Financial Statements of

FESTIVAL HYDRO INC.

Year ended December 31, 2014

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INDEPENDENT AUDITORS' REPORT

To the Shareholder of Festival Hydro Inc.

We have audited the accompanying financial statements of Festival Hydro Inc., which comprise the balance sheet as at December 31, 2014, the statements of earnings and retained earnings 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 Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the 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 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 controls. 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 financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Festival Hydro Inc. as at December 31, 2014, and its results of operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

May 28, 2015

London, Canada

FESTIVAL HYDRO INC.
Balance Sheet

December 31, 2014, with comparative information for 2013

		2014		2013
Assets				
Current assets:				
Accounts receivable (note 7)	$	3,361,960	$	3,035,458
Inventory (note 6)		102,865		156,243
Prepaid expenses and deposits		518,667		306,032
Payments in lieu of income taxes recoverable		77,047		200,910
Unbilled revenue		8,872,992		8,679,665
Due from Festival Hydro Services Inc. (note 17)		1,360,918		1,109,088
		14,294,449		13,487,396
Regulatory asset, net (note 8)		12,018,943		11,841,146
Plant and equipment (note 4)		36,614,127		36,785,468
Future payments in lieu of income taxes (note 12)		2,659,199		2,109,748
Unrealized gain on interest rate swap (note 20)		-		711,813
Intangibles assets (note 5)		1,863,117		1,691,748
Goodwill		515,359		515,359
	$	67,965,194	$	67,142,678
Liabilities and Shareholder's Equity				
Current liabilities:				
Bank indebtedness	$	2,670,294	$	1,339,170
Accounts payable and accrued liabilities		9,306,550		8,819,992
Accrued vacation, wages and benefits		381,766		356,094
Demand notes payable (note 9)		15,600,000		15,600,000
Current portion of long-term debt (note 19)		546,251		528,469
Current portion of customer deposits		250,262		259,019
Due to the Corporation of the City of Stratford		713,740		714,403
		29,468,863		27,617,147
Unrealized loss on interest rate swap (note 20)		536,877		-
Post-employment benefits (note 10)		1,401,958		1,397,008
Customer deposits, long-term		527,365		525,293
Long-term debt (note 19)		14,780,081		15,320,842
Shareholder's equity:				
Share capital (note 11)		15,568,388		15,568,388
Retained earnings		5,681,662		6,714,000
		21,250,050		22,282,388
Contingencies (note 18)				
Subsequent event (note 22)				
	$	67,965,194	$	67,142,678

See accompanying notes to financial statements.

On behalf of the Board:

W J Malcolm Director

David B McCann Director

FESTIVAL HYDRO INC.

Statement of Earnings and Retained Earnings

Year ended December 31, 2014, with comparative information for 2013

	2014	2013
Revenue:		
Distribution revenue	$ 10,930,038	$ 11,020,318
Unrealized gain on interest rate swap	-	711,813
Solar generation income	35,293	32,989
Late payment and other customer charges	211,594	183,896
Rentals and interest income	433,229	235,499
Other income	262,795	297,956
	11,872,949	12,482,471
Expenses:		
Operating and maintenance	2,006,036	1,881,778
Billing, data processing and collection	1,219,893	1,210,566
Administrative	1,896,556	1,741,817
Amortization of plant and equipment	1,912,497	2,129,199
Unrealized loss on interest rate swap	1,248,690	-
MIFRS regulatory adjustment	1,213,662	696,846
	9,497,334	7,660,206
Earnings before the undernoted	2,375,615	4,822,265
Interest expense	1,746,439	1,318,361
Earnings before payments in lieu of taxes	629,176	3,503,904
Provision for payments in lieu of income taxes (note 12):		
Current	411,000	438,000
Net earnings	218,176	3,065,904
Retained earnings, beginning of year	6,714,000	4,872,939
Dividends	(1,250,514)	(1,224,843)
Retained earnings, end of year	$ 5,681,662	$ 6,714,000

See accompanying notes to financial statements.

FESTIVAL HYDRO INC.

Statement of Cash Flows

Year ended December 31, 2014, with comparative information for 2013

	2014	2013
Cash provided by (used in):		
Operating activities:		
Net earnings	$ 218,176	$ 3,065,904
Items not involving cash:		
Amortization	1,912,497	2,129,199
Unrealized (gain) loss on interest rate swap	1,248,690	(711,813)
MIFRS regulatory adjustment	1,213,662	696,846
Post-employment benefits	4,950	(61,954)
Spare parts transfer back to inventory	18,301	20,263
Future payments in lieu of income taxes	(549,451)	622,395
Loss on disposal of plant and equipment	717,852	-
Change in non-cash operating working capital (note 16)	(295,486)	130,104
	4,489,191	5,890,944
Financing activities:		
Long-term debt	(522,979)	6,845,970
Customer deposits	(6,685)	(128,089)
Dividends	(1,250,514)	(1,224,843)
	(1,780,178)	5,493,038
Investing activities:		
Proceeds from disposal of plant and equipment	9,750	-
Purchase of plant and equipment	(2,425,133)	(9,099,456)
Regulatory asset, net	(1,391,459)	(1,047,463)
Intangibles	(233,295)	(1,610,864)
	(4,040,137)	(11,757,783)
Decrease in cash	(1,331,124)	(373,801)
Bank indebtedness, beginning of year	(1,339,170)	(965,369)
Bank indebtedness, end of year	$ (2,670,294)	$ (1,339,170)
Supplemental cash flow information:		
Taxes paid	$ 491,054	$ 861,304
Interest paid	1,773,105	1,611,458

See accompanying notes to financial statements.

