

NEWFOUNDLAND AND LABRADOR HYDRO

2018 Annual Performance Report
Transparency and Accountability

June 2019



Message from the Board of Directors

In accordance with the **Transparency and Accountability Act**, I am pleased to provide the 2018 Annual Performance Report for Newfoundland and Labrador Hydro (Hydro), on behalf of the Board of Directors.

The 2017-2019 Strategic Plan for Hydro outlined how the corporation would address the applicable strategic directions of the Provincial Government in relation to Hydro's role in the energy sector as communicated by the Minister of Natural Resources.

As the Board of Directors of Hydro, we are accountable for the preparation of this report and are accountable for the results.



John Green, QC
Chair
Newfoundland and Labrador Hydro

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1. Overview

As the main generator and transmitter of electricity for use in the province, Newfoundland and Labrador Hydro (Hydro) is focused on providing a safe, reliable and least-cost electricity supply to meet current energy demand and future growth of its customers.

The majority of Hydro's business is regulated by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB) and its electricity rates are set through periodic general rate applications. The regulated portion of the company includes the generation, transmission and distribution of electrical power and energy to utility, residential and commercial customers, as well as island industrial customers. The non-regulated activities of Hydro include electricity sales to industrial customers in Labrador west. Hydro is a wholly owned subsidiary of Nalcor Energy (Nalcor). In 2016 Hydro business operations were separated from Nalcor's other lines of business. In keeping with this separation, Hydro developed its own strategic plan for the 2017-2019 planning period.

Hydro's electricity production assets include nine hydroelectric plants, one oil-fired plant, four gas turbines, and 25 diesel plants. These assets along with a network of transmission and distribution lines bring electricity to communities throughout Newfoundland and Labrador (see Appendix 1).

Hydro also holds a 65.8 per cent interest in Churchill Falls (Labrador) Corporation Limited. The operations of Churchill Falls are managed by Nalcor's Power Supply division and included in the 2017-2019 Nalcor Strategic Plan and 2018 Nalcor Annual Performance Report.

Mandate

The **Hydro Corporation Act, 2007** mandates Hydro to be responsible for:

- Developing and purchasing power and energy on an economic and efficient basis.
- Engaging within the province and elsewhere in the development, generation, production, transmission, distribution, delivery, supply, sale, purchase and use of power from water, steam, gas, coal, oil, wind, hydrogen and other products.

- Supplying power, at rates consistent with sound financial administration, for domestic, commercial, industrial or other uses in the province and subject to the prior approval of the Lieutenant-Governor in Council, outside of the province.

Lines of Business

Hydro delivers safe, reliable, and least cost power to utility, industrial, residential and commercial customers in more than 200 communities in the province.

Hydro activities can be grouped as follows:

- Electricity production – Hydro has an installed generating capacity of 1,764 megawatts (MW) which includes the operations of nine hydroelectric generating stations, one oil-fired plant, four gas turbines, and 25 diesel plants, including 20 isolated diesel generating and distribution systems.
- Transmission and distribution – Hydro operates and maintains over 4,400 kilometres of transmission lines and 54 high voltage terminal stations which connect to generation and delivery points for Newfoundland Power on the island, industrial customers, and Hydro’s rural distribution systems province-wide. Hydro also operates and maintains approximately 2,700 kilometres of distribution lines throughout the province.
- The Newfoundland and Labrador System Operator (NLSO) acts as the independent operator to manage the provincial electricity system in real-time. It also provides Open Access to the provincial transmission network, which means providing transmission service to users like Hydro and other utilities, in an open, non-discriminatory and non-preferential manner.
- Customer service activities address the electricity requirements of Newfoundland Power, industrial customers and over 38,800 direct residential and commercial customers in rural Newfoundland and Labrador.
- Electricity system planning involves forecasting electricity requirements in the province and advancing options to ensure adequate supply of generation resources and transmission and distribution infrastructure to reliably meet forecasted demand.

Values

Employees of Hydro recognize that electricity is essential to social well-being and economic prosperity in Newfoundland and Labrador. In fulfilling Hydro's mandate, employees are unified by the following core values:

- Safety – relentless commitment to protecting ourselves, our colleagues, and our community.
- Open Communication – fostering an environment where information moves freely in a timely manner.
- Accountability – holding ourselves responsible for our actions and performance.
- Honesty and Trust – being sincere in everything we say and do.
- Teamwork – sharing our ideas in an open and supportive manner to achieve excellence.
- Respect and Dignity – appreciating the individuality of others by our words and actions.
- Leadership – empowering individuals to help guide and inspire others.

Primary Clients

Hydro sells electricity to three primary customer groups:

- Newfoundland Power - an investor-owned utility which distributes electrical power to 268,000 customers on the island portion of the province, with Hydro supplying over 90 per cent of its energy requirements.
- Industrial customers – regulated sales to North Atlantic Refining Limited, Vale Newfoundland and Labrador, Praxair Canada Inc., Teck Resources Limited, and Corner Brook Pulp and Paper Limited and unregulated sales to the Iron Ore Company of Canada and Wabush Mines in Labrador.
- Over 38,800 residential and commercial customers in rural Newfoundland and Labrador.

Vision

Providing electricity to enable social well-being and economic prosperity for the people of Newfoundland and Labrador.

Number of Employees, Physical Location and Other Key Statistics

Headquartered in St. John’s with assets and offices throughout the province, Hydro directly employed 945 people in permanent, term and temporary capacities as of December 31, 2018. The location of these employees reflects Hydro’s service area and the location of the company’s electricity assets, with 67 per cent located in rural areas. The gender composition of Hydro’s employee group is 79 per cent male and 21 per cent female. In 2018, Hydro advanced its commitment to diversity and inclusion and hired 26 of 56 (46 per cent) new hire apprentices, co-operative education and summer students and graduate engineers from under-represented groups including 16 women. In addition, 19 of the 50 (38 per cent) new managers, supervisors and engineers hired were women.

Gender	Rural	Urban	Total	Per cent
Female	77	122	199	21%
Male	560	186	746	79%
Total	637	308	945	
Per cent	67%	33%		

Board of Directors

As of December 31, 2018, the Hydro Board of Directors included:

- John Green, QC (Chair)
- Donna Brewer
- Fraser H. Edison
- Chris Loomis
- John Mallam
- Stan Marshall
- William Nippard
- David Oake
- Brendan Paddick
- Brian Walsh

2018 Consolidated Revenues and Expenses

In 2018, Hydro had revenues of \$715 million. The majority of Hydro’s revenues are from

regulated energy sales to utility, rural and industrial customers. Consolidated energy sales also include Hydro's share of Churchill Falls' sales to Hydro Québec. In 2018, Hydro's net income of \$62 million consisted of \$28 million from Hydro Regulated, \$1 million from Hydro Non-Regulated and \$33 million from Hydro's investment in Churchill Falls. The following table summarizes the 2018 consolidated revenue and expenses for Hydro:

<i>For the year ended December 31 (millions of dollars)</i>	(\$)	%
Energy sales	684	95.7
Other revenue	31	4.3
Revenue	715	
Fuels	189	27.0
Power purchased	108	15.4
Operating costs	178	25.4
Transmission rental	21	3.0
Depreciation and amortization	105	15.0
Net finance expense	85	12.2
Other expense	14	2.0
Expenses	700	
Profit before regulatory adjustments	15	
Regulatory adjustments	(47)	
Profit for the year	62	

The 2018 Consolidated Financial Statements for Hydro are appended to this document (see Appendix 2).

2. Highlights and Partnerships

Hydro works with a variety of agencies, departments and commissions to execute its mandate. During 2018, Hydro worked closely with each of these organizations to advance its mandate in the electricity sector in support of the strategic directions of the Provincial Government.

Department of Natural Resources

The Department of Natural Resources works with Hydro in policy-related areas for the electricity sector. In 2018, Hydro worked with the Department and Nalcor to identify and evaluate options to mitigate projected customer rate increases associated with the Muskrat Falls Project, and assess responses to potential new industrial customers. Hydro also provided input to amendments to the **Public Utilities Act**, 1994 and the **Electrical Power Control Act** required for open access¹ to the province's transmission system. As well, Hydro supported the efforts of the Department to progress consideration of renewable generation options for remote communities.

Newfoundland and Labrador Board of Commissioners of Public Utilities

The Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB) is responsible for regulatory oversight of Hydro's regulated utility activities. This responsibility covers a wide range of activities, including approval of its revenue requirements, rates, rate structure and capital program. The role of the PUB is detailed in the **Public Utilities Act**.

During 2018 there was significant regulatory activity related to the 2017 General Rate Application including public hearings and settlement negotiations. As well, Hydro filed a cost of service methodology application and significant other filings related to the study of electricity supply adequacy for the Island Interconnected System. Other regulatory activity included

¹ The open access transmission regime provides open, non-discriminatory and non-preferential access to service on the province's high-voltage electricity transmission system. It is an important component of broadening participation in both import and export electricity markets.

Hydro's 2018 capital budget and a number of supplemental capital project applications as well as significant ongoing reporting.

Department of Finance

The Department of Finance works with Hydro to address requirements related to financial structure, dividend policies as well as providing guarantees for the corporation's debt financing activities. During 2018, Hydro's debt financing activities included the Province issuing debt specifically on Hydro's behalf and lending those proceeds directly to Hydro.

Other Departments/Public Bodies

Hydro also interacts with the Departments of Municipal Affairs and Environment, Fisheries and Land Resources, Tourism, Culture, Industry and Innovation, Intergovernmental and Indigenous Affairs, and Service NL in relation to environmental aspects of the corporation's activities. For example, in 2018 Hydro interacted with the Department of Municipal Affairs and Environment on air emissions files, watercourse crossings associated with the construction of the third transmission line from Bay d'Espoir to the western Avalon Peninsula, and during rehabilitation repairs to the Grand Falls Dam. Parks and Natural Areas (Department of Tourism, Culture, Industry and Innovation) were engaged in post construction rehabilitation and environmental assessment requirements associated with the new transmission line. Intergovernmental and Indigenous Affairs were consulted for work requiring environmental approvals in Labrador. Hydro also engaged the Provincial Archaeology Office when performing distribution line upgrades in southern Labrador.

3. Issues

The strategic issues outlined below will be addressed by Hydro in order to realize its mandate and vision. Consistent with the underlying philosophy of the multi-year performance-based planning required under the provisions of *Transparency and Accountability Act*, these issues are at a governance level and reflect the priorities of the Hydro board and support the Provincial Government's strategic directions for the electricity sector.

Issue 1: Reliable electricity supply

Issue 2: Electricity rates and customer service

Issue 3: Safety

4. Outcomes

Issue 1: Reliable electricity supply

Hydro ensures there is a safe, reliable and least-cost electricity supply available to meet the needs of customers now and in the future. The company's mandate supports fulfillment of the strategic direction of government related to energy security and reliability in Newfoundland and Labrador.

During 2018, Hydro focused on providing a reliable electricity supply by maintaining and renewing assets, preparing for the interconnection between Labrador and the Island via the Labrador Island Link, as well as continuing to assess future customer requirements.

Like most other North American utilities, Hydro is managing a base of aging assets. The majority of Hydro's assets, including the hydroelectric installation at Bay d'Espoir, the Holyrood Thermal Generating Station, the Stephenville Gas Turbine, the Hardwoods Gas Turbine and much of Hydro's transmission and distribution systems, are more than 40 years old.

From 2005-2018, Hydro invested in excess of \$1.5 billion to expand, upgrade or replace its assets. For the 2017-2019 planning period, Hydro's capital expenditures are expected to continue at significant levels to ensure reliability of the electricity system for customers. In 2018, capital expenditures of \$157 million included sustaining capital focused on addressing the condition of aging assets.

The provincial electricity system is changing with the development of the Muskrat Falls generation project and associated transmission facilities including interconnection to the North American electricity grid through the Maritime link and to Labrador through the Labrador-Island Link. These changes present an opportunity to reliably meet the needs of customers during the planning period and beyond. In 2018, Hydro completed critical activities related to

the inter-provincial flow of electricity and the integration of Muskrat Falls power and assets. During the year, over 50 gigawatt hours (GWh)² was imported over the Maritime Link to displace more costly generation thermal generation and over 53 GWh of low cost recapture energy from Churchill Falls was delivered to the island during Labrador Island Link commissioning activities in 2018, displacing an equivalent amount of thermal generation and resulting in net savings of \$7.5 million. As well, the electricity system changes associated with the Maritime Link prevented customer reliability from being impacted by 11 system events.

In addition to meeting current needs, Hydro has a responsibility to assess electricity requirements in the province and identify options to meet future growth in customer requirements. In 2018, Hydro completed a reliability and resource adequacy study to address the long-term approach to providing least-cost reliable electricity service. The regulatory process and required actions related to meeting future needs will continue in 2019 and beyond.

In addition to the requirements of the Island electrical system, Hydro continued to assess electricity requirements and options to respond in the Labrador Interconnected System and isolated diesel communities. Hydro also worked with potential new industrial and data mining companies seeking possible service in Labrador West, Churchill Falls and Happy Valley-Goose Bay.

Issue 1: Reliable electricity supply	
Goal By December 31, 2019, Hydro will have advanced initiatives to support electricity system reliability.	
Indicators	<ul style="list-style-type: none"> ▪ Developed reliability improvement plans for key generating and transmission assets and supporting infrastructure. ▪ Completed required maintenance work and capital investments to support reliability. ▪ Assessed the adequacy of future electricity supply and identified options to address any issues.

² Gigawatt hours (GWh) is a unit of energy representing one billion (1 000 000 000) watt hours and is equivalent to one million kilowatt hours.

