Separate Financial Statements of

NIAGARA-ON-THE-LAKE HYDRO INC.

Year ended December 31, 2016

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INDEPENDENT AUDITORS' REPORT

To the Shareholder of Niagara-on-the-Lake Hydro Inc.

We have audited the accompanying separate financial statements of Niagara-on-the-Lake Hydro Inc. ("the Entity"), which comprise the separate statement of financial position as at December 31, 2016, the separate statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Separate Financial Statements

Management is responsible for the preparation and fair presentation of these separate financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

KPMG

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

Opinion

In our opinion, the separate financial statements present fairly, in all material respects, the financial position of Niagara-on-the-Lake Hydro Inc. as at December 31, 2016 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards**.**

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

April 27, 2017

Hamilton, Canada

NIAGARA-ON-THE-LAKE HYDRO INC.

Separate Statement of Financial Position
Year ended December 31, 2016, with comparative information for 2015

	Note	2016	2015
Assets			
Current assets			
Accounts receivable	6	2,854,604	3,076,877
Unbilled revenue		3,126,655	2,475,081
Income taxes receivable		137,479	415,229
Due from related parties	21	9,754	484,932
Material and supplies	7	361,700	306,346
Prepaid expenses		83,811	83,967
Total current assets		6,574,003	6,842,432
Non-current assets			
Property, plant and equipment	8	28,504,785	27,243,307
Deferred tax assets	9	-	89,532
Investment		100	100
Total non-current assets		28,504,885	27,332,939
Total assets		35,078,888	34,175,371
Regulatory balances	10	1,958,094	1,935,759
Total assets and regulatory balances		$ 37,036,982	$ 36,111,130

	Note	2016	2015
Liabilities			
Current liabilities			
Bank indebtedness	5	$ 424,343	$ 168,264
Current portion of long-term debt	12	2,338,027	1,763, 603
Derivatives		72,477	134,829
Accounts payable and accrued liabilities	11	4,049,300	4,503,295
Customer deposits		236,840	245,827
Due to related parties	21	368,586	629,560
Deferred revenue		128,368	315,876
Total current liabilities		7,617,941	7,761,254
Non-current liabilities			
Long-term debt	12	7,873,375	8,705,609
Liability for future benefits	13	330,064	324,051
Deferred revenue		2,840,351	1,281,565
Deferred tax liability	9	74,948	-
Total non-current liabilities		11,118,738	10,311,225
Total liabilities		18,736,679	18,072,479
Equity			
Share capital	14	2,632,307	2,632,307
Paid-up capital		4,269,026	4,269,026
Retained earnings		8,823,929	8,314,935
Accumulated other comprehensive income		70,873	70,873
Total equity		15,796,135	15,287,141
Total liabilities and equity		34,532,814	33,359,620
Regulatory balances	10	2,504,168	2,751,510
Total liabilities, equity and regulatory balances		$ 37,036,982	$ 36,111,130

See accompanying notes to the separate financial statements.

On behalf of the Board:

__________________________ Director   __________________________ Director

NIAGARA-ON-THE-LAKE HYDRO INC.

Separate Statement of Comprehensive Income
Year ended December 31, 2016, with comparative information for 2015

	Note	2016	2015
Revenue			
Distribution revenue		$ 4,844,660	$ 4,693,250
Other operating revenue	15	403,071	339,818
		5,247,731	5,033,068
Sale of energy		26,677,590	22,506,046
Total revenues		31,925,321	27,539,114
Operating expenses			
Operations and maintenance		1,217,324	1,024,164
Billing and collection		547,188	601,150
General administration		876,508	774,072
Depreciation and amortization		996,009	968,322
	16	3,637,029	3,367,708
Cost of power purchased		26,794,215	23,322,938
Total expenses		30,431,244	26,690,646
Income from operating activities		1,494,077	848,468
Finance income	17	(56,869)	(25,182)
Finance costs	17	482,933	441,386
Income before income taxes		1,068,013	432,264
Income tax recovery (expense)	9	(328,696)	(455,925)
Net income for the year		739,317	(23,661)
Net movement in regulatory balances		280,088	860,893
Tax on net movement		(10,411)	(123,068)
		269,677	737,825
Net income for the year and net movement in regulatory balances, being total comprehensive income		$ 1,008,994	$ 714,164

See accompanying notes to the separate financial statements.

NIAGARA-ON-THE-LAKE HYDRO INC.

Separate Statement of Changes in Equity
Year ended December 31, 2016, with comparative information for 2015

	Share capital	Paid-up capital	Retained earnings	Accumulated other comprehensive income	Total
Balance at January 1, 2015	$ 2,632,307	$4,269,026	$ 8,100,771	$ 70,873	$ 15,072,977
Net income and net movement in regulatory balances	-	-	714,164	-	714,164
Other comprehensive income	-	-	-	-	-
Dividends	-	-	(500,000)	-	(500,000)
Balance at December 31, 2015	$ 2,632,307	$4,269,026	$ 8,314,935	$ 70,873	$ 15,287,141
Balance at January 1, 2016	$ 2,632,307	$4,269,026	$ 8,314,935	$ 70,873	$ 15,287,141
Net income and net movement in regulatory balances	-	-	1,008,994	-	1,008,994
Other comprehensive income	-	-	-	-	-
Dividends	-	-	(500,000)	-	(500,000)
Balance at December 31, 2016	$ 2,632,307	$4,269,026	$ 8,823,929	$ 70,873	$ 15,796,135

See accompanying notes to the separate financial statements.

NIAGARA-ON-THE-LAKE HYDRO INC.