Festival Hydro Inc. (the "Company") was incorporated under the Business Corporations Act (Ontario) pursuant to Section 142 of the Electricity Act (the "EA") 1998 on July 11, 2000. The Corporation of the City of Stratford (the "City") passed a bylaw pursuant to Section 145 of the Electricity Act 1998 transferring certain assets and liabilities used in connection with the sales of electricity and electrical distribution systems from the Stratford Public Utility Commission - Electric Department. In exchange for these assets the City received a promissory note and common shares. This business is regulated by the Ontario Energy Board ("OEB").

1. Significant accounting policies:

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") including accounting principles prescribed by the OEB in the Accounting Procedures Handbook for Electric Distribution Utilities ("AP Handbook") and reflect the significant accounting policies as summarized below:

(a) Financial effects of distribution rate regulation:

(i) Rate regulation:

The Company is regulated by the OEB under the authority of the Ontario Energy Board Act, 1998. The OEB is charged with the responsibility of approving or fixing rates for the transmission and distribution of electricity, providing continued rate protection for rural and remote electricity customers, and for ensuring distribution companies fulfill obligations to connect and service customers.

The economic impact of rate regulation is reported in these financial statements. Regulatory assets represent certain costs that may be recovered from customers in future periods through the rate-making process. In its capacity to approve or fix rates, the OEB has specified the following regulatory treatments, which have resulted in accounting treatments that differ from GAAP for enterprises operating in a non-regulatory environment.

(ii) Settlement variances:

The Company has deferred certain retail settlement variances in accordance with Article 490 set out in the AP Handbook. The settlement variances relate primarily to service charges, non-competitive electricity charges, and power charges. The nature of the settlement variances is such that their balances shall change each reporting period-end date.

1. Significant accounting policies (continued):

(a) Financial effects of distribution rate regulation (continued):

(iii) Rate setting:

The distribution rates of the Company are based on a revenue requirement that provides a regulated Maximum Allowable Return on Equity on the amount of shareholder's equity supporting the business of electricity distribution, which is also determined by regulation. The Company files a rate application with the OEB annually. Rates are typically effective May 1 to April 30 of the following year. Accordingly, for the first four months of 2014, distribution revenue is based on the rates approved effective May 1, 2013. Once every five years, the Company is scheduled to file an Electricity Distribution Rate application ("EDR") where rates are rebased through a cost of service review. In the intervening years an Incentive Rate Mechanism application ("IRM") is filed. A cost of service EDR application is based upon a forecast of the amount of operating and capital expenses, debt and shareholder's equity required to support the Company's business. An IRM application results in a formulaic adjustment to distribution rates to increase distribution rates for the annual change in the GDP IPI FDD net of productivity factor and a "Stretch Factor" determined by the relative efficiency of an electricity distributor.

The Company's last cost of service EDR application, on which existing rates are based, was filed for 2010 and approved on April 1, 2010, with rates effective May 1, 2010. Such decision provided for a $9,610,278 service distribution revenue requirement and a rate base of $24,076,547 (60%) debt and $16,051,031(40%) equity, respectively. Such amounts do not include provision for the investment of the Company in the Smart Meter Initiative or the transformer station.

The Company filed a 2011 IRM application on October 29, 2010 to adjust its base rates effective May 1, 2011. Accordingly, the Company’s base rate was approved to increase by 0.38% effective May 1, 2011, as a result of an annual change in the GDP IPI FDD of 1.30% net of a productivity factor of 0.72% and a "Stretch Factor" of 0.20% determined by the relative efficiency of the Distribution Corporation.

The Company's 2012 IRM application was approved by the OEB on March 22, 2012 allowing the Company to adjust its base rates effective May 1, 2012. The Company's base rate was approved to increase by 1.08% effective May 1, 2012, as a result of an annual change in the GDP IPA FDD of 2.00%, net of a productivity factor of 0.72% and a "Stretch Factor" of 0.20% determined by the relative efficiency of the Company.

1. Significant accounting policies (continued):

(a) Financial effects of distribution rate regulation (continued):

(iii) Rate setting (continued):

The Company's 2013 IRM application was approved by the OEB on April 18, 2013 allowing the Company to adjust its base rates effective May 1, 2013. On March 21, 2013, the Board notified distribution companies that the Board had approved an annual change in the GDP IPA FDD of 1.60%. As such, the Company's adjustment to rates was 0.68% effective May 1, 2013, as a result of the GDP IPA FFD of 1.60%, net of a productivity factor of 0.72% and a Stretch Factor of 0.20% determined by the relative efficiency of the Company.

As part of the Company's 2013 IRM application, the OEB also approved an Incremental Capital Rate Rider to assist on the recovery of costs associated with building a new transformer station in 2013. The transformer station was energized in December 2013. The incremental capital rate rider, as approved, is effective May 1, 2013 and will be in effect until the date of the Company's next cost of service rate order.

The Company's 2014 IRM application was approved by the OEB on March 13, 2014 allowing the Company to adjust its distribution rates effective May 1, 2014. The Company's adjustment to rates will be 1.25%, as a result of an inflation factor of 1.70%, less a productivity factor of 0.0% and a stretch factor of 0.45% determined by the relative efficiency of the Company.

On May 27, 2014, the Company filed its 2015 cost of service application for rates effective January 1, 2015. The OEB issued its Decision and Order dated April 30, 2015. The Decision allows for a service revenue requirement on a rate base of 60% debt and 40% equity. The rates are to be effective May 1, 2015 with an implementation date of June 1, 2015. A number of rate riders were also being approved as part of the rate filing.

1. Significant accounting policies (continued):

(a) Financial effects of distribution rate regulation (continued):

(iv) Green Energy and Green Economy Act:

In early 2009, the government tabled the Green Energy and Green Economy Act ("GEGEA"). This new legislation makes fundamental changes to the roles and responsibilities of LDC's in the areas of renewable power generation, conservation and demand management delivery, and the development of smart distribution grids.

