Q. **2013 General Rate Application, Miscellaneous Information Requirements**

Provide the non-consolidated financial statements of Hydro for the years ended 2007 to 2012, as well as any budgeted statements for 2013 to 2015.

A. Please refer to PUB-NLH-282 Attachments 1 to 7 for the 2007 to 2013 non-consolidated financial statements of Hydro. Please refer to Finance Schedule I, pages 1 to 3, for Regulated Hydro's 2014 and 2015 Test Year financial statements.

[ ]

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007

Deloitte.

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Fort William Building
St. John's NL A1C 6H5
Canada

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Independent Auditors' Report

To the Directors of
Newfoundland and Labrador Hydro

We have audited the balance sheet of Newfoundland and Labrador Hydro as at December 31, 2007 and the statements of income and retained earnings and comprehensive income and cash flows for the year then ended. These financial statements have been prepared on a non-consolidated basis for regulatory purposes. The financial statements are the responsibility of the Company's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with the basis of accounting described in Note 1 to the financial statements. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year, except as disclosed in Note 3.

These financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are solely for the information and use of the Directors of Newfoundland and Labrador Hydro and the Newfoundland and Labrador Board of Commissioners of Public Utilities. The financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

Deloitte & Touche LLP

Chartered Accountants
February 25, 2008

BOARD OF DIRECTORS

DEAN T. MacDONALD[1]
Chief Executive Officer
Persona Inc.

EDMUND J. MARTIN
President and Chief Executive Officer
Newfoundland and Labrador Hydro

EDNA TURPIN
Consultant

GERALD J. SHORTALL
Chartered Accountant

TOM CLIFT
Associate Dean Academic Programs
Faculty of Business
Memorial University of Newfoundland

KEN MARSHALL
President
Rogers Cable - Atlantic Region

CHRIS KIELEY
Deputy Minister
Department of Natural Resources

CATHY BENNETT
Business Person

OFFICERS

DEAN T. MacDONALD[1]
Chairman

EDMUND J. MARTIN
President and Chief Executive Officer

DERRICK F. STURGE
Vice-President, Finance and Chief Financial Officer

JAMES R. HAYNES
Vice-President, Regulated Operations

JOHN E. MALLAM
Vice-President, Engineering Services

JIM M. KEATING
Vice-President, Business Development

ANDREW E. MacNEILL
Vice-President, Upper Churchill Operations

GERARD V. McDONALD
Vice-President, Human Resources and
Organizational Effectiveness

GILBERT J. BENNETT
Vice-President, Lower Churchill Project

WAYNE D. CHAMBERLAIN
General Counsel and Corporate Secretary

PETER A. HICKMAN
Assistant Corporate Secretary

MARK G.S. BRADBURY
Corporate Treasurer

GLENN H. MITCHELL
Corporate Controller

HEAD AND CORPORATE OFFICE
P.O. Box 12400
St. John's, Newfoundland and Labrador
A1B 4K7

[1] Resigned effective December 18, 2007

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	2007	2006
ASSETS		
Current assets		
Cash and cash equivalents	-	5.1
Short-term investments	-	0.6
Accounts receivable	69.1	59.4
Current portion of regulatory assets (Note 5)	12.1	45.3
Fuel and supplies	60.9	45.4
Prepaid expenses	0.8	1.1
	142.9	156.9
Property, plant and equipment (Note 4)	1,469.4	1,427.5
Sinking funds (Notes 8 and 11)	151.8	117.1
Regulatory assets (Note 5)	86.4	102.9
Long-term receivables (Note 6)	23.3	18.1
Investments (Note 7)	353.2	340.9
	2,227.0	2,163.4
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Bank indebtedness	8.0	6.0
Accounts payable and accrued liabilities	65.3	38.1
Accrued interest	30.6	30.6
Current portion of long-term debt (Note 8)	208.3	8.3
Current portion of regulatory liabilities (Note 5)	23.5	33.7
Promissory notes (Note 8)	7.0	59.4
Due to related parties (Note 17)	0.2	3.5
	342.9	179.6
Long-term debt (Note 8)	1,151.1	1,357.4
Regulatory liabilities (Note 5)	15.5	16.6
Employee future benefits (Note 9)	39.8	35.5
	55.3	52.1
Shareholder's equity (Note 10)		
Share capital	22.5	22.5
Contributed capital	17.6	17.6
Retained earnings	618.1	534.2
Accumulated other comprehensive income (Notes 3 and 11)	19.5	-
	677.7	574.3
Commitments and contingencies (Note 16)		
	2,227.0	2,163.4

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2007**	2006
Revenue		
Energy sales	**497.2**	471.4
Other	**2.0**	2.5
	499.2	473.9
Expenses		
Operations and administration (Note 17)	**104.5**	95.2
Fuels	**159.2**	154.6
Power purchased (Note 17)	**42.4**	42.8
Amortization	**38.4**	36.6
Interest (Note 13)	**98.2**	101.1
	442.7	430.3
Income from operations	**56.5**	43.6
Other income (expense)		
Equity in net income of CF(L)Co. (Note 7)	**15.6**	18.1
Preferred dividends from CF(L)Co.	**10.4**	10.0
Interest on share purchase debt (Note 13)	**(0.9)**	(1.7)
	25.1	26.4
Net income	**81.6**	70.0
Retained earnings, beginning of year	**534.2**	466.8
Add: adjustment opening retained earnings (Note 3)	**2.3**	-
	618.1	536.8
Dividends	**-**	2.6
Retained earnings, end of year	**618.1**	534.2

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended December 31 (millions of dollars)	**2007**	2006
Net Income	**81.6**	70.0
Other Comprehensive income		
Change in fair value of sinking fund investments	**0.2**	-
Comprehensive income	**81.8**	70.0

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2007**	2006
Cash provided by (used in)		
Operating activities		
Net income	**81.6**	70.0
Adjusted for items not involving a cash flow		
Amortization	**38.4**	36.6
Accretion of long-term debt	**0.7**	0.9
Equity in net income of CF(L)Co.	**(15.6)**	(18.1)
Loss on disposal of property, plant and equipment	**0.9**	1.6
Other	**(0.1)**	0.4
	105.9	91.4
Change in non-cash balances (Note 14)	**36.4**	57.5
Dividends from CF(L)Co.	**3.3**	1.3
	145.6	150.2
Financing activities		
Long-term debt issued	**-**	225.0
Long-term debt retired	**(0.2)**	(200.2)
Decrease in promissory notes	**(52.4)**	(91.9)
Dividends	**-**	(2.6)
	(52.6)	(69.7)
Investing activities		
Additions to property, plant and equipment	**(81.7)**	(56.3)
Proceeds on disposal of property, plant and equipment	**0.6**	0.5
Increase in sinking funds	**(19.6)**	(18.5)
Decrease (increase) in short-term investments	**0.6**	(0.1)
Additions to regulatory assets	**-**	(1.8)
	(100.1)	(76.2)
Net (decrease) increase in cash	**(7.1)**	4.3
Cash position, beginning of year	**(0.9)**	(5.2)
Cash position, end of year	**(8.0)**	(0.9)
Cash position is represented by		
Cash and cash equivalents	**-**	5.1
Bank indebtedness	**(8.0)**	(6.0)
	(8.0)	(0.9)
Supplementary disclosure of cash flow information		
Interest received	**0.2**	1.1
Interest paid	**102.6**	107.8

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and is exempt from paying income taxes under Section 149 (1)(d) of the Income Tax Act. The principal activity of Hydro is the development, generation and sale of electricity.

1. PRINCIPLES OF FINANCIAL STATEMENT PRESENTATION

These financial statements have been prepared in accordance with the significant accounting polices set out below. These financial statements materially differ from Canadian generally accepted accounting principles because they are non-consolidated. Hydro's investments in its subsidiary and jointly controlled companies have been accounted for using the equity method of accounting. Consolidated financial statements for the same period have been prepared for presentation to the Lieutenant-Governor in Council of the Province.

Preparation of these financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, litigation, amortization and property, plant and equipment, environmental and asset retirement obligations, amortization, property, plant and equipment and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB).

2. SIGNIFICANT ACCOUNTING POLICIES

Rates and Regulations

Hydro's revenues from its electricity sales to most customers within the Province are subject to rate regulation by the PUB. As well, Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.4%. Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 5.

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. There were no cash equivalents or short-term investments outstanding at December 31, 2007 (2006 - $5.7 million bearing interest rates ranging from 4.30% to 4.35%).

Fuel and Supplies

Fuel and supplies inventories are recorded at average cost.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment

Property, plant and equipment are recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction, and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Hydro recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

Contributions in aid of construction are funds received from customers and governments toward the cost of property, plant and equipment. Contributions are treated as a reduction to property, plant and equipment and the net property, plant and equipment are amortized.

Gain or losses on the disposal of property, plant and equipment are recognized in income as incurred.

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution system	30 years
Other	3 to 50 years

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

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kV. Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators, and conductors.

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

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Impairment of Long-Lived Assets

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying value of the property and assets. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Revenue Recognition

Revenue is recognized on the accrual basis, as power and energy deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB, whereas sales to Hydro-Québec and certain major industrial customers are at rates under the terms of the applicable contracts.

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

Credit Risk

Hydro is exposed to credit risk associated with trade receivables. Although a significant portion of the total accounts receivable balance are due from one customer, management does not consider Hydro to be exposed to a material credit risk since that customer is another regulated utility.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of cumulative net actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 13 years.

3. NEW ACCOUNTING POLICIES

Effective January 1, 2007, Hydro adopted four new accounting standards issued by The Canadian Institute of Chartered Accountants' (CICA). Section 1530, "Comprehensive Income," introduces a new financial statement which captures unrealized gains and loss on financial instruments. Section 3855, "Financial Instruments - Recognition and Measurement," establishes standards for recognizing and measuring financial instruments, namely financial assets, financial liabilities and derivatives. Depending on financial instruments' classification, changes in subsequent measurements are recognized in net income or Other Comprehensive Income (OCI). Section 3861, "Financial Instruments - disclosure and presentation" establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. Section 3865, "Hedges" specifies when and how hedge accounting may be applied. Hydro did not engage in any hedging relationships during this period.

3. NEW ACCOUNTING POLICIES (cont'd.)

Under the new standards, all financial instruments are classified into one of the following five categories: held-to-maturity, loans and receivables, available-for-sale, held-for-trading or other liabilities. All financial instruments, including derivatives, are carried at fair value on the balance sheet except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in OCI until the instrument is derecognized or impaired.

The Company has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Short-term investments	Held-to-maturity
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held-to-maturity
Sinking funds - other investments	Available for sale
Long-term receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Promissory notes	Other liabilities
Long-term debt	Other liabilities
Due to related parties	Other liabilities

These new standards have been applied prospectively without restatement of prior period amounts. Hydro recognized an increase to opening retained earnings of $2.3 million upon adoption of these standards. This adjustment arose from the measurement of outstanding long-term debt at amortized cost, using the effective interest method. As well, Hydro recognized an opening balance of accumulated other comprehensive income arising from unrealized gains on sinking fund investments of $19.3 million.

4. PROPERTY, PLANT AND EQUIPMENT

millions of dollars	Property Plant and Equipment in Service	Contributions In aid of Construction	Accumulated Amortization	Construction In Progress	Net Book Value
			2007		
Generation Plant					
Hydroelectric	**842.6**	**20.5**	**51.1**	**114.4**	**885.4**
Thermal	**244.2**	**0.8**	**188.3**	**0.8**	**55.9**
Diesel	**61.3**	**5.9**	**29.7**	**0.1**	**25.8**
Transmission and Distribution	**665.3**	**60.7**	**177.8**	**0.7**	**427.5**
Other	**205.2**	**8.5**	**123.4**	**1.5**	**74.8**
	2,018.6	**96.4**	**570.3**	**117.5**	**1,469.4**
millions of dollars			**2006**		
Generation Plant					
Hydroelectric	841.2	20.5	46.6	70.4	844.5
Thermal	235.7	0.8	184.3	1.0	51.6
Diesel	59.7	6.1	27.9	1.0	26.7
Transmission and Distribution	651.0	60.8	163.9	2.3	428.6
Other	190.9	5.5	114.0	4.7	76.1
	1,978.5	93.7	536.7	79.4	1,427.5

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

millions of dollars	**2007**	2006	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Long-term receivable	**12.1**	63.1	0.5
Foreign exchange losses	**73.3**	75.5	35.0
Deferred regulatory costs	**0.4**	0.6	2.0
Deferred major extraordinary repairs	**12.3**	8.7	5.0
Deferred study costs	**0.4**	0.3	2.0
Total regulatory assets	**98.5**	148.2	
Less current portion	**12.1**	45.3	
	86.4	102.9	
Regulatory liabilities			
Rate stabilization plan	**38.3**	49.6	n/a
Deferred purchased power savings	**0.7**	0.7	20.0
Total regulatory liabilities	**39.0**	50.3	
Less current portion	**23.5**	33.7	
	15.5	16.6	

The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event. Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods, that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities are no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations.