Issue 1: Reliable electricity supply	
	<ul style="list-style-type: none"> ▪ Advanced preparations for interconnection of electricity systems and integration of Muskrat Falls power and assets.
<p>Objective By December 31, 2018, Hydro will have progressed investments and implemented initiatives to enhance electricity system reliability.</p>	
Indicators	2018 Accomplishments
Developed annual reliability improvement plans for key generating and transmission assets and completed priority activities.	<p>In 2018, reliability improvement plans were developed identifying 226 actions with a target completion rate of 90 per cent. At year-end, priority actions, and overall 210 or 92.9 per cent of actions, were completed as planned.</p> <p>Reliability improvement plans included initiatives to improve the reliability of Hydro’s generation, transmission, terminal station and distribution assets. Plans addressed improving employee technical and process knowledge, improving effectiveness of asset management system processes and improving equipment installation, assessment, maintenance and replacement practices.</p> <p>Reliability improvement plans for 2018 included such activities as updating distribution and terminal station construction standards, training personnel on Hardwoods and Stephenville Gas Turbines control systems, and conducting expert condition assessment of select equipment.</p>
Completed required maintenance activities and capital projects to support readiness for the 2018/19 winter season.	<p>All winter readiness work (100 per cent) for the Holyrood Thermal Generating Station, within the Bay d'Espoir hydroelectric system, and on the transmission system was completed by the December 1 target date. By year-end, Hydro completed 98.7 per cent of winter readiness activities.</p> <p>All work was not completed due to resourcing or the inability to remove equipment from service without customer outages. As well, several capital projects planned for completion by the target date had some work remaining at year-end. However, in all cases where work was not completed, the risks of those tasks not being completed were assessed and determined to be low.</p>
Completed planned 2018 capital investments.	In 2018, Hydro invested \$157.0 million to upgrade or replace electricity generation, transmission and distribution equipment and supporting infrastructure. The expenditures included new transmission infrastructure and sustaining capital for terminal stations. Expenditures to maintain the hydraulic generation equipment and infrastructure across the province totaled \$23.8

Issue 1: Reliable electricity supply	
	<p>million, thermal generation equipment and infrastructure at Holyrood required expenditures totalling \$13.0 million, and gas turbines required \$13.7 million in expenditures.</p> <p>There was a \$56.1 million (26.3%) variance in actual expenditures compared to the budget of \$213.1 million in Hydro's overall capital program for 2018. Hydro completed an analysis for all 2018 projects that had an annual under-expenditure to identify the causes. This analysis demonstrated that estimates were higher than actuals for completed work, work was carried over to future years because equipment outages or resources were not available or schedules to complete work were underestimated at the budget phase, and several projects were not required and were cancelled.</p>
<p>Completed a study of supply adequacy for the Island Interconnected System (IIS) and developed draft options as required.</p>	<p>In 2018, Hydro completed the required analysis and on November 16th, filed the 2018 Reliability and Resource Adequacy Study with the PUB.</p> <p>The study addressed Hydro's long-term approach and draft options to provide least-cost reliable electricity service. A key component of the study approach was to start a dialogue with customers and stakeholders regarding electricity in Newfoundland and Labrador. The engagement focused on opinions and expectations around reliability and cost. Customers were also asked about their interest in actively managing their own electricity consumption, for example through participation in a time-of-use rate system.</p> <p>The 2018 Reliability and Resource Adequacy Study takes into consideration Hydro's current and future electricity supply, changing sources of supply, electricity load forecasts, key electricity system risks, rate impacts and input from customers and stakeholders. The study approach and modelling practices were externally reviewed and validated to ensure alignment with good utility practice. The intent is to review the study with the PUB and intervenors commencing in 2019 and receive approved system planning criteria for future inclusion in system planning.</p>
<p>Complete a transmission planning study of western Labrador including a review of alternatives to reliably</p>	<p>In 2018 Hydro completed the Labrador Interconnected System Transmission Expansion Study and filed the results with the PUB. The study included consideration for a range of load forecasts with the objective of identifying least-cost, reliable</p>

Issue 1: Reliable electricity supply	
<p>meet long-term load growth generally associated with mining in the area.</p>	<p>electricity transmission system additions required for both eastern and western Labrador.</p> <p>In western Labrador, Hydro identified the need to increase capacity of the 230 kV transmission system due to forecasted loads associated with expected load increases at Wabush Mines by Tacora. Hydro identified and evaluated alternatives to reliably meet long-term growth for the area and will include required capacity upgrades for its assets in the 2020 Capital Budget Application. Hydro also identified the need to explore a commercial arrangement³ to avoid industrial customer load curtailment in 2019.</p> <p>The study also included analysis of further transmission system expansion alternatives required to meet ranges of incremental load beyond baseline forecasts. Least-cost, reliable alternatives were presented complete with capital and lifecycle cost information.</p> <p>In 2018, Hydro proposed a Network Additions Policy for the Labrador Interconnected System (LIS) to the PUB. The intent of the proposed policy is to limit the rate increased that can result from investment in new transmission assets to service new load requests, and to provide a reasonable sharing of cost responsibility between the customer requesting service and the existing customers.</p>
<p>Completed planned activities related to the inter-provincial flow of electricity and the integration of Muskrat Falls power and assets.</p>	<p>In 2018, Hydro completed critical activities related to inter-provincial flow of electricity and the integration of Muskrat Falls power and assets. These activities included negotiation of commercial arrangements, putting operational processes in place, and regulatory activities. Notable accomplishments that were enabled by Hydro's support include:</p> <ul style="list-style-type: none"> ▪ Executed Power Purchase Agreement with Nalcor Energy Marketing to provide for imports over the Labrador Island Link and Maritime Link. ▪ Executed Interim Transmission Funding Agreements for the Labrador Island Link and Labrador Transmission Assets to have the assets be put into limited service in advance of full

³ Relates to accelerating the commissioning of Synchronous Condenser No. 3 in the Wabush Terminal Station. This asset is owned by the Iron Ore Company of Canada and is not yet commissioned. This unit will be able to provide the necessary voltage support to increase the load in 2019.

Issue 1: Reliable electricity supply	
	<p>commissioning of the Labrador Island Link and the Muskrat Falls generating station.</p> <ul style="list-style-type: none"> ▪ The Newfoundland and Labrador System Operator's initial transmission tariff was approved, on an interim basis, by the PUB. ▪ Executed an agreement for Hydro to support operations and maintenance at facilities owned by other Nalcor subsidiaries. ▪ Executed and obtained PUB approval, of the Pilot Agreement for Optimization of Hydraulic Resources, which will enable the use of Hydro's assets to gain value from newly established access to external markets.

The objectives and indicators for 2019 are consistent with the direction outlined in the 2017-2019 Strategic Plan.

Issue 1: Reliable electricity supply	
<p>Objective</p> <p>By December 31, 2019, Hydro will have further advanced investments and initiatives to enhance electricity system reliability.</p>	
<p>Indicators</p>	<ul style="list-style-type: none"> ▪ Developed annual reliability improvement plans for electricity generating and transmission assets and completed priority activities. ▪ Completed required maintenance activities and capital projects to support readiness for the 2019/20 winter season. ▪ Completed planned 2019 capital investments. ▪ Participated in regulatory review of 2018 Reliability and Resource Adequacy Study as required, and completed 2019 update to assess electricity supply adequacy for the Island Interconnected System (IIS). ▪ Supported the regulatory review of Labrador West Transmission Planning Study as required, and developed required capital budgets as part of the 2020 Capital Budget Application to the PUB. ▪ Completed critical activities related to the integration of Muskrat Falls power and assets.

Issue 2: Electricity rates and customer service

As the primary generator of electricity in the province, Hydro has a significant impact on social well-being and economic prosperity in the province. In fulfilling its mandate, Hydro supports the strategic direction of the Provincial Government regarding maximized value and more specifically the focus to minimize the burden on electricity customers in the province. This section of the report outlines Hydro progress related to electricity rates as well as customer service and energy efficiency activities.

Electricity rates are impacted by a number of factors including capital investments in the electricity system, power purchase costs, fuel costs and the overall cost of operations. Hydro's mandate requires a commitment to the provision of least-cost power to customers in Newfoundland and Labrador. This commitment is reflected in a prudent approach to capital investment that ensures the appropriate balance between cost and reliability. In 2018, Hydro also maintained its focus on completing the required maintenance of assets while managing operating costs.

A key driver of future electricity rates is the cost of the Muskrat Falls project. During 2018, Hydro worked with the Government of Newfoundland and Labrador and Hydro's parent company, Nalcor, to determine potential options to mitigate and manage these cost increases for customers. Hydro also provided input to the PUB's review of options to reduce the impacts of the Muskrat Falls Project costs on electricity rates.

Internally, Hydro is looking for opportunities to manage operating and capital costs as well as the cost of electricity supply. In 2018, Hydro proactively pursued innovation and productivity improvements, with an aim to achieve long-term sustainable improvements which reduce costs and provide value to Hydro customers. Through identifying, establishing and documenting specific measures, management can assure that operating funds are spent where they can

provide the greatest benefits and in amounts that provide least-cost services and that a corporate culture that maximizes value for Hydro’s customers is fostered. As noted above, the availability of transmission prior to the full commissioning of the Muskrat Falls Project, provided an opportunity in 2018 to reduce thermal generation using less costly off-island purchases.

Hydro delivers the majority of the electricity needed by Newfoundland Power to address their customers’ needs and also directly serves over 38,800 residential and commercial customers and several large industrial customers. Hydro’s commitment to customers also includes education and programs to help customers reduce their electricity use and costs. In 2018, Hydro continued efforts to help electricity residential, commercial and industrial consumers conserve energy.

Issue 2: Electricity rates and customer service	
Goal By December 31, 2019, Hydro will have supported measures to mitigate electricity rate increases and advanced customer service and energy efficiency initiatives.	
Indicators	<ul style="list-style-type: none"> ▪ Identified and implemented measures to manage operating and capital costs. ▪ Supported assessment and implementation of measures to mitigate the impact of the Muskrat Falls costs on rates. ▪ Evaluated customer satisfaction and developed and implemented initiatives to enhance customer service. ▪ Promoted energy conservation by residential, commercial and industrial customers.
Objective By December 31, 2018, Hydro will have implemented initiatives to manage costs, enhance customer service and energy efficiency.	
Indicators	2018 Accomplishments
Completed priority capital investments for 2018 and identified 2019 capital projects.	<p>Hydro has a Five Year Capital Plan, which details the cost and timing of asset replacements and refurbishments. The plan is a living document and is revised on an ongoing basis as new asset condition information becomes available, as asset management strategies evolve, and demands and priorities change.</p> <p>As noted, Hydro completed capital investments of \$157.0 M in 2018. In 2018, Hydro also identified and received regulatory</p>

Issue 2: Electricity rates and customer service	
	<p>approval of the 2019 capital plan. The capital plan prioritized projects based on improving customer reliability while minimizing the total capital investment. All 2019 projects address both the need to sustain the existing asset base and to grow the asset base in response to growing customer demand, while improving reliability and adhering to Hydro’s principles of safety and environmental responsibility.</p>
<p>Identified and implemented measures to manage costs.</p>	<p>In 2018, Hydro actual operating expenses of \$136.0 million were \$8.1 million lower than budget. This result was primarily due to cost management, variations in maintenance activity, a net decrease in intercompany costs and, a reduction in labor related costs.</p> <p>Hydro evaluated and implemented a number of innovation, productivity and cost management initiatives in 2018. These initiatives included: decreasing the frequency of information technology device replacement; improved oversight on overtime; implementation of an attendance support program; review and optimization of required very high frequency (VHF) coverage; and, promoting customer use of Hydro’s mobile and web portal platform to improve service and replace mailed communication. Together, the initiatives resulted in approximately \$5 million of sustainable annual cost savings.</p> <p>In 2018 Hydro continued its efforts to manage its operating and capital costs and advanced options to reduce the cost of electricity supply through imports. Hydro’s 2018 cost management efforts are summarized above.</p> <p>Hydro also achieved net savings of an estimated \$7.5 million as a result of activities to maximize the value of Hydro’s interconnection to the North American electricity grid and to minimize thermal generation. These activities include using Maritime Link electricity imports and recall power to minimize and avoid gas turbine production and reduce Holyrood unit operation.</p>
<p>Supported Government of Newfoundland and Labrador and Nalcor efforts to evaluate opportunities to mitigate the impact of the Muskrat Falls Project costs on rates.</p>	<p>In 2018, Hydro continued to participate in the Rate Mitigation Steering Committee chaired by the Department of Natural Resources with representatives from the Department of Finance, and Nalcor. The Committee continued its efforts to identify and evaluate options to mitigate the impact of Muskrat Falls costs on rates. In 2018, Hydro also provided</p>

Issue 2: Electricity rates and customer service	
	input to the PUB’s review of options to reduce the impacts of the Muskrat Falls Project costs on electricity rates (reference questions). This review will continue in 2019.
Measured residential customer satisfaction and developed a customer centric culture plan.	<p>In 2018, Hydro completed a residential customer satisfaction survey. The purpose of this research is to assess customer satisfaction with Hydro’s performance in providing service to residential customers and to determine any changes in customer satisfaction over time.</p> <p>The vast majority of residential customers remain satisfied with Hydro resulting in an 89 per cent overall satisfaction rating. The survey indicated that 47 percent of residential customers are very satisfied and 42 percent are somewhat satisfied. When compared to the overall satisfaction rating of 90 percent in 2016, Hydro has remained relatively consistent.</p> <p>Hydro planned to develop a customer centric culture plan in 2018. While some preliminary research was completed regarding the practices of other utilities, this initiative was not completed as planned as a result of other priorities.</p>
Completed priority customer service activities for Newfoundland Power and key accounts.	<p>All priority customer service activities outlined in the 2018 account management plans were completed as planned.</p> <p>In 2018, account management plans were developed for Newfoundland Power and other key accounts. These plans included scheduled customer meetings to discuss operations, reliability, projects, outage planning, account management, short/long term electricity system development, and energy efficiency. Also included was the communication of capital budget applications, specifically assigned assets charges, electricity rate changes, and general electricity system events that may impact these customers.</p>
Delivered energy conservation programs to residential, commercial and industrial customers.	<p>In 2018, Hydro delivered energy efficiency programs to residential and commercial customers. These programs included the joint utility program offerings for residential and commercial customers through the takeCHARGE program delivered in partnership with Newfoundland Power, as well as Hydro’s energy efficiency programs in isolated communities.</p> <p><i>takeCHARGE program</i></p> <p>In 2018, the takeCHARGE energy efficiency program continued to see success with rebates to Hydro’s residential customers</p>

Issue 2: Electricity rates and customer service

	<p>for insulation upgrades, thermostats, heat recovery ventilators, and small technologies. There were also rebates for energy efficient technologies purchased by Hydro’s commercial customers.</p> <p><i>Isolated Systems Community Energy Efficiency Program</i> In 2018, Hydro continued delivery of the Isolated Systems Community Energy Efficiency Program. This program promotes energy efficiency to residential and commercial customers in communities served by diesel electricity systems in Labrador and on the island. During 2018, 727 residential and business customers benefited from the direct, free installation of 12,147 energy efficient technologies with a total annual energy savings of 460 MWh.</p> <p><i>Business Efficiency Program</i> Hydro also delivered programs to business customers in the company’s interconnected and isolated areas in 2018. These programs provided facility audits and technical support to identify economical energy efficiency opportunities, and provide financial support for capital upgrades. In 2018, four commercial facility audits were completed to inform customers of opportunities for energy savings and eight projects were completed resulting in annual savings of 182 MWh. The program also supported 248 MWh of energy savings through mail-in rebates.</p> <p><i>Industrial Customers</i> In 2018, one industrial customer completed a lighting retrofit project that will result in 162 MWh of annual energy savings. Hydro provided financial support to the customer through the Industrial Energy Efficiency Program.</p>
<p>Complete planned energy efficiency initiatives for Hydro facilities and equipment.</p>	<p>In 2018, Hydro completed planned initiatives to enhance energy efficiency for Hydro facilities and equipment. The projects completed during the year, resulted in a savings of 429 MWh.</p> <p>More efficient lighting was installed at three diesel plants (Grey River, St. Lewis, and Nain), the Bay D'Espoir powerhouse, and other buildings. Programmable thermostats were installed in a number of buildings including the Wabush Terminal Station control building and the Flowers Cove line depot. Additional</p>

Issue 2: Electricity rates and customer service

	savings resulted from retrofitting street lights in Ramea with energy efficient street light fixtures.
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The objectives and indicators for 2019 are consistent with the direction outlined in the 2017-2019 Strategic Plan.