Separate Statement of Cash Flows
Year ended December 31, 2016, with comparative information for 2015

	2016	2015
Operating activities		
Net Income and net movement in regulatory balances	$ 1,008,994	$ 714,164
Adjustments for:		
Depreciation and amortization	1,095,472	1,021,974
Amortization of deferred revenue	(44,491)	(20,539)
Post-employment benefits	6,013	4,320
Losses on disposal of property, plant and equipment	8,590	12,958
Change in derivatives	(65,352)	(36,133)
Net finance costs	426,064	416,204
Income tax expense (recovery)	328,696	(602,999)
Contributions received from customers	1,603,277	600,721
	4,370,263	2,110,670
Change in non-cash operating working capital:		
Accounts receivable	222,273	(756,078)
Unbilled revenue	(651,574)	21,233
Due from related parties	475,178	(472,905)
Materials and supplies	(55,354)	(114,313)
Prepaid expenses	156	(72,473)
Accounts payable and accrued liabilities	(453,995)	(498,879)
Customer deposits	(8,987)	(95,170)
Due to related parties	(260,974)	(221,888)
Deferred revenue	(187,508)	315,876
	3,449,478	216,073
Regulatory balances	(269,677)	321,099
Income tax paid	-	(90,000)
Income tax received	113,534	357,237
Interest paid	(482,933)	(441,386)
Interest received	56,869	25,182
Net cash from operating activities	2,867,271	388,205
Investing activities		
Purchase of property, plant and equipment	(2,365,540)	(4,070,151)
Net cash used by investing activities	(2,365,540)	(4,070,151)
Financing activities		
Dividends paid	(500,000)	(500,000)
Repayment of long-term debt	(1,257,810)	(1,019,234)
Proceeds from long-term debt	-	5,000,000
Proceeds from line of credit	1,000,000	-
Net cash used in financing activities	(757,810)	3,480,766
Change in bank indebtedness	(256,079)	(201,180)
Cash (bank indebtedness), beginning of year	(168,264)	32,916
Bank indebtedness, end of year	$ (424,343)	$ (168,264)

See accompanying notes to the separate financial statements.

1. Reporting entity

Niagara-on-the-Lake Hydro Inc. is a rate regulated, municipality owned hydro distribution company incorporated under the laws of Ontario, Canada. The Corporation is located in the Town of Niagara-on-the-Lake. The address of the Corporation's registered office is 8 Henegan Road, Virgil, Ontario, L0S 1T0.

The Corporation delivers electricity and related energy services to residential and commercial customers in the Town of Niagara-on-the-Lake. The Corporation is wholly owned by Niagara-on-the-Lake Energy Inc. and the ultimate parent company is the Town of Niagara-on-the-Lake ("Town").

The financial statements are for the Corporation as at and for the year ended December 31, 2016.

2. Basis of presentation

(a) Statement of compliance

The Corporation's separate financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The separate financial statements are prepared by the Corporation for the Ontario Energy Board ("OEB") and for banking and income tax purposes. The separate financial statements are intended solely for the use of the Corporation, the OEB, Infrastructure Ontario, CIBC and for the federal and provincial income tax authorities and should not be used by parties other than the Corporation, the OEB, Infrastructure Ontario, CIBC and the federal and provincial income tax authorities.

The separate financial statements were approved by the Board of Directors on April 27, 2017.

(b) Basis of measurement

These separate financial statements have been prepared on the historical cost basis, unless otherwise stated.

(c) Functional and presentation currency

These separate financial statements are presented in Canadian dollars, which is the Corporation's functional currency.

(d) Rate regulation

The Corporation is regulated by the Ontario Energy Board ("OEB"), under the authority granted by the *Ontario Energy Board Act, 1998*. Among other things, the OEB has the power and responsibility to approve or set rates for the transmission and distribution of electricity, providing continued rate protection for electricity consumers in Ontario, and ensuring that transmission and distribution companies fulfill obligations to connect and service customers. The OEB may also prescribe license requirements and conditions of service to local distribution companies ("LDCs"), such as the Corporation, which may include, among other things, record keeping, regulatory accounting principles, separation of accounts for distinct businesses, and filing and process requirements for rate setting purposes.

The Corporation is required to bill customers for the debt retirement charge set by the province for certain customer classes. The Corporation may file to recover uncollected debt retirement charges from Ontario Electricity Financial Corporation ("OEFC") once each year.

2. Basis of presentation (continued)

(d) Rate regulation (continued)

Rate setting

(i) Distribution revenue

For the distribution revenue included in sale of electricity, the Corporation files a “Cost of Service” (“COS”) rate application with the OEB every five years where rates are determined through a review of the forecasted annual amount of operating and capital expenditures, debt and shareholder’s equity required to support the Corporation’s business. The Corporation estimates electricity usage and the costs to service each customer class to determine the appropriate rates to be charged to each customer class. The COS application is reviewed by the OEB and interveners, and rates are approved based upon this review, including any revisions resulting from that review.

In the intervening years an Incentive Rate Mechanism application (“IRM”) is filed. An IRM application results in a formulaic adjustment to distribution rates that were set under the last COS application. The previous year’s rates are adjusted for the annual change in the Gross Domestic Product Implicit Price Inflator for Final Domestic Demand (“GDP IPI-FDD”) net of a productivity factor and a “stretch factor” determined by the relative efficiency of an electricity distributor.

As a licensed distributor, the Corporation is responsible for billing customers for electricity generated by third parties and the related costs of providing electricity service, such as transmission services and other services provided by third parties. The Corporation is required, pursuant to regulation, to remit such amounts to these third parties, irrespective of whether the Corporation ultimately collects these amounts from customers.

The Corporation last filed a COS application on September 30, 2013 for rates effective May 1, 2014 to April 30, 2015. An IRM Application has been filed in each subsequent year.

