrument but not later than when the valuation is wholly supported by observable market data or the transaction has occurred.

Hydro has elected to defer the difference between the fair value of the power purchase derivative liability upon initial recognition and the transaction price of the power purchase derivative liability and to amortize the deferred asset on a straight-line basis over its effective term (Note 7). These methods, when compared with alternatives, were determined by Management to most accurately reflect the nature and substance of the transactions.

## 4. CURRENT AND FUTURE CHANGES IN ACCOUNTING POLICIES

The following is a list of standards/interpretations that have been issued and are effective for accounting periods commencing on or after January 1, 2021, as specified.

- *IFRS 16 – Leases – COVID-19 Related Rent Concessions beyond June 30, 2021 (Amendment to IFRS 16)*[1]
- *IAS 37 – Provisions, Contingent Liabilities and Contingent Assets – Onerous Contracts – Costs of Fulfilling a Contract (Amendments to IAS 37)*[2]
- *IAS 1 – Presentation of Financial Statements – Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)*[3]
- *IAS 1 – Presentation of Financial Statements– Disclosure of Accounting Policies (Amendments to IAS 1)*[3]
- *IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors – Definition of Accounting Estimates (Amendments to IAS 8)*[3]

[1] Effective for annual periods beginning on or after April 1, 2021
[2] Effective for annual periods beginning on or after January 1, 2022, with earlier application permitted.
[3] Effective for annual periods beginning on or after January 1, 2023, with earlier application permitted.

### 4.1 IFRS 16 – Leases – COVID-19-Related Rent Concessions beyond June 30, 2021 (Amendment to IFRS 16)

The IASB issued an extension to the practical expedient available to lessees that permits a lessee to elect not to assess whether a COVID-19 related rent concession is a lease modification. The extension allows the application of the practical expedient to reductions in lease payments originally due on or before June 30, 2022. Since Hydro does not have any COVID-19 related rent concessions, the application of this amendment does not have an impact on Hydro's financial statements.

### 4.2 IAS 37 – Provisions, Contingent Liabilities and Contingent Assets – Onerous Contracts – Costs of Fulfilling a Contract (Amendments to IAS 37)

The amendments to IAS 37 specify that the cost of fulfilling a contract comprises the costs that relate directly to the contract. Costs that relate directly to a contract can either be incremental costs of fulfilling that contract, such as direct labour and materials, or an allocation of other costs that relate directly to fulfilling contracts, such as the allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling the contract. These amendments apply to contracts for which the entity has not yet fulfilled all its obligations at the beginning of the annual reporting period in which the entity first applies the amendments and are currently not applicable to Hydro, however, may apply to future transactions.

### 4.3 IAS 1 – Presentation of Financial Statements – Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)

The IASB issued amendments to IAS 1 to promote consistency in applying the requirements by helping companies determine whether, in the Statement of Financial Position, debt and other liabilities with an uncertain settlement date should be classified as current (due or potentially due to be settled within one year) or non-current. The classification is based on rights that are in existence at the end of the reporting period and specify that classification is unaffected by expectations about whether an entity will exercise its right to defer settlement of a liability. The amendments are applied retrospectively upon adoption. Management is currently assessing the amendments and any potential impact on Hydro's financial statements.

### 4.4 IAS 1 – Presentation of Financial Statements– Disclosure of Accounting Policies (Amendments to IAS 1)

The IASB issued amendments to IAS 1, which change the requirements with regard to the disclosure of accounting policies. The amendments replace all instances of the term ‘significant accounting policies’ with ‘material accounting policy information’. Accounting policy information is material if, when considered together with other information included in an entity’s financial statements, it can reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements. The application of these amendments is not expected to have an impact on Hydro’s financial statements.

### 4.5 IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors – Definition of Accounting Estimates (Amendments to IAS 8)

The IASB issued amendments to IAS 8 to clarify the distinction between changes in accounting estimates and changes in accounting policies and the correction of errors. The amendments are intended to improve the understanding of the existing requirements and therefore are not expected to have an impact on Hydro’s financial statements.

## 5. TRADE AND OTHER RECEIVABLES

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Trade receivables | **121** | 97 |
| Due from related parties | **17** | 16 |
| Other receivables | **16** | 12 |
| Loss allowance | **(17)** | (17) |
| | **137** | 108 |

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| 0-60 days | **134** | 106 |
| 60+ days | **3** | 2 |
| | **137** | 108 |

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Loss allowance, beginning of the year | **(17)** | (14) |
| Change in balance during the year | **-** | (3) |
| Loss allowance, end of the year | **(17)** | (17) |

## 6. INVENTORIES

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Fuel | **46** | 54 |
| Materials and other | **51** | 50 |
| | **97** | 104 |

Fuel inventory includes No. 6 fuel in the amount of $34.8 million (2020 - $43.6 million). The cost of inventories recognized as an expense during the year is $126.1 million (2020 - $162.1) and is included in operating costs and fuels.

## 7. DEFERRED ASSET

The deferred asset related to Hydro's PPA with Nalcor Energy Marketing (Energy Marketing) is amortized into income on a straight-line basis over the assumed nine month term of the contract, which commenced on January 1, 2021. Subsequently in March, August and December 2021, Management reassessed the anticipated contract term and determined that a new deferred asset and derivative liability was required resulting in a deferred asset addition of $3.9 million, $3.2 million, and $55.7 million, respectively. The balances at March and August 2021 were fully amortized at December 31, 2021. The remaining $55.7 million balance is to be amortized into income on a straight-line basis over the assumed twelve month term commencing on January 1, 2022 and expiring December 31, 2022. The components of change are as follows:

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Deferred asset, beginning of the year | **23** | 9 |
| Additions | **63** | 38 |
| Amortization | **(30)** | (24) |
| Deferred asset, end of the year | **56** | 23 |

In February 2022, an amendment was made to suspend the existing terms of the PPA with Energy Marketing until April 30, 2022.

## 8. PROPERTY, PLANT AND EQUIPMENT

| *(millions of Canadian dollars)* | Generation Plant | Transmission and Distribution | Other | Assets Under Development | Total |
|---|---|---|---|---|---|
| Cost | | | | | |
| Balance at January 1, 2020 | 1,992 | 1,353 | 289 | 59 | 3,693 |
| Additions | - | - | - | 132 | 132 |
| Disposals | (6) | (3) | (3) | - | (12) |
| Transfers | 41 | 72 | 14 | (127) | - |
| Other adjustments | - | (1) | - | (4) | (5) |
| Decommissioning liabilities and revisions | 1 | - | - | - | 1 |
| Balance at December 31, 2020 | 2,028 | 1,421 | 300 | 60 | 3,809 |
| **Additions** | **1** | **-** | **-** | **161** | **162** |
| **Disposals** | **(13)** | **(2)** | **(2)** | **-** | **(17)** |
| **Transfers** | **93** | **64** | **26** | **(183)** | **-** |
| **Other adjustments** | **(1)** | **(2)** | **-** | **-** | **(3)** |
| **Balance at December 31, 2021** | **2,108** | **1,481** | **324** | **38** | **3,951** |
| Depreciation | | | | | |
| Balance at January 1, 2020 | 606 | 241 | 115 | - | 962 |
| Depreciation | 55 | 31 | 13 | - | 99 |
| Disposals | (4) | (2) | (3) | - | (9) |
| Balance at December 31, 2020 | 657 | 270 | 125 | - | 1,052 |
| **Depreciation** | **57** | **33** | **13** | **-** | **103** |
| **Disposals** | **(7)** | **(1)** | **(2)** | **-** | **(10)** |
| **Balance at December 31, 2021** | **707** | **302** | **136** | **-** | **1,145** |
| Carrying value | | | | | |
| Balance at January 1, 2020 | 1,386 | 1,112 | 174 | 59 | 2,731 |
| Balance at December 31, 2020 | 1,371 | 1,151 | 175 | 60 | 2,757 |
| **Balance at December 31, 2021** | **1,401** | **1,179** | **188** | **38** | **2,806** |

Capitalized interest for the year ended December 31, 2021 was $1.6 million (2020 - $1.5 million) related to assets under development.