The Green Energy and Green Economy Act provides LDC's with the freedom to own and operate a portfolio of renewable power generation and permits them to provide district heating services in their communities through co-generation. LDC's also bear added responsibilities to assist and enable consumers to reduce their peak demand and conserve energy in an effort to meet provincial conservation targets. LDC's gained new responsibilities in transforming their local distribution networks into smart grids harnessing advanced technologies to facilitate the connection of small scale generators and the two way flow of information.

(v) New LDC License Requirements - Conservation and Demand Management Targets:

On September 16, 2010, the OEB amended LDC licenses to include requirements for achieving certain CDM targets over a four year period commencing January 1, 2011. The Company’s license stated that "the license shall meet its 2014 annual peak demand savings of 6.230 MW and its 2011-2014 Net cumulative energy savings target of 29.250 GWh over a four year period beginning January 1, 2011". LDC's must also comply with a new CDM Code of the OEB, which provides LDC requirements for the development and delivery of CDM Strategy to the OEB for the achievement of LDC specific CDM targets, annual accounting and reporting to the OEB, and eligibility criteria for performance incentive payments. The Company commenced a number of new CDM initiatives during 2011 and 2012 in order to meet the four year period targets set out by the OEB and is actively working toward meeting its 2014 targets. CDM programs approved pursuant to the 2011-14 OPA agreement that have 2015 in-service dates will be credited to the 2011-14 program period.

1. Significant accounting policies (continued):

(a) Financial effects of distribution rate regulation (continued):

(v) LDC License Requirements - Conservation and Demand Management Targets (continued):

Effective January 1, 2011, the Company entered into an agreement with the Ontario Power Authority ("OPA") for funding totaling $1,220,132 to deliver CDM programs extending from January 1, 2011 to December 31, 2014. As at December 31, 2014, the Company had received $1,220,132 from the OPA and incurred CDM expenditures of $1,152,181. Amounts received not spent at December 31, 2014 totaling $67,951 are presented as accrued liabilities.

Upon the expiration of the OPA agreement the Company is required to repay to the OPA a prescribed portion of any excess funds received for program administration less any cost efficiency incentives. Based on the Company's budgeted CDM expenditures for 2014 and 2015, the Company expects the amount owing to the OPA at the end of the agreement will be $25,792.

On December 21, 2012, the Ministry of Energy issued a directive to the OPA under subsection 25.32 (4.1) of the Electricity Act to extend the funding time period for OPA contracted province wide CDM initiatives under the Green Energy Act 2009 (Ontario) framework to December 31, 2015. The Company has been approved separate funding from the OPA relating to the transitional CDM programs for 2015.

Festival entered into an agreement with the OPA for the delivery of CDM programs over the 2015-2020 period. Funding is expected to total approximately $8,800,000, which includes program administration costs and participant incentives. The Company plans to adopt the full cost recovery funding mechanism, whereby the IESO reimburses the LDC for all adequately documented costs incurred, upon meeting minimum performance targets.

(b) Revenue recognition:

In accordance with OEB regulation, the Company recognizes as revenue the regulated distribution tariffs associated with energy distributed and variances between energy purchase costs and energy billed are recorded as regulatory assets or liabilities for future rate application consideration.

The Company follows the practice of cycle billing customers' accounts and revenue is recognized in the period billed. An accrual is made in the accounts at December 31, for power supplied but not billed to customers between the date the meters were last read and the end of the year.

1. Significant accounting policies (continued):

(c) Spare transformers and meters:

Spare transformers and meters are classified as plant and equipment in accordance with guidance in the AP Handbook.

(d) Inventory:

Inventory consists primarily of consumable materials related to the maintenance of the electricity distribution infrastructure. The Company classifies major construction related components of its inventory to plant and equipment. Once capitalized, these items are not depreciated until put into service. Inventory is carried at the lower of cost and net realizable value, with cost determined on an average cost basis.

(e) Plant and equipment:

Plant and equipment assets are recorded at cost and are amortized on a straight-line basis over their estimated useful lives.

Asset	
Distribution lines, overhead	30 - 60 years
Transformers	35 - 40 years
Services	40 - 60 years
Meters	15 - 40 years
Buildings	10 - 60 years
Transportation equipment	10 - 20 years
Distribution lines, underground	25 - 55 years
Computer equipment	5 years
Smart meters	10 years
Distribution equipment	40 years
Other equipment	10 years
Office equipment	8 - 10 years
Solar generation	20 years
Contributed capital	40 - 60 years
Transformer station	15 - 60 years-

During 2013, the Company changed its estimate of the useful lives of depreciable assets. The impact of changes to estimated useful lives in 2014 was a reduction in deprecation expense of $1,381,478 (2013 - $951,058). The cumulative amount of $2,332,536, net of a reduction in overhead charges of $422,028 has been recorded in the OEB approved variance account 1576 and will be reimbursed to customers through a rate rider effective January 1, 2015.

1. Significant accounting policies (continued):

(e) Plant and equipment (continued):

Eligible capital expenditures approved under the OEB's Incremental Capital Module (ICM) are reclassified from construction work in progress to regulatory assets once the asset is determined to be in service. The assets are depreciated within the regulatory ICM Variance Account over the estimated useful lives. At the next Cost of Service Rate application, upon OEB approval, the net book value of the assets will be included in the LDC's rate base and the assets transferred from the ICM Variance Account back to their applicable plant and equipment asset and accumulated amortization accounts.

Maintenance and repair items are expensed as incurred. Additions, renewals or betterments are capitalized. Any normal gain or loss on sale or retirement of buildings or equipment is included in the statement of earnings and retained earnings in the year of disposal.

The cost of plant and equipment represents the original cost, consisting of direct materials, labour, contracted services and overhead directly attributable to the capital project. It may also include an allowance for funds during construction for larger projects spanning over a period of twelve months, as prescribed in the OEB's AP Handbook.