Issue 2: Electricity rates and customer service

Objective	
By December 31, 2019, Hydro will have implemented additional measures initiatives to manage costs and further advanced customer service and energy efficiency initiatives for customers.	
Indicators	<ul style="list-style-type: none"> ▪ Completed priority capital investments for 2019 and developed 2020 capital plan. ▪ Identified and implemented measures to manage costs. ▪ Supported PUB process to examine options to mitigate rate impacts of Muskrat Falls, the Rate Mitigation Steering Committee, and advanced Hydro initiatives to contribute to rate mitigation. ▪ Measured commercial customer satisfaction. ▪ Completed priority customer service activities for Newfoundland Power and key accounts. ▪ Delivered energy conservation programs to residential, commercial and industrial customers. ▪ Completed planned energy efficiency initiatives for Hydro facilities and equipment.

Issue 3: Safety

Achieving excellence in safety is Hydro’s number one priority and safety is a shared core value. For Hydro, safety excellence is more than a way of operating - it is an integral part of Hydro’s identity and strategy for the planning period and into the future. Hydro’s pursuit of safety excellence encompasses the safety of employees, customers and the general public.

In 2018, many areas of Hydro sustained excellent safety performance and the company is continuing to see its safety culture mature with employees identifying and addressing unsafe conditions and behaviours and accepting personal responsibility for their safety and the safety of others.

Achieving and maintaining excellent safety performance in all areas of the company remains an ongoing challenge. To move the company forward on its journey to safety excellence, Hydro completed initiatives involving procedures for performing high-risk work, electrical safety training to maintain employee competence, and employee injury prevention communication. To identify opportunities for improvement, Hydro also completed investigations of safety incidents and analysed performance to identify areas for improving the design and delivery of its safety programs.

Customer safety and public safety around electrical equipment are also key elements of Hydro’s safety commitment. During 2018, power outage safety and winter preparedness along with safety around hydroelectric dams and other electrical equipment continued to be key themes for Hydro’s customer and public communications.

Issue 3: Safety

Goal 1

By December 31, 2019, Hydro will have continued progress towards sustained safety excellence.

Indicators	<ul style="list-style-type: none"> ▪ Delivered electrical safety training for employees.
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Issue 3: Safety	
	<ul style="list-style-type: none"> ▪ Completed safety-related communications activities for employees and the general public.
<p>Objective By December 31, 2018, Hydro will have advanced safety training and communication programs to achieve long-term safety excellence.</p>	
Indicators	2018 Accomplishments
<p>Delivered employee safety training.</p>	<p>During 2018, Hydro delivered safety training for employees taking on new roles and refresher training for other employees. This training included technical training (e.g. work protection code refresher training for individuals working around electrical equipment), training required to meet legislative requirements (e.g. confined space entry) as well as safety coaching training.</p> <p><i>Work protection code, confined space entry, and working at heights training</i> During 2018, required training for new Hydro employees, employees taking on new roles and responsibilities and employees needing refresher training was completed. In total, 276 employees completed work protection code training, 57 employees completed confined space entry training, and 100 employees completed working at heights training.</p> <p><i>High voltage principles and practices training</i> During 2018, 47 Hydro employees completed high voltage switching principles and practices training to refresh knowledge related to this high risk work activity in electricity operations.</p> <p><i>Safety coaching training</i> Safety coaching training helps build the skills required to take action relating to at-risk behaviours by outlining a consistent approach to safety interactions and providing an opportunity to practice the approach. The majority of Hydro employees have completed safety coaching training but the training is offered periodically to new employees and others who have not completed the training. During 2018, 28 Hydro employees completed the training.</p> <p><i>Safe workplace observation program (SWOP) and incident investigation training</i> SWOP and incident investigation training is offered annually to</p>

Issue 3: Safety	
	<p>new employees and employees taking on new roles. In 2018, this training was completed as planned with 58 Hydro employees participating in SWOP training and 41 completing incident investigation training.</p> <p><i>The Working Mind</i> The Working Mind-Managers/Supervisors is offered to supervisors and managers as part of Hydro’s Mental Health Strategy. In 2018, 126 Hydro supervisors and managers participated in The Working Mind training.</p>
Completed employee communication activities for the 2018 injury prevention campaign.	<p>During 2018, Hydro continued employee safety communications (as part of Nalcor's employee safety communications campaign – Take a Moment for Safety) and completed all planned activities. To support the organization’s top trending injuries, communication efforts focused on key topics throughout the year, including: vehicle safety; slips, trips and falls; hand related injuries; and, mental health. In addition, with the legalization of cannabis in Canada, new education and awareness materials relating to cannabis in the workplace were developed to support managers, supervisors and employees. Internal communication included safety moments, fact sheets, posters, infographics, supervisor toolkits, employee information sessions and other education and awareness materials.</p>
Completed public safety communication activities related to power line safety, safety around electricity facilities, and power outage safety.	<p>In 2018, Hydro completed customer and public safety communication activities related to power line safety, safety around hydroelectric dams and reservoirs, and power outage safety.</p> <p>Activities included planning, developing and implementing various public communications, with a focus on creating and distributing digital content on these safety topics. Hydro's Twitter and Facebook channels were used regularly to share safety information and promote greater awareness amongst the public. For example:</p> <ul style="list-style-type: none"> ▪ Around harsh weather events, Hydro circulated timely informational content promoting preparedness and safety, e.g. Circulated reminders in advance of storms on what to do near downed power lines, how to stay safe during and prepare for power outages, etc. ▪ In advance of popular long weekends (i.e. Victoria Day, Labour Day), Hydro promoted tips for staying safe around

Issue 3: Safety	
	<p>dams and hydroelectric facilities while fishing/ boating; and developed and published new educational information on the dangers of low-head dams.</p> <ul style="list-style-type: none"> ▪ Throughout National Health and Safety Week (May 6-12), Hydro publicly circulated a series of posts with safety-oriented messages. <p>Hydro also promoted public safety at the Bishops Falls dam site highlighting new safety features through social media and television interviews, as well as stakeholder outreach in the region.</p>

The objectives and indicators for 2019 are consistent with the direction outlined in the 2017-2019 Strategic Plan.

Issue 3: Safety	
<p>Objective</p> <p>By December 31, 2019, Hydro will have continued progress towards sustained safety excellence by advancing safety programs.</p>	
Indicators	<ul style="list-style-type: none"> ▪ Delivered safety training for employees. ▪ Completed employee safety communication activities. ▪ Completed public safety communication activities related to power line safety, safety around electricity facilities, and power outage safety.

5. Opportunities and Challenges

During 2019, Hydro will build on accomplishments of the past and address future challenges and opportunities. The key challenges and opportunities that will be addressed reflect the next phase of Hydro's strategy execution.

Reliable Electricity Supply

In keeping with its mandate, Hydro ensures there is a reliable electricity supply available to meet current customer needs and future growth. Core to this is maintaining Hydro's systems in reliable operating condition through a combination of planned maintenance, rehabilitation of existing assets, and replacement of assets that have reached the end of their useful lives. In 2019 and beyond Hydro will sustain its focus on the completion of required maintenance and the identification and completion of required capital projects. Hydro will continue to assess customer electricity needs and evaluate options to address these needs.

Readiness for Interconnection/Integration

The development of the Muskrat Falls project transmission facilities will have implications for Newfoundland and Labrador's electricity system including the benefit of increased reliability and important export capabilities. In 2018, both the Labrador-Island Link and the Maritime Link interconnections were in operation. Interconnection with the North American grid and the move away from reliance on Holyrood is the biggest change that Hydro has experienced since the 1960's. Hydro will continue to evaluate opportunities and risks associated with interconnection and prepare for the completion of the Muskrat Falls generation project and the resulting changes to the provincial electricity system.

Electricity Rates

Nalcor Energy's June 23, 2017 Muskrat Falls project update stated that average island residential electricity rates are expected to increase to 22.89 cents (¢) (plus HST) per kilowatt

hour (kWh) in 2021 as a result of the project. The present average rate for these customers is 11.7 ¢ per kWh (plus HST), a gap of 11.19 ¢ per kWh. During 2019, Hydro will continue to support the PUB reference process regarding options to mitigate the impact of Muskrat Falls on electricity rates. As well, Hydro will continue to participate in the Rate Mitigation Steering Committee chaired by the Department of Natural Resources. Hydro is also leading its internal rate mitigation activities related to managing its operating and capital costs and using the new transmission lines to secure lower cost supplies of electricity prior to Muskrat Falls electricity becoming available.

Safety

Achieving and maintaining excellent safety performance in all areas of the company is an ongoing challenge. During 2019 and beyond, Hydro will continue to implement initiatives to move forward on the journey to sustaining safety excellence for employees. As well, Hydro will continue with communications related to safety around power lines, dams and other electricity equipment and facilities, meter reading safety, and power outage safety.

Appendix 1
Provincial Electricity Generation and Transmission System

LEGEND

- | | | | |
|--|--------------------------------------|--|---|
| | 735 kV | | FREQ. CONVERTOR |
| | 315 kV | | NF. POWER |
| | 230 kV | | CORNER BROOK PULP AND PAPER
PULP AND PAPER |
| | 138 kV | | ALGONQUIN POWER |
| | 69 kV | | MUSHUAU 1st NATION |
| | LOW VOLTAGE | | WIND GENERATION |
| | 138kV CUSTOMER OWNED | | OPERATED BY NALCOR |
| | 69kV CUSTOMER OWNED | | GAS TURBINE |
| | HYDRO PLANT | | DIESEL PLANT |
| | THERMAL PLANT | | |
| | TERMINAL STATION | | |
| | TERMINAL STATION & CONVERTER STATION | | |

DC LEGEND

- | | |
|--|----------------------|
| | ± 350 / ± 200kV HVdc |
| | SUBMARINE CABLE |
| | ELECTRODE LINE |
| | ELECTRODE STATION |



Provincial Generation and Transmission Grid

Appendix 2
Newfoundland and Labrador Hydro Consolidated Financial Statements

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018



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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, 2018, 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, 2018, 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.

Emphasis of Matter – Restated Comparative Information

We draw attention to Note 4 to the financial statements, which explains that certain comparative information presented for December 31, 2017 has been restated due to the adoption of IFRS 9, Financial Instruments. Our opinion is not modified in respect to this matter.

Other Matter

As part of our audit of the financial statements for the year ended December 31, 2018, we audited the adjustments in Note 4 that were applied to restate certain comparative information presented for the year ended December 31, 2017 related to the adoption of IFRS 9.

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.

Auditor's Responsibilities for the Audit of the Financial Statements (continued)

- 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 15, 2019


NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF FINANCIAL POSITION

<i>As at December 31 (millions of Canadian dollars)</i>	Notes	2018	2017
			(Restated - Note 4.1, 30)
ASSETS			
Current assets			
Cash and cash equivalents	5	30	38
Short-term investments	12	34	15
Trade and other receivables	6	149	148
Inventories	7	107	106
Prepayments		7	6
Deferred asset	8	21	31
Total current assets		348	344
Non-current assets			
Property, plant and equipment	9,30	2,652	2,565
Intangible assets	10	6	7
Long-term investments	12	-	34
Investment in joint arrangement		1	1
Other long-term assets	11	176	156
Total assets		3,183	3,107
Regulatory deferrals	13	159	117
Total assets and regulatory deferrals		3,342	3,224
LIABILITIES AND EQUITY			
Current liabilities			
Short-term borrowings	15	189	369
Trade and other payables	14	140	189
Current portion of long-term debt	15	7	7
Current portion of deferred contributions	16	2	1
Derivative liability	8,24	21	31
Total current liabilities		359	597
Non-current liabilities			
Long-term debt	15	1,784	1,482
Deferred contributions	16,30	24	23
Decommissioning liabilities	17	15	15
Employee future benefits	18	105	109
Total liabilities		2,287	2,226
Shareholder's equity			
Share capital	20	23	23
Contributed capital	20	152	150
Reserves		(13)	(22)
Retained earnings		822	768
Total equity		984	919
Total liabilities and equity		3,271	3,145
Regulatory deferrals	13	71	79
Total liabilities, equity and regulatory deferrals		3,342	3,224

Commitments and contingencies (Note 26)

See accompanying notes

On behalf of the Board:



 DIRECTOR



 DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF PROFIT AND COMPREHENSIVE INCOME

<i>For the year ended December 31 (millions of Canadian dollars)</i>	Notes	2018	2017
			(Restated - Note 4.1)
Energy sales		684	636
Other revenue		31	29
Revenue		715	665
Fuels		189	226
Power purchased		108	101
Operating costs	21	178	175
Transmission rental		21	20
Depreciation and amortization	9,10	105	96
Net finance expense	22	85	64
Other expense	23	14	6
Expenses		700	688
Profit (loss) before regulatory adjustments		15	(23)
Regulatory adjustments	13	(47)	(92)
Profit for the year		62	69
Other comprehensive income			
Total items that may or have been reclassified to profit or loss			
Regulatory adjustment		-	-
Actuarial gain (loss) on employee future benefits	18,19	9	(3)
Other comprehensive income (loss) for the year		9	(3)
Total comprehensive income for the year		71	66

See accompanying notes

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

<i>(millions of Canadian dollars)</i>	Notes	Share Capital	Contributed Capital	Employee Benefit Reserve	Retained Earnings	Total
Balance at January 1, 2018		23	150	(22)	768	919
Profit for the year		-	-	-	62	62
Actuarial gain on employee future benefits	18	-	-	9	-	9
Total comprehensive income for the year		-	-	9	62	71
Contributed capital	20	-	3	-	-	3
Regulatory adjustment	20	-	(1)	-	-	(1)
Dividends	20	-	-	-	(8)	(8)
Balance at December 31, 2018		23	152	(13)	822	984

(Restated - Note 4.1)

Balance at January 1, 2017		23	148	(19)	706	858
Profit for the year		-	-	-	69	69
Actuarial loss on employee future benefits	18	-	-	(3)	-	(3)
Total comprehensive income for the year		-	-	(3)	69	66
Contributed capital	20	-	3	-	-	3
Regulatory adjustment	20	-	(1)	-	-	(1)
Dividends	20	-	-	-	(7)	(7)
Balance at December 31, 2017		23	150	(22)	768	919

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO

CONSOLIDATED STATEMENT OF CASH FLOWS

<i>For the year ended December 31 (millions of Canadian dollars)</i>	Notes	2018	2017
Operating activities			
Profit for the year		62	69
Adjustments to reconcile profit to cash provided from operating activities:			
Depreciation - property, plant and equipment	9	103	94
Amortization - intangible assets	10	2	2
Employee future benefits		6	4
Regulatory adjustments	13	(47)	(92)
Finance income	22	(13)	(14)
Finance expense	22	98	78
Other		5	3
		216	144
Changes in non-cash working capital balances	28	(25)	(35)
Interest received		2	24
Interest paid		(104)	(95)
Net cash provided from operating activities		89	38
Investing activities			
Additions to property, plant and equipment		(197)	(374)
Additions to intangible assets	10	(1)	(1)
(Increase) decrease of sinking funds	11	(7)	68
Decrease in long-term investment	12	34	-
Increase in short-term investment	12	(19)	(15)
Decrease in long-term receivables		-	1
(Increase) decrease in reserve fund	11	(12)	15
Proceeds on disposal of property, plant and equipment		-	10
Changes in non-cash working capital balances	28	(23)	11
Net cash used in investing activities		(225)	(285)
Financing activities			
Proceeds from long-term debt		316	612
Retirement of long-term debt	15	-	(150)
Dividends paid	20	(8)	(7)
Decrease in short-term borrowings	15	(180)	(66)
Increase in contributed capital	20	1	-
Other		2	1
Rate stabilization plan refund	13	(3)	(131)
Net cash provided from financing activities		128	259
Net (decrease) increase in cash and cash equivalents		(8)	12
Cash and cash equivalents, beginning of year		38	26
Cash and cash equivalents, end of year		30	38

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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% 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 have been prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). Hydro has adopted accounting policies which are based on the IFRS applicable as at December 31, 2018, and includes individual IFRS, International Accounting Standards (IAS), and interpretations made by the IFRS Interpretations Committee and the Standing Interpretations Committee.