## 9. INTANGIBLE ASSETS

| *(millions of Canadian dollars)* | Computer Software | Feasibility Studies | Assets Under Development | Total |
|---|---|---|---|---|
| Cost | | | | |
| Balance at January 1, 2020 | 15 | 2 | - | 17 |
| Additions | - | - | 1 | 1 |
| Disposals | - | (1) | - | (1) |
| Transfers | 4 | - | (4) | - |
| Other adjustments | - | - | 4 | 4 |
| Balance at December 31, 2020 | 19 | 1 | 1 | 21 |
| **Additions** | **-** | **-** | **1** | **1** |
| **Transfers** | **1** | **-** | **(1)** | **-** |
| **Balance at December 31, 2021** | **20** | **1** | **1** | **22** |
| Amortization | | | | |
| Balance at January 1, 2020 | 11 | 1 | - | 12 |
| Amortization | 1 | 1 | - | 2 |
| Disposals | - | (1) | - | (1) |
| Balance at December 31, 2020 | 12 | 1 | - | 13 |
| **Amortization** | **2** | **-** | **-** | **2** |
| **Balance at December 31, 2021** | **14** | **1** | **-** | **15** |
| Carrying value | | | | |
| Balance at January 1, 2020 | 4 | 1 | - | 5 |
| Balance at December 31, 2020 | 7 | - | 1 | 8 |
| **Balance at December 31, 2021** | **6** | **-** | **1** | **7** |

## 10. OTHER LONG-TERM ASSETS

| *As at December 31 (millions of Canadian dollars)* | | **2021** | 2020 |
|---|---|---|---|
| Reserve fund | (a) | **43** | 39 |
| Sinking funds | (b) | **192** | 183 |
| Right-of-use assets | | **2** | 2 |
| Investment in joint arrangement | | **1** | 1 |
| | | **238** | 225 |
| Less: current portion of reserve fund | | **(6)** | (3) |
| | | **232** | 222 |

(a) In 2007 Churchill Falls commenced the creation of a $75.0 million segregated reserve fund pursuant to the terms of the Shareholders' Agreement to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement.

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

The movement in Hydro's proportionate share of the reserve fund for the year is as follows:

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Reserve fund, beginning of the year | **39** | 25 |
| Principal contributions | **5** | 13 |
| Mark-to-market adjustment | **(1)** | 1 |
| Reserve fund, end of the year | **43** | 39 |
| Less: current portion | **(6)** | (3) |
| | **37** | 36 |

(b) As at December 31, 2021, sinking funds include $191.7 million (2020 - $182.6 million) related to repayment of Hydro's long-term debt. Sinking fund investments consist of bonds, debentures, short-term borrowings and coupons issued by, or guaranteed by, the Government of Canada, provincial governments or Schedule 1 banks, and have maturity dates ranging from 2022 to 2033.

Hydro debentures, which are intended to be held to maturity, are deducted from debt while all other sinking fund investments are shown separately on the Consolidated Statement of Financial Position as assets. Annual contributions to the various sinking funds are in accordance with bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 1.42% to 6.82% (2020 – 1.52% to 6.82%).

The movement in sinking funds for the year is as follows:

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Sinking funds, beginning of the year | **183** | 174 |
| Contributions | **7** | 7 |
| Change in sinking fund investments in own debentures | **(11)** | (10) |
| Earnings | **13** | 12 |
| Sinking funds, end of the year | **192** | 183 |

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

| *(millions of Canadian dollars)* | 2022 | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| Sinking fund instalments | 7 | 7 | 7 | 7 | 4 |

## 11. REGULATORY DEFERRALS

| *(millions of Canadian dollars)* | | January 1 2021 | Reclass & Disposition | Regulatory Activity | **December 31 2021** | Remaining Recovery Settlement Period (years) |
|---|---|---|---|---|---|---|
| Regulatory asset deferrals | | | | | | |
| Rate stabilization plan (RSP) | (a) | 40 | 24 | (8) | **56** | n/a |
| Foreign exchange losses | (b) | 46 | - | (2) | **44** | 20.0 |
| Retirement asset pool | (c) | 13 | - | 6 | **19** | n/a |
| Supply cost variance deferral account | (d) | - | - | 18 | **18** | n/a |
| Power purchase expense recognition | (e) | - | - | 18 | **18** | n/a |
| Supply deferrals | (f) | 59 | (55) | 8 | **12** | n/a |
| Deferred energy conservation costs | (g) | 8 | - | - | **8** | n/a |
| Business system transformation program | (h) | 4 | - | 1 | **5** | n/a |
| Other | (k-t) | 2 | - | 2 | **4** | n/a |
| | | 172 | (31) | 43 | **184** | |
| Regulatory liability deferrals | | | | | | |
| Removal provision | (i) | (12) | - | (5) | **(17)** | n/a |
| Insurance amortization and proceeds | (j) | (3) | - | (4) | **(7)** | n/a |
| Other | (k-t) | (2) | - | (1) | **(3)** | n/a |
| | | (17) | - | (10) | **(27)** | |

### 11.1 Regulatory Adjustments Recorded in the Consolidated Statement of Profit and Comprehensive Income

| *For the year ended December 31 (millions of Canadian dollars)* | | **2021** | 2020 |
|---|---|---|---|
| RSP amortization | | **(24)** | (32) |
| Rural rate adjustment | | **2** | 2 |
| RSP fuel deferral | | **33** | 57 |
| RSP interest | | **(3)** | (2) |
| Total RSP activity | (a) | **8** | 25 |
| Supply deferral recovery | | **4** | 11 |
| Supply deferrals | | **(12)** | (55) |
| Total supply deferral activity | (f) | **(8)** | (44) |
| Supply cost variance deferrals | (d) | **(18)** | - |
| Power purchase expense recognition | (e) | **(18)** | - |
| Removal provision | (i) | **5** | 4 |
| Other | (b,c,g,h,j-t) | **(2)** | - |
| | | **(33)** | (15) |

The following section describes Hydro's regulatory assets and liabilities which will be, or are expected to be, reflected in customer rates in future periods and have been established through the rate setting process. In the absence of rate regulation, these amounts would be reflected in operating results in the year and profit for 2021 would have decreased by $32.7 million (2020 – $15.1 million).

**11.(a) RSP**

In 1986, the PUB ordered Hydro to implement the RSP which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, hydrology, load and associated interest. Adjustments required in utility rates to cover the amortization of the balance are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

During 2021, Hydro recorded a net increase in the RSP balance of $16.6 million (2020 - $23.7 million) resulting in a balance from customers of $56.5 million (2020 - $39.9 million). The increase in the RSP asset is primarily due to the recovery of the 2020 energy supply deferrals as per Board Order No. P.U. 15 (2021) resulting in a net increase to the RSP of $54.9 million (2020 - $19.8 million); and Board Order No. P.U. 6 (2021) which approved a transfer of the remaining balance in the 2017 GRA Cost Recovery Rider to the Island Industrial Customer RSP Current Plan resulting in a net increase to the RSP of $0.3 million; partially offset by adjustments related to the one-time fuel price bill credits for utility, rural and industrial customers as per Board Order No.'s P.U. 16 (2020) and P.U. 6 (2021) resulting in a net decrease of $30.9 million (2020 - net increase of $30.8 million) and normal operation of the RSP resulting in a net decrease of $7.7 million (2020 – $25.4 million).

Per Board Order No. P.U. 33 (2021) and Hydro's compliance filing, the RSP was discontinued for purposes of deferring variations in hydraulic production, No. 6 fuel, and load as at October 31, 2021. The Board ordered that the RSP will be maintained to provide timely recovery of the remaining balance resulting in the continuation of amortization and interest charges.

**11.(b) Foreign Exchange Losses**

In 2002, the PUB ordered Hydro to defer realized foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt and amortize the balance over a 40 year period. Accordingly, these costs were recognized as a regulatory asset. During 2021, amortization expense of $2.2 million (2020 - $2.2 million) was recorded.