Rate Stabilization Plan and Related Long-Term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003) RSP balances which accumulated prior to March 31, 2003, have been converted to a long-term receivable which bears interest at the weighted average cost of capital and is to be recovered over a four-year period, which commenced in 2004. The recovery period for industrial customers ended on December 31, 2007 and any remaining balances were transferred to the current plan. The recovery period for the utility customer will end on June 30, 2008. Any subsequent balances accumulating in the RSP including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2007, $31.5 million was recognized (2006 - $3.9 million deferred) in the RSP and $8.9 million (2006 - $83.6 million) was recovered through rates included in energy sales with a corresponding cost amortized in fuel expenses.

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of $2.2 million annually, is included in interest expense (Note 13).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 14 (2004), the PUB approved the deferral of external costs associated with the general rate application and hearing, to be amortized over a three-year period, which commenced in 2004. Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 General Rate Application in the amount of $0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred. In 2007, $0.2 million (2006 - $0.7 million) of amortization was recognized in operations and administration expenses.

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (HTGS). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program will be recognized as a regulatory asset which will be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007, Hydro incurred $2.0 million in expenses to repair a turbine at Holyrood Thermal Generating Station. These costs have been deferred as a major extraordinary repair. Subject to PUB approval, these costs will be amortized over a five-year period commencing in 2008. In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the cost of the asbestos abatement program and the boiler tube and turbine repairs in the year in which they were incurred. In 2007, $2.1 million (2006 - $1.1 million) of amortization was recognized in operating costs.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004) the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's Cost of Service study (COS), and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year in which they were incurred. In 2007, $0.2 million (2006 - $0.2 million) was deferred in relation to these studies and $0.1 million (2006 - nil) of amortization was recognized in operating costs.

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro Quebec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings are recognized as a regulatory liability. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were incurred.

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. Since Hydro's AFUDC (7.6%) is lower that its cost of debt (8.0%), the amount capitalized is lower and interest expense is higher by $0.3 million (2006 - $0.3 million) than that which would be permitted in the absence of rate regulation (Note 13).

Hydro depreciates its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method.

During 2005, pursuant to Order No. P.U. 7 (2002-2003) Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management currently estimates that accumulated amortization is approximately $170-180 million lower than it would otherwise be, and annual amortization expense is $10-11 million lower, primarily due to the use of sinking fund rather than straight line amortization for hydroelectric and transmission assets. An update to this study is planned for 2008.

6. LONG-TERM RECEIVABLES

Included in long-term receivables are two refundable deposits associated with an application for transmission service into Québec, bearing interest at prime until April, 2007 and at one year Guaranteed Income Certificate (GIC) rates thereafter.

7. INVESTMENTS

millions of dollars	Ownership Interest	**2007**	2006	
Churchill Falls (Labrador) Corporation Limited	65.8%			
Shares, at cost		**167.2**	167.2	
Equity in retained earnings at beginning of year		**171.0**	154.2	
Equity in net income for the year		**15.6**	18.1	
Dividends for the year		**(3.3)**	(1.3)	
		350.5	338.2	(a)
Lower Churchill Development Corporation Limited	51.0%	**2.7**	2.7	(b)
Gull Island Power Company Limited	100.0%	**-**	-	(c)
		353.2	340.9	

(a) A portion of Hydro's shareholding in CF(L)Co. is deposited in a voting trust pursuant to an agreement with Hydro-Québec in relation to CF(L)Co's General Mortgage Bonds. Effective February 25, 2008, the bonds were retired removing the requirement for the shares to be held in trust.

Effective June 18, 1999, the two shareholders of CF(L)Co., Hydro and Hydro-Québec, entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co. be subject to approval jointly by representatives of Hydro and Hydro-Québec. CF(L)Co. also receives revenues from Hydro-Québec, under a guaranteed winter availability contract through 2041.

7. INVESTMENTS (cont'd.)

(b) The Lower Churchill Development Corporation Limited (LCDC) was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (Lower Churchill Development) in Labrador.

Hydro, the designate for the Province's shareholding in LCDC, holds 1,540 Class A common shares of LCDC. Five hundred and twenty shares were acquired in 1979 pursuant to the signing of an Option Agreement between LCDC and the Province, dated November 24, 1978, and expiring November 24, 2008. Five hundred and ten shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

(c) Gull Island Power Company Limited (GIPCo.) is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (Gull Island Project). All project costs were funded by way of capital contributions from the Province. Hydro suspended all work on the Gull Island Project in 1976, in the absence of satisfactory arrangements for the financing of the project and the marketing of available power.

Upon agreement to continue with the Lower Churchill Development, LCDC has the option to purchase the GIPCo. assets pursuant to the provisions of the Option Agreement.

8. LONG-TERM DEBT

Series	Interest Rate %	Year of Issue	Year of Maturity			
millions of dollars				**2007**	2006	
AA	5.50	1998	2008	**199.9**	199.6	
V	10.50	1989	2014	**124.4**	124.7	(a)
X	10.25	1992	2017	**149.0**	149.4	(a)
Y	8.40	1996	2026	**292.7**	294.5	(a)
AB	6.65	2001	2031	**307.1**	306.6	(a)
AD	5.70	2003	2033	**123.5**	123.6	(a)
AE	4.30	2006	2016	**223.3**	223.2	
Total debentures				**1,419.9**	1,421.6	
Less sinking fund investments in own debentures				**60.8**	56.4	
				1,359.1	1,365.2	
Other				**0.3**	0.5	
				1,359.4	1,365.7	
Less current portion				**208.3**	8.3	
				1,151.1	1,357.4	

(a) Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2006 - 4.50% to 9.86%).

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of one percent annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

Hydro uses promissory notes to fulfill its short-term funding requirements. At year-end the promissory notes outstanding were at an interest rate of 4.45% (2006 - 4.30%).

8. LONG-TERM DEBT (cont'd.)

Hydro maintains a $50.0 million Canadian or US equivalent unsecured operating credit facility with its banker. Advances may take the form of a prime rate advance or the issuance of a Bankers' Acceptance (BA) with interest calculated at the prime rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the prime rate.

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2008	2009	2010	2011	2012
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayments	200.1	0.1	-	-	-
	208.3	8.3	8.2	8.2	8.2

9. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employer's contributions of $3.8 million (2006 - $3.5 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2007, cash payments to beneficiaries for its unfunded other employee future benefits was $1.9 million (2006 - $2.0 million). The most recent actuarial valuation was performed as at December 31, 2007.

millions of dollars	**2007**	2006
Accrued benefit obligation		
Balance at beginning of year	**57.1**	41.4
Current service cost	**1.9**	1.7
Interest cost	**3.1**	2.5
Actuarial (gain) loss	**(2.4)**	13.5
Benefits paid	**(1.9)**	(2.0)
Balance at end of year	**57.8**	57.1
Plan deficit at end of year	**57.8**	57.1
Unamortized actuarial loss	**(17.7)**	(21.3)
Unamortized past-service cost	**(0.3)**	(0.3)
Accrued benefit liability at end of year	**39.8**	35.5

millions of dollars	**2007**	2006
Components of benefit cost		
Current service cost	**1.9**	1.7
Interest cost	**3.1**	2.5
Actuarial (gain) loss	**(2.4)**	13.5
	2.6	17.7
Adjustments		
Difference between actual actuarial loss and amount recognized	**3.6**	(12.5)
Benefit expense	**6.2**	5.2

9. EMPLOYEE FUTURE BENEFITS (cont'd.)

The significant actuarial assumptions used in measuring the company's accrued benefit obligations and benefit expense are as follows:

	2007	2006
Discount rate	**5.5%**	5.3%
Rate of compensation increase	**3.5%**	3.5%

Assumed health care trend rates:

	2007	2006
Initial healthcare expense trend rate	**8.0%**	12.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2011**	2010

A 1% change in assumed healthcare trend rates would have had the following effects for 2007:

millions of dollars	Increase	Decrease
Current service cost	**0.4**	**(0.3)**
Interest cost	**0.6**	**(0.4)**
Accrued benefit obligation	**10.0**	**(7.7)**

10. SHAREHOLDERS' EQUITY

Share Capital

millions of dollars	2007	2006
Common shares of par value $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5

Contributed Capital

millions of dollars	2007	2006
Lower Churchill Development Corporation	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
	17.6	17.6

11. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in the fair market value of sinking fund investments designated as available for sale constitute the sole item in Accumulated Other Comprehensive Income.

millions of dollars	2007	2006
Adjusted opening balance arising from adoption of new accounting policies regarding financial instruments	**19.3**	-
Change in fair value of sinking fund investments	**0.2**	-
Balance, end of year	**19.5**	-

12. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31 are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might

12. FINANCIAL INSTRUMENTS (cont'd.)

receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	Fair Value	Carrying Value	Fair Value
millions of dollars	**2007**		2006	
Long-term debt including current portion	**1,359.4**	**1,691.4**	1,365.7	1,726.1

13. INTEREST EXPENSE

millions of dollars	**2007**	2006
Gross interest		
Long-term debt	**101.4**	101.9
Promissory notes	**0.9**	5.2
	102.3	107.1
Accretion of long-term debt	**0.7**	0.9
Amortization of foreign exchange losses	**2.2**	2.2
	105.2	110.2
Less		
Interest capitalized during construction	**6.3**	4.9
Interest earned	**12.9**	16.5
	86.0	88.8
Less		
Interest attributable to CF(L)Co. share purchase debt	**0.9**	1.7
Net interest attributable to Hydro	**85.1**	87.1
Debt guarantee fee	**13.1**	14.0
Net interest and guarantee fee	**98.2**	101.1

14. CHANGE IN NON-CASH BALANCES

millions of dollars	**2007**	2006
Accounts receivable	**(9.7)**	(2.2)
Fuel and supplies	**(15.5)**	5.9
Prepaid expenses	**0.3**	0.8
Long-term receivable	**(5.2)**	(18.1)
Regulatory assets	**49.7**	39.1
Regulatory liabilities	**(11.3)**	37.6
Accounts payable and accrued liabilities	**27.1**	(10.4)
Accrued interest	**-**	1.3
Due to related parties	**(3.3)**	0.3
Employee future benefits	**4.3**	3.2
	36.4	57.5

15. SEGMENT INFORMATION

Hydro operates in two business segments. Regulated operations encompass sales of power and energy to most customers within the province of Newfoundland and Labrador while other energy activities are primarily engaged in energy project development and sales to markets outside the province. The designation of segments has been based on regulatory status. The segment's accounting policies are the same as those described in Note 2.

15. SEGMENT INFORMATION (cont'd.)

millions of dollars	Regulated Operations	Other Energy Activities	Total
		2007	
Revenue	**440.7**	**58.5**	**499.2**
Depreciation	**38.4**	**-**	**38.4**
Interest	**103.2**	**(5.0)**	**98.2**
(Loss) Income from operations	**2.9**	**53.6**	**56.5**
Other Income - CF(L)Co			**25.1**
Net Income			**81.6**
Assets	**1,733.3**	**143.2**	**1,876.5**
Investment in Churchill Falls (Labrador) Corporation			**350.5**
Total Assets			**2,227.0**
Capital Expenditures	**36.0**	**45.7**	**81.7**

millions of dollars		2006	
Revenue	416.5	57.4	473.9
Depreciation	36.6	-	36.6
Interest	102.4	(1.3)	101.1
(Loss) Income from operations	(6.9)	50.5	43.6
Other Income			26.4
Net Income			70.0
Assets	1,732.9	92.3	1,825.2
Investment in Churchill Falls (Labrador) Corporation			338.2
Total Assets			2,163.4
Capital Expenditures	41.6	14.7	56.3

In 2007, sales to Hydro's two largest customers amounted to 66.8% and 11.1% (2006 - 62.4% and 13.5%) of total energy sales revenue. At December 31, 2007 approximately 69.7% (2006 – 69.0%) of the total accounts receivable balance outstanding is due from one customer.

Geographic Information

Revenues by geographic area:

millions of dollars	**2007**	2006
Newfoundland and Labrador	**445.1**	421.4
Québec	**54.1**	52.5
	499.2	473.9

Substantially all of Hydro's assets are located in the Province.

16. COMMITMENTS AND CONTINGENCIES

(a) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $1.2 million (2006 - $1.4 million).

16. COMMITMENTS AND CONTINGENCIES (cont'd.)

(a) (cont'd.)

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.8 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(b) Outstanding commitments for capital projects total approximately $16.5 million at December 31, 2007 (2006 - $3.6 million).

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

Type	Rating	In-Service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	15 MW	1998	25 years
Hydroelectric	4 MW	1998	25 years
Hydroelectric	32 MW	2003	30 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2008	20 years

Estimated payments due in each of the next 5 years are as follows:

millions of dollars	**2008**	**2009**	**2010**	**2011**	**2012**
Power purchases	37.3	56.0	59.0	65.8	66.5

(d) Hydro has issued two irrevocable letters of credit, one in the amount of $7.2 million to New Brunswick System Operator as credit support related to application for point to point transmission service. The second letter of credit has been issued to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement.

17. RELATED PARTY TRANSACTIONS

The Province, CF(L)Co, LCDC and GIPCo are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province.

millions of dollars		**2007**	2006
Due to GIPCo.	- promissory notes at 4.3% (2006 - 4.25%)	**0.1**	0.1
Due to (from) CF(L)Co.	- nil (2006 - promissory notes at 4.30% - 4.55%)	**-**	3.5
	- other	**0.1**	(0.1)
		0.2	3.5

(a) Hydro has entered into a long-term power contract with CF(L)Co. for the purchase of $6.1 million (2006 -$6.1 million) of the power produced by CF(L)Co.