These annual audited consolidated 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 annual audited consolidated financial statements are presented in Canadian Dollars (CAD) and all values rounded to the nearest million, except when otherwise noted. The annual audited consolidated financial statements were approved by Hydro's Board of Directors (the Board) on March 1, 2019.

2.2 Basis of Consolidation

The annual audited consolidated financial statements include the financial statements of Hydro, its subsidiary company, LCDC, and its share of investments in a joint operation and a joint venture. Intercompany transactions and balances have been eliminated upon consolidation.

Effective June 18, 1999, Hydro, Churchill Falls, and Hydro-Québec entered into a Shareholders' Agreement (the Shareholders' Agreement) which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Québec on the Board of Directors of Churchill Falls. Although Hydro holds a 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of a joint operation. Accordingly, Hydro has recognized its share of assets, liabilities and profit or loss in relation to its interest in Churchill Falls subsequent to the effective date of the Shareholders' Agreement.

Churchill Falls holds 33.33% of the equity share capital of Twin Falls Power Corporation Limited (Twin Falls). This investment is accounted for using the equity method.

NEWFOUNDLAND AND LABRADOR HYDRO

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2.3 Cash and Cash Equivalents and Short-Term Investments

Cash and cash equivalents consist of amounts on deposit with a Schedule 1 Canadian Chartered bank, 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. Cash and cash equivalents as well as short-term investments are measured at cost, which approximates fair value.

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 the 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 using the cost model and thus are recorded 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, respectively. Likewise, when a major inspection is performed, its cost is recognized in the carrying amount of the plant and equipment as a replacement if the recognition criteria are satisfied. All other repairs and maintenance costs are recognized in profit or loss as incurred. Property, plant and equipment is not revalued for financial reporting purposes. Depreciation of these assets commences when the assets are ready for their intended use. The estimated useful life and amortization method are reviewed periodically with the effect of any changes in estimate being accounted for on a prospective basis.

Hydro

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

Generation plant	
Hydroelectric	45 to 100 years
Thermal	35 to 65 years
Diesel	25 to 55 years
Transmission	
Lines	30 to 65 years
Terminal stations	40 to 55 years
Distribution system	30 to 55 years
Other assets	5 to 55 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.

NEWFOUNDLAND AND LABRADOR HYDRO

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Churchill Falls

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

Hydroelectric generation plant	25 to 100 years
Transmission and terminals	30 to 65 years
Service facilities and other	5 to 45 years

Churchill Falls assets' residual values, useful lives and method of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate. The carrying value of property, plant and equipment is reviewed for impairment whenever events indicate that the carrying amounts of those assets may not be recoverable.

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 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	5 to 20 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 profit or loss in the period in which they are incurred.

2.8 Impairment of Non-Financial Assets

At the end of each reporting period, Hydro reviews the carrying amounts of its non-financial assets, to determine whether there is any indication that those assets may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any.

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. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual CGUs, or otherwise they are allocated to the smallest group of CGUs for which a reasonable and consistent allocation basis can be identified. The recoverable amount is the higher of fair value less costs to sell and value in use. 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. Value in use is generally computed by reference to the present value of future cash flows expected to be derived from non-financial assets.

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. An impairment loss is recognized immediately in profit or loss.

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 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 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, 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 upon retirement.

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 Order No. P.U. 36 (2015), Hydro recognizes the amortization of employee future benefit actuarial gains and losses in profit or loss as a regulatory adjustment.

The retirement benefit obligation recognized in the 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.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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 profit or loss 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.

Hydro recognizes revenue from the sale of electricity to Regulated industrial, utility and rural customers in Newfoundland and Labrador and to Non-Regulated industrial, utility and external market customers.

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 it transfers 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 certain major industrial customers are either at rates under the terms of the applicable contracts, or at market rates. Hydro will continue to recognize revenue as customers are invoiced on a monthly basis using practical expedient IFRS 15.B16. Hydro recognizes revenue at the amount to which it has the right to invoice, which corresponds directly to the value of Hydro's performance to date.

Churchill Falls provides energy to two primary customers: Hydro-Québec and Hydro.

A power contract with Hydro-Québec dated May 12, 1969 (the Power Contract) provided for the sale of a significant amount of the energy from Churchill Falls. The Power Contract had a 40-year term that expired August 31, 2016, and was followed by a Renewed Power Contract with Hydro-Québec for an additional 25 years beginning September 1, 2016. The rate during the term of the Renewed Power Contract is 2.0 mills per kWh.

Churchill Falls also recognizes revenue from Hydro-Québec under a Guaranteed Winter Availability Contract (GWAC) through 2041. The GWAC was signed with Hydro-Québec in 1998 and provides for the sale of 682 MW of guaranteed seasonal availability to Hydro-Québec during the months of November through March in each year until 2041.

Under the Power Contract and Renewed Power Contract, Churchill Falls has the right to recall 300 MW (Recall Power). All of the Recall Power is sold by Churchill Falls to Hydro. Churchill Falls also sells an additional 225 MW to Hydro.

2.14 Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Lessors accounting

Amounts due from lessees under finance leases are recognized as receivables at the amount of Hydro's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on Hydro's net investment outstanding in respect of the leases.

Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized on a straight-line basis over the lease term.

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Lessee accounting

Assets held under finance leases are initially recognized as assets of Hydro at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the Consolidated Statement of Financial Position as a finance lease obligation.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognized immediately in profit or loss, unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with Hydro's general policy on borrowing costs (Note 2.7). Contingent rental costs are recognized as operating costs in the periods in which they are incurred.

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognized as a liability. The aggregate benefit of incentives is recognized as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

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 profit or loss 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

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. 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 fair value through profit or loss) 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 fair value through profit or loss are recognized immediately in profit or loss. All recognized financial assets and financial liabilities are subsequently measured in their entirety at either amortized cost or fair value, depending on the classification of the financial assets and financial liabilities.

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Classification of Financial Instruments

Hydro has classified each of its financial instruments into the following categories: amortized cost and derivatives designated as fair value through profit or loss.

<u>Financial Instrument</u>	<u>Category</u>
Cash and cash equivalents	Amortized cost
Short-term investments	Amortized cost
Trade and other receivables	Amortized cost
Reserve fund	FVTOCI
Derivative instruments	FVTPL
Long-term investments	Amortized cost
Sinking funds – investments in same Hydro issue	Amortized cost
Sinking funds – other investments	Amortized cost
Long-term receivables	Amortized cost
Trade and other payables	Amortized cost
Short-term borrowings	Amortized cost
Long-term debt	Amortized cost

(i) Effective Interest Method

The effective interest method is a method of calculating the amortized cost of a debt instrument and allocating interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) excluding expected credit losses for debt financial assets, through the expected life of the debt instrument, or, where appropriate, a shorter period to the gross carrying amount on initial recognition.

Income or expense is recognized on an effective interest basis for debt instruments other than those financial assets and liabilities classified as at FVTPL.

Financial Assets

(ii) Financial Assets at Amortized Cost

The amortized cost of a financial asset is the amount at which the financial asset is measured at initial recognition minus the principal repayments, plus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, adjusted for any loss allowance. The gross carrying amount of a financial asset is the amortized cost of a financial asset before adjusting for any loss allowance.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of a financial asset, except for financial assets that have subsequently become credit-impaired. For financial assets that have subsequently become credit-impaired, interest income is recognized by applying the effective interest rate to the amortized cost of the financial asset. If, in subsequent reporting periods, the credit risk on the credit-impaired financial instrument improves so that the financial asset is no longer credit-impaired, interest income is recognized by applying the effective interest rate to the gross carrying amount of the financial asset.

Interest income is recognized in profit or loss and is included in 'net finance expense'.

(iii) Financial Assets at FVTPL

Financial assets that do not meet the criteria for being measured at amortized cost or fair value through other comprehensive income (FVTOCI) are measured at FVTPL. Specifically:

- Investments in equity instruments are classified at FVTPL, unless Hydro designates an equity investment that is neither held for trading nor a contingent consideration arising from a business combination at FVTOCI on initial recognition.
- Debt instruments that do not meet the amortized cost criteria or the FVTOCI criteria are classified at

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FVTPL. In addition, debt instruments that meet either the amortized cost criteria or the FVTOCI criteria may be designated at FVTPL upon initial recognition if such designation eliminates or significantly reduces a measurement or recognition inconsistency that would arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases.

Hydro has not designated any debt instruments at FVTPL nor does Hydro hold any equity investments classified 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. The net gain or loss recognized in profit or loss includes any dividend or interest earned on the financial asset and is included in 'net finance expense'.

(iv) Financial Assets at FVTOCI

Financial assets classified at FVTOCI are initially measured at fair value plus transaction costs. Any change 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.

Financial Liabilities

(v) Financial liabilities at amortized cost

Financial liabilities that do not meet the criteria of FVTPL or are not designated as such are subsequently measured at amortized cost using the effective interest method.

(vi) Derivative Instruments and Financial Instruments Used for Hedging

Derivative instruments are utilized by Hydro to manage risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Derivatives are initially measured at fair value at the date the derivative contracts are entered into and are subsequently measured at their fair value at the end of each reporting period. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as a hedging relationship.

2.18 Derecognition of Financial Instruments

Hydro derecognizes a financial asset only 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 entity. If Hydro neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, its retained interest in the asset and any associated liability for amounts it may have to pay is recognized. If Hydro retains substantially all the risks and rewards of ownership of a transferred financial asset, it continues to recognize the financial asset and also recognizes the collateralized borrowing for the proceeds received.

On derecognition of a financial asset measured at amortized cost, the difference between the asset's carrying amount and the sum of the consideration received and receivable is recognized in profit or loss. In addition, on derecognition of an investment in a debt instrument classified as at FVTOCI, the cumulative gain or loss previously accumulated in the fair value reserve is reclassified to profit or loss. In contrast, on derecognition of an investment in equity instrument which Hydro has elected on initial recognition to measure at FVTOCI, the cumulative gain or loss previously accumulated in the fair value reserve is not reclassified to profit or loss, but is transferred to retained earnings.

Hydro derecognizes financial liabilities when, and only when, its obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable, including any non-cash assets transferred or liabilities assumed, is recognized in profit or loss.

2.19 Impairment of Financial Assets

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

Hydro recognizes lifetime expected credit losses (ECL) for trade and other receivables. The expected credit losses 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 and cash equivalents, restricted cash, short-term investments, long-term investments, 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 expected credit losses 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.

Significant increase in credit risk

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, Hydro compares the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition. In making this assessment, Hydro considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort. Forward-looking information considered includes the future prospects of the industries in which Hydro's debtors operate, obtained from economic expert reports, financial analysts, governmental bodies and other similar organizations, as well as consideration of various external sources of actual and forecasted economic information that relate to Hydro's core operations.

In particular, the following information is taken into account when assessing whether credit risk has increased significantly since initial recognition:

- an actual or expected significant deterioration in the financial instrument's external (if available) or internal credit rating;
- significant deterioration in external market indicators of credit risk for a particular financial instrument,
- existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant decrease in the debtor's ability to meet its debt obligations;
- an actual or expected significant deterioration in the operating results of the debtor;
- significant increases in credit risk on other financial instruments of the same debtor;
- an actual or expected significant adverse change in the regulatory, economic, or technological environment of the debtor that results in a significant decrease in the debtor's ability to meet its debt obligations.

Irrespective of the outcome of the above assessment, Hydro presumes that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due, unless Hydro has reasonable and supportable information that demonstrates otherwise.

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Hydro assumes that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date. A financial instrument is determined to have low credit risk if the financial instrument has a low risk of default, the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfill its contractual cash flow obligations. Hydro considers a financial asset to have low credit risk when it has an internal or external credit rating of 'investment grade' as per globally understood definition.

Hydro regularly monitors the effectiveness of the criteria used to identify whether there has been a significant increase in credit risk and revises them as appropriate to ensure that the criteria are capable of identifying significant increase in credit risk before the amount becomes past due.

Definition of default

Hydro considers that an event default has occurred when there is a breach of financial covenants by a counterparty or information developed internally or obtained from external sources indicates that the debtor is unlikely to pay its creditors, including Hydro, in full. Irrespective of the outcome of the above assessment, Hydro considers that default has occurred when a financial asset is more than 90 days past due unless Hydro has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

Credit-impaired financial assets

A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired includes observable data about significant financial difficulty of the issuer or the borrower; a breach of contract, such as a default or past due event; the lender of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession that the lender would not otherwise consider; it is becoming probable that the borrower will enter bankruptcy or other financial reorganization; or the disappearance of an active market for that financial asset because of financial difficulties.

Write-off policy

Hydro writes off a financial asset when there is information indicating that the counterparty is in severe financial difficulty and there is no realistic prospect of recovery. Financial assets written off may still be subject to enforcement activities under Hydro's recovery procedures, taking into account legal advice where appropriate. Any recoveries made are recognized in profit or loss.

Measurement and recognition of expected credit losses

The measurement of expected credit losses is a function of the probability of default, loss given default (i.e. the magnitude of the loss if there is a default) and the exposure at default. The assessment of the probability of default and loss given default is based on historical data adjusted by forward-looking information as described above. As for the exposure at default, for financial assets, this is represented by the assets' gross carrying amount at the reporting date.

For financial assets, the expected credit loss is estimated as the difference between all contractual cash flows that are due to Hydro in accordance with the contract and all the cash flows that Hydro expects to receive, discounted at the original effective interest rate. For a lease receivable, the cash flows used for determining the expected credit losses is consistent with the cash flows used in measuring the lease receivable in accordance with IAS 17 Leases.