**11.(c) Retirement Asset Pool**

As per Board Order No. P.U. 30 (2019), the Board approved Hydro's proposed depreciation methodology which includes the deferral of gains and losses on retirement of assets. The deferral will be recovered through future depreciation expense. In 2021, Hydro deferred $6.1 million (2020 - $2.1 million) of retirement asset activity resulting in a total balance of $19.3 million.

**11.(d) Supply Cost Variance Deferral Account**

In Board Order No. P.U. 33 (2021), the PUB approved Hydro's proposal to establish an account to defer payments under the Muskrat Falls Project agreements, rate mitigation funding, project cost recovery from customers and supply cost variances. The deferral commenced activity on November 1, 2021. As at December 31, 2021, $18.3 million was deferred for future recovery from customers.

**11.(e) Power Purchase Expense Recognition**

In Board Order No. P.U. 9 (2021) and Board Order No. P.U. 33 (2021), the PUB approved Hydro's proposal to deviate from IFRS to allow recognition of expenses related to the purchase of energy in accordance with the commercial terms of the Muskrat Falls Power Purchase Agreement. As at December 31, 2021, IFRS power purchase expenses were $14.8 million higher during Muskrat Falls pre-commissioning and $2.8 million higher during post-commissioning than commercial payments which resulted in the deferral of a regulatory asset of $17.6 million.

**11.(f) Supply Deferrals**

Pursuant to Board Order No. P.U. 22 (2017), the Board approved Supply deferral costs using three specific deferral accounts: the Energy Supply, Holyrood Conversion and Isolated Systems Supply cost deferrals. During 2021, Hydro recorded a net decrease to the supply deferrals of $47.4 million (2020 – net increase $24.3 million) resulting in a balance from customers of $12.3 million (2020 - $59.7 million). The decrease in the supply deferral asset is primarily due to the recovery of the 2020 supply cost deferral of $54.9 million from the RSP as per Board Order No. P.U. 15 (2021); Board Order No. P.U. 21 (2019) approved the recovery from customers of $18.4 million over a 20 month period; of which, in 2021 Hydro recovered $4.5 million (2020 - $10.9 million); Board Order No. P.U. 6 (2021) which approved a transfer of the remaining balance in the 2017 GRA cost recovery Rider to the Island Industrial Customer, which resulted in a net decrease to the supply deferral of $0.3 million (2020 - $nil); and normal operation of the supply deferral, resulting in a net increase of $12.3 million (2020 - $54.9 million), with recovery of the period's activity to be determined through an annual application process.

Per Board Order No. P.U. 33 (2021) and Hydro's compliance application, the Energy Supply and Holyrood Conversion Deferrals were discontinued as at October 31, 2021 with the account maintained to provide for a timely recovery of the remaining balance.

**11.(g) Deferred Energy Conservation Costs**

In 2021, Hydro deferred $1.1 million (2020 - $0.6 million) in Energy Conservation Costs associated with an electrical conservation demand management program for residential, industrial, and commercial sectors. As per Board Order No. P.U. 22 (2017), Hydro recovered $1.5 million (2020 – $1.5 million) of the balance through a rate rider.

**11.(h) Business System Transformation Program**

As per Board Order No.'s P.U. 23 (2019) and P.U. 30 (2019), the Board approved the deferral of business system transformation program costs. The recovery of the deferral is subject to a future Board order. During the year, Hydro deferred $1.0 million (2020 – $1.1 million).

**11.(i) Removal Provision**

As per Board Order No. P.U. 30 (2019), the Board approved Hydro's proposed depreciation methodology which includes the provision for removal costs. Hydro recorded a net increase to the provision relating to 2021 activity of $4.9 million (2020 - $4.1 million) resulting in a total balance of $16.9 million (2020 - $12.0 million). The increase was driven by removal depreciation of $5.2 million (2020 - $5.1 million) which was partially offset by removal costs of $0.3 million (2020 - $1.0 million).

**11.(j) Insurance Amortization and Proceeds**

Pursuant to Board Order No. P.U. 13 (2012), Hydro records net insurance proceeds against the capital costs and amortizes the balance over the life of the asset. Under IFRS, Hydro is required to recognize the insurance proceeds and corresponding amortization in regulatory liabilities. During 2021, Hydro recorded a net increase of $4.2 million (2020 - $nil) to the regulatory liability. The increase was driven by insurance proceeds of $4.5 million (2020 - $nil) which was partially offset by insurance amortization of $0.3 million (2020 - $nil).

**11.(k) Deferred Lease Costs**

In Board Order No's. P.U. 17 (2016), P.U. 23 (2016) and No. P.U. 49 (2016) the Board approved amortization of lease costs associated with mobile diesel units at Holyrood Thermal Generating Station (HTGS) over a period of five years. In 2021, Hydro recorded amortization of $0.1 million (2020 - $0.3 million) of the deferred lease costs.

**11.(l) Deferred Foreign Exchange on Fuel**

Hydro purchases fuel for HTGS in USD. There are regulatory mechanisms that allow Hydro to defer variances in fuel prices (including foreign exchange fluctuations). During 2021, Hydro recognized an increase to regulatory assets due to foreign exchange losses on fuel purchases of $0.6 million (2020 - $0.2 million gains).

**11.(m) Phase Two Hearing Costs**

Pursuant to Board Order No. P.U. 13 (2016), Hydro received approval to defer consulting fees and salary related costs relating to Phase Two of the investigation into the reliability and adequacy of power on the Island Interconnected system after the interconnection with the Muskrat Falls generating station. In 2019, Phase Two of the Board's investigation was concluded with recovery to be addressed in a future Board Order. There were no additions in 2021 or 2020. The total deferred balance is $1.4 million (2020 - $1.4 million).

**11.(n) Asset Disposal**

As per Board Order No. P.U. 49 (2016), the Board ordered that Hydro recognize a regulatory asset of $0.4 million related to the Sunnyside transformer that was disposed of in 2014. Hydro is required to recover the deferred asset in rate base and amortize the asset for 22.4 years commencing in 2015. Hydro is required to exclude the new Sunnyside transformer from rate base until the Sunnyside transformer original asset deferral has been fully amortized.

**11.(o) Hydraulic Resources Optimization Deferral Account**

In Board Order No. P.U. 49 (2018), a deferral account to capture the revenues and costs associated with the hydraulic optimization activities was approved. For the year ended December 31, 2021, the balance of hydraulic optimization activities is a net gain of $1.3 million (2020 - $1.0 million) recorded as a deferred liability.

**11.(p) Deferred Purchased Power Savings**

In 1997, the PUB ordered Hydro to defer $1.1 million related to reduced purchased power rates resulting from the interconnection of communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system and amortize the balance over a 30 year period. The remaining unamortized savings in the amount of $0.2 million (2020 - $0.2 million) are deferred as a regulatory liability.

**11.(q) Non-Customer Contributions in Aid of Construction**

Pursuant to Board Order No. P.U. 1 (2017), Hydro recognized amortization of deferred contributions in aid of construction (CIAC) from entities which are non-customer related parties in profit or loss. During 2021, Hydro recorded $1.2 million (2020 - $0.9 million) in non-customer related party CIAC amortization as a regulatory adjustment. In the absence of rate regulation, IFRS requires these non-customer related party CIACs to be recorded as contributed capital with no corresponding amortization. As a result, during 2021 Hydro also recorded an increase of $1.2 million (2020 - $0.9 million) to contributed capital to recognize the amount that was reclassified to profit or loss.

**11.(r) Employee Future Benefits Actuarial Loss**

Pursuant to Board Order No. P.U. 36 (2015), Hydro has recognized the amortization of employee future benefit actuarial gains and losses in net income. During 2021 Hydro recorded $0.2 million (2020 - $0.1 million) employee future benefits losses as a regulatory adjustment. In the absence of rate regulation, IFRS would require Hydro to include employee future benefits actuarial gains and losses in other comprehensive income. As a result, during 2021 Hydro also recorded a decrease of $0.2 million (2020 - $0.1 million) to other comprehensive income to recognize the amount that was reclassified to profit or loss.

**11.(s) Reliability and Resource Adequacy Study**

Pursuant to Board Order No. P.U. 29 (2019), the Board approved the deferral of costs associated with the Reliability and Resource Adequacy proceeding. Hydro deferred $1.3 million in 2021 (2020 - $0.6 million) resulting in a regulatory asset of $2.1 million (2020 - $0.8 million). The recovery of the balance is to be determined in a future Board Order.