On September 25, 2015, the Corporation submitted an IRM Application to the OEB requesting approval to change distribution rates effective May 1, 2016. The IRM Application, which provided a mechanistic and formulaic adjustment to distribution rates and charges, was approved by the OEB on March 17, 2016. The GDP IPI-FDD for 2016 is 2.1%, the Corporation’s stretch factor is 0.30% and the productivity factor determined by the OEB is 0%, resulting in a net adjustment of 1.80% to the previous year’s rates.

The OEB issued a new distribution rate design for residential electricity customers which will be phased in over a four year period commencing January 2016. Under this new policy, electricity distributors will structure residential rates so that all the distribution charges will be collected through a fully fixed monthly charge instead of the current fixed and variable rate charge.

2. Basis of presentation (continued)

(d) Rate regulation (continued)

(ii) Electricity rates- Commodity

The OEB sets electricity prices for certain low-volume consumers twice each year based on an estimate of how much it will cost to supply the province with electricity for the next year. All remaining consumers pay the market price for electricity or pursuant to their contract with a retailer. The Corporation is billed for the cost of the electricity that its customers use by the Independent Electricity System Operator and passes this cost on to the customer at cost without a mark-up.

(e) Use of estimates and judgments

(i) Assumptions and estimation uncertainty

The preparation of separate 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, income and expenses and disclosure of contingent assets and liabilities. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in material adjustment is included in the following notes:

(i) Note 3(b) – measurement of unbilled revenue
(ii) Notes 8 – estimation of useful lives of its property, plant and equipment
(iii) Note 10 – recognition and measurement of regulatory balances
(iv) Note 13 – measurement of defined benefit obligations: key actuarial assumptions
(v) Note 18 – recognition and measurement of provisions and contingencies

(ii) Judgments

Information about judgments made in applying accounting policies that have the most significant effects on the amounts recognized in the separate financial statements is included in the following notes:

(i) Note 20 – leases: classification as financing versus operating

3. Significant accounting policies

The accounting policies set out below have been applied consistently in all years presented in these separate financial statements.

(a) Financial instruments

All financial assets are classified as loans and receivables and all financial liabilities are classified as other liabilities with the exception of derivatives which are classified as financial liabilities at fair value through profit or loss. Loans, receivables and other liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequently, they are measured at amortized cost using the effective interest method less any impairment for the financial assets as described in note 3(e).

Hedge accounting has not been used in the preparation of these separate financial statements.

(b) Revenue recognition

Sale and distribution of electricity

Revenue from the sale and distribution of electricity is recognized as the electricity is delivered to customers on the basis of cyclical meter readings and estimated customer usage since the last meter reading date to the end of the year. Revenue includes the cost of electricity supplied, distribution, and any other regulatory charges. The related cost of power is recorded on the basis of power used.

For customer billings related to electricity generated by third parties and the related costs of providing electricity service, such as transmission services and other services provided by third parties, the Corporation has determined that it is acting as a principal for these electricity charges and, therefore, has presented electricity revenue on a gross basis.

Customer billings for debt retirement charges are recorded on a net basis as the Corporation is acting as an agent for this billing stream.

Other revenue

Revenue earned from the provision of services is recognized as the service is rendered. Amounts received in advance are presented as deferred revenue.

Certain customers and developers are required to contribute towards the capital cost of construction of distribution assets in order to provide ongoing service. Cash contributions are recorded as deferred revenue. When an asset other than cash is received as a capital contribution, the asset is initially recognized at its fair value, with a corresponding amount recognized as deferred revenue. The deferred revenue, which represents the Corporation's obligation to continue to provide the customers access to the supply of electricity, is amortized to income on a straight-line basis over the useful life of the related asset.

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

3. Significant accounting policies (continued)

(c) Materials and supplies

Materials and supplies, the majority of which is consumed by the Corporation in the provision of its services, is valued at the lower of cost and net realizable value, with cost being determined on a weighted average basis, and includes expenditures incurred in acquiring the materials and supplies and other costs incurred in bringing them to their existing location and condition.

(d) Property, plant and equipment

Items of property, plant and equipment ("PP&E") used in rate-regulated activities and acquired prior to January 1, 2014 are measured at deemed cost established on the transition date, less accumulated depreciation. All other items of PP&E are measured at cost, or, where the item is contributed by customers, its fair value, less accumulated depreciation.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes contracted services, materials and transportation costs, direct labour, overhead costs, borrowing costs and any other costs directly attributable to bringing the asset to a working condition for its intended use.

Borrowing costs on qualifying assets are capitalized as part of the cost of the asset based upon the weighted average cost of debt incurred on the Corporation's borrowings. Qualifying assets are considered to be those that take in excess of 12 months to construct.

When parts of an item of PP&E have different useful lives, they are accounted for as separate items (major components) of PP&E.

When items of PP&E are retired or otherwise disposed of, a gain or loss on disposal is determined by comparing the proceeds from disposal, if any, with the carrying amount of the item and is included in profit or loss.

Major spare parts and standby equipment are recognized as items of PP&E.

The cost of replacing a part of an item of PP&E is recognized in the net book value of the item if it is probable that the future economic benefits embodied within the part will flow to the Corporation and its cost can be measured reliably. In this event, the replaced part of PP&E is written off, and the related gain or loss is included in profit or loss. The costs of the day-to-day servicing of PP&E are recognized in profit or loss as incurred.

The need to estimate the decommissioning costs at the end of the useful lives of certain assets is reviewed periodically. The Corporation has concluded it does not have any legal or constructive obligation to remove PP&E.