Where lifetime ECL is measured on a collective basis to cater to cases where evidence of significant increases in credit risk at the individual instrument level may not yet be available, the financial instruments are grouped by the nature of the financial instruments; past due status; nature and size of industry of debtors; nature of collaterals for finance lease receivables; and external credit ratings where available. The grouping is regularly reviewed by management to ensure the constituents of each group continue to share similar credit risk characteristics.

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If Hydro has measured the loss allowance for a financial instrument at an amount equal to lifetime ECL in the previous reporting period, but determines at the current reporting date that the conditions for lifetime ECL are no longer met, Hydro measures the loss allowance at an amount equal to 12 month ECL at the current reporting date.

Hydro recognizes an impairment gain or loss in profit or loss for all financial instruments with a corresponding adjustment to their carrying amount through a loss allowance account, except for investments that are measured at FVTOCI, for which the loss allowance is recognized in other comprehensive income and accumulated in the investment revaluation reserve, and does not reduce the carrying amount of the financial asset in the Statement of Financial Position.

2.20 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 profit or loss 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 profit or loss in the period in which they become receivable.

2.21 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 based upon Board Order No. P.U. 49 (2016) is 6.6% in 2018 and 6.6% in 2017 +/- 20 basis points. On July 28, 2017, Hydro Regulated filed its 2017 GRA to set a new rate of return for 2018 and 2019. The hearing portion of Hydro Regulated's 2017 GRA has concluded and the PUB's decision and Order on the 2017 GRA is not expected until the second quarter of 2019. Any adjustments to the requested revenue requirements from January 1, 2018 until final rates are approved, will not be known until that time and any required adjustments will be reflected when the Order is received.

Hydro applies various 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 annual audited consolidated financial statements are disclosed in Note 13.

3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the annual audited consolidated 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.

3.1 Use of Judgments

(i) 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 in Hydro Regulated, 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.

(ii) 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.

(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.

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) Intangible Assets

Amounts recorded for amortization are based on the useful lives of Hydro's assets. These useful lives are Management's best estimate of the service lives of these assets. Changes to these lives would not materially affect the amount of amortization recorded.

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(iii) 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.

(iv) 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.

(v) Revenue

In the absence of a signed agreement with Hydro-Québec relating to the AEB, Churchill Falls has an agreement with Hydro-Québec to continue to use the 2008 AEB on an interim basis until final judgment is obtained in the Declaratory Judgment case.

3.3 Use of Assumptions

Deferred Assets and Derivative Liabilities

Effective October 1, 2015, Hydro entered into a power purchase agreement (PPA) with Nalcor Energy Marketing Corporation (Nalcor 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 Nalcor 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. In September 2016, the terms of the PPA were amended to require a 60 day termination notice by either party. This replaced the previous termination clause of 90 days prior the end of the operating year. Management's assumption is that the term of the PPA at December 31, 2018, 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 is completed.

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 8). These methods, when compared with alternatives, were determined by Management to more 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 January 1, 2018, January 1, 2019 or January 1, 2020, as specified.

- IFRS 9 – Financial Instruments¹
- IFRS 15 – Revenue from Contracts with Customers¹
- IFRIC 22 – Foreign Currency Transactions and Advance Consideration¹
- IFRS 16 – Leases²
- IFRS 9 – Prepayment Features with Negative Compensation²
- IAS 19 – Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)²
- IAS 28 – Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)²
- IAS 23 – Borrowing Costs (Amendments to IAS 23)²
- IFRS 11 – Joint Arrangements (Amendments to IFRS 11)²
- IAS 1 – Presentation of Financial Statements³ and IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors³ (Amendments to IAS 1 and IAS 8)

¹ Effective for annual periods beginning on or after January 1, 2018.

² Effective for annual periods beginning on or after January 1, 2019, with earlier application permitted.

³ Effective for annual periods beginning on or after January 1, 2020, with earlier application permitted.

4.1 IFRS 9 – Financial Instruments

IFRS 9 - Financial Instruments (as revised in July 2014) became effective for accounting periods commencing on January 1, 2018. IFRS 9 introduces new requirements for the classification and measurement of financial assets and financial liabilities, impairment for financial assets and general hedge accounting. Details of these new requirements as well as their impact on Hydro's consolidated financial statements are described below.

Hydro has applied IFRS 9 in accordance with the transition provisions set out in IFRS 9.

4.1.1 Classification and measurement of financial assets

The date of initial application of IFRS 9 is January 1, 2018. Hydro has applied the requirements of IFRS 9 to instruments that have not been derecognized as at January 1, 2018 and has not applied the requirements to instruments that have already been derecognized as at January 1, 2018. Comparative amounts in relation to instruments that have not been derecognized as at January 1, 2018 have been restated where appropriate.

All recognized financial assets that are within the scope of IFRS 9 are required to be subsequently measured at amortized cost or fair value on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets.

Management reviewed and assessed Hydro's existing financial assets as at January 1, 2018 based on the facts and circumstances that existed at that date, and concluded that the initial application of IFRS 9 has had the following impact on Hydro's financial assets with regards to classification and measurement:

- financial assets classified as held-to-maturity and loans and receivables under IAS 39 that were measured at amortized cost continue to be measured at amortized cost under IFRS 9 as they are held within a business model to collect contractual cash flows and these cash flows consist solely of payments of principal and interest on the principal amount outstanding;
- the short-term investments and sinking funds have been classified as financial assets at amortized cost under IFRS 9 as they are held within a business model whose objective is to collect contractual cash flows, which consist solely of payments of principal and interest on the principal amount outstanding;
- financial assets that were measured at FVTPL under IAS 39 continue to be measured as such under IFRS 9.

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For financial assets that have been reclassified to the amortized cost category, the fair value gain that would have been recognized if these financial assets had not been reclassified as part of the transition to IFRS 9 was \$5.3 million for the year ended December 31, 2018.

4.1.5 illustrates the change in classification of Hydro's financial assets upon application of IFRS 9.

4.1.6 details the amount of adjustment for each financial statement line item affected by the application of IFRS 9 for the current and prior reporting periods.

4.1.2 Impairment of financial assets

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires Hydro to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets.

As at January 1, 2018, Management reviewed and assessed Hydro's existing financial assets and amounts due from customers for impairment using reasonable and supportable information that is available without undue cost or effort in accordance with the requirements of IFRS 9 to determine the credit risk of the respective items at the date they were initially recognized, and compared that to the credit risk as at January 1, 2017 and January 1, 2018. The comparison made as at January 1, 2017, January 1, 2018 and December 31, 2018 determines whether 12 month expected credit losses should be recognized or a lifetime expected credit loss should be recognized where credit risk has increased significantly for the respective financial instruments at that date. The change resulting from the application of the impairment model under IFRS 9 has not resulted in a material adjustment from what was previously recorded under IAS 39.

4.1.3 Classification and measurement of financial liabilities

The application of IFRS 9 has had no impact on the classification and measurement of Hydro's financial liabilities.

4.1.4 General hedge accounting

The new general hedge accounting requirements retain the three types of hedge accounting. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about Hydro's risk management activities have also been introduced.

In accordance with IFRS 9's transition provisions for hedge accounting, Hydro has applied IFRS 9 hedge accounting requirements prospectively from the date of initial application on January 1, 2018. Hydro's qualifying hedging relationships in place as at January 1, 2018 qualified for hedge accounting in accordance with IFRS 9 and were therefore regarded as continuing hedging relationships. No rebalancing of any of the hedging relationships was necessary on January 1, 2018. As the critical terms of the hedging instruments match those of their corresponding hedged items, all hedging relationships continue to be effective under IFRS 9's effectiveness assessment requirements. Hydro has not designated any hedging relationships under IFRS 9 that would not have met the qualifying hedge accounting criteria under IAS 39. Consistent with prior periods, Hydro has continued to designate the change in fair value of the entire forward contract, i.e. including the forward element, as the hedging instrument in Hydro's cash flow hedge relationships.

The application of the IFRS 9 hedge accounting requirements has had no impact on the results and financial position of Hydro for the current and/or prior years. Refer to Note 24 for detailed disclosures regarding Hydro's risk management activities.

4.1.5 Disclosures in relation to the initial application of IFRS 9

The table below illustrates the classification and measurement of financial assets and financial liabilities under IFRS 9 and IAS 39 at January 1, 2018.

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<u>Financial instrument</u>	<u>Category under IAS 39</u>	<u>Category under IFRS 9</u>
Cash and cash equivalents	Loans and receivables	Amortized cost
Short-term investments	AFS financial assets	Amortized cost
Trade and other receivables	Loans and receivables	Amortized cost
Derivative instruments	FVTPL	FVTPL
Long-term investments	AFS financial assets	Amortized cost
Sinking funds – investments in same Hydro issue	Held-to-maturity investments	Amortized cost
Sinking funds – other investments	AFS financial assets	Amortized cost
Long-term receivables	Loans and receivables	Amortized cost
Reserve fund	AFS financial assets	FVTOCI
Trade and other payables	Other financial liabilities	Amortized cost
Short-term borrowings	Other financial liabilities	Amortized cost
Long-term debt	Other financial liabilities	Amortized cost

The tables below address the changes resulting from the change in measurement category of Hydro's sinking funds in other investments.

<i>(millions of Canadian dollars)</i>	IAS 39 carrying amount December 31, 2017	Reclassification	Remeasurement	IFRS 9 carrying amount January 1, 2018	Retained earnings effect on January 1, 2018
Financial assets					
Amortized cost					
<u>Additions:</u>					
From available-for-sale (IAS 39)	-	190	(34)	156	-
Total	-	190	(34)	156	-
Financial assets					
FVTOCI					
<u>Subtractions:</u>					
Available-for-sale (IAS 39) to amortized cost (IFRS 9)	190	(190)	-	-	-
Total	190	(190)	-	-	-
Total financial asset balances, reclassifications and remeasurements at January 1, 2018	190	-	(34)	156	-

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4.1.6 Financial impact of the application of IFRS 9

The tables below show the amount of adjustment for each financial statement line item affected by the application of IFRS 9 for the current and prior years.

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2018	2017
Impact on other comprehensive income for the year		
<i>Items that may be reclassified subsequently to profit or loss:</i>		
Net fair value gain on available-for-sale financial instruments	5	11
Impact on other comprehensive income for the year	5	11

<i>(millions of Canadian dollars)</i>	As previously reported	IFRS 9 adjustments	As restated
Impact on assets, liabilities and equity as at January 1, 2017			
Other long-term assets	203	(45)	158
Total effect on assets	203	(45)	158
Reserves	26	(45)	(19)
Retained earnings	706	-	706
Total effect on equity	732	(45)	687

<i>(millions of Canadian dollars)</i>	As previously reported	IFRS 9 adjustments	As restated
Impact on assets, liabilities and equity as at December 31, 2017			
Other long-term assets	190	(34)	156
Total effect on assets	190	(34)	156
Reserves	12	(34)	(22)
Retained earnings	768	-	768
Total effect on equity	780	(34)	746

The application of IFRS 9 has had no impact on the cash flows of Hydro.

4.2 IFRS 15 – Revenue from Contracts with Customers

IFRS 15 – Revenue from Contracts with Customers (as amended in April 2016) became effective for accounting periods commencing on January 1, 2018. Hydro has applied IFRS 15 in accordance with the fully retrospective transitional approach using practical expedients for completed contracts (IFRS 15.C5(a)), modified contracts (IFRS 15.C5(c)) and allowing both non-disclosure of the amount of the transaction price allocated to the remaining performance obligations, and an explanation of when it expects to recognize that amount as revenue for all reporting periods presented before the date of initial application (IFRS 15.C5(d)). Subsequent to adopting IFRS 15 there were no material adjustments to the amounts reported in Hydro’s annual audited consolidated financial statements.

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 – Revenue, IAS 11 – Construction Contracts and the related interpretations.

IFRS 15 covers only revenue arising from contracts with customers. Under IFRS 15, a customer of Hydro is a party that has contracted with Hydro to obtain goods or services that are an output of Hydro’s ordinary activities in exchange for consideration. Unlike the scope of IAS 18, the recognition and measurement of interest income and dividend income from debt and equity investments are no longer within the scope of IFRS 15. Instead, they are within the scope of IFRS 9.

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As mentioned above, IFRS 15 establishes a single model to deal with revenue from contracts with customers. Its core principle is that Hydro should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which Hydro expects to be entitled, in exchange for those goods or services.

Hydro's accounting policies for its revenue streams are disclosed in detail in Note 2.

4.3 IFRIC 22 – Foreign Currency Transactions and Advance Consideration

IFRIC 22 addresses how to determine the 'date of transaction' for the purpose of determining the exchange rate to use on initial recognition of an asset, expense or income, when consideration for that item has been paid or received in advance in a foreign currency which resulted in the recognition of a non-monetary asset or non-monetary liability (for example, a non-refundable deposit or deferred revenue).

The application of these amendments to IFRIC 22 did not have a material impact on Hydro's annual audited consolidated financial statements.

4.4 IFRS 16 – Leases

IFRS 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. It will supersede the following lease standard and interpretations upon its effective date:

- IAS 17 – Leases;
- IFRIC 4 – Determining Whether an Arrangement contains a Lease;
- SIC-15 – Operating Leases – Incentives; and
- SIC-27 – Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

IFRS 16 applies a control model to the identification of leases, distinguishing between leases and service contracts on the basis of whether there is an identified asset controlled by the customer.

The standard introduces significant changes to lessee accounting: it removes the distinction between operating and finance leases under IAS 17 and requires a lessee to recognize a right-of-use asset and a lease liability at lease commencement for all leases, except for short-term leases and leases of low value assets.

In contrast to lessee accounting, the IFRS 16 lessor accounting requirements remain largely unchanged from IAS 17, which continue to require a lessor to classify a lease as either an operating lease or a finance lease.

IFRS 16 is effective for reporting periods beginning on or after January 1, 2019 with early application permitted (as long as IFRS 15 is also applied). Management has elected to adopt the standard as of the effective date.

A lessee can apply IFRS 16 either by a full retrospective approach or a modified retrospective approach. Management intends to apply the modified approach, as a result there is no requirement to restate comparative information, the cumulative effect of initially applying IFRS 16 will be presented as an adjustment to opening retained earnings. Management anticipates the application of IFRS 16 may have a material impact on the amounts reported and disclosures made in Hydro's annual audited consolidated financial statements. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 16 until Management concludes its detailed review.

4.5 IFRS 9 – Prepayment Features with Negative Compensation

Under IFRS 9, a debt instrument can be measured at amortized cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

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The amendments are effective for annual periods beginning on or after January 1, 2019 with earlier application permitted. The application of these amendments to IFRS 9 will not have a material impact on Hydro's annual audited consolidated financial statements.

4.6 IAS 19 – Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)

The amendments to IAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments specify that when a plan amendment, curtailment or settlement occurs during the annual reporting period, an entity is required to:

- Determine current service cost for the remainder of the period after the plan amendment, curtailment or settlement, using the actuarial assumptions used to remeasure the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event; and
- Determine net interest for the remainder of the period after the plan amendment, curtailment or settlement using: the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event; and the discount rate used to remeasure that net defined benefit liability (asset).