Construction Work in Progress ("CWIP”) relates to assets not currently in use and therefore is not depreciated.

(f) Intangible assets:

Intangible assets are initially recorded at cost. Amortization is provided on a straight-line basis over the estimated useful lives.

Intangible assets include contribution payments made to Hydro One Networks Inc. for dedicated infrastructure pursuant to an agreement in order to receive connections to transmission facilities and the cost of a permanent bypass.

In the event that facts and circumstances indicate that intangible assets may be impaired, any write-down of the carrying value of intangible assets is charged against the results of operations.

(g) Goodwill:

Goodwill represents the excess of cost over fair value of net assets of businesses acquired. The carrying value of goodwill is evaluated for impairment on an annual basis, or more frequently if circumstances require, with any write-down of the carrying value of goodwill being charged against the results of operations. No goodwill was impaired during the year.

1. Significant accounting policies (continued):

(h) Contributed capital:

Contributed capital contributions are required contributions received from outside sources, used to finance additions to plant and equipment. Contributed capital contributions received are treated as a contra account included in the determination of plant and equipment. The amount is subsequently amortized by a charge to accumulated amortization and a credit to amortization expense, at an equivalent rate to that used for the amortization of the related plant and equipment.

(i) Post-employment benefits:

The Company has a number of unfunded benefit plans providing post employment medical, dental and life insurance benefits to retired employees. These plans provide benefits to certain employees when they no longer provide active service. Future benefit expense is recognized in the period in which the employees render the services.

Post-employment benefits are recorded on an accrual basis. The accrued benefit obligation and current service costs are calculated using the projected benefits method pro-rated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value of benefits attributed to employees' services rendered in the period. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. Actuarial gains and losses are expensed as incurred.

(j) Other long-term liabilities:

Customer deposits are cash collections from customers to guarantee the payment of energy bills. Deposits expected to be refunded to customers within the next fiscal year are classified as a current liability.

(k) Related party transactions:

Transactions with related parties represent the culmination of the earnings process and are measured at the exchange amount agreed to by the parties.

1. Significant accounting policies (continued):

(l) Payments-in-lieu of corporate income taxes and capital taxes:

The current tax-exempt status of the Company under the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) reflects the fact that the Company is wholly owned by a municipality. This tax-exempt status might be lost in a number of circumstances, including if the municipality ceases to own 90% or more of the shares or capital of the Company, or if a non-government entity has rights immediately or in the future, either absolutely or contingently, to acquire more than 10% of the shares of the Company.

Commencing October 1, 2001, the Company was required, under the Electricity Act, 1998 to make payments in lieu of corporate taxes to the Ontario Electricity Financial Corporation. These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) as modified by the EA, 1998 and related regulations.

As a result of becoming subject to payments in lieu of corporate income taxes ("PILs"), the Company's taxation year was deemed to have ended immediately beforehand and a new taxation year was deemed to have commenced immediately thereafter. The Company was therefore deemed to have disposed of each of its assets at their then fair market value and to have reacquired such assets at that same amount for purposes of computing its future income subject to PILs. For purposes of certain provisions, the Company was deemed to be a new company and, as a result, tax credits or tax losses not previously utilized by the Company would not be available to it after the change in tax status. Essentially, the Company was taxed as through it had a "fresh start" at the time of its change in tax status.

1. Significant accounting policies (continued):

(m) Financial assets and liabilities:

The standards require that as financial assets and liabilities are initially recognized that they be measured at fair value, except for certain related party transactions. After initial recognition, financial assets are categorized as assets held for trading, held-to-maturity investments, loans and receivables or available-for-sale assets. Financial liabilities are categorized as held-for-trading or other financial liabilities. All financial instruments are measured on the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other liabilities, which are measured at amortized cost. Subsequent measurement and changes in fair value depend on their initial classification, as follows: held-for-trading are measured at fair value and changes in fair value are recognized in the statement of earnings and retained earnings.

The Company has classified its financial instruments as follows:

Cash and bank indebtedness	Held-for-trading
Accounts receivable	Loans and receivables
Payments in lieu of income taxes recoverable	Loans and receivables
Unbilled revenue	Loans and receivables
Due from Festival Hydro Services Inc.	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Accrued vacation, wages and benefits	Other liabilities
Demand notes payable	Other liabilities
Due to the Corporation of the City of Stratford	Other liabilities
Payments in lieu of income taxes payable	Other liabilities

(n) Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates.

2. Future accounting changes:

Transition to International Financial Reporting Standards ("IFRS"):

Publicly accountable enterprises in Canada were required to adopt International Financial Reporting Standards ("IFRS") in place of Canadian GAAP for annual reporting purposes for fiscal years beginning on or after January 1, 2011. On September 10, 2010, the Accounting Standards Board ("AcSB") granted an optional one-year deferral for IFRS adoption for entities subject to rate regulation. Subsequent deferrals granted by the AcSB have resulted in the extension of the adoption of IFRS to January 1, 2015. Management has elected to defer adoption of IFRS until January 1, 2015. The OEB has required as an interim step that LDC's adopt a modified IFRS ("MIFRS") in that the amortization periods and the burden calculations reflect the standards under IFRS. As such, the Company has adopted MIFRS on January 1, 2013 with the changes being accounted for prospectively as changes in estimates. The Company will continue to prepare its financial statements in accordance with Canadian GAAP, as modified by MIFRS, until January 1, 2015, at which point the Company will transition to IFRS.

In January 2014, the International Accounting Standards Board ("IASB") published IFRS 14 *Regulatory Deferral Accounts.* This standard provides specific guidance on accounting for the effects of rate regulation and permits first-time adopters of IFRS to continue using previous GAAP to account for regulatory deferral account balances while the IASB completes its comprehensive rate regulation project. Adoption of this standard is optional for entities eligible to use it. Deferral account balances and movements in the balances will be required to be presented as separate line items on the face of the financial statements distinguished from assets, liabilities, income and expenses that are recognized in accordance with other IFRSs. Extensive disclosures will be required to enable users of the financial statements to understand the features and nature of, and risks associated with, rate regulation and the effect of rate regulation on the entity's financial position, performance and cash flows.