Depreciation is calculated to write off the cost of items of PP&E using the straight-line method over their estimated useful lives, and is generally recognized in profit or loss. Depreciation methods, useful lives, and residual values are reviewed at each reporting date and adjusted prospectively if appropriate. Land is not depreciated. Construction-in-progress assets are not depreciated until the project is complete and the asset is available for use.

3. Significant accounting policies (continued)

(d) Property, plant and equipment (continued)

The estimated useful lives are as follows:

Asset	Years
Buildings	30 - 60
Transformer stations	45 - 55
Distribution lines – overhead	45 - 60
Distribution lines – underground	45 - 60
Distribution – transformers	45
Distribution – meters	15 - 40
Equipment, trucks and other	3 - 15

(e) Impairment

(i) Financial assets measured at amortized cost

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss is calculated as the difference between an asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Interest on the impaired assets continues to be recognized through the unwinding of the discount. Losses are recognized in profit or loss. An impairment loss is reversed through profit or loss if the reversal can be related objectively to an event occurring after the impairment loss was recognized.

(ii) Non-financial assets

The carrying amounts of the Corporation's non-financial assets, other than materials and supplies and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

3. Significant accounting policies (continued)

(e) Impairment (continued)

(ii) Non-financial assets (continued)

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss.

For other assets, an impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(f) Customer deposits

Customer deposits represent cash deposits from electricity distribution customers and retailers to guarantee the payment of energy bills. Interest is paid on customer deposits.

Deposits are refundable to customers who demonstrate an acceptable level of credit risk as determined by the Corporation in accordance with policies set out by the OEB or upon termination of their electricity distribution service.

(g) Provisions

A provision is recognized if, as a result of a past event, the Corporation has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

(h) Regulatory balances

Regulatory deferral account debit balances represent costs incurred in excess of amounts billed to the customer. Regulatory deferral account credit balances represent amounts billed to the customer in excess of costs incurred by the Corporation.

Regulatory deferral account debit balances are recognized if it is probable that future billings in an amount at least equal to the deferred cost will result from inclusion of that cost in allowable costs for rate-making purposes. The offsetting amount is recognized in net movement in regulatory balances in profit or loss or Other Comprehensive Income (“OCI”). When the customer is billed at rates approved by the OEB for the recovery of the deferred costs, the customer billings are recognized in revenue. The regulatory debit balance is reduced by the amount of these customer billings with the offset to net movement in regulatory balances in profit or loss or OCI.

The probability of recovery of the regulatory deferral account debit balances is assessed annually based upon the likelihood that the OEB will approve rates to recover the balance. The assessment of likelihood of recovery is based upon previous decisions made by the OEB for similar circumstances, policies or guidelines issued by the OEB, etc. Any resulting impairment loss is recognized as a loss in the year incurred.

3. Significant accounting policies (continued)

(h) Regulatory balances (continued)

When the Corporation is required to refund amounts to ratepayers in the future, the Corporation recognizes a regulatory deferral account credit balance. The offsetting amount is recognized in net movement in regulatory balances in profit or loss or OCI. The amounts returned to the customers are recognized as a reduction of revenue. The credit balance is reduced by the amount of these customer repayments with the offset to net movement in regulatory balances in profit or loss or OCI.

(i) Post-employment benefits

(i) Pension plan

The Corporation provides a pension plan for all its full-time employees through Ontario Municipal Employees Retirement System (“OMERS”). OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund (“the Fund”), and provides pensions for employees of Ontario municipalities, local boards and public utilities. The Fund is a contributory defined benefit pension plan, which is financed by equal contributions from participating employers and employees, and by the investment earnings of the Fund. To the extent that the Fund finds itself in an under-funded position, additional contribution rates may be assessed to participating employers and members.

OMERS is a defined benefit plan. However, as OMERS does not segregate its pension asset and liability information by individual employers, there is insufficient information available to enable the Corporation to directly account for the plan. Consequently, the plan has been accounted for as a defined contribution plan. The Corporation is not responsible for any other contractual obligations other than the contributions. Obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in profit or loss when they are due.

(ii) Post-employment benefits, other than pension

The Corporation provides some of its retired employees with life insurance and medical benefits beyond those provided by government sponsored plans.

The obligations for these post-employment benefit plans are actuarially determined by applying the projected unit credit method and reflect management’s best estimate of certain underlying assumptions. Re-measurements of the net defined benefit obligations, including actuarial gains and losses and the return on plan assets (excluding interest), are recognized immediately in other comprehensive income. When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognized immediately in profit or loss.

3. Significant accounting policies (continued)

(j) Leased assets

Leases, where the terms cause the Corporation to assume substantially all the risks and rewards of ownership, are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

All other leases are classified as operating leases and the leased assets are not recognized on the Corporation's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

(k) Finance income and finance costs

Finance income is recognized as it accrues in profit or loss, using the effective interest method. Finance income comprises interest earned on cash balances.

Finance costs comprise interest expense on borrowings. Finance costs are recognized in profit or loss.

(l) Income taxes

The income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case, it is recognized in equity.

The Corporation is currently exempt from taxes under the Income Tax Act (Canada) and the Ontario Corporations Tax Act (collectively the "Tax Acts"). Under the *Electricity Act*, 1998, the Corporation makes payments in lieu of corporate taxes to the Ontario Electricity Financial Corporation ("OEFC"). These payments are calculated in accordance with the rules for computing taxable income and taxable capital and other relevant amounts contained in the Tax Acts as modified by the *Electricity Act*, 1998, and related regulations. Prior to October 1, 2001, the Corporation was not subject to income or capital taxes. Payments in lieu of taxes are referred to as income taxes.

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. Deferred tax assets are recognized for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted, at the reporting date.