The amendments also clarify that an entity first determines any past service cost, or a gain or loss on settlement, without considering the effect of the asset ceiling. This amount is recognized in profit or loss. An entity then determines the effect of the asset ceiling after the plan amendment, curtailment or settlement. Any change in that effect, excluding amounts included in the net interest, is recognized in other comprehensive income.

The amendments apply to plan amendments, curtailments, or settlements occurring on or after the beginning of the first annual reporting period that begins on or after January 1, 2019, with early application permitted. These amendments will apply only to any future plan amendments, curtailments, or settlements of Hydro.

4.7 IAS 28 – Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)

The amendments clarify that an entity applies IFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). This clarification is relevant because it implies that the expected credit loss model in IFRS 9 applies to such long-term interests.

The amendments also clarified that, in applying IFRS 9, an entity does not take account of any losses of the associate or joint venture, or any impairment losses on the net investment, recognized as adjustments to the net investment in the associate or joint venture that arise from applying IAS 28 Investments in Associates and Joint Ventures.

The amendments should be applied retrospectively and are effective from January 1, 2019, with early application permitted. The application of these amendments to IAS 28 will not have a material impact on Hydro's annual audited consolidated financial statements.

4.8 IAS 23 – Borrowing Costs (Amendments to IAS 23)

The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete.

An entity applies those amendments to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies those amendments (January 1, 2019), with early application permitted. Since Hydro's current practice is in line with these amendments, Hydro does not expect any effect on its annual audited consolidated financial statements.

4.9 IFRS 11 – Joint Arrangements (Amendments to IFRS 11)

The amendment to IFRS 11 clarifies that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.

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The amendments are effective for annual periods beginning on or after January 1, 2019 with earlier application permitted. These amendments are currently not applicable to Hydro but may apply to future transactions.

4.10 IAS 1 – Presentation of Financial Statements and IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors (Amendments to IAS 1 and IAS 8)

The International Accounting Standards Board issued amendments to IAS 1 and IAS 8 to align the definition of ‘material’ across the standards and to clarify certain aspects of the definition and to include the concept of ‘obscuring information’.

The new definition states that “information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity”.

The amendments are effective for annual periods beginning on or after January 1, 2020 with earlier application permitted. The amendments are intended to improve the understanding of the existing requirements rather than to significantly impact Hydro’s materiality judgments.

5. CASH AND CASH EQUIVALENTS

As at December 31, 2018 and 2017, cash and cash equivalents consist entirely of cash.

6. TRADE AND OTHER RECEIVABLES

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
Trade receivables	121	118
Due from related parties	18	13
Other receivables	27	34
Allowance for doubtful accounts	(17)	(17)
	149	148

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
0-60 days	145	134
60+ days	4	14
	149	148

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
Allowance for doubtful accounts, beginning of year	(17)	(16)
Amounts provided for during the year	-	(1)
Allowance for doubtful accounts, end of year	(17)	(17)

7. INVENTORIES

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
No. 6 fuel	48	48
Material and other	47	47
Diesel fuel	4	4
Other fuel	5	4
Construction aggregates	3	3
	107	106

The cost of inventories recognized as an expense during the year is \$193.2 million (2017 - \$234.1 million) and is included in operating costs and fuels.

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8. DEFERRED ASSET

The deferred asset related to Hydro's power purchase agreement (PPA) with Nalcor Energy Marketing is amortized into income on a straight-line basis over the assumed 12 month term of the contract, which commenced on January 1, 2018. The components of change are as follows:

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
Deferred asset, beginning of year	31	51
Additions	21	31
Amortization	(31)	(51)
Deferred asset, end of year	21	31

9. PROPERTY, PLANT AND EQUIPMENT

<i>(millions of Canadian dollars)</i>	Generation Plant	Transmission and Distribution	Other	Construction in Progress	Total
Cost					
Balance at January 1, 2017	1,774	860	243	104	2,981
Additions	-	1	-	388	389
Disposals	(3)	(4)	(4)	-	(11)
Transfers	68	334	22	(424)	-
Other adjustments	-	-	(1)	(2)	(3)
Decommissioning liabilities and revisions	(1)	-	-	-	(1)
Balance at December 31, 2017	1,838	1,191	260	66	3,355
Additions	-	-	-	202	202
Disposals	(11)	(9)	(3)	-	(23)
Transfers	90	107	21	(219)	(1)
Other adjustments	(1)	-	-	2	1
Decommissioning liabilities and revisions	-	(1)	-	-	(1)
Balance at December 31, 2018	1,916	1,288	278	51	3,533
Depreciation					
Balance at January 1, 2017	458	160	84	-	702
Depreciation	53	27	14	-	94
Disposals	(2)	(1)	(3)	-	(6)
Balance at December 31, 2017	509	186	95	-	790
Depreciation	54	34	15	-	103
Disposals	(8)	(2)	(2)	-	(12)
Balance at December 31, 2018	555	218	108	-	881
Carrying value					
Balance at January 1, 2017	1,316	700	159	104	2,279
Balance at December 31, 2017	1,329	1,005	165	66	2,565
Balance at December 31, 2018	1,361	1,070	170	51	2,652

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10. INTANGIBLE ASSETS

<i>(millions of Canadian dollars)</i>	Computer Software	Feasibility Studies	Assets Under Development	Total
Cost				
Balance at January 1, 2017	12	2	-	14
Additions	-	-	1	1
Transfers	1	-	(1)	-
Balance at December 31, 2017	13	2	-	15
Additions	-	-	1	1
Transfers	1	-	(1)	-
Balance at December 31, 2018	14	2	-	16
Amortization				
Balance at January 1, 2017	5	1	-	6
Amortization	2	-	-	2
Balance at December 31, 2017	7	1	-	8
Amortization	2	-	-	2
Balance at December 31, 2018	9	1	-	10
Carrying value				
Balance at January 1, 2017	7	1	-	8
Balance at December 31, 2017	6	1	-	7
Balance at December 31, 2018	5	1	-	6

11. OTHER LONG-TERM ASSETS

<i>(millions of Canadian dollars)</i>		2018	2017 (Restated - Note 4.1)
Long-term receivables	(a)	-	-
Reserve fund	(b)	12	-
Sinking funds	(c)	164	156
Other long-term assets		176	156
Less: current portion of reserve fund		-	-
Less: current portion of sinking funds		-	-
		176	156

(a) The balance of \$0.2 million (2017 - \$0.3 million) includes the non-current portion of receivables associated with customer payment plans and the long-term portion of employee purchase programs.

(b) 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. Churchill Falls invested \$17.0 million in each of 2007, 2008 and 2009 and \$8.0 million in each of 2010, 2011 and 2012. In December 2018, \$18.8 million (2017 - \$22.5 million withdrawn) was invested into the fund as part of the Shareholder's Agreement to re-establish the \$75.0 million withdrawn in recent years. Hydro has recorded its 65.8% proportionate share of the amount invested of \$12.4 million (2017 - \$14.8 million withdrawn). As per the terms of the Shareholders' Agreement, these funds will be replaced over a five year period beginning in 2018.

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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.

Hydro's proportionate share of the reserve fund consists of the following:

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
Reserve fund, beginning of year	-	15
Principal investment (withdrawals)	12	(15)
Reserve fund, end of year	12	-
Less: current portion	-	-
	12	-

Hydro's proportionate share of reserve fund contributions due for the next five years are as follows:

<i>(millions of Canadian dollars)</i>	2019	2020	2021	2022	2023
Reserve fund contributions	12	12	6	6	-

- (c) As at December 31, 2018, sinking funds include \$164.4 million (2017 - \$156.4 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 2.57% to 6.82% (2017 – 2.57% to 6.82%).

The sinking funds consist of the following:

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
		(Restated - Note 4.1)
Sinking funds, beginning of year	156	222
Contributions	7	7
Change in sinking fund investments in own debentures	(10)	11
Earnings	11	11
Disposals and maturities	-	(95)
Sinking funds, end of year	164	156

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

<i>(millions of Canadian dollars)</i>	2019	2020	2021	2022	2023
Sinking fund installments	7	7	7	7	7

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12. INVESTMENTS

<i>As at December 31 (millions of Canadian dollars)</i>	Year of Maturity	2018	2017
\$28.0 million Redeemable GIC, interest at 1.40%	2019	18	18
\$23.6 million Redeemable GIC, interest at 1.46%	2019	16	16
\$22.2 million Short-term Bearer Deposit Note, interest at 1.52%	2018	-	15
Total investments, end of year		34	49
Less: redemptions to be received within the next year		(34)	(15)
Long-term investments, end of year		-	34

Hydro recorded its 65.8% proportionate share of the investments purchased by Churchill Falls.

13. REGULATORY DEFERRALS

<i>(millions of Canadian dollars)</i>		January 1 2018	Reclass & Regulatory Disposition	Regulatory Activity	December 31 2018	Remaining Recovery Settlement Period (years)
Regulatory asset deferrals						
2018 cost deferral	(a)	-	-	19	19	n/a
Deferred energy conservation costs	(b)	9	-	-	9	n/a
Deferred foreign exchange on fuel	(c)	(1)	-	1	-	n/a
Deferred lease costs	(d)	4	-	(1)	3	2.4
Energy supply deferrals	(e)	52	-	25	77	n/a
Foreign exchange losses	(f)	52	-	(2)	50	23.0
Phase Two hearing costs	(g)	1	-	-	1	n/a
		117	-	42	159	
Regulatory liability deferrals						
Deferred specifically assigned industrial revenue	(h)	-	-	(1)	(1)	n/a
Insurance amortization and proceeds	(i)	(3)	-	1	(2)	n/a
Labrador refund	(j)	(1)	-	-	(1)	1.0
Rate stabilization plan (RSP)	(k)	(75)	3	4	(68)	n/a
Other	(q)	-	-	1	1	n/a
		(79)	3	5	(71)	

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

<i>For the year ended December 31 (millions of Canadian dollars)</i>		2018	2017
RSP amortization		(10)	(53)
RSP fuel deferral		2	(19)
RSP interest		4	9
Rural rate adjustment		-	(3)
Total RSP activity	(k)	(4)	(66)
2014 cost deferral	(l)	-	1
2015 cost deferral	(m)	-	(3)
2016 cost deferral	(n)	-	(4)
2018 cost deferral	(a)	(19)	-
Amortization of deferred foreign exchange losses	(f)	2	2
Deferred energy conservation costs	(b)	-	(1)
Deferred foreign exchange on fuel	(c)	(1)	1
Deferred lease costs	(d)	1	1
Deferred specifically assigned industrial revenue	(h)	1	-
Energy supply deferrals	(e)	(25)	(21)
Insurance amortization and proceeds	(i)	(1)	(1)
Non-customer contributions in aid of construction	(o)	(1)	(1)
Other	(p,q,r,s)	-	-
		(47)	(92)

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 2018 would have decreased by \$46.6 million (2017 – a decrease of \$91.9 million).

13.(a) 2018 Cost Deferral

In Board Order No. P.U. 48 (2018), the Board approved the 2018 cost deferral of \$18.5 million (2017 - \$nil) related to the differential in the 2018 depreciation, loss on retirement and removal costs associated with the proposed change in depreciation methodology as outlined in a general rate application settlement agreement.

13.(b) Deferred Energy Conservation Costs

In 2018, Hydro deferred \$1.5 million (2017 - \$1.5 million) in the Energy Conservation Costs regulatory asset associated with an electrical conservation program for residential, industrial, and commercial sectors. In addition, as per Board Order No. P.U. 22 (2017), Hydro recovered \$1.2 million (2017 – \$0.5 million) of the balance through a rate rider.

13.(c) Deferred Foreign Exchange on Fuel

Hydro purchases a significant amount of fuel for Holyrood Thermal Generating Station (HTGS) in USD. The RSP allows Hydro to defer variances in fuel prices (including foreign exchange fluctuations). During 2018, Hydro recognized in regulatory assets, foreign exchange losses on fuel purchases of \$1.1 million (2017 - \$0.4 million gain).

13.(d) Deferred Lease Costs

In Board Order No. P.U. 17 (2016), Board Order No. P.U. 23 (2016) and Board Order No. P.U. 49 (2016) the Board approved the amortization of diesel units at HTGS over a period of five years. In 2018, Hydro recorded amortization of \$1.3 million (2017 - \$1.3 million) of the deferred lease costs.

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13.(e) Energy Supply Deferrals

Pursuant to Board Order No. P.U. 22 (2017), the Board approved the deferral of Energy Supply deferrals which includes the Energy Supply, Holyrood Conversion and Isolated Systems Supply deferral. The recovery of the deferral is subject to future Board order. In 2018, Hydro recorded a net increase to the deferral of \$25.3 million (2017 - \$21.3 million).

13.(f) 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 2018, the amortization of \$2.2 million (2017 - \$2.2 million) reduced regulatory assets.

13.(g) Phase Two Hearing Costs

Pursuant to Board Order No. P.U. 13 (2016), Hydro received approval to defer consulting fees, salary transfers and overtime 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. As a result, Hydro recorded a net increase to the regulatory asset of \$0.1 million (2017 - \$0.3 million).

13.(h) Deferred Specifically Assigned Industrial Revenue

In Board Order No. P.U. 7 (2018), Hydro was ordered to establish a deferral account, commencing April 1, 2018, to track the difference between the approved specifically assigned charges used to derive interim rates and the amount that would be charged if the proposed methodology in the general rate application is approved. During 2018, Hydro deferred \$0.5 million.

13.(i) 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 2018, Hydro recorded a decrease to regulatory liabilities resulting from amortization of \$0.6 million (2017 - \$0.5 million) related to the assets.

13.(j) Labrador Refund

Pursuant to Board Order No. P.U. 22 (2017), during 2017 Hydro refunded Labrador Industrial Transmission customers' excess revenues relating to the period of 2014 to 2017. The Board also ordered that Hydro apply a rate reduction for a 30-month period to address excess revenues relating to Hydro's rural customers on the Labrador Interconnected System. In 2018, Hydro recorded amortization of excess revenues which resulted in a decrease to profit of \$0.2 million (2017 - \$0.5 million).

13.(k) 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 and load and associated interest. Additionally, the RSP also includes costs associated with the island interconnected and isolated systems. 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. On March 14, 2018, the PUB issued Board Order P.U. 7 (2018) which approved interim rates for Island Industrial and Labrador Industrial customers effective April 1, 2018. On May 28, 2018, the PUB issued Board Order P.U. 15 (2018). The order approved interim rates to be charged to Newfoundland Power commencing on July 1, 2018.