**11.(t) Frequency Converter Revenue Deferral Account**

In Board Order No. P.U. 35 (2020), the Board approved the deferral of the cumulative revenue requirement impact associated with the loss on the sale of a frequency converter, commencing December, 2019. The disposition of the cumulative revenue requirement impact included in the deferral account balance will be addressed as part of Hydro's next general rate application. During 2021, Hydro deferred $0.2 million as a regulatory liability (2020 - $0.2 million).

## 12. TRADE AND OTHER PAYABLES

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Trade payables | **73** | 103 |
| Accrued interest payable | **25** | 25 |
| Due to related parties | **5** | 5 |
| Other payables | **32** | 21 |
| | **135** | 154 |

## 13. DEBT

### 13.1 Short-term Borrowings

Hydro utilized its $300.0 million government guaranteed promissory note program to fulfil its short-term funding requirements. As at December 31, 2021, there were two promissory notes outstanding for a total of $55.0 million with a maturity date of January 10, 2022 bearing an average interest rate of 0.20% (2020 - $262.0 million bearing an average interest rate of 0.17%). Upon maturity, the promissory notes were reissued.

Hydro's $200.0 million CAD or USD equivalent committed revolving term facility with a maturity date of July 27, 2021 was increased to $500.0 million on April 16, 2021, and extended to reflect a new maturity date of July 31, 2022. As at December 31, 2021, there were no amounts drawn on the facility (2020 - $nil). Borrowings in CAD may take the form of Prime Rate Advances, Bankers' Acceptances (BAs), and letters of credit, with interest calculated at the Prime Rate or BA fee. Borrowings in USD may take the form of Base Rate Advances and letters of credit. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. Hydro's committed credit facility with its banker of $300.0 million matured during the year and was not renewed.

Churchill Falls maintains a $10.0 million CAD or USD equivalent unsecured demand operating credit facility with its banker. Advances may take the form of a Prime Rate advance, or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Churchill Falls bank accounts, with interest calculated at the Prime Rate. There were no amounts drawn on this facility as at December 31, 2021 (2020 - $nil).

Churchill Falls has issued three irrevocable letters of credit totalling $2.0 million (2020 - $2.0 million), $1.0 million of which does not impact the borrowing limit of the operating credit facility (2020 - $1.0 million). The letters of credit ensure satisfactory management of its waste management system and compliance with a certificate of approval for the transportation of special and hazardous wastes, granted by the Provincial Department of Environment and Conservation.

### 13.2 Long-term Debt

The following table represents the value of long-term debt measured at amortized cost:

| *As at December 31 (millions of Canadian dollars)* | Face Value | Coupon Rate % | Year of Issue | Year of Maturity | **2021** | 2020 |
|---|---|---|---|---|---|---|
| Hydro | | | | | | |
| Y* | 300 | 8.40 | 1996 | 2026 | **297** | 297 |
| AB* | 300 | 6.65 | 2001 | 2031 | **304** | 304 |
| AD* | 125 | 5.70 | 2003 | 2033 | **124** | 124 |
| AF | 500 | 3.60 | 2014/2017 | 2045 | **482** | 481 |
| 1A | 600 | 3.70 | 2017/2018 | 2048 | **638** | 639 |
| 2A | 300 | 1.75 | 2021 | 2030 | **287** | - |
| Total | 2,125 | | | | **2,132** | 1,845 |
| Less: Sinking fund investments in own debentures | | | | | **84** | 73 |
| | | | | | **2,048** | 1,772 |
| Less: Sinking fund payments due within one year | | | | | **7** | 7 |
| Total | | | | | **2,041** | 1,765 |

*Sinking funds have been established for these issues.

Hydro's promissory notes and debentures are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments, by the Province, with exception of Series 1A and Series 2A which are borrowed directly from the Province. The Province charges Hydro a guarantee fee of 25 basis points annually on the total debt (net of sinking funds) with a remaining term to maturity of less than or equal to 10 years and 50 basis points annually on total debt (net of sinking funds) with a remaining term to maturity greater than 10 years for debt outstanding as of December 31, 2010. For debt issued subsequent to December 31, 2010, the guarantee rate is 25 basis points annually on the total debt (net of sinking funds) with an original term to maturity of less than or equal to 10 years and 50 basis points annually on total debt (net of sinking funds) with an original term to maturity greater than 10 years. The guarantee fee recorded for the year ended December 31, 2021 was $8.6 million (2020 - $8.6 million).

On April 13, 2021, the Province of Newfoundland and Labrador issued long-term debt with a face value of $300.0 million, specifically on Hydro's behalf. The debt matures on June 2, 2030 with a coupon rate of 1.75%, paid semi-annually.

## 14. DEFERRED CONTRIBUTIONS

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

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Deferred contributions, beginning of the year | **28** | 27 |
| Additions | **5** | 3 |
| Amortization | **(2)** | (2) |
| Deferred contributions, end of the year | **31** | 28 |
| Less: current portion | **(1)** | (2) |
| | **30** | 26 |

## 15. DECOMMISSIONING LIABILITIES

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

The reconciliation of the beginning and ending carrying amounts of decommissioning liabilities for December 31, 2021 are as follows:

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Decommissioning liabilities, beginning of the year | **16** | 15 |
| Revisions | **(1)** | 1 |
| Decommissioning liabilities, end of the year | **15** | 16 |
| Less: current portion | **(2)** | - |
| | **13** | 16 |

The total estimated undiscounted cash flows required to settle the HTGS obligations at December 31, 2021 are $15.2 million (2020 - $15.2 million). Payments to settle the liability are expected to occur between 2022 and 2025. The fair value of the decommissioning liabilities was determined using the present value of future cash flows discounted at Hydro's credit adjusted risk free rate of 1.3% (2020 - 0.5%). Hydro has recorded $14.6 million (2020 - $14.8 million) related to HTGS obligations.

The total estimated undiscounted cash flows required to settle the PCB obligations at December 31, 2021 are $0.6 million (2020 - $1.1 million). Payments to settle the liability are expected to occur between 2022 and 2025. The fair value of the decommissioning liabilities was determined using the present value of future cash flows discounted at Hydro's credit adjusted risk free rate of 1.3% (2020 - 0.5%). Hydro has recorded $0.6 million (2020 - $1.0 million) related to PCB obligations.

Hydro's assets include generation plants, transmission assets and distribution systems. These assets can continue to run indefinitely with ongoing maintenance activities. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related decommissioning liability cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is required to remove, a decommissioning liability for those assets will be recognized at that time.

## 16. LEASES

### Amounts Recognized in the Consolidated Statement of Profit and Comprehensive Income

| *For the year ended December 31 (millions of Canadian dollars)* | | **2021** | 2020 |
|---|---|---|---|
| Variable lease payments not included in the measurement of leases | (a) | **29** | 28 |

(a) Variable lease payments not included in the measurement of leases include payments made to Nalcor for power generated from assets which are owned by the Province. These variable lease payments are included in power purchased in the Consolidated Statement of Profit and Comprehensive Income.

The total cash outflow for leases for the year ended December 31, 2021 amount to $28.7 million (2020 - $28.3 million).

## 17. EMPLOYEE FUTURE BENEFITS

### 17.1 Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions for the year ended December 31, 2021 of $9.7 million (2020 - $9.4 million) are expensed as incurred.

### 17.2 Other Benefits

Hydro provides group life insurance and health care benefits on a cost shared basis to retired employees, and in certain cases their surviving spouses, in addition to a retirement allowance. In 2021, cash payments to beneficiaries for its unfunded other employee future benefits were $3.7 million (2020 - $3.8 million). An actuarial valuation was performed as at December 31, 2021.