4. Standards issued but not yet adopted

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

Revenue Recognition

The IASB has issued IFRS 15, Revenue from Contracts with Customers ("IFRS 15"). IFRS 15 replaces IAS 11 Construction Contracts, IAS 18 Revenue and various interpretations and establishes principles regarding the nature, amount, timing and uncertainty of revenue arising from contracts with customers. The standard requires entities to recognize revenue for the transfer of goods or services to customers measured at the amounts an entity expects to be entitled to in exchange for those goods or services. IFRS 15 is effective for annual periods beginning on or after January 1, 2018. The Corporation is assessing the impact of IFRS 15 on its results of operations, financial position and disclosures.

Financial Instruments

In July 2014, the IASB issued a new standard, IFRS 9 Financial Instruments, which will replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 is effective for annual periods beginning on or after January 1, 2018 and must be applied retrospectively. The Corporation is assessing the impact of IFRS 9 on its results of operations, financial position, and disclosures.

Leases

In January 2016, IASB issued IFRS 16 to establish principles for the recognition, measurement, presentation, and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that faithfully represents those transactions. IFRS 16 replaces IAS 17 and it is effective for annual periods beginning on or after January 1, 2019. The Corporation is assessing the impact of IFRS 16 on its results of operations, financial positions, and disclosures.

5. Bank indebtedness

	2016	2015
Cash balances	$ 237,140	$ 246,127
Bank overdrafts used for cash management purposes	(661,483)	(414,391)
	$ (424,343)	$ (168,264)

6. Accounts receivable

	2016	2015
Customer trade receivables	$ 2,949,675	$ 3,113,948
Less: Allowance for doubtful accounts	95,071	37,071
	$ 2,854,604	$ 3,076,877

7. Materials and supplies

No amounts were written down due to obsolescence in 2016 or 2015.

8. Property, plant and equipment

	January 1, 2016	Additions/ Depreciation	Transfers	Disposals/ Retirements	December 31, 2016
Cost					
Land	$ 307,134	$ -	$ -	$ -	$ 307.134
Buildings	666,750	81,142	-	-	747,892
Transformer stations	6,773,352	58,011	-	-	6,831,363
Distribution lines - overhead	5,738,710	620,430	-	(109,628)	6,249,512
Distribution lines – underground	8,203,882	1,015,766	-	-	9,219,648
Distribution - transformers	2,755,617	771,374	(103,507)	(4,127)	3,419,357
Distribution - meters	1,651,197	132,325	-	(6,085)	1,777,437
Equipment and trucks	1,537,599	178,313	-	-	1,715,912
Work in progress	1,233,208	2,098,586	(2,556,596)	-	775,198
	28,867,449	4,955,947	(2,660,103)	(119,840)	31,043,453
Accumulated Depreciation					
Buildings	34,949	18,319	-	-	53,268
Transformer stations	179,941	152,810	-	-	332,751
Distribution lines - overhead	44,226	169,734	-	(105,270)	108,690
Distribution lines - underground	401,724	229,980	-	-	631,704
Distribution - transformers	88,457	97,795	(69,696)	(3,717)	112,839
Distribution - meters	258,177	136,024	-	(2,263)	391,938
Equipment and trucks	616,668	290,810	-	-	907,478
Work in progress	-	-	-	-	-
	1,624,142	1,095,472	(69,696)	(111,250)	2,538,668
Carrying amount	$ 27,243,307	$ 3,860,475	$ (2,590,407)	$ (8,590)	$ 28,504,785

As at December 31, 2016, the property, plant and equipment are subject to a general security agreement as described in note 12.

During the year borrowing costs of $nil (2015 - $13,000) were capitalized as part of the cost of property, plant and equipment. A capitalization rate of nil% (2015 – 2.89%) was used to determine the amount of borrowing costs to be capitalized.

8. Property, plant and equipment (continued)

	January 1, 2015	Additions/ Depreciation	Transfers	Disposals/ Retirements	December 31, 2015
Cost					
Land	$ 307,134	$ -	$ -	$ -	$ 307,134
Buildings	659,742	7,008	-	-	666,750
Transformer stations	4,223,598	2,549,754	-	-	6,773,352
Distribution lines - overhead	5,602,854	343,131	-	207,275	5,738,710
Distribution lines - underground	7,374,421	829,461	-	-	8,203,882
Distribution - transformers	2,532,426	301,873	(73,191)	5,491	2,755,617
Distribution - meters	1,600,156	51,041	-	-	1,651,197
Equipment and trucks	1,391,519	180,679	-	34,599	1,537,599
Work in progress	1,352,830	4,339,783	(4,459,405)	-	1,233,208
	25,044,680	8,602,730	(4,532,596)	247,365	28,867,449
Accumulated Depreciation					
Buildings	17,413	17,536	-	-	34,949
Transformer stations	99,040	125,558	(39,906)	4,751	179,941
Distribution lines - overhead	75,332	163,951	-	195,057	44,226
Distribution lines - underground	191,400	210,324	-	-	401,724
Distribution - transformers	1,404	87,053	-	-	88,457
Distribution - meters	127,397	130,780	-	-	258,177
Equipment and trucks	324,606	326,661	-	34,599	616,668
Work in progress	-	-	-	-	-
	836,592	1,061,863	(39,906)	234,407	1,624,142
Carrying amount	$ 24,208,088	$ 7,540,867	$ (4,492,690)	$ 12,958	$ 27,243,307

9. Income tax expense (recovery)

Current tax expense (recovery)

	2016	2015
Current period	$ 164,216	$ (340,559)
	$ 164,216	$ (340,559)

Deferred tax expense (recovery)

	2016	2015
Origination and reversal of temporary differences	$ 164,480	$ 796,484
	$ 164,480	$ 796,484