3. Financial effects of distribution rate regulation:

The financial results presented are in accordance with generally accepted accounting principles and within that framework the Company accounts for the impact or regulatory actions in the following manner:

(a) Regulatory decisions to adjust distribution rates:

In the event that a regulatory decision is rendered, providing regulatory approval and certainty to the recognition of an asset, or creation of a liability, and culminating in an adjustment to Company distribution rates, such occurrences are immediately reflected in the Company's accounts.

3. Financial effects of distribution rate regulation (continued):

(b) Regulatory direction and practice:

In the absence of a regulatory decision impacting rates, and where the Company is required by regulatory accounting practice or direction to accumulate balances for future rate recovery or create liabilities for future discharge, those amounts are recorded in accordance with that regulatory direction. Management assesses the future uncertainty with respect to the final regulatory disposition of those amounts, and to the extent required, makes accounting provisions to reduce the deferred balances accumulated or to increase the recorded liabilities. Upon rendering of the final regulatory decision adjusting distribution rates, the provisions are adjusted to reflect the final impact of that decision, and such adjustment is reflected in net earnings for the period.

Amounts currently confirmed by final regulatory decision, and amounts currently accounted for in the absence of final regulatory decision together with related provision for future uncertainty, are more fully described in note 8 to the financial statements.

4. Plant and equipment:

			2014	2013
	Cost	Accumulated amortization	Net book value	Net book value
Distribution lines, underground	$ 23,168,547	$ 13,474,017	$ 9,694,530	$ 9,622,544
Distribution lines, overhead	25,184,073	9,313,375	15,870,698	15,367,422
Transformers	12,107,934	6,614,489	5,493,445	5,479,899
Services	4,808,326	2,802,637	2,005,689	1,945,717
Meters	5,130,777	1,956,723	3,174,054	3,865,875
Buildings	2,428,957	1,207,566	1,221,391	1,323,640
Transportation equipment	2,890,629	2,061,936	828,693	903,564
Distribution equipment	1,060,334	833,371	226,963	254,797
Computer equipment	1,733,308	1,010,952	722,356	571,580
Office equipment	580,491	443,804	136,687	141,995
Other equipment	481,883	379,801	102,082	81,341
Solar generation	302,239	52,016	250,223	257,724
Contributions, capital	(5,061,596)	(1,498,267)	(3,563,329)	(3,499,578)
Major spare parts inventory	450,645	-	450,645	468,948
	$ 75,266,547	$ 38,652,420	$ 36,614,127	$ 36,785,468

5. Intangible assets:

Intangible assets consist of the following agreements entered into with Hydro One Networks related to increased electricity distribution capacity:

			2014	2013
	Cost	Accumulated amortization	Net book value	Net book value
St. Marys CCRA Agreement	$ 480,000	$ 48,000	$ 432,000	$ 464,000
Permanent Bypass Agreement	1,463,321	32,204	1,431,117	1,227,748
	$ 1,943,321	$ 80,204	$ 1,863,117	$ 1,691,748

The St. Marys CCRA agreement is amortized over the remaining 15 years of the CCRA agreement. The Permanent Bypass agreement is amortized over the same useful life of the major components of the transformer station, being 45 years.

6. Inventory:

The amount of inventory consumed by the Company and recognized as an expense during 2014 was $121,711 (2013 - $114,751).

7. Accounts receivable:

	2014	2013
Energy, water and sewage	$ 3,285,758	$ 2,945,996
Sundry	214,387	215,731
	3,500,145	3,161,727
Less: allowance for doubtful accounts	(138,185)	(126,269)
	$ 3,361,960	$ 3,035,458

Included in accounts receivable is approximately $466,681 (2013 - $471,560) of customer receivables for water consumption and sewage removal that the Company bills and collects on behalf of the Corporation of the City of Stratford. As the Company does not assume liability for collection of these amounts, any amount relating to water consumption and sewage removal that is determined to be uncollectable is charged to the Corporation of the City of Stratford. At year end, there is nothing (2013 - nil) included in the allowance for doubtful accounts for uncollectable amounts relating to water consumption and sewage removal.

8. Regulatory asset, net:

Regulatory assets and liabilities arise as a result of the rate-setting process. The Company has recorded the following assets and liabilities:

	2014	2013
Assets:		
Other regulatory assets	$ 47,510	$ 47,479
Post-market opening retail settlement variances:		
Cost of power variance	2,886,644	1,269,302
LRAM variance	281,735	121,555
Transformer Station Incremental Capital Account	14,441,581	15,053,811
Smart meter entity charges	14,033	15,670
2010 rate application costs	3,725	15,725
Low voltage charges	220,683	127,887
Transmission network and connection charges	529,740	687,820
IFRS conversion costs	115,083	113,398
Stranded meter recovery	234,537	-
	18,775,271	17,452,647
Liabilities:		
PILs and HST variance account	(182,031)	(127,377)
IFRS - CGAAP Transitional PPE Recoveries	(1,448,219)	(696,846)
Retail settlement variance accounts	(60,097)	(54,842)
Wholesale market charges	(2,401,760)	(2,360,459)
Future regulatory taxes payable	(2,659,199)	(2,109,748)
	(6,751,306)	(5,349,272)
	12,023,965	12,103,375
Recoveries (repayments):		
2010 disposition variance	(56,321)	(312,135)
2012 disposition variance	1,640	1,640
Recovery of regulatory assets	49,659	48,266
	(5,022)	(262,229)
	$ 12,018,943	$ 11,841,146