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Accrued benefit obligation, beginning of the year | **130** | 123 |
| Current service cost | **5** | 5 |
| Interest cost | **4** | 4 |
| Benefits paid | **(4)** | (4) |
| Actuarial (gain) loss | **(17)** | 2 |
| Transfers | **2** | - |
| Accrued benefit obligation, end of the year | **120** | 130 |

| *For the year ended December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Component of benefit cost | | |
| Current service cost | **5** | 5 |
| Interest cost | **4** | 4 |
| Total benefit expense for the year | **9** | 9 |

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

| | **2021** | 2020 |
|---|---|---|
| Discount rate - benefit cost | **2.70%** | 3.20% |
| Discount rate - accrued benefit obligation | **3.35%** | 2.70% |
| Rate of compensation increase | **3.50%** | 3.50% |

Assumed healthcare trend rates:

| | **2021** | 2020 |
|---|---|---|
| Initial health care expense trend rate | **5.53%** | 5.64% |
| Cost trend decline to | **3.60%** | 3.60% |

Current rate 5.53%, reducing linearly to 3.6% in 2040 and thereafter.

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

| *Increase (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Current service and interest cost | **2** | 2 |
| Accrued benefit obligation | **19** | 22 |

| *Decrease (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Current service and interest cost | **(1)** | (1) |
| Accrued benefit obligation | **(14)** | (17) |

## 18. SHAREHOLDER'S EQUITY

### 18.1 Share Capital

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Common shares of par value of $1 each | | |
| Authorized - 25,000,000 | | |
| Issued, paid and outstanding - 22,503,942 | **23** | 23 |

### 18.2 Contributed Capital

| *As at December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Contributed capital, beginning of the year | **151** | 152 |
| Amortization | **(1)** | (1) |
| Contributed capital, end of the year | **150** | 151 |

During 2021, Lower Churchill Management Corporation (LCMC) contributed $0.2 million (2020 - $0.2 million) in additions to property, plant and equipment. Pursuant to Board Order No. P.U. 1 (2017), Hydro recognized $1.2 million (2020 - $0.9 million) in amortization as a regulatory adjustment.

### 18.3 Dividends

| *For the year ended December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Declared during the year | | |
| Final dividend for prior year: $0.03 per share (2020 - $0.03) | **1** | 1 |
| Interim dividend for current year: $0.64 per share (2020 - $0.54) | **14** | 12 |
| | **15** | 13 |

## 19. OPERATING COSTS

| *For the year ended December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Salaries and benefits | **109** | 113 |
| Maintenance and materials | **30** | 27 |
| Professional services | **10** | 10 |
| Insurance | **7** | 6 |
| Travel and transportation | **6** | 4 |
| Other operating costs | **7** | 15 |
| | **169** | 175 |

## 20. NET FINANCE EXPENSE

| *For the year ended December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Finance income | | |
| Interest on sinking fund | **13** | 12 |
| Interest on reserve fund | **1** | - |
| Other interest income | **1** | 2 |
| | **15** | 14 |
| Finance expense | | |
| Long-term debt | **96** | 92 |
| Debt guarantee fee | **9** | 9 |
| Other | **2** | 3 |
| | **107** | 104 |
| Interest capitalized during construction | **(2)** | (2) |
| | **105** | 102 |
| Net finance expense | **90** | 88 |

## 21. OTHER EXPENSE

| *For the year ended December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Loss on disposal of property, plant and equipment | **7** | 3 |
| Insurance proceeds | **(5)** | - |
| Rent and royalties | **6** | 4 |
| Other | **1** | 2 |
| Other expense | **9** | 9 |

## 22. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

### 22.1 Fair Value

The estimated fair values of financial instruments as at December 31, 2021 and 2020 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions.

As a significant number of Hydro's assets and liabilities do not meet the definition of a financial instrument, the fair value estimates below do not reflect the fair value of Hydro as a whole.

Establishing Fair Value

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the nature of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. For assets and liabilities that are recognized at fair value on a recurring basis, Hydro determines whether transfers have occurred between levels in the hierarchy by reassessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period. There were no transfers between Level 1, 2 and 3 fair value measurement for the years ended December 31, 2021 and 2020.

| *As at (millions of Canadian dollars)* | **Level** | **Carrying Value** | **Fair Value** | Carrying Value | Fair Value |
|---|---|---|---|---|---|
| | | **December 31, 2021** | | December 31, 2020 | |
| Financial assets | | | | | |
| Sinking funds - investments in Hydro debt issue | **2** | **84** | **94** | 73 | 88 |
| Sinking funds - other investments | **2** | **192** | **230** | 183 | 234 |
| Reserve fund | **2** | **43** | **43** | 39 | 39 |
| Financial liabilities | | | | | |
| Derivative liability | **3** | **56** | **56** | 23 | 23 |
| Long-term debt (including amount due within one year before sinking funds) | **2** | **2,132** | **2,508** | 1,845 | 2,394 |

The fair value of cash, trade and other receivables, related party loan receivable, short-term borrowings and trade and other payables approximates their carrying values due to their short-term maturity.

The fair values of Level 2 financial instruments are determined using quoted prices in active markets, which in some cases are adjusted for factors specific to the asset or liability. Level 2 derivative instruments are valued based on observable commodity future curves, broker quotes or other publicly available data. Level 2 fair values of other risk management assets and liabilities and long-term debt are determined using observable inputs other than unadjusted quoted prices, such as interest rate yield curves and currency rates.

Level 3 financial instruments include the derivative liability relating to the PPA with Energy Marketing and represents the future value provided to Energy Marketing through the contract.

The following table summarizes quantitative information about the valuation techniques and unobservable inputs used in the fair value measurement of Level 3 financial instruments as at December 31, 2021:

| *(millions of Canadian dollars)* | Carrying Value | Valuation Techniques | Significant Unobservable Input(s) | Range |
|---|---|---|---|---|
| Derivative liability (PPA) | 56 | Modelled pricing | Volumes (MWh) | 27-34% of available generation |

The derivative liability arising under the PPA is designated as a Level 3 instrument as certain forward market prices and related volumes are not readily determinable to estimate a portion of the fair value of the derivative liability. Hence, fair value measurement of this instrument is based upon a combination of internal and external pricing and volume estimates. As at December 31, 2021, the effect of using reasonably possible alternative assumptions for volume inputs to valuation techniques may have resulted in a -$0.1 million to +$0.9 million change in the carrying value of the derivative liability.

The components of the change impacting the carrying value of the derivative liability for the years ended December 31, 2021 and 2020 are as follows:

| ***(millions of Canadian dollars)*** | **Level 3** |
|---|---|
| **Balance at January 1, 2021** | **(23)** |
| **Purchases** | **(63)** |
| **Changes in profit or loss** | |
| **Mark-to-market** | **(21)** |
| **Settlements** | **51** |
| **Total** | **30** |
| **Balance at December 31, 2021** | **(56)** |

| *(millions of Canadian dollars)* | Level 3 |
|---|---|
| Balance at January 1, 2020 | (9) |
| Purchases | (38) |
| Changes in profit or loss | |
| Mark-to-market | 1 |
| Settlements | 23 |
| Total | 24 |
| Balance at December 31, 2020 | (23) |

**22.2 Risk Management**

Hydro is exposed to certain credit, liquidity and market risks through its operating, investing and financing activities. Financial risk is managed in accordance with Hydro's Board approved Financial Risk Management Policy, which outlines the objectives and strategies for the management of financial risk, including the use of derivative contracts. Permitted financial risk management strategies are aimed at minimizing the volatility of Hydro's expected future cash flows.

Credit Risk

Hydro's expected future cash flow is exposed to credit risk through its operating activities, primarily due to the potential for non-performance by its customers, and through its financing and investing activities, based on the risk of non-performance by counterparties to its financial instruments. The degree of exposure to credit risk on cash and derivative assets as well as from the sale of electricity to customers, including the associated accounts receivable, is determined by the financial capacity and stability of those customers and counterparties. The maximum exposure to credit risk on these financial instruments is represented by their carrying values on the Consolidated Statement of Financial Position at the reporting date.

The COVID-19 pandemic has increased the credit risk of the Company, as the potential risk for non-performance of the Company's customers has increased with the current economic slowdown. Hydro had established flexible collection practices during the COVID-19 pandemic for its customers and has since returned to its normal customer collections practices. Hydro is continuing to monitor the risk of non-performance by its customers and as at December 31, 2021 the impact on the Company's expected credit loss allowance is not considered material. As well, Hydro is continuing to monitor the implications of COVID-19, including the risk of credit losses, pronouncements from governments and regulators and, if required, will make adjustments to the expected credit loss allowance in future periods.