(b) Under an agreement between Hydro and CF(L)Co., Hydro provides certain engineering, technical, management and administrative services to CF(L)Co. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. For the year ended December 31, 2007 the fees paid to Hydro for these services amounted to approximately $2.2 million (2006 - $1.9 million).

17. RELATED PARTY TRANSACTIONS (cont'd.)

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2007, Hydro paid $1.2 million to the PUB (2006 - $0.8 million) of which $0.1 million was included in accrued liabilities reflected at December 31, 2007.

18. SUBSEQUENT EVENTS

Effective January 1, 2008, the Province created a new crown corporation to hold its investments in the energy sector. Hydro is in the process of transferring its non-regulated assets and personnel including its investments in CF(L)Co GIPCo and LCDC to the new parent company. The segment information related to regulated operations in Note 15 is indicative of the operation that will remain in Hydro.

19. COMPARATIVE FIGURES

Certain of the 2006 comparative figures have been reclassified to conform with the 2007 financial statement presentation. Specifically, deferred charges in the amount of $3.4 million have been reclassified to debt as a result of the adoption of CICA Section 3855. In addition, a reclassification of investments of $19.8 million is reported with the sinking funds as opposed to an offset against debt.

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2008

Deloitte.

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Auditors' Report

To the Directors of
Newfoundland and Labrador Hydro

We have audited the balance sheet of Newfoundland and Labrador Hydro as at December 31, 2008 and the statements of income and retained earnings and comprehensive income and cash flows for the year then ended. These financial statements have been prepared on a non-consolidated basis for regulatory purposes. The financial statements are the responsibility of the Company's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with the basis of accounting described in Note 1 to the financial statements. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year, except as disclosed in Note 3.

These financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are solely for the information and use of the Directors of Newfoundland and Labrador Hydro and the Newfoundland and Labrador Board of Commissioners of Public Utilities. The financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

Deloitte & Touche LLP

Chartered Accountants
February 20, 2009

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Lawyer and Corporate Director

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Nalcor Energy

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General Counsel and Corporate Secretary

PETER A. HICKMAN
Assistant Corporate Secretary

MARK G.S. BRADBURY
Corporate Treasurer

GLENN H. MITCHELL
Corporate Controller

HEAD AND CORPORATE OFFICE
P.O. Box 12400
St. John's, Newfoundland and Labrador
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NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	2008	2007
ASSETS		
Current assets		
Cash and cash equivalents	0.1	-
Accounts receivable	69.4	69.1
Current portion of regulatory assets (Note 5)	5.0	17.2
Fuel and supplies	43.0	60.9
Prepaid expenses	1.2	0.8
	118.7	148.0
Property, plant and equipment (Notes 4 and 18(d))	1,354.3	1,469.4
Sinking funds (Notes 8 and 13)	163.9	151.8
Regulatory assets (Note 5)	74.6	81.3
Long-term receivables (Note 6)	25.4	23.3
Investments (Note 7)	359.8	353.2
	2,096.7	2,227.0
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Bank indebtedness (Note 8)	4.6	8.0
Accounts payable and accrued liabilities	46.2	65.3
Accrued interest	28.7	30.6
Current portion of long-term debt (Note 8)	8.3	208.3
Current portion of regulatory liabilities (Note 5)	22.3	23.5
Deferred capital contribution (Note 18 (e))	2.2	-
Promissory notes (Note 8)	163.0	7.0
Due to related parties (Notes 13 and 18)	3.5	0.2
	278.8	342.9
Long-term debt (Note 8)	1,146.4	1,151.1
Regulatory liabilities (Note 5)	31.5	15.5
Employee future benefits (Note 9 and 18(d))	41.9	39.8
Total liabilities	1,498.6	1,549.3
Shareholder's equity		
Share capital (Note 10)	22.5	22.5
Contributed capital (Notes 10 and 18(d))	15.4	17.6
Accumulated other comprehensive income (Notes 12 and 13)	15.9	19.5
Retained earnings (Note 18(d))	544.3	618.1
	598.1	677.7
Commitments and contingencies (Note 17)		
	2,096.7	2,227.0

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2008**	2007
Revenue		
Energy sales	**498.3**	497.2
Other	**2.2**	2.0
	500.5	499.2
Expenses		
Operations and administration	**103.0**	104.5
Fuels	**164.8**	159.2
Interest (Note 14)	**78.7**	98.2
Power purchased (Note 17(c))	**44.9**	42.4
Amortization	**40.4**	38.4
	431.8	442.7
Income from operations	**68.7**	56.5
Other income (expense)		
Equity in net income of Churchill Falls (Note 7(a))	**11.8**	15.6
Preferred dividends from Churchill Falls	**9.0**	10.4
Interest on share purchase debt (Note 14)	**-**	(0.9)
Write-down of assets (Note 7(b))	**(2.7)**	-
	18.1	25.1
Net income	**86.8**	81.6
Retained earnings, beginning of year	**618.1**	534.2
Add: adjustment to long-term debt (Note 13)	**-**	2.3
Deduct: adjustment to retained earnings (Note 18(d))	**160.6**	-
Retained earnings, end of year	**544.3**	618.1

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended December 31 (millions of dollars)	**2008**	2007
Net income	**86.8**	81.6
Other comprehensive income		
Change in fair value of sinking fund investments	**(3.6)**	0.2
Comprehensive income	**83.2**	81.8

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2008**	2007
Cash provided by (used in)		
Operating activities		
Net income	**86.8**	81.6
Adjusted for items not involving a cash flow		
Amortization	**40.4**	38.4
Accretion of long-term debt	**0.5**	0.7
Loss on disposal of property, plant and equipment	**2.6**	0.9
Equity in net income of Churchill Falls	**(11.8)**	(15.6)
Write-down of investments	**2.7**	-
Other	**-**	(0.1)
	121.2	105.9
Change in non-cash working capital balances (Note 15)	**30.6**	36.4
Dividends from Churchill Falls	**2.5**	3.3
	154.3	145.6
Financing activities		
Long-term debt retired	**(200.1)**	(0.2)
Increase (decrease) in promissory notes	**156.0**	(52.4)
Advance to Nalcor Energy (Note 18 (d))	**(3.0)**	-
Increase in deferred capital contribution	**2.2**	-
	(44.9)	(52.6)
Investing activities		
Additions to property, plant and equipment	**(85.8)**	(81.7)
Increase in sinking funds	**(20.8)**	(19.6)
Decrease in short-term investments	**-**	0.6
Proceeds on disposal of property, plant and equipment	**0.7**	0.6
	(105.9)	(100.1)
Net increase (decrease) in cash	**3.5**	(7.1)
Cash position, beginning of year	**(8.0)**	(0.9)
Cash position, end of year	**(4.5)**	(8.0)
Cash position is represented by		
Cash and cash equivalents	**0.1**	-
Bank indebtedness	**(4.6)**	(8.0)
	(4.5)	(8.0)
Supplementary disclosure of cash flow information		
Interest received	**0.2**	0.2
Interest paid	**99.7**	102.6

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

1. PRINCIPLES OF FINANCIAL STATEMENT PRESENTATION

Newfoundland and Labrador Hydro is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador ("Province") as a Crown corporation and is exempt from paying income taxes under Section 149 (1)(d) of the Income Tax Act. The principal activity of Hydro is the development, generation and sale of electricity.

These financial statements have been prepared in accordance with the significant accounting polices set out below. These financial statements materially differ from Canadian generally accepted accounting principles because they are non-consolidated. Hydro's investments in its subsidiary and jointly controlled companies have been accounted for using the equity method of accounting. Consolidated financial statements for the same period have been prepared for presentation to the Lieutenant-Governor in Council of the Province.

Preparation of these financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, litigation, amortization and property, plant and equipment, environmental and asset retirement obligations, and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities ("PUB").

2. SIGNIFICANT ACCOUNTING POLICIES

Rates and Regulations

Hydro's revenues from its electricity sales to most customers within the Province are subject to rate regulation by the PUB. As well, Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service ("COS") methodology. The allowed rate of return on rate base is 7.4% (2007 - 7.4%). Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 5.

Cash and Cash Equivalents and Short-Term Investments

Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. There were no cash equivalents or short-term investments outstanding at December 31, 2008 (2007 - nil).

Fuel and Supplies

Fuel and supplies inventories are recorded at the lower of average cost or net realizable value.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment

Property, plant and equipment are recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction, and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Hydro recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

Contributions in aid of construction are funds received from customers and governments toward the cost of property, plant and equipment. Contributions are treated as a reduction to property, plant and equipment and the net property, plant and equipment are amortized.

Gain or losses on the disposal of property, plant and equipment are recognized in income as incurred.

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution system	30 years
Other	3 to 50 years

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

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kV. Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Distribution system assets include poles, transformers, insulators, and conductors.

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

Impairment of Long-Lived Assets

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying value of the property and assets. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Revenue Recognition

Revenue is recognized on the accrual basis, as power and energy deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB, whereas sales to Hydro-Québec and certain major industrial customers are at rates under the terms of the applicable contracts.

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At the date of settlement and at each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of cumulative net actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 13 years.

3. CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2008, Hydro adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA").

Inventories

Section 3031, Inventory requires inventories to be measured at the lower of cost or net realizable value; disallows the use of last-in-first-out inventory costing methodology; and requires that, when circumstances which previously caused inventories to be written down no longer exist, the amount of the write-down is to be reversed. This new standard did not have any impact on Hydro's financial results or disclosures.

Disclosure and Presentation of Financial Instruments

Section 3862, Financial Instruments, Disclosures and Section 3863, Financial Instruments, Presentation sets out new accounting recommendations for disclosure and presentation of financial instruments. The new recommendations require disclosure of both quantitative and qualitative information that enables users of financial statements to evaluate the nature and extent of exposure to risks from financial instruments. These new standards did not have any impact on Hydro's financial results. The additional disclosure is included in Note 13.

Capital Disclosures

Section 1535, Capital Disclosures requires Hydro to include additional information in the notes to the financial statements about its capital and the manner in which it is managed. This additional disclosure includes quantitative and qualitative information regarding objectives, policies and processes for managing capital. The additional required disclosure is provided in Note 11 to these financial statements.

4. PROPERTY, PLANT AND EQUIPMENT

	Capital Assets in Service	Contributions in aid of Construction	Accumulated Amortization	Construction in Progress	Net Book Value
(millions of dollars)			**2008**		
Generation plant					
Hydroelectric	**844.1**	**20.5**	**55.6**	**1.5**	**769.5**
Thermal	**247.5**	**0.8**	**190.6**	**1.8**	**57.9**
Diesel	**62.1**	**6.0**	**31.7**	**0.9**	**25.3**
Transmission and distribution	**679.3**	**60.2**	**192.3**	**4.2**	**431.0**
Other	**211.4**	**8.7**	**133.2**	**1.1**	**70.6**
	2,044.4	**96.2**	**603.4**	**9.5**	**1,354.3**
(millions of dollars)			2007		
Generation plant					
Hydroelectric	842.6	20.5	51.1	114.4	885.4
Thermal	244.2	0.8	188.3	0.8	55.9
Diesel	61.3	5.9	29.7	0.1	25.8
Transmission and distribution	665.3	60.7	177.8	0.7	427.5
Other	205.2	8.5	123.4	1.5	74.8
	2,018.6	96.4	570.3	117.5	1,469.4

4. PROPERTY, PLANT AND EQUIPMENT (cont'd.)

At the end of 2008, pursuant to an asset transfer agreement ("the Transfer Agreement") between Hydro and Nalcor Energy ("Nalcor"), Hydro's parent company, $157.2 million worth of property, plant and equipment was transferred from Hydro to Nalcor for consideration equal to net book value (Note 18 (d)).

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

(millions of dollars)	**2008**	2007	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Long-term receivable	-	12.1	-
Foreign exchange losses	**71.1**	73.3	34.0
Deferred regulatory costs	**0.2**	0.4	1.0
Deferred major extraordinary repairs	**7.6**	12.3	4.0
Deferred study costs	**0.2**	0.4	1.0
Deferred wind power costs	**0.5**	-	1.0
Total regulatory assets	**79.6**	98.5	
Less current portion	**5.0**	17.2	
	74.6	81.3	
Regulatory liabilities			
Rate stabilization plan	**53.2**	38.3	n/a
Deferred purchased power savings	**0.6**	0.7	19.0
Total regulatory liabilities	**53.8**	39.0	
Less current portion	**22.3**	23.5	
	31.5	15.5	

The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event. Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities are no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations.

Rate Stabilization Plan and Related Long-Term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan ("RSP") which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Rate Stabilization Plan and Related Long-Term Receivable (cont'd.)