8. Regulatory asset, net (continued):

Post-market opening retail settlement variances - represent amounts that have accumulated since Market Opening and comprise:

(a) variances between amounts charged by the Independent Electricity System Operator ("IESO") for the operation of the wholesale electricity market and grid, various wholesale market settlement charges and transmission and network charges, and the amounts billed to customers by the Company based on the OEB approved wholesale market rates, transmission network and transmission connection rates;

(b) variances between the amounts charged by the IESO to allow for purchases of electricity and the amounts billed to customers by the Company based on OEB approved rates;

(c) deferred payments in lieu of income taxes - represent variances that result from the difference between OEB approved PILs recoverable in electricity distribution service charges and the actual amount of these charges to customers that relates to the recovery of PILs;

(d) low voltage (sub-transmission) charges-variance between the amounts charged by Hydro One for Low Voltage charges and the amounts billed to customers by the Company based on OEB approved rates;

(e) as part of the 2010 rate application, the Company claimed for disposal $2.1 million in regulatory liability balances. The amount was re-paid to customers over a four year period ending May 1, 2014. The balances approved for disposition by the OEB were placed into a new account called 2010 disposition variance. The amount repaid in 2014 totaled $256,406 (2013 - $536,936). The remaining balance at December 31, 2014 totals $56,321 (2013 - $312,135);

(f) the OEB conducted a review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for certain LDCs. On June 24, 2011 the OEB issued its decision for these LDCs and provided guidelines for remaining LDCs for the calculation and disposition accumulated in the PILs regulatory variance accounts. As part of the Company's 2014 rate application, the OEB approved $271,992 to be recovered through rates for the period May 1, 2012 to April 30, 2013. The balance remaining at December 31, 2014 totals $1,640 (2013 - $1,640);

8. Regulatory asset, net (continued):

(g) Incremental Capital (ICM) account - The Company received approval from the OEB to establish an ICM regulatory asset account effective May 1, 2013 related to the construction of the Stratford transformer station. The account is comprised of the cost of the eligible in service capital expenditures for the transformer station under ICM, offset by the revenues collected since May 1, 2013 through the OEB approved ICM rate riders. This account includes the recorded depreciation on the asset for the year plus carrying charges calculated on the outstanding balance based on OEB prescribed rates;

Eligible capital expenditures totaling $15,311,782 were reclassified from plant and equipment and intangible assets for the year ended December 31, 2013 (2012 - nil). Depreciation, calculated for the twelve months of operation in 2014 was $337,644 (2013 - $28,137). Revenues earned through the ICM rate rider and applied to this account in 2014 totaled $762,167 (2013 - $380,411);

The balance in the ICM variance account was presented to the OEB for disposition as part of the Company's 2015 cost of service rate application. In the April 30, 2015 Decision and Order, approval was received from the OEB to transfer the assets from the ICM variance account back to their applicable plant and equipment, intangible asset and accumulated amortization accounts; and

(h) IFRS-CGAAP Transitional recoveries – As outlined in the OEB's Accounting Procedures Handbook, the Company is to record differences arising as a result of accounting policy changes caused by the transition from previous Canadian GAAP to modified International Financial Reporting Standards ("IFRS"). Changes to asset useful lives and overhead capitalization policies were applied effective January 1, 2013 on a prospective basis. The December 31, 2014 account 1576 regulatory liability balance of $1,910,508 (2013 - $696,846) represents the impact of changes to estimated useful lives and overhead capitalization polices.

As a result of a change in policy to recognize gain and losses on all asset classes at time of asset disposal, a onetime adjustment was recognized for previously disposed assets which had not been written off. As directed by the OEB, the loss has been recorded in the account 1575 for a total of $462,289.

The balance in the IFRS-CGAAP Transitional recoveries accounts 1575 and 1576 of $462,289 and ($1,910,508), respectively, have been approved by the OEB for disposition as part of the Company's 2015 cost of service rate application, with the net amount to be returned to customers over a seven month period from June 1, 2015 to December 31, 2015.

9. Demand notes payable:

	2014	2013
Demand notes payable to shareholder, bearing interest at 7.25% per annum, with interest payments only, due on demand	$ 15,600,000	$ 15,600,000

Interest paid on the demand notes for the year ended December 31, 2014 was $1,131,000 (2013 - $1,131,000).

10. Post-employment benefits:

The Company has a number of unfunded benefit plans providing post-retirement benefits (other than pension) to eligible retirees. The Company pays certain medical, dental and life insurance costs for eligible retirees up to the age of sixty-five, and life insurance for beyond age sixty-five for existing employees and retirees hired prior to June 1, 2011. This results in a liability on the balance sheet at year end as follows:

	2014	2013
Post-employment benefits:		
Balance, beginning of year	$ 1,397,008	$ 1,458,962
Service cost	23,676	34,450
Interest cost	57,629	54,885
Actuarial gain	(22,090)	(91,659)
Benefits paid	(54,265)	(59,630)
Post-employment benefits, end of year	$ 1,401,958	$ 1,397,008

The accrued benefit obligation for post-employment benefits is based on an actuarial valuation for accounting purposes as at January 1, 2014. The actuarial valuation was based on assumptions about future events. The economic assumptions used in the valuation is the Company's best estimates of expected rates of:

	2014	2013
Wage and salary escalation	2.60%	3.10%
Annual increase in health care costs	7.00%	8.00%
Annual increase in dental care costs	4.60%	5.00%
Discount rate on accrued benefit obligations	3.90%	4.60%

11. Share capital:

		2014		2013
Authorized:				
Unlimited Class A special shares, non-cumulative, 5.0%				
Unlimited Class B special shares				
Unlimited common shares				
Issued:				
6,100 Class A special shares	$	6,100,000	$	6,100,000
6,995 common shares		9,468,388		9,468,388
	$	15,568,388	$	15,568,388

Dividends paid on the 6,100 Class A special shares during 2014 totaled $305,000 (2013 - $305,000). Dividends paid on the 6,995 common shares during 2014 totaled $945,514 (2013 - $919,843).