Credit risk on cash is minimal, as Hydro's cash deposits are held by a Schedule 1 Canadian Chartered Bank with a rating of A+ (Standard and Poor's).

Credit exposure on Hydro's sinking funds is limited by restricting the holdings to long-term debt instruments issued by the Government of Canada or any province of Canada, Crown corporations and Schedule 1 Canadian Chartered Banks. The following credit risk table provides information on credit exposures according to issuer type and credit rating for the remainder of the sinking funds portfolio:

| | **Issuer Credit Rating** | **Fair Value of Portfolio (%)** | **Issuer Credit Rating** | **Fair Value of Portfolio (%)** |
|---|---|---|---|---|
| | **2021** | | 2020 | |
| Provincial Governments | **AA- to AAA** | **16.62%** | AA- to AAA | 17.10% |
| Provincial Governments | **A- to A+** | **26.02%** | A- to A+ | 26.53% |
| Provincially owned utilities | **AA- to AAA** | **23.31%** | AA- to AAA | 24.03% |
| Provincially owned utilities | **A- to A+** | **34.05%** | A- to A+ | 32.34% |
| | | **100.00%** | | 100.00% |

Credit exposure on the reserve fund is mitigated by adhering to an investment policy which restricts the holdings to long-term debt instruments issued or guaranteed by the Government of Canada or any province of Canada. Investment in the long-term debt instruments of Canadian banks are also permitted, provided the bank is rated A or higher by Standard and Poor's. With the exception of Government of Canada, holdings of any one issuer are limited to 10% of the total principal amount of the portfolio. The following credit risk table provides information on credit exposure according to issuer type and credit rating for the reserve fund:

| | **Issuer Credit Rating** | **Fair Value of Portfolio(%)** | **Issuer Credit Rating** | **Fair Value of Portfolio (%)** |
|---|---|---|---|---|
| | **2021** | | 2020 | |
| Provincial Governments | **AA- to AAA** | **10.58%** | AA- to AAA | - |
| Provincial Governments | **A- to A+** | **38.14%** | A- to A+ | 40.58% |
| Provincially owned utilities | **AA- to AAA** | **4.82%** | AA- to AAA- | 8.26% |
| Provincially owned utilities | **A- to A+** | **5.30%** | A- to A+ | 6.00% |
| Schedule 1 Canadian banks | **AA- to AAA** | **15.59%** | AA- to AAA | 18.53% |
| Schedule 1 or 2 Canadian banks | **A- to A+** | **25.57%** | A- to A+ | 26.63% |
| | | **100.0%** | | 100.0% |

Hydro's exposure to credit risk on its energy sales and associated accounts receivable is determined by the credit quality of its customers. Hydro's three largest customers account for 82.8% (2020 - 81.3%) of total energy sales and 62.2% (2020 – 64.3%) of accounts receivable. Energy sales for the three largest customers include $448.6 million (2020 - $455.0 million) for Regulated Hydro, as well as $39.3 million (2020 - $41.4 million) for Non-Regulated Hydro. Churchill Falls' exposure to credit risk on energy sales is limited, as Churchill Falls' main customer, Hydro-Québec is an investment grade utility.

Liquidity Risk

Hydro is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Liquidity risk management is aimed at ensuring cash is available to meet those obligations as they become due.

Short-term liquidity is mainly provided through cash on hand, funds from operations, and a $300.0 million promissory note program. In addition, Hydro maintains a $500.0 million (2020 - $200.0 million) committed revolving term credit facility with its primary banker. These credit facilities are held with its primary banker in order to meet any requirements beyond those forecasted for a given period. Churchill Falls also maintains a $24.0 million (2020 - $23.0 million) minimum cash balance, business interruption insurance, as well as a $10.0 million (2020 - $10.0 million) unsecured credit facility with its banker.

Long-term liquidity risk for Hydro is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2026 to 2048. Sinking funds have been established for these issues, with the exception of the issues maturing in 2030, 2045 and 2048.

For Churchill Falls, long-term liquidity risk is managed by maintenance of the reserve fund in accordance with the Shareholders' Agreement and a dividend management policy that meets long-term liquidity requirements associated with Churchill Falls' capital expenditure program.

The following are the contractual maturities of Hydro's financial liabilities, including principal and interest, as at December 31, 2021:

| *(millions of Canadian dollars)* | <1 Year | 1-3 Years | 3-5 Years | > 5 Years | Total |
|---|---|---|---|---|---|
| Trade and other payables | 135 | - | - | - | 135 |
| Short-term borrowings | 55 | - | - | - | 55 |
| Contract payable | 18 | - | - | - | 18 |
| Derivative liability | 56 | - | - | - | 56 |
| Debt guarantee fee | 9 | 17 | 17 | 126 | 169 |
| Long-term debt including sinking funds | 7 | 13 | 311 | 1,794 | 2,125 |
| Interest | 98 | 195 | 183 | 998 | 1,474 |
| | 378 | 225 | 511 | 2,918 | 4,032 |

Market Risk

In the course of carrying out its operating, financing and investing activities, Hydro is exposed to possible market price movements that could impact expected future cash flow and the carrying value of certain financial assets and liabilities. Market price movements to which Hydro has significant exposure include those relating to prevailing interest rates, foreign exchange rates, most notably the USD/CAD, and current commodity prices, most notably the spot prices for fuel and electricity. These exposures are addressed as part of the Financial Risk Management Policy.

*Interest Rates*

Changes in prevailing interest rates will impact the fair value of financial assets and liabilities which includes Hydro's cash and sinking funds. Expected future cash flows associated with those financial instruments can also be impacted. The impact of a 0.5% change in interest rates on net income and other comprehensive income associated with cash and short-term debt was negligible throughout 2021 due to the short time period to maturity. There was no impact on profit and other comprehensive income associated with long-term debt as all of Hydro's long-term debt has fixed interest rates.

Changes in prevailing interest rates will impact the fair value of financial assets classified as FVTOCI, which includes Churchill Falls' reserve fund. Expected cash flows from these assets are also impacted in certain circumstances, such as when reserve fund securities are sold prior to maturity. The impact to other comprehensive income for a 0.5% decrease or increase in interest rate would be +$0.1 million and -$0.1 million, respectively.

*Foreign Currency and Commodity Exposure*

Hydro's primary exposure to both USD foreign exchange and commodity price risk arises from its purchases of No. 6 fuel for consumption at the HTGS, and these risks are mitigated through the operation of the regulatory mechanisms.

## 23. RELATED PARTY TRANSACTIONS

Hydro enters into various transactions with its parent and other affiliates. These transactions occur within the normal course of operations and are measured at the exchange amount, which is the amount of consideration agreed to by the related parties. Related parties with which Hydro transacts are as follows:

| Related Party | Relationship |
|---|---|
| Nalcor | 100% shareholder of Hydro |
| Churchill Falls | Joint arrangement of Hydro |
| The Province | 100% shareholder of Nalcor |
| Twin Falls | Joint venture of Churchill Falls |
| Energy Marketing | Wholly-owned subsidiary of Nalcor |
| Hydro-Québec | 34.2% shareholder of Churchill Falls |
| Labrador-Island Link Operating Corporation (LIL Opco) | Wholly-owned subsidiary of Nalcor |
| Lower Churchill Management Corporation | Wholly-owned subsidiary of Nalcor |
| Muskrat Falls Corporation (Muskrat Falls) | Wholly-owned subsidiary of Nalcor |
| Nalcor Energy – Oil and Gas Inc. | Wholly-owned subsidiary of Nalcor |
| Board of Commissioners of Public Utilities (PUB) | Agency of the Province |

Routine operating transactions with related parties are settled at prevailing market prices under normal trade terms. Outstanding balances due to or from related parties are non-interest bearing with settlement within 30 days, unless otherwise stated.