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003) RSP balances which accumulated prior to March 31, 2003, were converted to a long-term receivable bearing interest at the weighted average cost of capital to be recovered over a four-year period, which commenced in 2004. The recovery period for industrial customers ended on December 31, 2007 and for the utility customers on June 30, 2008. Any remaining balances were transferred to the current plan. Any subsequent balances accumulating in the RSP including financing charges are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2008, $9.1 million was recognized (2007 - $31.5 million) in the RSP and $14.9 million (2007 - $8.9 million) was recovered through rates and included in energy sales, with a corresponding cost amortized in fuels expenses.

Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of $2.2 million annually, is included in interest expense (Note 14).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 General Rate Application in the amount of $0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred. In 2008, $0.2 million (2007 - $0.2 million) of amortization was recognized in operations and administration expenses.

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station ("HTGS"). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset which will be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006) the

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Deferred Major Extraordinary Repairs (cont'd.)

PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007 $2.0 million of expenses related to a turbine failure were deferred as a major extraordinary repair. This amount, net of insurance proceeds, has been expensed in 2008 (Note 19). In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year in which they were incurred. In 2008, $2.7 million (2007 - $2.1 million) of amortization was recognized in operating costs.

Deferred Wind Power Costs

Pursuant to Order No. P.U. 20 (2008) the PUB has agreed to allow Hydro to defer $0.5 million in costs associated with connecting the wind farms at St. Lawrence and Fermeuse to the Island Interconnected Grid through Newfoundland Power's transmission system and accordingly, these costs have been recognized as a regulatory asset. These costs will be expensed in 2009. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004) the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year in which they were incurred. In 2008, there were no additions (2007 - $0.2 million) and $0.2 million (2007 - $0.1 million) of amortization was recognized in operating and administration expenses.

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings in the amount of $0.6 million (2007 - $0.7 million) are recognized as a regulatory liability. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were incurred.

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction ("AFUDC"), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2008, Hydro's AFUDC of 7.6% is higher than its cost of debt of 7.3% the amount capitalized is higher and interest expense is lower by $0.4 million than that which would be permitted in the absence of rate regulation. In 2007, Hydro's AFUDC of 7.6% is lower than its cost of debt of 8.0%, the amount capitalized is lower and interest expense is higher by $0.3 million than that which would be permitted in the absence of rate regulation (Note 15).

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method.

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Property, Plant and Equipment (cont'd.)

During 2005 Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management currently estimates that accumulated amortization is approximately $170.0 million - $180.0 million lower than it would otherwise be, and annual amortization expense is $10.0 million - $11.0 million lower, primarily due to the use of sinking fund rather than straight line amortization for hydroelectric and transmission assets. An update to this study began in 2008 and is presently ongoing.

6. LONG-TERM RECEIVABLES

Included in long-term receivables are two refundable deposits in the amount of $25.4 million (2007 - $23.3 million) associated with an application for transmission service into Québec, bearing interest at prime until April, 2007 and at one year Guaranteed Income Certificate ("GIC") rates thereafter.

7. INVESTMENTS

(millions of dollars)	Ownership Interest	**2008**	2007	
Churchill Falls (Labrador) Corporation	65.80%			
Shares, at cost		**167.2**	167.2	
Equity in retained earnings at beginning of year		**183.3**	171.0	
Equity in net income for the year		**11.8**	15.6	
Dividends for the year		**(2.5)**	(3.3)	
		359.8	350.5	(a)
Lower Churchill Development Corporation Limited	51.00%	**-**	2.7	(b)
Gull Island Power Company Limited	100.00%	**-**	-	(c)
		359.8	353.2	

(a) A portion of Hydro's shareholding in Churchill Falls (Labrador) Corporation ("Churchill Falls") was deposited in a voting trust pursuant to an agreement with Hydro-Québec in relation to Churchill Falls' General Mortgage Bonds. Effective February 25, 2008, the bonds were retired removing the requirement for the shares to be held in trust.

Effective June 18, 1999, the two shareholders of Churchill Falls, Hydro and Hydro-Québec, entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Québec.

(b) The Lower Churchill Development Corporation Limited ("LCDC") was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River ("Lower Churchill Development") in Labrador.

Hydro, the designate for the Province's shareholding in LCDC, holds 1,540 Class A common shares of LCDC. Five hundred and twenty shares were acquired in 1979 pursuant to the signing of an Option Agreement between LCDC and the Province, dated November 24, 1978. Five hundred and ten shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province. On November 20, 2008, LCDC was advised by the Province that it would not be extending the Option Agreement. As a consequence LCDC's option expired on November 24, 2008, which had the effect of terminating the Option Agreement and Hydro's share of this agreement in the amount of $2.7 million was expensed as a write-down of assets in the current year.

7. INVESTMENTS (cont'd.)

(c) Gull Island Power Company Limited ("GIPCo.") is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland ("Gull Island Project"). All project costs were funded by way of capital contributions from the Province. Hydro suspended all work on the Gull Island Project in 1976, in the absence of satisfactory arrangements for the financing of the project and the marketing of available power.

8. LONG-TERM DEBT

Series	Face Value	Coupon Rate %	Year of Issue	Year of Maturity			
(millions of dollars)					**2008**	2007	
AA	200.0	5.50	1998	2008	**-**	199.9	
V	125.0	10.50	1989	2014	**124.5**	124.4	(a)
X	150.0	10.25	1992	2017	**149.1**	149.0	(a)
Y	300.0	8.40	1996	2026	**292.9**	292.7	(a)
AB	300.0	6.65	2001	2031	**306.9**	307.1	(a)
AD	125.0	5.70	2003	2033	**123.5**	123.5	(a)
AE	225.0	4.30	2006	2016	**223.5**	223.3	
Total debentures	1,425.0				**1,220.4**	1,419.9	
Less sinking fund investments in own debentures					**65.9**	60.8	
					1,154.5	1,359.1	
Other					**0.2**	0.3	
					1,154.7	1,359.4	
Less payments due within one year					**8.3**	208.3	
					1,146.4	1,151.1	

(a) Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2007 - 4.50% to 9.86%).

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of one percent annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31. The guarantee fee for 2008 was waived by the Province.

Hydro uses promissory notes to fulfill its short-term funding requirements. At year-end the promissory notes outstanding were at interest rates ranging from 1.40% to 2.90% (2007 - 4.30% to 4.45%).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year-end there were no amounts drawn on the facility (2007 – nil). Advances may take the form of a prime rate advance or the issuance of a Bankers' Acceptance ("BA") with interest calculated at the prime rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the prime rate. At year-end, Hydro had two letters of credit outstanding (Note 17(d)) reducing the availability of the credit facility by $7.5 million.

8. LONG-TERM DEBT (cont'd)

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

(millions of dollars)	**2009**	**2010**	**2011**	**2012**	**2013**
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayments	0.1	-	-	-	-
	8.3	8.2	8.2	8.2	8.2

9. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $3.8 million (2007 - $3.8 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2008, cash payments to beneficiaries for its unfunded other employee future benefits was $2.2 million (2007 - $1.9 million). The most recent actuarial valuation was performed as at December 31, 2006 with an extrapolation of the December 31, 2006 valuation to December 31, 2008. The next actuarial valuation will be performed as at December 31, 2009.

(millions of dollars)	**2008**	2007
Accrued benefit obligation		
Balance at beginning of year	**57.8**	57.1
Transfer to Nalcor Energy	**(1.4)**	-
Current service cost	**1.7**	1.9
Interest cost	**3.1**	3.1
Actuarial gain	**(15.9)**	(2.4)
Benefits paid	**(2.2)**	(1.9)
Balance at end of year	**43.1**	57.8
Plan deficit	**43.1**	57.8
Unamortized actuarial loss	**(0.5)**	(17.7)
Unamortized past service cost	**(0.2)**	(0.3)
Transfer to Nalcor	**(0.5)**	-
Accrued benefit liability at end of year	**41.9**	39.8

(millions of dollars)	**2008**	2007
Components of benefit cost		
Current service cost	**1.7**	1.9
Interest cost	**3.1**	3.1
Actuarial gain	**(15.9)**	(2.4)
	(11.1)	2.6
Adjustments		
Difference between actual actuarial gain and amount recognized	**16.8**	3.6
Benefit expense	**5.7**	6.2

9. EMPLOYEE FUTURE BENEFITS (cont'd.)

The significant actuarial assumptions used in measuring the company's accrued benefit obligations and benefit expense are as follows:

	2008	2007
Discount rate	**7.5%**	5.5%
Rate of compensation increase	**3.5%**	3.5%

Assumed health care trend rates:

	2008	2007
Initial health care expense trend rate	**7.0%**	8.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2011**	2011

A 1% increase in assumed health care trend rates would have had the following effect:

(millions of dollars)	**2008**	2007
Current service and interest cost	**1.0**	1.0
Accrued benefits obligation	**5.8**	10.0

A 1% decrease in assumed health care trend rates would have had the following effect:

(millions of dollars)	**2008**	2007
Current service and interest cost	**(0.6)**	(0.7)
Accrued benefits obligation	**(4.6)**	(7.7)

10. SHAREHOLDER'S EQUITY

Share Capital

(millions of dollars)	**2008**	2007
Common shares of par value $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5

Contributed Capital

(millions of dollars)	**2008**	2007
Total contributed capital	**15.4**	17.6

The contributed capital related to the Muskrat Falls project was transferred to Nalcor as at December 31, 2008 pursuant to the Transfer Agreement (Note 18(d)).

11. CAPITAL MANAGEMENT

Hydro's primary objectives when managing capital are to minimize Hydro's cost of capital within the confines of established risk parameters, and to safeguard Hydro's ability to continue as a going concern. Hydro requires access to capital due to the capital intensive nature of the business which is required to ensure the continued delivery of safe and reliable service to its customers.

The capital managed by Hydro is composed of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity and its earnings before interest and taxes ("EBIT") coverage of interest. Adjustments to the capital structure are accomplished through adjustments to the amount of dividends paid to the shareholder, cash infusion via contributed equity, new debt issuance or debt issuance with differing characteristics.

Hydro's goal is to achieve a capital structure and cash flows to support debt. A summary of the capital structure is outlined below:

(millions of dollars)	**2008**		2007	
Debt				
Long-term debt	**1,146.4**		1,151.1	
Current portion of long-term debt	**8.3**		208.3	
Promissory notes	**163.0**		7.0	
Sinking funds	**(163.9)**		(151.8)	
	1,153.8	**65.9%**	1,214.6	64.2%
Equity				
Share capital	**22.5**		22.5	
Contributed capital	**15.4**		17.6	
Accumulated other comprehensive income	**15.9**		19.5	
Retained earnings	**544.3**		618.1	
	598.1	**34.1%**	677.7	35.8%
Total debt and equity	**1,751.9**	**100.0%**	1,892.3	100.0%

12. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in the fair market value of sinking fund investments designated as available for sale constitute the sole item in Accumulated Other Comprehensive Income.

(millions of dollars)	**2008**	2007
Balance, beginning of year	**19.5**	-
Adjustment due to the adoption of new accounting policies	**-**	19.3
Change in fair value of sinking fund investments	**(3.6)**	0.2
Balance, end of year	**15.9**	19.5

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial Instruments

Hydro has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Short-term investments	Held-to-maturity
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held-to-maturity
Sinking funds - other investments	Available for sale
Long-term receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Promissory notes	Other liabilities
Long-term debt	Other liabilities
Due to related parties	Other liabilities

Each of these financial instruments is measured at amortized cost, except sinking funds - other investments and cash and cash equivalents which are measured at fair value.

In 2007, Hydro recognized an increase to opening retained earnings of $2.3 million resulting from the measurement of outstanding long-term debt at amortized cost, using the effective interest method. As well, Hydro recognized an opening balance of accumulated other comprehensive income arising from unrealized gains on sinking fund investments of $19.3 million.

Fair Value

The estimated fair values of financial instruments as at December 31 are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
(millions of dollars)	**2008**		2007	
Financial Liabilities				
Long-term debt including amount due within one year	**1,154.7**	**1,454.5**	1,359.4	1,691.4

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents which are expensed as incurred, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management

Exposure to credit risk, liquidity risk and market risk arises in the normal course of Hydro's business.

(a) Credit Risk

Hydro is exposed to credit risk in the event of non performance by counterparties to its financial instruments. The majority of Hydro's receivables are from regulated utilities which minimizes credit risk. There is risk that Hydro will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments which arise in the normal course of business do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Hydro manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers.

Hydro manages its investment credit risk exposure by restricting its investments to high quality securities such as Canada Treasury Bills, Bankers' Acceptances drawn on Schedule 1 Canadian Chartered Banks and Term Deposits issued by Schedule 1 Canadian Chartered Banks.

(b) Liquidity Risk

Hydro is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Hydro manages this risk by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cashflows. Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations, a $300 million promissory note program and a $50 million operating credit facility. Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues.

(c) Market Risk

Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates.

Interest Rates

Interest rate risk is managed within the corporate financing strategy where floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management include the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Hydro attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Exposure to changes in interest rates exists on interest expense related to the short-term debt portfolio and interest income related to the sinking fund investment portfolios. Hydro estimates that an increase of 100 basis points from the actual average yield on the short-term debt portfolio in 2008 would have resulted in a change in interest expense of $1.3 million (2007 – $0.2 million). Similarly, an increase of 100 basis points from the actual average yield on the sinking fund investment portfolio in 2008 would have resulted in a change in interest income of $2.0 million (2007 – $1.8 million) and a decrease in other comprehensive income of $16.1 million (2007 - $16.1 million). Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

(c) Market Risk (cont'd.)