12. Payment in lieu of income taxes:

The provision for payment in lieu of income taxes ("PILs") varies from amounts which would be computed by applying the Company's combined statutory income tax rate as follows:

		2014		2013
Basic rate applied to income before PILs 2014 - 26.5% (2013 - 26.5%)	$	167,000	$	929,000
Tax effect of non-deductible expenses		4,000		1,000
Tax effect of other temporary differences		213,000		(457,000)
Other items		27,000		(35,000)
Tax provision	$	411,000	$	438,000

Future income tax assets of $2,659,199 (2013 - $2,109,748) have been recorded at year end based on substantively enacted income tax rates. Such future income tax assets relate in part to the tax basis of depreciable capital assets and intangible assets in excess of amounts recorded for accounting purposes, and in part to the timing differences between the recognition of revenue and expenses for accounting and income tax purposes.

13. Pension agreements:

Effective February 1, 1989, the Company commenced participation in the Ontario Municipal Employees Retirement System (OMERS) which is a multi-employer plan, for all active employees at the date as well as for all new employees. As of December 31, 2014, there were forty three active employees. The plan is a contributory defined benefit plan which specifies the amount of the retirement benefit to be received by the employees based on their length of service and rates of pay. As this is a multi-employer plan, no liability has been recorded on the Company's books.

Contributions for the year by the Company were $ $370,220 (2013 - $384,704). Contributions were set at a rate of 9.0% for employee earnings below the year's maximum pensionable earnings and 14.6% thereafter, effective the first full pay of January, 2014.

14. Public liability insurance:

The Company is a member of the Municipal Electrical Association Reciprocal Insurance Exchange ("MEARIE"). MEARIE is a pooling of public liability insurance risks of many of the electrical distribution utilities in Ontario. All members of the pool are subject 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. It is anticipated that should such an assessment occur it would be funded over a period of up to five years. As at December 31, 2014, no assessments have been made.

15. Financial instruments:

(a) Credit risk:

Credit risk is the risk that a counterparty will fail to discharge its obligation to the Company reducing the expected cash inflow from Company assets recorded at the balance sheet date. Credit risk can be concentrated in debtors that are similarly affected by economic or other conditions.

The Company has assessed that there are no significant concentrations of credit risk other than the present uncertainty relating to the recovery of regulatory assets. The final regulatory amount recoverable will be assessed in future years by the regulator after the approval of those costs.

(b) Interest rate risk:

Interest rate risk arises from the possibility that the value of, or cash related to, a financial instrument will fluctuate as a result of changes in market interest rates. The Company has entered into an interest rate swap, as described in note 20, to reduce its exposure to fluctuations in interest expense on certain of its debt instruments.

16. Change in non-cash operating working capital:

	2014	2013
Cash increase (decrease):		
Accounts receivable	$ (326,502)	$ 396,641
Inventory	53,378	392,760
Prepaid expenses	(212,635)	(20,266)
Payment in lieu of income taxes	123,863	(275,648)
Unbilled revenue	(193,327)	(1,721,694)
Accounts payable and accrued liabilities	486,558	1,590,111
Accrued vacation, wages and benefits	25,672	3,970
Due to the Corporation of the City of Stratford	(663)	43,534
Due from Festival Hydro Services Inc.	(251,830)	(279,304)
	$ (295,486)	$ 130,104

17. Due from Festival Hydro Services Inc. ("FHSI"):

The Company performs all of the administrative functions for FHSI. Most expenses and revenue are paid and received through the Company according to a service level agreement dated June 27, 2013 and effective September 1, 2012.

The Company charged interest on the balance owing from FHSI at an interest rate equivalent to 5.09% up to May 27, 2013 and at a rate of prime after May 27, 2013 as per the revised intercompany loan agreement. Net interest received by the Company for the year was $38,702 (2013 - $37,317). The loan is due on demand and no later than September 1, 2017.

The Company and FHSI are wholly owned by the Corporation of the City of Stratford.

18. Contingencies:

(a) Prudential support:

As a purchaser of electricity through the IESO, the Company is required to provide security to minimize the risk of default, based on its expected activity in the market. The IESO may draw on this security if the Company fails to make payment required by a default notice issued by the IESO. To satisfy this requirement, the Company has provided the IESO with an irrevocable standby letter of credit in the amount of $3,095,139 (2013 - $3,095,139) which renews automatically on an annual basis.

(b) Connection and cost recovery agreement - St. Mary's Transformer Station:

The Company and Hydro One Networks Inc. entered into a twenty-five year capital cost recovery agreement ("CCRA") in September, 2002 relating to Hydro One Networks Inc. building new feeder positions at the existing St. Mary's Transformer Station. Under the terms of the agreement, the Company has guaranteed new load growth which, if not met, would require the Company to provide a financial contribution toward the capital investment of the Transformer Station.

The CCRA has been trued-up effective July 5, 2013. Since load growth has fallen below target amounts, a contribution in the amount of approximately $480,000 was owing to Hydro One Networks. This amount owing has been set up as an Intangible Asset subject to 15 year amortization over the remaining life of the agreement. The final amount owing is currently being negotiated with Hydro One Networks.

(c) Connection and cost recovery agreement - Stratford Transformer Station ("Festival Hydro MTS1"):

The Company and Hydro One Networks Inc. entered into a twenty-five year capital cost recovery agreement in November, 2012, relating to Hydro One Networks Inc. building a new 230kV line to connect Festival Hydro`s MTS1 to Hydro One`s 230kV circuit. Under the terms of the agreement, the Company has guaranteed new load growth which, if not met, would require the Company to provide a financial contribution toward the capital investment.