| *As at December 31 (millions of Canadian dollars)* | | **2021** | 2020 |
|---|---|---|---|
| *Amounts owed by related parties:* | | | |
| **Trade and other receivables:** | | | |
| LCMC | | **-** | 3 |
| Energy Marketing | | **4** | 4 |
| Hydro-Québec | | **11** | 9 |
| Nalcor | | **2** | - |
| **Related party loan receivable:** | | | |
| Muskrat Falls | (a) | **53** | - |
| *Amounts owed to related parties:* | | | |
| **Trade and other payables:** | | | |
| Churchill Falls | | **1** | 1 |
| Nalcor | | **1** | 4 |
| Energy Marketing | | **3** | - |
| **Contract payable:** | | | |
| Muskrat Falls | (b) | **18** | - |
| **Long-term debt:** | | | |
| The Province | | **925** | 639 |
| **Other liabilities:** | | | |
| The Province | | **6** | 4 |
| Various related parties | | **1** | 1 |

| *For the year ended December 31 (millions of Canadian dollars)* | | **2021** | 2020 |
|---|---|---|---|
| *Revenues:* | | | |
| **Energy and transmission sales:** | | | |
| LCMC | | **2** | 3 |
| Energy Marketing | | **2** | - |
| Hydro-Québec | | **66** | 62 |
| **Rebate recoveries:** | | | |
| The Province | | **2** | 2 |
| Nalcor | | **1** | 1 |
| **Operating contract revenues:** | | | |
| Nalcor | | **25** | 26 |
| **Other revenue:** | | | |
| Hydro-Québec | (c) | **16** | - |
| *Expenses:* | | | |
| **Power purchased:** | | | |
| Churchill Falls | | **16** | 16 |
| Muskrat Falls | | **57** | - |
| Nalcor | | **29** | 28 |
| **Net operating costs:** | | | |
| Various related parties | | **6** | 6 |
| **Net finance expense:** | | | |
| The Province | | **31** | 31 |
| **Rental and royalty:** | | | |
| The Province | | **6** | 4 |

(a) As at December 31, 2021, Hydro has a related party loan receivable from Muskrat Falls of $53.2 million (2020 - $nil) which includes interest charged on the balance outstanding at a rate of 5.43% as required under the Power Purchase Agreement. The balance is repayable by Muskrat Falls as cash is available while still meeting its debt servicing costs.

(b) Hydro entered into a Power Purchase Agreement with Muskrat Falls for the purchase of energy and capacity from the Muskrat Falls Plant. The contract payable balance represents the timing difference between the value of the energy and capacity delivered to Hydro and the contractual payments made under the Power Purchase Agreement in the reporting period.

(c) In August 2021, Churchill Falls and Hydro-Québec reached a Settlement Agreement regarding the Declaratory Judgment case surrounding the interpretation of the Renewed Power Contract, which came into effect September 1, 2016, and alignment on a final Annual Energy Base, which establishes Hydro-Québec's annual energy entitlement for the term of the contract. This settlement has been included in other revenue.

### 23.1 Key Management Personnel Compensation

Compensation for key management personnel, which Hydro defines as its executives who have the primary authority and responsibility for planning, directing and controlling the activities of the entity, includes compensation for senior executives. Salaries and employee benefits include base salaries, performance contract payments, vehicle allowances and contributions to employee benefit plans. Post-employment benefits include contributions to the Province's Public Service Pension Plan in the amount of $0.2 million (2020 - $0.2 million).

| *For the year ended December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Salaries and employee benefits | **2** | 2 |

## 24. COMMITMENTS AND CONTINGENCIES

(a) Hydro is subject to legal claims with respect to various matters. For some legal claims, it is not possible at this time to predict with any certainty the outcome of such litigation. Should these claims result in an unfavorable outcome for Hydro, they may have a significant adverse impact on Hydro's financial position.

(b) Outstanding commitments for capital projects total approximately $34.3 million as at December 31, 2021 (2020 - $16.7 million).

(c) Hydro has entered into a number of long-term power purchase agreements as follows:

| **Type** | **Rating** | **Effective Date** | **Term** |
|---|---|---|---|
| Hydroelectric | 6.5 MW | 2021 | 24 years |
| Hydroelectric | 4 MW | 1998 | 25 years |
| Hydroelectric | 300 MW | 1998 | 43 years |
| Hydroelectric | 225 MW | 2015 | 25 years |
| Cogeneration | 15 MW | 2003 | 20 years |
| Wind | 390 kW | 2004 | Continual |
| Wind | 27 MW | 2008 | 20 years |
| Wind | 27 MW | 2009 | 20 years |
| Hydroelectric, Solar, Battery | 240 kW Hydro<br>189 kW Solar<br>334.5 kW Battery | 2019. Amended in 2020. | 15 years |
| Biomass | 450 kW | 2018 | 1 year post in-service of Muskrat Falls |

Estimated payments due in each of the next five years are as follows:

| *(millions of Canadian dollars)* | 2022 | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| Power purchases | 80.9 | 70.2 | 70.4 | 71.3 | 72.5 |

(d) Through a power purchase agreement signed October 1, 2015, with Energy Marketing, Hydro maintains the transmission services contract it entered into with Hydro-Québec TransÉnergie which concludes in 2024.

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

| | |
|---|---|
| 2022 | $19.7 million |
| 2023 | $19.9 million |
| 2024 | $ 5.0 million |

(e) In 2013, Hydro entered into a Power Purchase Agreement with Muskrat Falls for the purchase of energy and capacity from the Muskrat Falls Plant. The supply period under the agreement is 50 years and contractual payments commenced in November 2021 upon commissioning of the Muskrat Falls Plant. Estimated payments for the next five years have not yet been determined as they may be impacted by the Province's rate mitigation plan.

(f) In 2013, Hydro entered into the Transmission Funding Agreement (TFA) with LIL Opco, in which Hydro has committed to make payments which will be sufficient for LIL Opco to recover all costs associated with rent payments under the LIL Lease and payments to cover operating and maintenance costs incurred by LIL Opco. Hydro will be required to begin mandatory payments associated with the TFA upon commissioning of the Labrador-Island Link (LIL) assets. The term of the TFA is anticipated to continue until the service life of the LIL assets has expired.

(g) In 2014, Hydro entered into three Capacity Assistance Agreements, one with Vale Newfoundland & Labrador Limited (Vale) and two with Corner Brook Pulp and Paper Limited (CBPP) for the purchase of relief power during the winter period. In May 2021, Hydro entered into a second revised agreement with CBPP that expires on April 30, 2023. In December 2021, Hydro entered into a revised agreement with Vale that expires in March of 2022. Payment for services will be dependent on the successful provision of capacity assistance for the winter period by Vale and CBPP.

(h) In December of 2021, CF(L)Co entered into an agreement for the sale of excess energy to Hydro-Québec. The Agreement has a term of 5 years.

(i) Water Management Agreement (WMA) was enacted by the Board of Commissioners of Public Utilities between Churchill Falls and Nalcor. Nalcor subsequently assigned the WMA to Muskrat Falls. The agreement provides for coordinated production for the efficient use of water on the Churchill River system by ensuring that water is available to meet delivery requirements and contractual commitments for both Churchill Falls and Muskrat Falls, while maximizing the energy produced from the water resource. As at December 31, 2021 Muskrat Falls has stored approximately 1.3 TWh of energy in the Churchill Falls reservoir.

## 25. CAPITAL MANAGEMENT

Hydro's principal business requires ongoing access to capital in order to maintain assets to ensure the continued delivery of safe and reliable service to its customers. Therefore, Hydro's primary objective when managing capital is to ensure ready access to capital at a reasonable cost, to minimize its cost of capital within the confines of established risk parameters, and to safeguard Hydro's ability to continue as a going concern.

The capital managed by Hydro is comprised of debt (long-term debentures, short-term borrowings, bank credit facilities and bank indebtedness) and equity (share capital, shareholder contributions, reserves and retained earnings).