Reconciliation of effective tax rate

	2016	2015
Income before taxes	$ 1,068,013	$ 432,264
Canada and Ontario statutory Income tax rates	26.5%	26.5%
Expected tax provision on income at statutory rates	283,023	114,550
Increase (decrease) in income taxes resulting from:		
Under (over) provided in prior periods	(23,295)	32,391
Regulatory adjustments	74,224	308,984
Other	(5,256)	-
Income tax expense (recovery)	$ 328,696	$ 455,925

Significant components of the Corporation’s deferred tax balances

	2016	2015
Deferred tax assets (liabilities):		
Regulatory balances	$ (774,851)	$ (604,548)
Property, plant and equipment	593,479	582,910
Post-employment benefits	94,727	85,874
Cumulative eligible capital	2,094	2,251
Other	9,603	23,045
	$ (74,948)	$ 89,532

10. Regulatory balances

Reconciliation of the carrying amount for each class of regulatory balances

Regulatory deferral account debit balances	January 1, 2016	Additions	Recovery/ reversal	December 31, 2016	Remaining recovery/ reversal years
Group 1 deferred accounts	$ 1,685,361	$ 477,020	$ (1,130,613)	$ 1,031,768	1
Other regulatory accounts	250,398	304,996	370,932	926,326	1-3
Income tax	-	-	-	-	-
	$ 1,935,759	$ 782,016	$ (759,681)	$ 1,958,094	

Regulatory deferral account debit balances	January 1, 2015	Additions	Recovery/ reversal	December 31, 2015	Remaining years
Group 1 deferred accounts	$ 678,830	$ 529,852	$ 476,679	$ 1,685,361	1
Other regulatory accounts	207,596	(282,972)	325,774	250,398	1-4
Income tax	410,154	-	(410,154)	-	-
	$ 1,296,580	$ 246,880	$ 392,299	$ 1,935,759	

Regulatory deferral account credit balances	January 1, 2016	Additions	Recovery/ reversal	December 31, 2016	Remaining years
Group 1 deferred accounts	$ (1,184,736)	$ (728,127)	$ 781,591	$ (1,131,272)	1
Other regulatory accounts	(981,614)	226,199	(21,908)	(777,323)	1-3
Income tax	(585,160)	(10,413)	-	(595,573)	-
	$ (2,751,510)	$ (512,341)	$ 759,683	$ (2,504,168)	

Regulatory deferral account credit balances	January 1, 2015	Additions	Recovery/ reversal	December 31, 2015	Remaining years
Group 1 deferred accounts	$ (807,731)	$ (408,503)	$ 31,498	$ (1,184,736)	1
Other regulatory accounts	(1,170,180)	(240,666)	429,232	(981,614)	1-4
Income tax	(417,870)	(167,290)	-	(585,160)	-
	$ (2,395,781)	$ (816,459)	$ 460,730	$ (2,751,510)	

The regulatory balances are recovered or settled through rates approved by the OEB which are determined using historical data. Future consumption is impacted by various factors including the economy and weather. The Corporation has received approval from the OEB to establish its regulatory balances.

10. Regulatory balances (continued)

Settlement of the Group 1 deferral accounts is done through an application to the OEB. The OEB authorized the Corporation to dispose of a debit balance of $364,613 as of December 31, 2014 through rate riders that take effect May 1, 2016 to April 30, 2017. The OEB requires the Corporation to estimate its income taxes when it files a COS application to set its rates. As a result, the Corporation has recognized a regulatory deferral account for the amount of deferred taxes that will ultimately be recovered from/paid back to its customers. This balance will fluctuate as the Corporation's deferred tax balance fluctuates.

Regulatory balances attract interest at OEB prescribed rates, which are based on Bankers' Acceptances three-month rate plus a spread of 25 basis points. In 2016 the average rate was 1.19%.

11. Accounts payable and accrued liabilities

	2016	2015
Accounts payable – energy purchases	$ 2,064,815	$ 1,492,394
Trade payables	1,873,967	2,884,721
Debt retirement charge payable to OEFC	76,667	116,059
Payroll payable	33,851	10,121
	$ 4,049,300	$ 4,503,295

12. Long-term debt

	2016	2015
Notes payable	$ 7,056,709	$ 7,788,942
Demand loans	2,238,026	1,663,603
Ontario Infrastructure debenture	916,667	1,016,667
	10,211,402	10,469,212
Current portion	2,338,027	1,763,603
Long-term portion	$ 7,873,375	$ 8,705,609

12. Long-term debt (continued)

The notes payable consist of three notes payable. The first note bears interest at 7.25%. The outstanding principal is $2,745,196 as of December 31, 2016. This note is unsecured with no fixed terms of repayment. The second note bears interest at 3% and is due on February 1, 2025. The outstanding balance is $2,514,985 at December 31, 2016. The third note bears interest at 3% and is due October 1, 2025. The outstanding balance is $1,796,528 at December 31, 2016. The second and third loans are due on demand to the Town. The Town has waived its right to demand payment until January 1, 2018. These loans are postponed in favour of the demand instalment loan described below.

The Corporation has two demand instalment loans bearing interest at prime plus 0.75%. The loans are secured by a general security agreement over the assets of the Corporation and are repayable in monthly principal and interest instalments of $28,889. The loans are guaranteed by the parent, Niagara-on-the-Lake Energy Inc. and a related company, Energy Services Niagara Inc.

The Corporation has a third demand instalment loan which bears interest at the underlying market rate for banker's acceptance notes. The loan is secured by a general security agreement over the assets of the Corporation and is repayable in equal monthly principal and interest instalments beginning January, 2019. Until such time repayment is not required. The loan is guaranteed by the parent, Niagara-on-the-Lake Energy Inc. and a related company, Energy Services Niagara Inc.