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During 2018, Hydro recorded a net decrease in regulatory liabilities of \$7.2 million (2017 - decrease of \$269.4 million) resulting in an RSP ending balance for 2018 of \$67.0 million (2017 - \$74.2 million). The decrease in the RSP is primarily caused by the RSP surplus payout and the normal operation of the RSP. As per Board Order No. P.U. 36 (2016), the RSP was reduced by \$3.4 million (2017 - \$130.8 million) relating to the refund of the utility surplus balance. The reduction was comprised of a \$3.2 million (2017 - \$128.8 million) refund to customers and \$0.2 million (2017 - \$2.0 million) in administrative costs. The remaining portion of the utility surplus balance of \$9.9 million (2017 - \$12.6 million) is expected to be applied against the current balance of the RSP upon approval by the Board. The normal operation of the RSP resulted in an increase to net income of \$3.8 million (2017 - \$66.2 million).

13.(l) 2014 Cost Deferral

In Board Order No. P.U. 22 (2017), the Board approved \$37.7 million of the \$38.7 million 2014 cost deferral, resulting in a loss in 2017 of \$1.0 million and the disposition of the deferral balance from the RSP. There was no additional activity in 2018.

13.(m) 2015 Cost Deferral

In Board Order No. P.U. 22 (2017), the Board approved \$27.7 million of the 2015 cost deferral, resulting in a gain in 2017 of \$3.2 million and the disposition of the deferral balance from the RSP. There was no additional activity in 2018.

13.(n) 2016 Cost Deferral

The 2016 cost deferral of \$32.4 million consisted of energy supply costs of \$31.0 million and other costs of \$1.4 million. As a result of Board Order No. P.U. 22 (2017), \$31.0 million was re-classified to the energy supply deferral. The Board also approved other 2016 costs of \$5.0 million, which resulted in an increase in profit or loss of \$3.6 million in 2017, and the disposition of the deferral balance from the RSP. There was no additional activity in 2018.

13.(o) 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 not customers in profit or loss. During 2018, Hydro recorded \$1.0 million (2017 - \$1.1 million) non-customer CIAC amortization as a regulatory adjustment. In the absence of rate regulation, IFRS requires non-customer CIACs to be recorded as contributed capital with no corresponding amortization. As a result, during 2018 Hydro also recorded an increase of \$1.0 million (2017 - \$1.1 million) to contributed capital to recognize the amount that was reclassified to profit or loss.

13.(p) 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.

13.(q) 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 \$0.3 million (2017 - \$0.4 million) are deferred as a regulatory liability.

13.(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 2018, Hydro recorded \$0.2 million (2017 - \$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 2018 Hydro also recorded a decrease of \$0.2 million (2017 - \$0.1 million) to other comprehensive income to recognize the amount that was reclassified to profit or loss.

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13.(s) Hearing Costs

As per Board Order No. P.U. 49 (2016), the Board approved \$0.8 million in hearing costs to be deferred and amortized over a three year period commencing 2015. In 2017, Hydro recorded amortization of \$0.3 million. There was no additional activity in 2018.

14. TRADE AND OTHER PAYABLES

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
Trade payables	75	131
Accrued interest payable	25	24
Due to related parties	7	8
Other payables	33	26
	140	189

As at December 31, 2018 trade and other payables included balances of \$0.3 million (2017 - \$18.6 million) denominated in USD.

15. DEBT

15.1 Short-term Borrowings

On June 29, 2018, Hydro signed an extension to its \$200.0 million CAD or USD equivalent committed revolving term credit facility resulting in a new maturity date of July 27, 2020. As at December 31, 2018, there were no amounts drawn on the facility (2017 - \$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 prevailing Government BA fee. Borrowings in USD may take the form of Base Rate Advances, London Interbank Offer Rate (LIBOR) Advances and letters of credit. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate.

On March 14, 2018 Hydro repaid an intercompany loan in the amount of \$225.0 million to Nalcor. This loan was set to mature on March 30, 2018 and carried an interest rate of 1.845%.

In addition, Hydro utilized its \$300.0 million government guaranteed promissory note program to fulfill its short-term funding requirements. As at December 31, 2018, there were \$189.0 million in promissory notes outstanding with a maturity date of January 3, 2019 bearing an interest rate of 1.77% (2017 - \$144.0 million bearing an interest rate of 1.13%).

On January 3, 2019, Hydro reissued a promissory note in the amount of \$196.0 million with a maturity date of January 21, 2019 bearing an interest rate of 1.80%. Upon maturity, the promissory note was reissued.

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
Promissory notes - borrowed from Nalcor	-	225
Promissory notes - borrowed from external markets	189	144
	189	369

NEWFOUNDLAND AND LABRADOR HYDRO
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Churchill Falls maintains a \$10.0 million CAD or USD equivalent unsecured demand operating credit facility with its primary banker. There were no amounts drawn on this facility as at December 31, 2018 (2017 - \$nil), however \$1.0 million of the borrowing limit has been used to issue irrevocable letters of credit (2017 - \$1.0 million). Borrowings in CAD may take the form of Prime Rate Advances, BAs, or letters of credit, with interest calculated at the Prime Rate or prevailing Government BA fee. Borrowings in USD may take the form of Base Rate Advances. The facility also provides coverage for overdrafts on Churchill Falls bank accounts, with interest calculated at the Prime Rate. Churchill Falls has issued three irrevocable letters of credit, totalling \$2.0 million, to ensure satisfactory management of its waste management and compliance with a certificate of approval for the transportation of special hazardous wastes granted by the Department of Environment and Conservation.

15.2 Long-term Debt

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

<i>As at December 31 (millions of Canadian dollars)</i>	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	2018	2017
Hydro						
γ*	300	8.40	1996	2026	296	295
AB*	300	6.65	2001	2031	305	305
AD*	125	5.70	2003	2033	124	124
AF	500	3.60	2014/2017	2045	480	480
1A	600	3.70	2017/2018	2048	641	330
Total	1,825				1,846	1,534
Less: Sinking fund investments in own debentures					55	45
					1,791	1,489
Less: Sinking fund payments due within one year					7	7
Total					1,784	1,482

*Sinking funds have been established for these issues.

**Hydro's V Series debentures had a balance of \$0.2 million outstanding as at December 31, 2018.

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. 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 charged by the Province for the year ended December 31, 2018 was \$6.9 million (December 31, 2017 - \$4.1 million).

On March 14, 2018, Hydro issued additional long-term debt, Series 1A, with face value of \$300.0 million. The Province issued debt specifically on Hydro's behalf and lent the proceeds to Hydro. The debt, repayable to the Province, matures on October 17, 2048 with a coupon rate of 3.70% paid semi-annually.

NEWFOUNDLAND AND LABRADOR HYDRO
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16. 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.

<i>As at (millions of Canadian dollars)</i>	2018	2017
Deferred contributions, beginning of year	24	14
Additions	2	1
Other adjustments	2	11
Amortization	(2)	(2)
Deferred contributions, end of year	26	24
Less: current portion	(2)	(1)
	24	23

17. 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, 2018 and December 31, 2017 are as follows:

<i>As at (millions of Canadian dollars)</i>	2018	2017
Decommissioning liabilities, beginning of year	15	16
Accretion	-	-
Revisions	-	(1)
Decommissioning liabilities, end of year	15	15

The total estimated undiscounted cash flows required to settle the HTGS obligations as at December 31, 2018 are \$15.2 million (2017 - \$15.2 million). Payments to settle the liability are expected to occur between 2020 and 2023. 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 2.3% (2017 - 2.6%). Hydro has recorded \$13.9 million (2017 - \$13.5 million) related to HTGS obligations.

The total estimated undiscounted cash flows required to settle the PCB obligations as at December 31, 2018 are \$1.1 million (2017 - \$1.8 million). Payments to settle the liability are expected to occur between 2019 and 2025. The fair value of the decommissioning liabilities was determined using the present value of future cash flows discounted at Hydro's and Churchill Falls' credit adjusted risk free rates of 2.5% to 2.9%, respectively, (2017 - 2.8% to 3.2%). Hydro has recorded \$0.9 million (2017 - \$1.5 million) related to PCB obligations.

A significant number of 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.

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18. EMPLOYEE FUTURE BENEFITS

18.1 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, 2018 of \$9.6 million (2017 - \$9.8 million) are expensed as incurred.

18.2 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 upon retirement. In 2018, cash payments to beneficiaries for its unfunded other employee future benefits were \$3.0 million (2017 - \$4.1 million). An actuarial valuation was performed as at December 31, 2018.

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
Accrued benefit obligation, beginning of year	109	103
Current service cost	5	4
Interest cost	4	4
Benefits paid	(3)	(4)
Actuarial (gain) loss	(9)	3
Transfers and other	(1)	(1)
Accrued benefit obligation, end of year	105	109

When an employee transfers to a related party, the associated accrued benefit obligation is allocated to each respective party based on years of service.

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2018	2017
Component of benefit cost		
Current service cost	5	4
Interest cost	4	4
Total benefit expense for the year	9	8

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

	2018	2017
Discount rate - benefit cost	3.55%	3.90%
Discount rate - accrued benefit obligation	3.90%	3.55%
Rate of compensation increase	3.50%	3.50%

Assumed healthcare trend rates:

	2018	2017
Initial health care expense trend rate	5.85%	6.00%
Cost trend decline to	4.50%	4.50%
Year that rate reaches the rate it is assumed to remain at	2028	2028

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

<i>Increase (millions of Canadian dollars)</i>	2018	2017
Current service and interest cost	2	2
Accrued benefit obligation	17	18
<i>Decrease (millions of Canadian dollars)</i>	2018	2017
Current service and interest cost	(1)	(1)
Accrued benefit obligation	(13)	(14)

NEWFOUNDLAND AND LABRADOR HYDRO
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19. ACCUMULATED OTHER COMPREHENSIVE INCOME

The components of, and changes in, accumulated other comprehensive income are as follows:

<i>(millions of Canadian dollars)</i>	2018	2017
Employee future benefits		
Balance at January 1	(22)	(19)
Regulatory adjustment	-	-
Net actuarial gain (loss) on defined benefit plans	9	(3)
Balance at December 31	(13)	(22)

20. SHAREHOLDER'S EQUITY

20.1 Share Capital

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
Common shares of par value of \$1 each		
Authorized - 25,000,000		
Issued, paid and outstanding - 22,503,942	23	23

20.2 Contributed Capital

<i>As at December 31 (millions of Canadian dollars)</i>	2018	2017
Contributed capital, beginning of year	150	148
Additions	3	3
Amortization	(1)	(1)
Contributed capital, end of year	152	150

During 2018, the Churchill Falls (Labrador) Corporation Trust (the Trust) contributed capital in the amount of \$1.3 million (2017 - \$0.2 million). In addition, Lower Churchill Management Corporation (LCMC) contributed \$1.7 million (2017 - \$2.7 million) in additions to property, plant and equipment. Pursuant to Board Order No. P.U. 1 (2017), Hydro recognized \$1.0 million (2017 - \$1.1 million) in amortization as a regulatory adjustment.

20.3 Dividends

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2018	2017
Declared during the year		
Final dividend for prior year: \$0.06 per share (2017 - \$0.02)	1	1
Interim dividend for current year: \$0.30 per share (2017 - \$0.28)	7	6
	8	7

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21. OPERATING COSTS

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2018	2017
Salaries and benefits	112	110
Maintenance and materials	32	34
Professional services	10	8
Rental and royalty	4	4
Travel and transportation	7	6
Equipment rental	2	2
Insurance	5	5
Other operating costs	6	6
	178	175

22. NET FINANCE EXPENSE

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2018	2017
Finance income		
Interest on sinking fund	11	12
Other interest income	2	2
	13	14
Finance expense		
Long-term debt	90	78
Debt guarantee fee	7	4
Accretion	-	1
Other	4	6
	101	89
Interest capitalized during construction	(3)	(11)
	98	78
Net finance expense	85	64

23. OTHER EXPENSE

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2018	2017
Loss on disposal of property, plant and equipment	11	5
Net change in PPA fair value (a)	-	-
Foreign exchange loss (gain)	2	(1)
Other	1	2
Other expense	14	6

(a) Net change in PPA fair value

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2018	2017
PPA gains		
Settlement of realized profit	(49)	(42)
Mark-to-market of derivative	18	(9)
	(31)	(51)
PPA losses		
Amortization of deferral	31	51
	31	51
Net change in PPA fair value	-	-

NEWFOUNDLAND AND LABRADOR HYDRO
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24. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

24.1 Fair Value

The estimated fair values of financial instruments as at December 31, 2018 and December 31, 2017 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, 2018 and December 31, 2017.

	Level	Carrying Value December 31, 2018	Fair Value	Carrying Value December 31, 2017	Fair Value
<i>As at (millions of Canadian dollars)</i>					
Financial assets					
Sinking funds - investments in Hydro debt issue	2	55	63	45	56
Sinking funds - other investments	2	164	195	156*	190
Reserve fund	2	12	12	-	-
Financial liabilities					
Derivative liabilities	3	21	21	31	31
Long-term debt (including amount due within one year before sinking funds)	2	1,846	2,100	1,534	1,848

*The carrying value of certain financial assets has been restated. Please refer to Note 4.1

The fair value of cash and cash equivalents, trade and other receivables, short-term borrowings and trade and other payables, approximates their carrying values due to their short-term maturity. The fair value of long-term investments approximates its carrying value due to the underlying nature of the investment.

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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 Nalcor Energy Marketing and represents the future value provided to Nalcor 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, 2018:

<i>(millions of Canadian dollars)</i>	Carrying Value	Valuation Techniques	Significant Unobservable Input(s)	Range
Derivative liability (PPA)	21	Modelled pricing	Volumes (MWh)	14-25% 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, 2018, the effect of using reasonable alternative assumptions for volume inputs to valuation techniques may have resulted in \$nil to \$2.3 million change in the carrying value of the power purchase derivative liability.

24.2 Risk Management

Hydro is exposed to certain credit, liquidity and market price risks through its operating, investing and financing activities. Financial risk is managed in accordance with Nalcor’s Board approved Financial Management Risk 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 cash equivalents 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.

Credit risk on cash and cash equivalents 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).

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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 (%)
	2018		2017	
Provincial Governments	A- to A+	44.98%	A- to A+	46.25%
Provincially owned utilities	A- to A+	55.02%	A- to A+	53.75%
		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 (%)
	2018		2017	
Provincial Governments	A- to A+	38.57%	A- to A+	-
Provincially owned utilities	A- to A+	8.91%	A- to A+	-
Schedule 1 Canadian banks	AA- to AAA	14.15%	AA- to AAA	-
Schedule 1 or 2 Canadian banks	A- to A+	38.37%	A- to A+	-
		100.0%		-

Credit exposure on derivative assets is limited by the Financial Risk Management Policy, which restricts available counterparties for hedge transactions to Schedule 1 Canadian Chartered Banks, and Federally Chartered US Banks.

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 81.8% (2017 - 81.9%) of total energy sales and 62.4% (2017 - 55.8%) of accounts receivable. Energy sales for the three largest customers include \$455.9 million (2017 - \$409.6 million) for regulated Hydro, as well as \$33.1 million (2017 - \$39.9 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, including any derivative liabilities related to hedging activities. 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 and cash equivalents on hand, funds from operations, and a \$300.0 million promissory note program. In addition, Hydro maintains a \$200.0 million (2017 - \$200.0 million) unsecured demand operating facility with its primary banker in order to meet any requirements beyond those forecasted for a given period. Churchill Falls also maintains a \$22.5 million (2017 - \$22.0 million) minimum cash balance, business interruption insurance, as well as a \$10.0 million (2017 - \$10.0 million) unsecured credit facility with its banker.