A summary of the capital structure is outlined below:

| *(millions of Canadian dollars)* | **2021** | | 2020 | |
|---|---|---|---|---|
| **Debt** | | | | |
| Sinking funds | **(192)** | | (183) | |
| Short-term borrowings | **55** | | 262 | |
| Current portion of long-term debt | **7** | | 7 | |
| Long-term debt | **2,041** | | 1,765 | |
| | **1,911** | **61.8%** | 1,851 | 62.9% |
| **Equity** | | | | |
| Share capital | **23** | | 23 | |
| Contributed capital | **150** | | 151 | |
| Reserves | **(6)** | | (22) | |
| Retained earnings | **1,015** | | 939 | |
| | **1,182** | **38.2%** | 1,091 | 37.1% |
| **Total Debt and Equity** | **3,093** | **100.0%** | 2,942 | 100.0% |

### 25.1 Hydro

Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity, and its interest coverage.

For the regulated portion of Hydro's operations, Management targets a capital structure comprised of 75% debt and 25% equity, a ratio which Management believes to be optimal with respect to its cost of capital. This capital structure is maintained by a combination of dividend policy, shareholder contributions and debt issuance. The issuance of any new debt with a term greater than one year requires prior approval of the PUB. Hydro's committed operating facility has a covenant requiring Hydro to ensure that its consolidated debt to total capitalization ratio does not exceed 85%. As at December 31, 2021, Hydro was in compliance with this covenant.

Legislation stipulates that the total of the Government guaranteed short-term loans issued by Hydro and outstanding at any time shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short-term loans are those loans issued with a term not exceeding two years. On February 20, 2020, the Lieutenant-Governor in Council issued Order in Council OC2020-18 to increase the level of short-term borrowings permitted by Hydro from $300 million to $500 million, effective until March 31, 2022. As a result, the current limit is now $500.0 million and $55.0 million is outstanding as at December 31, 2021 (2020 - $262.0 million). The Hydro Corporation Act, 2007 (the Act) limits Hydro's total borrowings outstanding at any point in time, which includes both short-term borrowings and long-term debt. Hydro's total borrowing limit under the Act is $2.6 billion.

Historically, Hydro Regulated addressed longer-term capital funding requirements by issuing government guaranteed long-term debt in the domestic capital markets. However, in December 2017, Hydro Regulated's process changed; the Province now issues debt in the domestic capital markets, on Hydro Regulated's behalf, and in turn loans the funds to Hydro Regulated on a cost recovery basis. Any additional funding to address long-term capital funding requirements will require approval from the Province and the PUB.

### 25.2 Churchill Falls

Churchill Falls’ objective when managing capital is to maintain its ability to continue as a going concern. Churchill Falls’ requirements for capital in the future are expected to increase, coincident with the aging of the plant and related infrastructure and the execution of the long-term asset management plan. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. Managing the level of dividend payments is a key aspect of ensuring the availability of funding to maintain the plant and infrastructure.

At present, the capital position of Churchill Falls is comprised entirely of equity capital (issued capital, shareholder contributions, reserves and retained earnings). The capital structure is adjusted through the amount of dividends paid to shareholders.

Churchill Falls maintains a $10.0 million Canadian or US equivalent unsecured operating credit facility with its banker. Advances may take the form of a Prime Rate advance or the issuance of a Bankers' Acceptance (BA) with interest calculated at the Prime Rate or prevailing Government BA Fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate. There were no amounts drawn on this facility as at December 31, 2021 (2020 - $nil).

Churchill Falls has issued three irrevocable letters of credit totaling $2.0 million (2020 - $2.0 million), $1.0 million of which does not impact the borrowing limit of the operating credit facility (2020 - $1.0 million). The letters of credit ensure satisfactory management of its waste management system and compliance with a certificate of approval for the transportation of special and hazardous wastes, granted by the Provincial Department of Environment and Conservation.

## 26. SUPPLEMENTARY CASH FLOW INFORMATION

| *For the year ended December 31 (millions of Canadian dollars)* | **2021** | 2020 |
|---|---|---|
| Trade and other receivables | **(29)** | 38 |
| Inventories | **7** | 10 |
| Prepayments | **-** | (1) |
| Trade and other payables | **(17)** | (14) |
| Contract payable | **18** | - |
| Changes in non-cash working capital balances | **(21)** | 33 |
| Related to: | | |
| Operating activities | **(22)** | 31 |
| Investing activities | **1** | 2 |
| | **(21)** | 33 |

## 27. SEGMENT INFORMATION

Hydro operates in four business segments. The designation of segments is based on a combination of regulatory status and management accountability.

Hydro Regulated activities encompass sales of electricity to customers within the Province that are regulated by the PUB. Hydro Non-Regulated activities include the sale of energy to mining operations in Labrador West as well as costs of Hydro that are excluded from the determination of customer rates. Churchill Falls operates a hydroelectric generating facility which sells electricity to Hydro-Québec and Hydro Regulated. Energy Marketing includes the sale of electricity and transmission to Energy Marketing.

| *(millions of Canadian dollars)* | Hydro Regulated | Churchill Falls | Energy Marketing | Non-Regulated Activities | Inter-Segment | Total |
|---|---|---|---|---|---|---|
| | For the year ended December 31, 2021 | | | | | |
| **Energy sales** | 538 | 99 | 4 | 47 | (32) | 656 |
| **Other revenue** | 16 | 16 | 21 | - | 4 | 57 |
| **Revenue** | 554 | 115 | 25 | 47 | (28) | 713 |
| **Fuels** | 122 | - | - | - | - | 122 |
| **Power purchased** | 123 | - | 4 | 43 | (32) | 138 |
| **Operating costs** | 129 | 39 | - | 1 | - | 169 |
| **Transmission rental** | - | - | 21 | - | - | 21 |
| **Depreciation and amortization** | 84 | 21 | - | - | - | 105 |
| **Net finance expense (income)** | 91 | (1) | - | - | - | 90 |
| **Other expense** | 2 | 7 | - | - | - | 9 |
| **Expenses** | 551 | 66 | 25 | 44 | (32) | 654 |
| **Share of profit of joint arrangement** | - | 1 | - | - | - | 1 |
| **Preferred dividends** | - | (4) | - | - | 4 | - |
| **Profit before regulatory adjustments** | 3 | 52 | - | 3 | - | 58 |
| **Regulatory adjustments** | (33) | - | - | - | - | (33) |
| **Profit for the year** | 36 | 52 | - | 3 | - | 91 |
| **Capital expenditures*** | 115 | 48 | - | - | - | 163 |
| **Total assets** | 2,910 | 718 | 59 | 7 | - | 3,694 |

***Capital expenditures include non-cash additions of $0.2 million contributed by Lower Churchill Management Corporation and $1.6 million of interest capitalized during construction.**

| *(millions of Canadian dollars)* | Hydro Regulated | Churchill Falls | Energy Marketing | Non-Regulated Activities | Inter-Segment | Total |
|---|---|---|---|---|---|---|
| | For the year ended December 31, 2020 | | | | | |
| Energy sales | 557 | 94 | 4 | 50 | (32) | 673 |
| Other revenue | 6 | - | 20 | - | 3 | 29 |
| Revenue | 563 | 94 | 24 | 50 | (29) | 702 |
| Fuels | 158 | - | - | - | - | 158 |
| Power purchased | 75 | - | 4 | 43 | (32) | 90 |
| Operating costs | 135 | 38 | - | 1 | 1 | 175 |
| Transmission rental | 1 | - | 20 | - | - | 21 |
| Depreciation and amortization | 79 | 21 | - | - | 1 | 101 |
| Net finance expense (income) | 90 | (1) | - | - | (1) | 88 |
| Other expense | 4 | 5 | - | - | - | 9 |
| Expenses | 542 | 63 | 24 | 44 | (31) | 642 |
| Preferred dividends | - | (3) | - | - | 3 | - |
| Profit before regulatory adjustments | 21 | 34 | - | 6 | (1) | 60 |
| Regulatory adjustments | (15) | - | - | - | - | (15) |
| Profit for the year | 36 | 34 | - | 6 | (1) | 75 |
| Capital expenditures* | 90 | 42 | - | - | 1 | 133 |
| Total assets | 2,780 | 683 | 26 | 9 | - | 3,498 |

*Capital expenditures include non-cash additions of $0.2 million contributed by Lower Churchill Management Corporation and $1.5 million of interest capitalized during construction.