The CCRA is trued-up (a) following the fifth and tenth anniversaries of the in-service date; and (b) following the fifteenth anniversary of the in-service date if the actual load is 20% higher or lower than the load forecast at the end of the tenth anniversary of the in-service date.

19. Long-term debt:

	2014	2013
Subordinate, secured loan advances from Infrastructure Ontario Projects Corporation (OIPC), bearing interest at 4.4%, with payments of $100,585 due semi-annually, maturing June 15, 2025	$ 1,677,084	$ 1,800,378
Subordinate, secured loan advances from Infrastructure Ontario Projects Corporation (OIPC), bearing interest at 3.98%, with payments of $13,733 due semi-annually maturing October 2025	242,758	260,045
Royal Bank revolving term loan, bearing interest at 2.93% maturing May 31, 2030 and a stamping fee bearing interest at 0.42% maturing May 31, 2023	13,401,000	13,783,000
Accrued interest to December 31	5,490	5,888
	15,326,332	15,849,311
Less: current portion	546,251	528,469
Long-term debt	$ 14,780,081	$ 15,320,842

The Company was approved financing from OIPC of up to $2,500,000 for its smart meter project, which consists of two fifteen year debentures with fixed repayment terms and fixed interest rates.

During the year, the Company incurred interest expense in respect of the OIPC loans of $87,657 (2013 - $93,592).

20. Credit facility arrangement:

The Company entered into a credit facility agreement (the "agreement") with the Royal Bank effective June 29, 2012 to meet its short-term and long-term financing needs. The agreement allows for the following types of credit facilities:

(i) $10,000,000 revolving term facility by way of either RBP based loans, overdrafts or bankers acceptance;

(ii) $3,600,000 revolving term facility by way of a letter of guarantee;

(iii) $14,000,000 non-revolving term facility by way of RBP based loan or bankers acceptance; and

(iv) $14,000,000 revolving term facility by way of either RBP based loans or bankers acceptance, repayable in full on the last day of a ten year term from drawdown as selected by the Company.

The credit facilities are secured by a general security agreement.

As at December 31, 2014, there were borrowings under facility (i) of $2,671,354 (2013 - $1,340,230). The Company also made use of its letter of guarantee under facility (ii) to furnish the IESO with prudential support of $3,095,139 (2013 - $3,095,139). The borrowing under facility (iii) was undertaken to finance the construction of the transformer station in the south west section of the City of Stratford. The terms and conditions of the agreement indicate that the aggregate of facility (iii) and facility (iv) shall not exceed $14,000,000 at any time. The proceeds of borrowing under facility (iv) were used to repay in full all borrowing under facility (iii) effective May 31, 2013. Effective May 31, 2013, an amount of $14,000,000 was advanced under facility (iv). The loan balance under facility (iv) outstanding at December 31, 2014 totaled $13,401,000 (2013 - $13,783,000).

The Company also maintains a VISA Business credit facility to a maximum amount of $40,000 (2013 - $30,000).

During the year, the Company utilized the overdraft facility and incurred interest expense in respect of this lending arrangement of $29,238 (2013 - $15,790).

20. Credit facility arrangement (continued):

Interest rate swap

The Company entered into an interest rate swap agreement on a notional principal of $14,000,000 effective May 31, 2013, maturing May 31, 2038. The swap is a receive variable pay fixed swap with the Royal Bank. This agreement has effectively converted variable interest rates on the bankers acceptances under facility (iv) to an effective fixed interest rate of 2.93% plus stamping fee of 0.42%. The stamping fee is subject to change every 10 years.

The Company has determined this swap does not meet the standard to apply hedge accounting. Since the standard is not met, the interest rate swap contract has been marked to market at December 31, 2014 with the unrealized loss for the year of ($1,248,690) (2013 - gain of $711,813) recorded in the statement of earnings.

21. Related party transactions:

During the year, and within the normal course of operations, the Company provided water and sewer billing and collection services to the Corporation of the City of Stratford. Revenue earned by the Company was $438,542 (2013 - $437,209). The Company also provided street light maintenance and capital services for the City of Stratford for which it earned revenues of $151,148 (2013 - $170,486).

During the year, the Company collected and remitted $3,208,006 (2013 - $3,183,813) for water services and $5,702,484 (2013 - $5,595,613) for sewage services to the shareholder.

The Company leases space to the Corporation of the City of Stratford for which it earned revenue in the year of $33,647 (2013 - $32,826). The Company also leases space to FHSI for which it earned revenue in the year of $43,945 (2013 - $44,106).

During the year, the Company provided labour services, trucking services, materials, management services, billing and collecting services, joint pole attachment approval, and electricity for WiFi equipment on Company poles to FHSI. Revenue earned by the Company for these services was $203,838 (2013 - $242,536).

The Company has five fibre service agreements with FHSI. Expenses paid by the Company relating to these five contracts totaled $155,711 (2013 - $146,791). The Company also purchased advertising on the Walled Garden from FHSI in 2014 for $6,000 (2013 - 6,000).

22. Subsequent event:

In the Decision and Order for the Company's 2015 Cost of Service Application (EB-2014-0073) published by the Ontario Energy Board (OEB) on April 30, 2015, the OEB determined that the payment for the permanent bypass agreement arising in 2013, which has been previously recorded as an intangible asset, should be removed from intangible assets and expensed starting in 2015. As the expense is incurred upon declassification of the asset for regulatory purposes, the balance has not been adjusted at December 31, 2014. During 2015, the Company will reclassify the net book value of the permanent bypass agreement totaling $1,431,117, from an intangible asset to the permanent bypass regulatory deferral and variance account. The balance will be collected from customers over a period of thirty-one months, based on billing consumption commencing June 1, 2015 and ending December 31, 2017.