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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 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, 2018:

<i>(millions of Canadian dollars)</i>	<1 Year	1-3 Years	3-5 years	> 5 Years	Total
Trade and other payables	140	-	-	-	140
Short-term borrowings	189	-	-	-	189
Derivative liability	21	-	-	-	21
Long-term debt including sinking funds	7	13	13	1,792	1,825
Interest	92	185	185	1,220	1,682
	449	198	198	3,012	3,857

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, electricity, and No. 6 fuel. 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 cash equivalents, short-term investments 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 cash equivalents and short-term debt was negligible throughout 2018 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 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 operation of the RSP.

NEWFOUNDLAND AND LABRADOR HYDRO
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The components of the change impacting the carrying value of the derivative asset and derivative liability for the years ended December 31, 2018 and December 31, 2017 are as follows:

<i>(millions of Canadian dollars)</i>	Level III
Balance at January 1, 2018	(31)
Purchases	(21)
Changes in profit or loss	
Mark-to-market	(18)
Settlements	49
Total	31
Balance at December 31, 2018	(21)
Balance, January 1, 2017	(51)
Purchases	(31)
Changes in profit or loss	
Mark-to-market	9
Settlements	42
Total	51
Balance at December 31, 2017	(31)

25. 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
Nalcor Energy – Bull Arm Fabrication Inc.	Wholly-owned subsidiary of Nalcor
Nalcor Energy – Oil and Gas Inc.	Wholly-owned subsidiary of Nalcor
PUB	Agency of the Province
The Trust	Created by the Province with Churchill Falls as the beneficiary

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.

- (a) On September 29, 2017 Hydro renewed an intercompany loan with Nalcor in the amount of \$225.0 million to Hydro. This loan matured on March 30, 2018 and had an interest rate of 1.845%. The loan was repaid on March 14, 2018.
- (b) For the year ended December 31, 2018, Lower Churchill Management Corporation contributed \$1.7 million (2017 - \$2.7 million) in additions to property, plant and equipment.
- (c) Hydro is required to incur the costs of operations, hearings and application costs of the PUB, including costs of any experts and consultants engaged by the PUB. During 2018, Hydro incurred \$1.9 million (2017 - \$1.8 million) in costs related to the PUB and has included \$0.7 million (2017 - \$3.0 million) in trade and other payables.

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- (d) As at December 31, 2018, Hydro has a payable to related parties of \$7.4 million (2017 - \$8.1 million) and a receivable from related parties for \$18.0 million (2017 - \$13.4 million). This payable/receivable consists of various intercompany operating costs and power purchases.
- (e) The debt guarantee fee for 2018 was \$6.9 million (2017 - \$4.1 million). It was paid to the Province on March 29, 2018.
- (f) For the year ended December 31, 2018, Hydro recovered \$2.0 million (2017 - \$2.2 million) of operating costs from related parties representing the provision of administrative services.
- (g) For the year ended December 31, 2018, Hydro incurred costs of \$5.4 million (2017 - \$3.9 million) in operating costs from related parties representing the provision for administrative services.
- (h) For the year ended December 31, 2018, Hydro has purchased \$28.4 million (2017 - \$26.3 million) of power generated from assets related to Exploits Generation, which are owned by the Province. In addition, Hydro operates these assets on behalf of Nalcor and recovered costs in the amount of \$30.4 million (2017 - \$21.9 million).
- (i) For the year ended December 31, 2018, Hydro has incurred intercompany labour expense of \$1.2 million (2017 - \$1.6 million) and recovered intercompany labour expense of \$1.6 million (2017 - \$1.5 million) for operating and capital labour. Additionally, the fixed charge associated with this labour is \$0.1 million (2017 - \$0.2 million) incurred and \$0.3 million (2017 - \$0.3 million) recovered respectively.
- (j) Hydro received \$0.8 million (2017 - \$0.8 million) from Nalcor associated with the Upper Churchill Redress Agreement to be used to reduce the electricity accounts of each residential customer in Innu Communities and to Mushuau Innu First Nation.
- (k) Hydro recorded \$2.0 million (2017 - \$1.8 million) as an energy rebate from the Province to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan. As at December 31, 2018, there is a balance of \$0.4 million (2017 - \$0.6 million) outstanding in trade and other receivables.
- (l) Hydro received \$0.4 million (2017 - \$0.5 million) from other lines of business as a contribution in aid of construction for Information Systems assets.
- (m) During 2018, Churchill Falls generated revenue from Hydro-Québec of \$94.8 million (2017 - \$94.6 million) and Hydro has recognized its share of \$62.4 million (2017 - \$62.2 million).
- (n) Under the terms of the Lease and amendments thereto, Churchill Falls is required to pay the Province an annual rental of 8% of the consolidated net profits before income taxes and an annual royalty of \$0.50 per horsepower year generated, as defined in the Lease. At December 31, 2018, \$6.7 million (2017 - \$6.4 million) was payable to the Province. Hydro has recognized its share of \$4.4 million (2017 - \$4.2 million).
- (o) In February 3, 2010, the Province established the Trust with Churchill Falls as the beneficiary. The purpose of the Trust is to fund the external costs and expenses incurred in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. To date, \$5.8 million (2017 - \$5.6 million) has been received and \$1.8 million (2017 - \$nil) has been accrued as receivable from the Trust. Hydro has recognized its share of \$3.8 million (2017 - \$3.7 million) as received and \$1.2 million (2017 - \$nil) accrued as receivable from the Trust.
- (p) As at December 31, 2018, Churchill Falls capacity penalty payable was \$0.4 million (2017 - \$0.4 million), of which Hydro has recorded its share of \$0.3 million (2017 - \$0.3 million). The capacity penalty relates to the supply of power to Hydro-Québec. Churchill Falls did not incur a capacity penalty in 2018 (2017 - \$nil).

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- (q) On March 14, 2018, Hydro issued new long-term debt, Series 1A, with face value of \$300.0 million (2017 - \$300.0 million). The Province issued debt specifically on Hydro's behalf and lent the proceeds to Hydro.
- (r) Hydro recorded \$1.4 million as a receivable from Lower Churchill Management Corporation to reimburse costs of running the Holyrood Gas Turbine to accommodate the interconnection of Soldier's Pond.

25.1 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 (2017 - \$0.2 million).

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2018	2017
Salaries and employee benefits	2	2

26. COMMITMENTS AND CONTINGENCIES

- (a) Hydro has received claims instituted by various companies and individuals with respect to power delivery claims and other miscellaneous matters. Although the outcome of such matters cannot be predicted with certainty, Management believes that Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, is not expected to materially affect its financial position.
- (b) Outstanding commitments for capital projects total approximately \$35.0 million as at December 31, 2018 (2017 - \$54.4 million).
- (c) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	Effective Date	Term
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years
Wind	300 kW	2010	Continual
Hydroelectric	175 kW	2017	15 years
Biomass	450 kW	2018	1 year post in-service of Muskrat Falls in-service date

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

<i>(millions of Canadian dollars)</i>	2019	2020	2021	2022	2023
Power purchases	32.5	32.9	32.5	32.1	32.1

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- (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 five years are estimated to be as follows:

2019	\$21.1 million
2020	\$21.4 million
2021	\$21.6 million
2022	\$21.8 million
2023	\$22.0 million

- (e) In August 2016, Churchill Falls received judgment from the Québec Superior Court regarding a Motion for Declaratory Judgment filed by Hydro-Québec relating to the interpretation of the 1969 Power Contract between Churchill Falls and Hydro-Québec and the associated Renewal Contract. The Court ruled in favour of Hydro-Québec and the ruling requires Churchill Falls to pay court costs of approximately \$0.4 million to Hydro-Québec. Churchill Falls has filed a Notice of Appeal with the Québec Court of Appeal and the appeal hearing was held on December 4, 2018. The decision of the Court of Appeal is expected to be issued in 2019.
- (f) 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 commences at the date of commissioning of the Muskrat Falls Plant. Estimated payments for the next five years have not yet been determined.
- (g) 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 Lower Churchill Project assets. The term of the TFA is anticipated to continue until the service life of the LIL assets has expired.
- (h) In 2018, Hydro entered into three additional agreements in order to enable transmission of energy from Labrador to the island; the Labrador Island Link Interim Transmission Funding Agreement (LIL interim TFA); Labrador Transmission Assets Interim Transmission Funding Agreement (LTA interim TFA); and a Minimum Performance Guarantee (the Guarantee). The LIL Interim TFA is between the Labrador Island Link Limited Partnership (Partnership) and Hydro to provide for cost reimbursement, from Hydro to the Partnership, for operating and maintenance costs resulting from the LIL being made available for service earlier than would otherwise be required. The LTA Interim TFA is between the Labrador Transmission Corporation (LTC) and Hydro to provide for cost reimbursement, from Hydro to LTC, for operating and maintenance costs resulting from the LTA being made available for service earlier than would otherwise be required. Both of the Interim TFA's were developed based on existing long-term Transmission Funding Agreement, executed in 2013. The Guarantee is between Nalcor Energy and Hydro and provides Hydro with guaranteed minimum average availability of the LIL and LTA during the term of the Interim TFA's. Should performance deficiencies by either or both of the LIL and LTA result in Hydro realizing a net loss from the use of off-island purchases, Nalcor will reimburse Hydro, in proportion to the contribution of these deficiencies to the net loss, for the operating and maintenance costs of the LIL and LTA.

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- (i) 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 2016, Hydro also entered into two new Capacity Assistance Agreements, one with Praxair and a second agreement with Vale for the purchase of relief power. The agreements with Vale and Praxair have a supply period defined as December 1 to March 31 for each contract year, concluding March 2018. In November 2017, Hydro entered into a revised agreement with CBPP that expires the earlier of April 30, 2022 or the commissioning of the Muskrat Falls plant. Payment for services will be dependent on the successful provision of capacity assistance for the winter period by Vale, CBPP and Praxair. In December 2018, Hydro entered into a revised agreement with Vale that expires in March of 2019; the agreement with Praxair was not renewed.

27. 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:

<i>(millions of Canadian dollars)</i>	2018	2017	
		(Restated - Note 4.1)	
Debt			
Sinking funds	(164)	(156)	
Short-term borrowings	189	369	
Current portion of long-term debt	7	7	
Long-term debt	1,784	1,482	
	1,816	1,702	64.9%
Equity			
Share capital	23	23	
Contributed capital	152	150	
Reserves	(13)	(22)	
Retained earnings	822	768	
	984	919	35.1%
Total Debt and Equity	2,800	2,621	100.0%

27.1 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 restricting the issuance of debt such that consolidated debt to total capitalization ratio cannot exceed 85%. As at December 31, 2018, Hydro was in compliance with this covenant.

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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. The current limit is set at \$300.0 million and \$189.0 million is outstanding as at December 31, 2018 (2017 - \$144.0 million). Issuance of short-term borrowings and long-term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both short-term and long-term debt to \$2.1 billion at any point in time.

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. In 2017, through an Order in Council, the Province was authorized to borrow up to \$700.0 million on Hydro Regulated's behalf, expiring March 31, 2018. On March 14, 2018, the Province issued \$300.0 million in debt and lent the proceeds to Hydro Regulated. As at December 31, 2018, \$600.0 million had been issued under this borrowing authorization. Any additional funding to address long-term capital funding requirements, will require approval from the Province and the PUB.

27.2 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, 2018 (2017 - \$nil).

Churchill Falls has issued three irrevocable letters of credit totaling \$2.0 million (2017 - \$2.0 million), \$1.0 million of which does not impact the borrowing limit of the operating credit facility (2017 - \$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.

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28. SUPPLEMENTARY CASH FLOW INFORMATION

<i>For the year ended December 31 (millions of Canadian dollars)</i>	2018	2017
Trade and other receivables	-	(28)
Inventories	(1)	(17)
Prepayments	(1)	(1)
Trade and other payables	(46)	22
Changes in non-cash working capital balances	(48)	(24)
Related to:		
Operating activities	(25)	(35)
Investing activities	(23)	11
	(48)	(24)

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29. 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 recapture energy, purchased from Churchill Falls, 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 Nalcor Energy Marketing.

	Hydro Regulated	Churchill Falls	Energy Marketing	Non-Regulated Activities	Inter-Segment	Total
<i>(millions of Canadian dollars)</i>						
For the year ended December 31, 2018						
Energy sales	557	89	7	34	(3)	684
Other revenue	7	-	21	-	3	31
Revenue	564	89	28	34	-	715
Fuels	189	-	-	-	-	189
Power purchased	71	-	7	33	(3)	108
Operating costs	136	41	-	-	1	178
Transmission rental	-	-	21	-	-	21
Depreciation and amortization	87	18	-	-	-	105
Net finance expense (income)	87	(1)	-	(1)	-	85
Other expense	13	1	-	-	-	14
Expenses	583	59	28	32	(2)	700
Preferred dividends	-	(3)	-	-	3	-
(Loss) profit before regulatory adjustments	(19)	33	-	2	(1)	15
Regulatory adjustments	(47)	-	-	-	-	(47)
Profit for the year	28	33	-	2	(1)	62
Capital expenditures*	160	43	-	-	-	203
Total assets	2,700	615	23	4	-	3,342

*Capital expenditures include non-cash additions of \$1.7 million contributed by Lower Churchill Management Corporation.

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	Hydro Regulated	Churchill Falls	Energy Non-Regulated Marketing	Inter- Activities Segment	Total	
<i>(millions of Canadian dollars)</i>						
For the year ended December 31, 2017						
Energy sales	506	91	3	40	(4)	636
Other revenue	5	1	20	-	3	29
Revenue	511	92	23	40	(1)	665
Fuels	226	-	-	-	-	226
Power purchased	62	-	3	39	(3)	101
Operating costs	130	44	-	1	-	175
Transmission rental	-	-	20	-	-	20
Depreciation and amortization	78	18	-	-	-	96
Net finance expense (income)	65	(1)	-	-	-	64
Other expense	6	-	-	-	-	6
Expenses	567	61	23	40	(3)	688
Preferred dividends	-	(2)	-	-	2	-
(Loss) profit before regulatory adjustments	(56)	33	-	-	-	(23)
Regulatory adjustments	(92)	-	-	-	-	(92)
Profit for the year	36	33	-	-	-	69
Capital expenditures*	344	46	-	-	(1)	389
Total assets	2,582	592	32	18	-	3,224

*Capital expenditures include non-cash additions of \$2.7 million contributed by Lower Churchill Management Corporation.

30. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform to the basis of presentation adopted during the current reporting period. The changes have been summarized as follows:

	Previously Reported	Third party contributed capital asset Presentation	Reclassified Balance
<i>(millions of Canadian dollars)</i>			
Property, plant and equipment	2,554	11	2,565
Deferred contributions	12	11	23