Foreign Currency and Commodity Exposure

Fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar. Hydro's primary exposure to both foreign exchange and commodity price risk arise from its purchases of No. 6 fuel for consumption at the HTGS.

During 2008, Hydro had total purchases of No. 6 fuel of $103.9 million (2007 - $122.0 million). These purchases are denominated in U.S. dollars.

Hydro's exposure to both the foreign exchange and commodity price risk associated with these purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in actual fuel prices and exchange rates as compared to that approved in Hydro's most recent COS used to set rates, are captured in the RSP and are either refunded to or collected from customers via automatic rate adjustments. Hydro also employs the periodic use of forward currency contracts as a means by which exposure to exchange rates on a particular day can be avoided. As at December 31, 2008 there were no forward contracts outstanding.

14. INTEREST EXPENSE

(millions of dollars)	**2008**	2007
Gross interest		
Long-term debt	**94.1**	101.4
Promissory notes	**4.2**	0.9
	98.3	102.3
Accretion of long-term debt	**0.5**	0.7
Amortization of foreign exchange losses	**2.2**	2.2
	101.0	105.2
Less		
Interest capitalized during construction	**9.6**	6.3
Interest earned	**12.7**	12.9
	78.7	86.0
Less		
Interest attributable to CF(L)Co. share purchase debt	**-**	0.9
Net interest attributable to Hydro	**78.7**	85.1
Debt guarantee fee	**-**	13.1
Net interest and guarantee fee	**78.7**	98.2

15. CHANGE IN NON-CASH WORKING CAPITAL BALANCES

(millions of dollars)	2008	2007
Accounts receivable	**(0.3)**	(9.7)
Fuel and supplies	**17.9**	(15.5)
Prepaid expenses	**(0.4)**	0.3
Long-term receivables	**(2.1)**	(5.2)
Regulatory assets	**18.9**	49.7
Regulatory liabilities	**14.8**	(11.3)
Accounts payable and accrued liabilities	**(19.1)**	27.1
Accrued interest	**(1.9)**	-
Due to related parties	**0.2**	(3.3)
Employee future benefits	**2.6**	4.3
	30.6	36.4

16. SEGMENT INFORMATION

Hydro operates in two business segments. Regulated operations encompass sales of power and energy to most customers within the province of Newfoundland and Labrador while other energy activities are primarily engaged in energy project development and sales to markets outside the province. The designation of segments has been based on regulatory status. The segment's accounting policies are the same as those described in Note 2.

(millions of dollars)	Regulated	Other Energy Activities 2008	Total
Revenue			
Energy sales	**440.1**	**58.2**	**498.3**
Other	**2.2**	**-**	**2.2**
	442.3	**58.2**	**500.5**
Expenses			
Operations and administration	**99.1**	**3.9**	**103.0**
Fuels	**164.8**	**-**	**164.8**
Interest	**87.6**	**(8.9)**	**78.7**
Power purchased	**41.4**	**3.5**	**44.9**
Amortization	**40.4**	**-**	**40.4**
Write-down of assets	**-**	**2.7**	**2.7**
	433.3	**1.2**	**434.5**
Net income before equity in Churchill Falls	**9.0**	**57.0**	**66.0**
Equity in net income of Churchill Falls	**-**	**11.8**	**11.8**
Preferred shares	**-**	**9.0**	**9.0**
Net income	**9.0**	**77.8**	**86.8**
Capital expenditures	**45.6**	**40.2**	**85.8**
Total assets	**1,711.5**	**385.2**	**2,096.7**

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

16. SEGMENT INFORMATION (cont'd.)

(millions of dollars)	Regulated	Other Energy Activities	Total
		2007	
Revenue			
Energy sales	438.7	58.5	497.2
Other	2.0	-	2.0
	440.7	58.5	499.2
Expenses			
Operations and administration	98.5	6.0	104.5
Fuels	159.2	-	159.2
Interest	103.2	(5.0)	98.2
Power purchased	38.5	3.9	42.4
Amortization	38.4	-	38.4
Write-down of assets	-	-	-
	437.8	4.9	442.7
Net income before equity in Churchill Falls	2.9	53.6	56.5
Equity in net income of Churchill Falls	-	14.7	14.7
Preferred shares	-	10.4	10.4
Net income	2.9	78.7	81.6
Capital expenditures	36.0	45.7	81.7
Total assets	1,733.3	493.7	2,227.0

In 2008, sales to Hydro's two largest customers amounted to 66.5% and 10.9% (2007 - 66.8% and 11.1%) of total energy sales revenue. At December 31, 2008 approximately 68.3% (2007 - 69.7%) of the total accounts receivable balance outstanding is due from one customer.

Geographic Information

Revenues by geographic area:

(millions of dollars)	**2008**	2007
Newfoundland and Labrador	**447.9**	445.1
Québec	**52.6**	54.1
	500.5	499.2

All of Hydro's assets are located in the Province.

17. COMMITMENTS AND CONTINGENCIES

(a) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.1 million (2007 - $1.2 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $22.2 million (2007 - $21.8 million) related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

17. COMMITMENTS AND CONTINGENCIES (cont'd.)

(b) Outstanding commitments for capital projects total approximately $6.2 million (2007 - $16.5 million).

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

Type	Rating	In-Service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

During 2008, the enactment of the Abitibi-Consolidated Rights and Assets Act resulted in the cancellation of two long-term power purchase agreements (Note 20).

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

(millions of dollars)	**2009**	**2010**	**2011**	**2012**	**2013**
Power purchases	25.6	26.4	29.6	30.0	30.6

(d) Hydro has issued two irrevocable letters of credit, one in the amount of $7.2 million to New Brunswick System Operator as credit support related to application for point to point transmission service. The second letter of credit has been issued to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement.

18. RELATED PARTY TRANSACTIONS

The Province, Nalcor, Churchill Falls, LCDC, GIPCo and Nalcor Energy – Oil and Gas are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province.

(millions of dollars)	**2008**	2007
Due to GIPCo.	**0.1**	0.1
Due to Churchill Falls	**0.5**	-
Due to Nalcor	**2.9**	0.1
	3.5	0.2

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $6.0 million (2007 -$6.1 million) of the power produced by Churchill Falls.

(b) For the year ended December 31, 2008, approximately $1.8 million (2007 - $2.2 million) of operating costs representing charges for engineering, technical, management and administrative services were charged to Churchill Falls. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2008, Hydro incurred $0.6 million in costs related to the PUB (2007 - $1.2 million) of which $0.1 million (2007 - $0.1 million) was included in accrued liabilities.

18. RELATED PARTY TRANSACTIONS (cont'd.)

(d) During 2008, certain assets and liabilities and their related debt and equity were transferred from Hydro to Nalcor Energy. Details of the transactions are noted below which resulted in a payable of $6.1 million by Hydro to Nalcor. In June, 2008, an advance payment for these assets was made by Hydro to Nalcor resulting in a $3.1 million liability as at December 31, 2008 which is recorded as part of Due to related parties.

(millions of dollars)	**2008**
Capital assets	157.2
Contributed capital	(2.2)
Employee future benefits	(0.5)
Retained earnings from non-regulated activity in Hydro	(160.6)
Sub total	(6.1)
Payment made in 2008	3.0
Total due to Nalcor	(3.1)

(e) During 2008, Nalcor advanced $4.5 million as a contribution in aid of construction related to the Ramea Wind-Hydrogen-Diesel Project. As at December 31, 2008, $1.7 million of this funding has not been utilized to cover the costs of the associated capital project and has been recorded as a deferred capital contribution. Hydro also received contribution in aid of construction from the Province related to wind feasibility studies. As at December 31, 2008, the full amount of $0.5 million has been recorded as a deferred capital contribution.

(f) During 2008, Hydro received $0.4 million (2007 - nil) as a rate subsidy for rural isolated customers from the Province and $1.5 million (2007 - $0.6 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with $0.1 million (2007 - $0.6 million) recorded as accounts receivable at year-end.

19. CHANGE IN ESTIMATE

In 2007, Hydro incurred $2.0 million in expenses to repair a turbine at HTGS and these costs were deferred as a major extraordinary repair. Pursuant to Order No. P.U. 31 (2008) the PUB denied Hydro's request to treat the repair of the turbine as a major extraordinary repair and therefore, the full cost of the repair, net of insurance proceeds of $0.8 million, was recorded in operations and administration expense during 2008.

20. SIGNIFICANT OCCURRENCE

In late 2008, Abitibi-Consolidated announced the shut-down of the Grand Falls Pulp and Paper Mill resulting in the loss of a major industrial customer. Revenue from this customer for the year ended December 31, 2008 was $5.1 million (2007 - $4.9). The Abitibi-Consolidated Rights and Assets Act enacted on December 16, 2008 resulted in the cancellation of two power purchase agreements from two non-utility generators in which Abitibi was a partner.

21. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform with the 2008 financial statement presentation.

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009

Deloitte.

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Auditors' Report

To the Directors of
Newfoundland and Labrador Hydro

We have audited the balance sheet of Newfoundland and Labrador Hydro (the "Company") as at December 31, 2009 and the statements of income and retained earnings, comprehensive income and cash flows for the year then ended. These financial statements have been prepared on a non-consolidated basis for regulatory purposes. The financial statements are the responsibility of the Company's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and the results of its operations and its cash flows for the year then ended in accordance with the basis of accounting described in Note 2 to the financial statements. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

These financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are solely for the information and use of the Directors of Newfoundland and Labrador Hydro and the Newfoundland and Labrador Board of Commissioners of Public Utilities. The financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

Deloitte & Touche LLP

Chartered Accountants
March 9, 2010

BOARD OF DIRECTORS

JOHN OTTENHEIMER Q.C. (Chair)
Corporate Director

ED MARTIN
President and Chief Executive Officer
Nalcor Energy

CATHY BENNETT
Owner/Operator
Bennett Restaurants Ltd.

TOM CLIFT
Associate Dean, Academic Programs
Memorial University - Faculty of Business

KEN MARSHALL
President
Rogers Cable - Atlantic Region

GERRY SHORTALL
Chartered Accountant
Corporate Director

OFFICERS

JOHN OTTENHEIMER Q.C. (Chair)
Corporate Director

ED MARTIN
President and Chief Executive Officer
Nalcor Energy

MARK BRADBURY
Corporate Treasurer
Nalcor Energy

GILBERT BENNETT
Vice President
Lower Churchill Project

WAYNE CHAMBERLAIN
General Counsel and Corporate Secretary
Nalcor Energy

JIM HAYNES
Vice President Regulated Operations
Newfoundland and Labrador Hydro

PETER HICKMAN
Assistant Corporate Secretary
Nalcor Energy

ANDY MACNEILL
Vice President
Churchill Falls

JOHN MALLAM
Vice President Engineering Services
Newfoundland and Labrador Hydro

GERARD MCDONALD
Vice President Human Resources and
Organizational Effectiveness
Nalcor Energy

GLENN H. MITCHELL
Corporate Controller
Nalcor Energy

DERRICK STURGE
Vice President Finance and Chief Financial Officer
Nalcor Energy

HEAD OFFICE
Newfoundland and Labrador Hydro
Hydro Place. 500 Columbus Drive
Canada A1B 4K7

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2009**	2008
ASSETS		
Current assets		
Cash and cash equivalents	**10.9**	-
Short-term investments	**20.0**	-
Accounts receivable	**69.7**	69.4
Current portion of regulatory assets (Note 5)	**4.8**	5.0
Fuel and supplies	**50.0**	43.0
Prepaid expenses	**1.5**	1.2
	156.9	118.6
Property, plant and equipment (Notes 4 and 18 (e))	**1,364.2**	1,354.3
Sinking funds (Notes 8 and 13)	**179.6**	163.9
Regulatory assets (Note 5)	**69.3**	74.6
Long-term receivables (Note 6)	**23.9**	25.4
Derivative instruments (Note 13 (c))	**7.0**	**-**
Investments (Note 7)	**367.7**	359.8
	2,168.6	2,096.6
LIABILITIES		
Current liabilities		
Bank indebtedness (Note 8)	**-**	4.5
Accounts payable and accrued liabilities	**52.9**	46.2
Accrued interest	**28.7**	28.7
Current portion of long-term debt (Note 8)	**8.2**	8.3
Current portion of regulatory liabilities (Note 5)	**89.8**	22.3
Deferred capital contribution (Note 18 (f))	**0.2**	2.2
Promissory notes (Note 8)	**-**	163.0
Due to related parties (Notes 13 and 18)	**21.4**	3.5
	201.2	278.7
Long-term debt (Note 8)	**1,141.6**	1,146.4
Regulatory liabilities (Note 5)	**32.8**	31.5
Long-term related party note payable	**23.9**	-
Employee future benefits (Notes 9 and 18 (e))	**44.0**	41.9
	1,443.5	1,498.5
SHAREHOLDER'S EQUITY		
Share capital (Note 10)	**22.5**	22.5
Contributed capital (Notes 10 and 18 (e))	**115.4**	15.4
	137.9	37.9
Accumulated other comprehensive income (Note 12)	**21.0**	15.9
Retained earnings (Note 18 (e))	**566.2**	544.3
	587.2	560.2
	725.1	598.1
Commitments and contingencies (Note 17)		
Subsequent events (Note 19)	**2,168.6**	2,096.6