The Corporation has entered into interest rate swap agreements to fix the interest rates on two demand instalment loans at 6.03% and 5.38% with maturity dates of August 2018 and October 2020.

The Corporation obtained an Ontario Infrastructure Projects Corporation ("OIPC") Fixed Term Debenture of $1,500,000 on February 15, 2011 due February 16, 2026. The debenture bears interest at a rate of 4.27%. The loan is payable in the amount of $8,333 monthly principal plus interest. The loan is secured by a general security agreement over the assets of the Corporation.

The Corporation has available a $3,000,000 revolving demand facility, which when drawn bears interest at prime plus 0.15%. As of December 31, 2016 the amount drawn is $nil (2015 - $nil).

13. Post-employment benefits

(a) OMERS pension plan

The Corporation provides a pension plan for its employees through OMERS. The plan is a multi-employer, contributory defined benefit pension plan with equal contributions by the employer and its employees. In 2016, the Corporation made employer contributions of $147,576 to OMERS (2015 - $137,003), of which $52,079 (2015 - $38,157) has been capitalized as part of PP&E and the remaining amount of $95,497 (2015 - $98,846) has been recognized in profit or loss. The Corporation estimates that a contribution of $135,500 to OMERS will be made during the next fiscal year.

13. Post-employment benefits (continued)

(a) OMERS pension plan (continued)

As at December 31, 2016, OMERS had approximately 470,000 members, of whom 16 are current employees of the Corporation. The most recently available OMERS annual report is for the year ended December 31, 2016, which reported that the plan was 93.4% funded, with an unfunded liability of $5.7 billion. This unfunded liability is likely to result in future payments by participating employers and members.

(b) Post-employment benefits other than pension

The Corporation pays certain medical and life insurance benefits on behalf of some of its retired employees. The Corporation recognizes these post-employment benefits in the year in which employees' services were rendered. The Corporation is recovering its post-employment benefits in rates based on the expense and re-measurements recognized for post-employment benefit plans.

Reconciliation of the obligation	2016	2015
Defined benefit obligation, beginning of year	$ 324,051	$ 319,731
Included in profit or loss		
Current service cost	22,407	21,524
Interest cost	12,690	12,500
	359,148	353,755
Benefits paid	(29,084)	(29,704)
Defined benefit obligation, end of year	$ 330,064	$ 324,051

Actuarial assumptions	2016	2015
General inflation	2.00%	2.00%
Discount (interest) rate	4.10%	4.10%
Salary levels	3.30%	3.30%
Medical costs	6.50%	6.50%
Dental costs	4.50%	4.50%

A 1% increase in the assumed discount rate would result in the defined benefit obligation decreasing by approximately $44,000. A 1% decrease in the assumed discount rate would result in the defined benefits obligation increasing by approximately $54,000.

14. Share capital

	2016	2015
Authorized:		
Unlimited number of common shares		
Issued:		
1,001 common shares	$ 2,632,307	$ 2,632,307

Dividends

The holders of the common shares are entitled to receive dividends as declared by the Corporation.

The Corporation paid dividends in the year on common shares of $500 per share (2015 - $500) which amount to total dividends paid in the year of $500,000 (2015 - $500,000).

15. Other revenue

	2016	2015
Pole rental	$ 74,062	$ 72,017
Late payment charges	64,838	60,802
Amortization of deferred revenue	44,491	20,540
Change of occupancy	31,650	34,230
Other	188,030	152,229
	$ 403,071	$ 339,818

16. Operating expenses

	2016	2015
Salaries and benefits	$ 1,078,038	$ 1,135,841
Depreciation and amortization	996,009	968,322
Contracted Services/Labour	813,903	671,302
Vehicle maintenance	65,894	50,473
Other	683,185	541,770
	$ 3,637,029	$ 3,367,708

17. Finance income and costs

		2016		2015
Finance income				
Interest income on bank deposits	$	56,869	$	25,182
Finance costs				
Interest expense on long-term debt		482,933		454,394
Less capitalized borrowing costs		-		(13,008)
		482,933		441,386
Net finance costs recognized in profit or loss	$	(426,064)	$	(416,204)

18. Commitments and contingencies

General

From time to time, the Corporation is involved in various litigation matters arising in the ordinary course of its business. The Corporation has no reason to believe that the disposition of any such current matter could reasonably be expected to have a materially adverse impact on the Corporation's financial position, results of operations or its ability to carry on any of its business activities.

General Liability Insurance

The Corporation is a member of the Municipal Electric Association Reciprocal Insurance Exchange (MEARIE). MEARIE is a pooling of public liability insurance risks of many of the LDCs in Ontario. All members of the pool are subjected to assessment for losses experienced by the pool for the years in which they were members, on a pro-rata basis based on the total of their respective service revenues. As at December 31, 2016, no assessments have been made.

19. Amortization

		2016		2015
Amortization				
Amortization of capital assets charged to operations	$	996,009	$	968,322
Amortization of capital assets charged to capital assets through overhead capitalization		99,463		93,541
	$	1,095,472	$	1,061,863

20. Operating Leases

The Corporation is committed to lease agreements for various vehicles and equipment.

The future minimum non-cancellable annual lease payments are as follows:

	2016	2015
Less than one year	$ 5,112	$ 5,212
Between one and five years	16,919	14,233
	$ 22,031	$ 19,445

During the year ended December 31, 2016 an expense of $3,528 (2015 - $16,511) was recognized in net income in respect of operating leases.