See accompanying notes

On behalf of the Board:

JOHN OTTENHEIMER

GERRY SHORTALL

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2009**	2008
Revenue		
Energy sales	**504.5**	498.3
Other	**2.9**	2.2
	507.4	500.5
Expenses		
Fuels	**155.2**	164.8’
Operations and administration	**121.4**	103.0
Interest (Note 14)	**83.5**	78.7
Power purchased	**51.0**	44.9
Amortization	**41.7**	40.4
	452.8	431.8
Income from operations	**54.6**	68.7
Other income (expense)		
Equity in net income of Churchill Falls (Note 7 (a))	**7.9**	11.8
Preferred dividends from Churchill Falls	**3.9**	9.0
Write-down of investment (Note 7 (b))	**-**	(2.7)
	11.8	18.1
Net income	**66.4**	86.8
Retained earnings, beginning of year	**544.3**	618.1
Equity transfer (Note 18 (e))	**-**	(160.6)
	610.7	544.3
Dividends	**44.5**	-
Retained earnings, end of year	**566.2**	544.3

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended December 31 (millions of dollars)	**2009**	2008
Net income	**66.4**	86.8
Other comprehensive income		
Change in fair value of sinking fund investments	**(1.1)**	(3.6)
Unrealized gains on derivatives designated as cash flow hedges	**6.2**	-
Comprehensive income	**71.5**	83.2

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2009**	2008
Cash provided by (used in)		
Operating activities		
Net income	**66.4**	86.8
Adjustments for items not involving cash		
Amortization	**41.7**	40.4
Accretion of long-term debt	**0.4**	0.5
Loss on disposal of property, plant and equipment	**1.3**	2.6
Unrealized gain on derivative instruments	**(0.8)**	-
Equity in net income of Churchill Falls	**(7.9)**	(11.8)
Write-down of investment	**-**	2.7
	101.1	121.2
Changes in non-cash operating working capital balances (Note 15)	**118.8**	30.6
Dividends from Churchill Falls	**-**	2.5
	219.9	154.3
Financing activities		
Repayment long-term debt	**(0.1)**	(200.1)
(Decrease) increase in promissory notes	**(163.0)**	156.0
Dividends paid to Nalcor Energy	**(44.5)**	-
Advance to Nalcor Energy	**-**	(3.0)
Contributed capital	**100.0**	-
(Decrease) increase in deferred capital contribution	**(2.0)**	2.2
	(109.6)	(44.9)
Investing activities		
Additions to property, plant and equipment	**(54.1)**	(85.8)
Increase in sinking funds	**(22.0)**	(20.8)
Increase in short-term investments	**(20.0)**	-
Proceeds on disposal of property, plant and equipment	**1.2**	0.7
	(94.9)	(105.9)
Net increase in cash	**15.4**	3.5
Cash position, beginning of year	**(4.5)**	(8.0)
Cash position, end of year	**10.9**	(4.5)
Cash position is represented by		
Bank Indebtedness	**(4.1)**	(4.5)
Cash equivalents	**15.0**	-
	10.9	(4.5)
Supplementary disclosure of cash flow information		
Interest received	**-**	0.2
Interest paid	**91.2**	99.7

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

Newfoundland and Labrador Hydro (Hydro), a Nalcor Energy company, is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and is exempt from paying income taxes under Section 149 (1)(d) of the Income Tax Act. The principal activity of Hydro is the development, generation and sale of electricity.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
These financial statements have been prepared in accordance with the significant accounting polices set out below. These financial statements materially differ from Canadian generally accepted accounting principles (GAAP) because they are non-consolidated. Hydro's investments in its subsidiary and jointly controlled companies have been accounted for using the equity method of accounting. Consolidated financial statements for the same period have been prepared for presentation to the Lieutenant-Governor in Council of the Province.

Use of Estimates
Preparation of these financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, amortization and property, plant and equipment, environmental and asset retirement obligations, and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB), and these differences could be material.

Rates and Regulations
Hydro's revenues from its electricity sales to most customers within the Province are subject to rate regulation by the PUB. As well, Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.4% (2008 - 7.4%). Hydro applies certain accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation, these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 5.

Cash and Cash Equivalents and Short-term Investments
Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Cash and cash equivalents and short-term investments are measured at fair value. There were cash equivalents and short-term investments outstanding at December 31, 2009 totaling $35.0 million (2008 – nil) bearing interest at rates ranging from 0.26% to 0.65%.

Fuel and Supplies
Fuel and supplies inventories are recorded at the lower of average cost or net realizable value.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment

Property, plant and equipment is recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction, and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Hydro recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

Contributions in aid of construction are funds received from customers and governments toward the cost of property, plant and equipment. Contributions are treated as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

Gain or losses on the disposal of property, plant and equipment are recognized in income as incurred.

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on distribution system and other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution system	30 years
Other	3 to 50 years

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

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)
Distribution system assets include poles, transformers, insulators, and conductors.

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

Impairment of Long-lived Assets
Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Revenue Recognition
Revenue is recognized on the accrual basis, as power and energy deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB, whereas sales to Hydro-Québec and certain major industrial customers are at rates under the terms of the applicable contracts.

Foreign Currency Translation
Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At the date of settlement and at each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

Employee Future Benefits
Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of cumulative net actuarial gains and losses over 10% of the accrued benefit obligation is amortized over the expected average remaining service life of the employee group, which is approximately 13 years.

Financial Instruments and Hedging Activities

Financial Instruments
Financial assets and financial liabilities are recognized on the balance sheet when Hydro becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Hydro has classified each of its financial instruments into the following categories: financial assets and liabilities held for trading; loans and receivables; financial assets held to maturity; financial assets available for sale; and other financial liabilities.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Financial Instruments and Hedging Activities (cont'd.)

Financial Instruments (cont'd.)
Hydro has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Short-term investments	Available-for-sale
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held-to-maturity
Sinking funds - other investments	Available-for-sale
Long-term receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Promissory notes	Other liabilities
Long-term debt	Other liabilities
Due to related parties	Other liabilities

Each of these financial instruments is measured at amortized cost, except for sinking fund – other investments, cash and cash equivalents and short-term investments which are measured at fair value.

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short-term investments which are expensed as incurred, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Derivative Instruments and Hedging Activities
Derivative instruments are utilized by Hydro to manage market risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Hydro may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Hydro formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

Hydro has designated forward foreign exchange contracts as cash flow hedges (Note 13). In a cash flow hedge relationship, the portion of unrealized gains or losses on the hedging item that is determined to be an effective hedge is recognized in Other Comprehensive Income (OCI), while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income.

Hydro had no fair value hedges in place at December 31, 2009 or 2008.

3. CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2009, Hydro adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA):

New Accounting Policies

Goodwill and Intangible Assets
Effective January 1, 2009, Hydro adopted Section 3064, Goodwill and Intangible Assets which establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets and provides more comprehensive guidance particularly with respect to internally developed intangible assets. This new standard did not have any material impact on Hydro's financial results or disclosures.

3. CHANGES IN ACCOUNTING POLICIES (cont'd.)

New Accounting Policies (cont'd.)

Financial Instruments
EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities issued by the Emerging Issues Committee. This abstract requires that an entity's own credit risk (for financial liabilities) and the credit risk of the counterparty (for financial assets) should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this abstract did not have a material impact on Hydro's Consolidated Financial Statements.

Hydro also adopted the changes made by the CICA to Section 3862, Financial instruments – Disclosures whereby an entity shall classify and disclose fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels:

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

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

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. The required disclosures are included in Note 13.

Future Accounting Changes

International Financial Reporting Standards (IFRS)
In October 2009, the Accounting Standards Board (AcSB) issued a third and final Omnibus Exposure Draft confirming that publically accountable enterprises in Canada will be required to apply IFRS in full and without modification, for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. Accordingly, starting in 2011, Hydro will present its financial statements in accordance with IFRS, and will be required to present restated comparative information for its year-ended December 31, 2010 balances, and will also restate its opening balance sheet as at January 1, 2010.

Hydro is continuing to assess the financial reporting impacts of the adoption of IFRS, however, the impact of these differences on Hydro's future financial position and results of operations are not reasonably estimable or determinable at this time. Hydro does anticipate a significant increase in disclosure resulting from the adoption of IFRS and is continuing to assess the level of disclosure required as well as any system changes that may be necessary to compile and process the information.

The International Accounting Standards Board (IASB) project schedule had indicated that a final standard on rate-regulated activities would be released in the second quarter of 2010. Commentary received on the Exposure Draft, and the resulting activities now planned by the IASB, creates uncertainty as to if and when a final standard will be released. If a final standard is released, it may not be until late 2011. Accordingly, Hydro is unable to conclude on the impact, if any, of differences that will apply to accounting for rate-regulated activities under IFRS versus Canadian GAAP.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

4. PROPERTY, PLANT AND EQUIPMENT

(millions of dollars)	Plant and Equipment in Service	Contributions in aid of Construction	Accumulated Amortization	Construction in Progress	Net Book Value
			2009		
Generation plant					
Hydroelectric	**847.7**	**20.5**	**61.3**	**1.2**	**767.1**
Thermal	**255.8**	**0.8**	**196.0**	**0.2**	**59.2**
Diesel	**64.6**	**5.9**	**33.5**	**2.8**	**28.0**
Transmission and distribution	**701.6**	**60.9**	**205.7**	**2.2**	**437.2**
Other	**212.8**	**8.7**	**135.6**	**4.2**	**72.7**
	2,082.5	**96.8**	**632.1**	**10.6**	**1,364.2**
(millions of dollars)			2008		
Generation plant					
Hydroelectric	844.1	20.5	55.6	1.5	769.5
Thermal	247.5	0.8	190.6	1.8	57.9
Diesel	62.1	6.0	31.7	0.9	25.3
Transmission and distribution	679.3	60.2	192.3	4.2	431.0
Other	211.4	8.7	133.2	1.1	70.6
	2,044.4	96.2	603.4	9.5	1,354.3

At the end of 2008, pursuant to an asset transfer agreement (the Transfer Agreement) between Hydro and Nalcor Energy (Nalcor), Hydro's parent company, $157.2 million worth of property, plant and equipment was transferred from Hydro to Nalcor for consideration equal to net book value (Note 18 (e)).

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

(millions of dollars)	**2009**	2008	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Foreign exchange losses	**68.9**	71.1	32.0
Deferred regulatory costs	**-**	0.2	-
Deferred major extraordinary repairs	**4.9**	7.6	2.8
Deferred study costs	**0.1**	0.2	2.0
Deferred wind power costs	**-**	0.5	-
Deferred energy conservation costs	**0.2**	-	n/a
Total regulatory assets	**74.1**	79.6	
Less current portion	**4.8**	5.0	
	69.3	74.6	
Regulatory liabilities			
Rate stabilization plan	**122.0**	53.2	n/a
Deferred purchased power savings	**0.6**	0.6	17.5
Total regulatory liabilities	**122.6**	53.8	
Less current portion	**89.8**	22.3	
	32.8	31.5	

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities is no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event.

Rate Stabilization Plan and Related Long-term Receivable
On January 1, 1986, Hydro, having received the approval of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003), RSP balances which accumulated prior to December 31, 2003, were converted to a long-term receivable bearing interest at the weighted average cost of capital to be recovered over a four-year period, which commenced in 2004. The recovery period for industrial customers ended on December 31, 2007 and for the utility customers on June 30, 2008. Any remaining balances were transferred to the current plan. Any subsequent balances accumulating in the RSP including financing charges are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian GAAP would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2009, $42.3 million was recognized (2008 - $9.1 million) in the RSP and $18.3 million (2008 - $14.9 million) was recovered through rates and included in energy sales, with a corresponding cost amortized in fuels expense.

Foreign Exchange Losses
Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding, to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of $2.2 million annually, is included in interest expense (Note 14).

Deferred Regulatory Costs
Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 General Rate Application in the amount of $0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include these costs in operating costs in the year incurred. In 2009, $0.2 million (2008 - $0.2 million) of amortization was recognized in operations and administration expense.

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (HTGS). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset to be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007 $2.0 million of expenses related to a turbine failure were deferred as a major extraordinary repair. This amount, net of insurance proceeds, was expensed in 2008. In the absence of rate regulation, Canadian GAAP would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year incurred. In 2009, $2.7 million (2008 - $2.7 million) of amortization was recognized in operating costs.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004), the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the cost of these studies in operating costs in the year incurred. In 2009, there were no additions (2008 - nil) and $0.1 million (2008 - $0.2 million) of amortization was recognized in operating and administration expense.

Deferred Wind Power Costs

Pursuant to Order No. P.U. 20 (2008), the PUB agreed to allow Hydro to defer $0.5 million in costs associated with connecting the wind farms at St. Lawrence and Fermeuse to the Island Interconnected Grid through Newfoundland Power's transmission system and, accordingly, these costs have been recognized as a regulatory asset. These costs were expensed in 2009. In the absence of rate regulation, Canadian GAAP would require that Hydro include these costs in operating costs in the year incurred.

Deferred Energy Conservation Costs

Pursuant to Order No. P.U. 8 (2007), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors and, accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include this program as operating costs in the year incurred. In 2009, $0.2 million (2008 – nil) was deferred.

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings in the amount of $0.6 million (2008 - $0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2009, Hydro's AFUDC of 7.6% is higher than its cost of debt of 7.2%, the amount capitalized is higher and interest expense is lower by $0.1 million than that which would be permitted in the absence of rate regulation. In 2008, Hydro's AFUDC of 7.6% is higher than its cost of debt of 7.3%, the amount capitalized is higher and interest expense is lower by $0.4 million than that which would be permitted in the absence of rate regulation (Note 14).

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method. During 2005, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management currently estimates that accumulated amortization is approximately $170.0-$180.0 million lower than it would otherwise be and annual amortization expense is $10.0-$11.0 million lower, primarily due to the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets. A more recent study indicated that the amounts could be significantly higher. An update to this study is to be completed in 2010.

6. LONG-TERM RECEIVABLES

Long-term receivables consist of two refundable deposits in the amount of $23.9 million (2008 - $25.4 million) associated with an application for transmission service into Québec, bearing interest at one year Guaranteed Income Certificate (GIC) rates.

7. INVESTMENTS

(millions of dollars)	Ownership Interest	**2009**	2008	
Churchill Falls (Labrador) Corporation	65.80%			
Shares, at cost		**167.2**	167.2	
Equity in retained earnings at beginning of year		**192.6**	183.3	
Equity in net income for the year		**7.9**	11.8	
Dividends for the year		**-**	(2.5)	
		367.7	359.8	(a)
Lower Churchill Development Corporation Limited	51.00%	**-**	-	(b)
Gull Island Power Company Limited	100.00%	**-**	-	(c)
		367.7	359.8	

(a) A portion of Hydro's shareholding in Churchill Falls (Labrador) Corporation (Churchill Falls) was deposited in a voting trust pursuant to an agreement with Hydro-Québec in relation to Churchill Falls' General Mortgage Bonds. Effective February 25, 2008, the bonds were retired removing the requirement for the shares to be held in trust.

Effective June 18, 1999, the two shareholders of Churchill Falls, Hydro and Hydro-Québec, entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Québec.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

7. INVESTMENTS (cont'd.)

(b) The Lower Churchill Development Corporation Limited (LCDC) was established with the objective of developing all or part of the hydroelectric potential of the lower Churchill River (Lower Churchill Development) in Labrador.

Hydro, the designate for the Province's shareholding in LCDC, holds 1,540 Class A common shares of LCDC. 520 shares were acquired in 1979 pursuant to the signing of an Option Agreement between LCDC and the Province, dated November 24, 1978. 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province. On November 20, 2008, LCDC was advised by the Province that it would not be extending the Option Agreement. As a consequence LCDC's option expired on November 24, 2008, which had the effect of terminating the Option Agreement and Hydro's share of this agreement in the amount of $2.7 million was expensed in 2008.

(c) Gull Island Power Company Limited (GIPCo) is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (Gull Island Project). All project costs were funded by way of capital contributions from the Province. Hydro suspended all work on the Gull Island Project in 1976, in the absence of satisfactory arrangements for the financing of the project and the marketing of available power.

8. LONG-TERM DEBT

Series	Face Value	Coupon Rate %	Year of Issue	Year of Maturity		
(millions of dollars)					**2009**	2008
V *	125.0	10.50	1989	2014	**124.5**	124.5
X *	150.0	10.25	1992	2017	**149.2**	149.1
Y *	300.0	8.40	1996	2026	**293.1**	292.9
AB *	300.0	6.65	2001	2031	**306.8**	306.9
AD *	125.0	5.70	2003	2033	**123.6**	123.5
AE	225.0	4.30	2006	2016	**223.7**	223.5
Total debentures	1,225.0				**1,220.9**	1,220.4
Less: sinking fund investments in own debentures					**71.1**	65.9
					1,149.8	1,154.5
Other					**-**	0.2
					1,149.8	1,154.7
Less: payments due within one year					**8.2**	8.3
					1,141.6	1,146.4

* Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2008 - 4.50% to 9.86%).

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments by the Province. The Province charges Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31. During 2008 and 2009, the guarantee fee was waived by the Province.

8. LONG-TERM DEBT (cont'd.)

Hydro uses promissory notes to fulfill its short-term funding requirements. At December 31, 2009 there were no promissory notes outstanding (2008 – $163.0 million).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year-end there were no amounts drawn on the facility (2008 – nil). Advances may take the form of a Prime Rate advance or the issuance of a Bankers' Acceptance (BA) with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year-end, Hydro had two letters of credit outstanding (Note 17(d)) reducing the availability of the credit facility by $7.5 million. In February 2010, Hydro issued 22 additional letters of credit, see Note 19.

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

(millions of dollars)	**2010**	**2011**	**2012**	**2013**	**2014**
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayment	-	-	-	-	125.0
	8.2	8.2	8.2	8.2	133.2

9. EMPLOYEE FUTURE BENEFITS

Pension Plan
Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $3.8 million (2008 - $3.8 million) are expensed as incurred.

Other Benefits
Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2009, cash payments to beneficiaries for its unfunded other employee future benefits was $2.2 million (2008 - $2.2 million). The most recent actuarial valuation was performed at December 31, 2009.

(millions of dollars)	**2009**	2008
Accrued benefit obligation		
Balance at beginning of year	**43.1**	57.8
Transfer to Nalcor Energy	**(0.5)**	(1.4)
Current service cost	**1.1**	1.7
Interest cost	**3.2**	3.1
Actuarial loss (gain)	**13.3**	(15.9)
Benefits paid	**(2.2)**	(2.2)
Balance at end of year	**58.0**	43.1
Plan deficit	**58.0**	43.1
Unamortized actuarial loss	**(13.8)**	(0.5)
Unamortized past service cost	**(0.2)**	(0.2)
Transfer to Nalcor Energy	**-**	(0.5)
Accrued benefit liability at end of year	**44.0**	41.9

9. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits (cont'd.)

(millions of dollars)	**2009**	2008
Components of benefit cost		
Current service cost	**1.1**	1.7
Interest cost	**3.2**	3.1
Actuarial loss (gain)	**13.3**	(15.9)
	17.6	(11.1)
Difference between actual actuarial (gain) loss and amount recognized	**(13.3)**	16.8
Benefit expense	**4.3**	5.7

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

	2009	2008
Discount rate – benefit cost	**7.5%**	5.5%
Discount rate – accrued benefit obligation	**6.5%**	7.5%
Rate of compensation increase	**3.5%**	3.5%

Assumed healthcare trend rates:

	2009	2008
Initial healthcare expense trend rate	**7.5%**	7.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2014**	2011

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

Increase	**2009**	2008
Current service and interest cost	**0.7**	1.0
Accrued benefits obligation	**8.9**	5.8

Decrease	**2009**	2008
Current service and interest cost	**(0.5)**	(0.6)
Accrued benefits obligation	**(7.0)**	(4.6)

10. SHAREHOLDER'S EQUITY

Share Capital

(millions of dollars)	**2009**	2008
Common shares of par value $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5

Contributed Capital

(millions of dollars)	**2009**	2008
Total contributed capital	**115.4**	15.4

During 2009, Nalcor contributed capital of $100.0 million (2008 – nil).Contributed capital of $2.2 million related to the Muskrat Falls project was transferred to Nalcor as at December 31, 2008 pursuant to the Transfer Agreement (Note 18(d)).

11. CAPITAL MANAGEMENT

Hydro's primary objectives when managing capital are to minimize Hydro's cost of capital within the confines of established risk parameters, and to safeguard Hydro's ability to continue as a going concern. Hydro requires access to capital due to the capital intensive nature of the business which is required to ensure the continued delivery of safe and reliable service to its customers.

The capital managed by Hydro is composed of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity and its earnings before interest and taxes (EBIT) coverage of interest. Adjustments to the capital structure are accomplished through adjustments to the amount of dividends paid to the shareholder, cash infusion through contributed equity, new debt issuance or debt issuance with differing characteristics.

Hydro's goal is to achieve a capital structure and cash flows to support debt. A summary of the capital structure is outlined below:

(millions of dollars)	**2009**		2008	
Debt				
Bank indebtedness	**-**		4.5	
Long-term debt	**1,141.6**		1,146.4	
Current portion of long-term debt	**8.2**		8.3	
Promissory notes	**-**		163.0	
Sinking funds	**(179.6)**		(163.9)	
	970.2	**57.2%**	1,158.3	65.9%
Equity				
Share capital	**22.5**		22.5	
Contributed capital	**115.4**		15.4	
Accumulated other comprehensive income	**21.0**		15.9	
Retained earnings	**566.2**		544.3	
	725.1	**42.8%**	598.1	34.1%
Total debt and equity	**1,695.3**	**100.0%**	1,756.4	100.0%

12. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in the fair market value of sinking fund investments designated as available for sale and unrealized gains on derivatives designated as cash flow hedges comprise accumulated other comprehensive income.

(millions of dollars)	**2009**	2008
Balance, beginning of year	**15.9**	19.5
Change in fair value of sinking fund investments	**(1.1)**	(3.6)
Unrealized gains on derivatives designated as cash flow hedges	**6.2**	-
Balance, end of year	**21.0**	15.9

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value

The estimated fair values of financial instruments as at December 31 are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
(millions of dollars)	**2009**		2008	
Financial liabilities				
Long-term debt including amount due within one year	**1,149.8**	**1,440.6**	1,154.7	1,454.5

Establishing Fair Value

The fair value of cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness and accounts payable and accrued liabilities approximates their carrying values due to their short-term maturity.

The fair value of long-term debt is determined using the present value of future cash flows under current financing agreements, based on Hydro's current estimated borrowing rate for loans with similar terms and conditions.

Fair Value Hierarchy

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

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

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

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

Financial instruments included in Level 1 are cash and cash equivalents and short-term investments. Financial instruments included in Level 2 are the derivative instruments and sinking funds – other investments. There are no financial instruments in Level 3.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management

Exposure to credit risk, liquidity risk and market risk arises in the normal course of Hydro's business.

(a) Credit Risk

Hydro is exposed to credit risk in the event of non performance by counterparties to its financial instruments. The majority of Hydro's receivables are from regulated utilities which minimizes credit risk. There is risk that Hydro will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments which arise in the normal course of business do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Hydro manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers.

Hydro manages its investment credit risk exposure by restricting its investments to high quality securities such as Canada Treasury Bills, Bankers' Acceptances drawn on Schedule 1 Canadian Chartered Banks and Term Deposits issued by Schedule 1 Canadian Chartered Banks.

(b) Liquidity Risk

Hydro is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Hydro manages this risk by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cash flows. Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations, a $300 million promissory note program and a $50 million operating credit facility. Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues.

(c) Market Risk

Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates. During 2009, the Board of Directors of Nalcor, approved a formal financial risk management policy that outlined the risks associated with the operations of Nalcor and its subsidiaries and approaches and guidelines to be followed in the management of those risks. This policy will be reviewed by the Board annually or more frequently if there is a material change to Nalcor's financial risks and outlines a formal approval process for various hedging instruments used. The Audit Committee will provide oversight on behalf of the Board with the exception of any items that specifically require Board approval.

Interest Rates

Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management include the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Hydro attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Exposure to changes in interest rates exists on interest expense related to the short-term debt portfolio and interest income related to the sinking fund investment portfolios. Hydro estimates that a change of 100 basis points from the actual average yield on the short-term debt portfolio in 2009 would have resulted in a change in interest expense of $0.5 million (2008 – $1.3 million). Similarly, a change of 100 basis points from the actual average yield on the sinking fund investment portfolio in 2009 would have resulted in a change in interest income of $2.3 million (2008 – $2.0 million) and a change in other comprehensive income of $16.6 million (2008 - $16.1 million). Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

(c) Market Risk (cont'd.)

Foreign Currency and Commodity Exposure

Fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar. Hydro's primary exposure to both foreign exchange and commodity price risk arises from its purchases of No. 6 fuel for consumption at the HTGS and electricity sales denominated in US dollars.

During 2009, Hydro had total purchases of No. 6 fuel of $87.5 million (2008 - $103.9 million). These purchases are denominated in US dollars. Hydro's exposure to both the foreign exchange and commodity price risk associated with these fuel purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in actual fuel prices and exchange rates as compared to that approved in Hydro's most recent COS used to set rates, are captured in the RSP and are either refunded to or collected from customers through automatic rate adjustments. Hydro also employs the periodic use of forward currency contracts as a means by which exposure to exchange rates on a particular day can be avoided.

During 2009, total electricity sales denominated in US dollars were $42.5 million. Hydro mitigates this risk through the use of forward contracts. During 2009, Hydro entered into a series of 24 monthly foreign currency forward contracts, the last of which matures April 2011, in the amount of $87.8 million US dollars at an average exchange rate of 1.17 to hedge 75% of Hydro's forecasted US dollars sales. The nominal contract value range from $2.4 million to $6.0 million. During the year, eight of the contracts were settled with the effective portion of the gain reported as energy sales and the ineffective portion as other income. The fair value of the 16 contracts outstanding as at December 31, 2009 is $7.0 million. These contracts have been designated as part of a hedging relationship.