21. Related party transactions

(a) Parent and ultimate controlling party

The sole shareholder of the Corporation is Niagara-on-the-Lake Energy Inc., which in turn is wholly-owned by the Town of Niagara-on-the-Lake (the "Town'). The Town produces consolidated financial statements that are available for public use.

(b) Outstanding balances due from (to) related parties:

	2016	2015
Energy Niagara Services Inc.	$ (9,169)	$ 469,609
Niagara-on-the-Lake Energy Inc.	18,923	15,323
Town of Niagara-on-the-Lake	(368,586)	(629,560)
	$ (358,832)	$ (144,628)

Amounts are non-interest bearing with no fixed terms of repayment.

(c) Transactions with companies under common control

The Corporation received $146,546 (2015 - $154,530) for operations, billing and administrative services from a company under common control.

21. Related party transactions (continued)

(d) Transactions with ultimate parent (the Town)

The Corporation had the following significant transactions with its ultimate parent, a government entity:

The Corporation delivers electricity to the Town throughout the year for the electricity needs of the Town and its related organizations. Electricity delivery charges are at prices and under terms approved by the OEB. The Corporation also provides water and waste water billing services to the Town for a fee for service.

(e) Key management personnel

The key management personnel of the Corporation have been defined as members of and the Board of Directors and executive managerial team members:

The compensation paid or payable is as follows:

	2016	2015
Salaries and benefits	$ 377,817	$ 349,957
OMERS contributions	44,143	40,313
Directors' fees	22,240	27,474
	$ 444,200	$ 417,744

22. Financial instruments and risk management

Fair value disclosure

The carrying values of cash balances, accounts receivable, unbilled revenue, due from/to related parties, bank indebtedness, line of credit and accounts payable and accrued liabilities approximate fair value because of the short maturity of these instruments. The carrying value of the customer deposits approximates fair value because the amounts are payable on demand.

The fair value of the long-term debt at December 31, 2016 is $9,945,000. The fair value is calculated based on the present value of future principal and interest cash flows, discounted at the current rate of interest at the reporting date. The interest rate used to calculate fair value at December 31, 2016 ranged from 2.41% to 2.72% based upon the outstanding term of the loan.

22. Financial instruments and risk management (continued)

Financial risks

The Corporation understands the risks inherent in its business and defines them broadly as anything that could impact its ability to achieve its strategic objectives. The Corporation's exposure to a variety of risks such as credit risk, interest rate risk, and liquidity risk, as well as related mitigation strategies are discussed below.

(a) Credit risk

Financial assets carry credit risk that a counterparty will fail to discharge an obligation which could result in a financial loss. Financial assets held by the Corporation, such as accounts receivable, expose it to credit risk. The Corporation earns its revenue from a broad base of customers located in the Town. No single customer accounts for a balance in excess of 7% of total accounts receivable.

The carrying amount of accounts receivable is reduced through the use of an allowance for impairment and the amount of the related impairment loss is recognized in profit or loss. Subsequent recoveries of receivables previously provisioned are credited to profit or loss. The balance of the allowance for impairment at December 31, 2016 is $95,071 (2015 - $37,071). An impairment loss of $6,754 (2015 - $50,647) was recognized during the year.

The Corporation's credit risk associated with accounts receivable is primarily related to payments from distribution customers. At December 31, 2016, $116,183 (2015 - $57,803) is considered 60 days past due. The Corporation has approximately 9 thousand customers, the majority of whom are residential. Credit risk is managed through collection of security deposits from customers in accordance with directions provided by the OEB. As at December 31, 2016, the Corporation holds security deposits in the amount of $236,840 (2015 - $245,827).

(b) Market risk

Market risks primarily refer to the risk of loss resulting from changes in commodity prices, foreign exchange rates, and interest rates. The Corporation currently does not have any material commodity or foreign exchange risk. The Corporation is exposed to fluctuations in interest rates as the regulated rate of return for the Corporation's distribution business is derived using a complex formulaic approach which is in part based on the forecast for long-term Government of Canada bond yields. This rate of return is approved by the OEB as part of the approval of distribution rates. The Corporation's demand loans have a variable interest rate based on prime plus a margin. As a result, the Corporation is exposed to interest rate risk due to fluctuations in the prime rate.

22. Financial instruments and risk management (continued)

(c) Liquidity risk

The Corporation monitors its liquidity risk to ensure access to sufficient funds to meet operational and investing requirements. The Corporation's objective is to ensure that sufficient liquidity is on hand to meet obligations as they fall due while minimizing interest exposure. The Corporation has access to a $3,000,000 credit facility and monitors cash balances daily to ensure that a sufficient level of liquidity is on hand to meet financial commitments as they become due. As at December 31, 2016, $1,000,000 (2015 – $nil) had been drawn under the Corporation's credit facility.

The Corporation also has a bilateral facility for $1,400,000 (the "LC" facility) for the purpose of issuing letters of credit mainly to support the prudential requirements of the IESO, of which $1,349,198 million has been drawn and posted with the IESO (2015 - $1,349,198).

The majority of accounts payable, as reported on the statement of financial position, are due within 30 days.

(d) Capital disclosures

The main objectives of the Corporation, when managing capital, are to ensure ongoing access to funding to maintain and improve the electricity distribution system, compliance with covenants related to its credit facilities, prudent management of its capital structure with regard for recoveries of financing charges permitted by the OEB on its regulated electricity distribution business, and to deliver the appropriate financial returns.

The Corporation's definition of capital includes shareholder's equity and long-term debt. As at December 31, 2016, shareholder's equity amounts to $15,796,135 (2015 - $15,287,141) and long-term debt amounts to $7,873,375 (2015 - $8,705,609).

23. Comparative information

Certain comparative information has been reclassified to conform with the financial statement presentation adopted in the current year.