Effect of Hedge Accounting on Financial Statements

(millions of dollars)	**Net Gains Included in Net Income**	**Unrealized Gains Included in OCI**
Ineffective portion	0.5	-
Effective portion	2.4	6.2

14. INTEREST EXPENSE

(millions of dollars)	**2009**	2008
Gross Interest		
Long-term debt	**90.5**	94.1
Promissory notes	**0.6**	4.2
	91.1	98.3
Accretion of long-term debt	**0.4**	0.5
Amortization of foreign exchange losses	**2.2**	2.2
Other	**7.1**	2.7
	100.8	103.7
Less		
Interest capitalized during construction	**0.8**	9.6
Interest earned	**16.5**	15.4
Net interest revenue	**17.3**	25.0
Net interest expense	**83.5**	78.7

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

15. CHANGES IN NON-CASH OPERATING WORKING CAPITAL BALANCES

(millions of dollars)	**2009**	2008
Accounts receivable	**(0.3)**	(0.3)
Fuel and supplies	**(7.0)**	17.9
Prepaid expenses	**(0.3)**	(0.4)
Long-term receivables	**1.5**	(2.1)
Regulatory assets	**5.5**	18.9
Regulatory liabilities	**68.8**	14.8
Accounts payable and accrued liabilities	**6.7**	(19.1)
Accrued interest	**-**	(1.9)
Due to related parties	**17.9**	0.2
Employee future benefits	**2.1**	2.6
Long-term related party note payable	**23.9**	-
	118.8	30.6

16. SEGMENT INFORMATION

Hydro operates in three business segments. Hydro Regulated encompasses sales of power and energy to most customers within the Province, non-regulated activities are primarily engaged in energy project development and energy marketing activities involve the sale of electricity to markets outside the Province. The designation of segments has been based on regulatory status and management accountability. The segments' accounting policies are the same as those previously described in Note 2.

(millions of dollars)	**Hydro Regulated**	**Non Regulated Activities**	**Energy Marketing**	**Total**
		2009		
Revenue				
Energy sales	**443.8**	**6.0**	**54.7**	**504.5**
Other	**2.2**	**-**	**0.7**	**2.9**
	446.0	**6.0**	**55.4**	**507.4**
Expenses				
Fuels	**155.2**	**-**	**-**	**155.2**
Operations and administration	**100.9**	**3.3**	**17.2**	**121.4**
Interest	**83.5**	**-**	**-**	**83.5**
Power purchased	**46.8**	**-**	**4.2**	**51.0**
Amortization	**41.7**	**-**	**-**	**41.7**
	428.1	**3.3**	**21.4**	**452.8**
Net income from operations	**17.9**	**2.7**	**34.0**	**54.6**
Equity in net income of Churchill Falls	**-**	**7.9**	**-**	**7.9**
Preferred dividends	**-**	**3.9**	**-**	**3.9**
Net income	**17.9**	**14.5**	**34.0**	**66.4**
Capital expenditures	**54.1**	**-**	**-**	**54.1**
Total assets	**1,766.0**	**392.4**	**10.2**	**2,168.6**

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

16. SEGMENT INFORMATION (cont'd.)

(millions of dollars)	Hydro Regulated	Non Regulated Activities	Energy Marketing	Total
		2008		
Revenue				
Energy sales	440.1	6.9	51.3	498.3
Other	2.2	-	-	2.2
	442.3	6.9	51.3	500.5
Expenses				
Fuels	164.8	-	-	164.8
Operations and administration	99.1	3.9	-	103.0
Interest	87.6	(8.9)	-	78.7
Power purchased	41.4	-	3.5	44.9
Amortization	40.4	-	-	40.4
	433.3	(5.0)	3.5	431.8
Net income from operations	9.0	11.9	47.8	68.7
Equity in net income of Churchill Falls	-	11.8	-	11.8
Preferred dividends	-	9.0	-	9.0
Write-down of investments	-	(2.7)	-	(2.7)
Net income	9.0	30.0	47.8	86.8
Capital expenditures	45.6	40.2	-	85.8
Total assets	1,711.4	381.5	3.7	2,096.6

In 2009, sales to Hydro's two largest customers amounted to 69.2% and 7.5% (2008 - 66.5% and 10.9%) of total energy sales revenue. At December 31, 2009 approximately 66.6% (2008 - 68.3%) of the total accounts receivable balance outstanding is due from one customer.

Geographic Information

Revenues by geographic area:

(millions of dollars)	**2009**	2008
Newfoundland and Labrador	**450.6**	447.9
Québec	**13.6**	52.6
Nova Scotia	**39.7**	-
New Brunswick	**3.5**	-
	507.4	500.5

All of Hydro's assets are located in the Province.

17. COMMITMENTS AND CONTINGENCIES

(a) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.1 million (2008 - $0.1 million).

17. COMMITMENTS AND CONTINGENCIES (cont'd.)

(b) One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.9 million (2008 - $22.2 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate effect of such an action cannot be ascertained at this time, in the opinion of Hydro's management, following consultation with its legal counsel, no liability should be recognized.

(c) Outstanding commitments for capital projects total approximately $9.2 million (2008 - $6.2 million).

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

Type	Rating	In-service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

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

(millions of dollars)	**2010**	**2011**	**2012**	**2013**	**2014**
Power purchases	27.0	27.6	28.5	29.5	30.2

On December 16, 2008, the Province introduced legislation cancelling two power purchase agreements related to hydro facilities.

(e) Hydro has issued two irrevocable letters of credit, one in the amount of $7.2 million to New Brunswick System Operator as credit support related to an application for point to point transmission service. The second letter of credit has been issued to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement.

(f) Effective March 31, 2009, Hydro's five-year power sales agreement to sell energy to Hydro-Québec expired. Effective April 1, 2009, Hydro entered into a power sales agreement with a third party with respect to the energy previously sold to Hydro-Québec. To facilitate market access, Hydro entered into a five-year transmission service agreement with Hydro-Québec TransÉnergie to acquire access to 265 MW of transmission capacity from Labrador through Québec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing service request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that of the competing request.

Pursuant to Hydro's five-year transmission service agreement with Hydro-Québec TransÉnergie, the transmission rental payments for the next five years are as follows:

2010	$ 19.2 million
2011	$ 19.2 million
2012	$ 19.2 million
2013	$ 19.2 million
2014	$ 4.8 million

(g) Hydro has received funding in the amount of $2.5 million from the Atlantic Canada Opportunities Agency in relation to wind-hydrogen-diesel research and development project in the community of Ramea; this funding is repayable by annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2009, there have been no commercial implementations.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

18. RELATED PARTY TRANSACTIONS

The Province, Nalcor, Churchill Falls, LCDC, GIPCo Nalcor Energy – Bull Arm Fabrication and Nalcor Energy – Oil and Gas are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province.

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

(millions of dollars)	**2009**	2008
Due to GIPCo	**-**	0.1
Due to Churchill Falls	**0.6**	0.5
Due to Nalcor	**20.8**	2.9
	21.4	3.5

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $5.9 million (2008 -$6.0 million) of the power produced by Churchill Falls.

(b) For the year ended December 31, 2009, approximately $1.9 million (2008 - $1.8 million) of operating costs representing charges for engineering, technical, management and administrative services were charged to Churchill Falls.

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2009, Hydro incurred $0.6 million in costs related to the PUB (2008 - $0.6 million) of which $0.1 million (2008 - $0.1 million) was included in accrued liabilities.

(d) As at December 31, 2009, Hydro has a payable to Nalcor of $20.8 million (2008 - $2.9 million). This payable consists of various intercompany operating costs.

(e) During 2008, certain assets and liabilities and their associated debt and equity were transferred from Hydro to Nalcor Energy. Details of the transactions are noted below:

(millions of dollars)	2008
Property, plant and equipment	157.2
Contributed capital	(2.2)
Employee future benefits	(0.5)
Retained earnings from non-regulated activity in Hydro	(160.6)
Total	(6.1)

(f) During 2009, Nalcor advanced $1.1 million (2008 - $4.5 million) as a contribution in aid of construction related to the Ramea Wind-Hydrogen-Diesel Project. Hydro also received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2009, $0.2 million has been recorded as a deferred capital contribution.

(g) During 2009, Hydro received $0.4 million (2008 – $0.4 million) as a rate subsidy for rural isolated customers from the Province and $1.6 million (2008 - $1.5 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with $0.1 million (2008 - $0.1 million) recorded as accounts receivable at year-end.

19. SUBSEQUENT EVENTS

(a) In January 2010, Hydro entered into 28 swap contracts to hedge the commodity price risk on electricity sales in the amount of $24.7 million.

(b) In February 2010, Hydro issued 22 letters of credit, for transmission bookings, reducing the availability of its credit facility by $11.5 million.

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010

BOARD OF DIRECTORS

JOHN OTTENHEIMER Q.C. (Chair)
Corporate Director

ED MARTIN
President and Chief Executive Officer
Nalcor Energy

CATHY BENNETT
Owner/Operator
Bennett Restaurants Ltd.

TOM CLIFT
Associate Dean, Academic Programs
Memorial University - Faculty of Business

KEN MARSHALL
President
Rogers Cable - Atlantic Region

GERALD SHORTALL
Chartered Accountant
Corporate Director

OFFICERS

JOHN OTTENHEIMER Q.C. (Chair)
Corporate Director

ED MARTIN
President and Chief Executive Officer

GILBERT BENNETT
Vice President
Lower Churchill Project

WAYNE CHAMBERLAIN
General Counsel and Corporate Secretary

JIM HAYNES
Vice President Regulated Operations

ANDY MACNEILL
Vice President
Churchill Falls

JOHN MacISAAC
Vice President
Project Execution and Technical Services

GERARD MCDONALD
Vice President Human Resources and
Organizational Effectiveness

DERRICK STURGE
Vice President Finance and Chief Financial Officer

PETER HICKMAN
Assistant Corporate Secretary

MARK BRADBURY
Corporate Treasurer and Chief Risk Officer

S. KENT LEGGE
Corporate Controller

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Independent Auditor's Report

To the Directors of Newfoundland and Labrador Hydro

We have audited the accompanying non-consolidated financial statements of Newfoundland and Labrador Hydro, which comprise the non-consolidated balance sheet as at December 31, 2010, and the non-consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information. The non-consolidated financial statements have been prepared by management based on the financial reporting provisions of Section 59 of The Hydro Corporation Act.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these non-consolidated financial statements in accordance with the financial reporting provisions of Section 59 of The Hydro Corporation Act, 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.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the non-consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the non-consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the non-consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the non-consolidated 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 non-consolidated financial statements present fairly, in all material respects, the financial position of Newfoundland and Labrador Hydro as at December 31, 2010, and the results of its operations and its cash flows for the year then ended in accordance with the financial reporting provisions of Section 59 of The Hydro Corporation Act.

Basis of Accounting and Restrictions on Distribution and Use

Without modifying our opinion, we draw attention to Note 2 to the non-consolidated financial statements, which describes the basis of accounting. The non-consolidated financial statements are prepared to assist Newfoundland and Labrador Hydro meet the requirements of the Newfoundland and Labrador Board of Commissioners of Public Utilities. As a result, the non-consolidated financial statements may not be suitable for another purpose. Our report is intended solely for Newfoundland and Labrador Hydro and the Newfoundland and Labrador Board of Commissioners of Public Utilities and should not be distributed to or used by parties other than Newfoundland and Labrador Hydro and the Newfoundland and Labrador Board of Commissioners of Public Utilities.

Other Matter

Newfoundland and Labrador Hydro has prepared separate financial statements for the year ended December 31, 2010 in accordance with Canadian Generally Accepted Accounting Principles on which we issued a standard auditor's report to the shareholders of Newfoundland and Labrador Hydro dated April 1, 2011.

Deloitte & Touche LLP

Chartered Accountants
April 1, 2011

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2010**	2009
ASSETS		
Current assets		
Cash and cash equivalents	**37.7**	10.9
Short-term investments	**9.0**	20.0
Accounts receivable	**70.3**	69.8
Current portion of regulatory assets (Note 4)	**3.8**	4.8
Inventory	**53.4**	50.0
Prepaid expenses	**2.3**	1.5
Derivative assets (Note 13)	**2.0**	5.7
	178.5	162.7
Property, plant and equipment (Note 3)	**1,386.1**	1,364.2
Sinking funds (Notes 7 and 13)	**208.4**	179.6
Regulatory assets (Note 4)	**65.9**	69.3
Long-term receivables (Note 5)	**25.4**	23.9
Derivative assets (Note 13)	**-**	1.3
Investments (Note 6)	**384.3**	367.7
	2,248.6	2,168.7
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	**107.6**	74.4
Accrued interest	**28.7**	28.7
Current portion of long-term debt (Note 7)	**8.2**	8.2
Current portion of regulatory liabilities (Note 4)	**118.9**	89.8
Deferred capital contribution (Note 18(d))	**0.1**	0.2
Derivative liabilities (Note 13)	**0.3**	-
	263.8	201.3
Long-term debt (Note 7)	**1,136.7**	1,141.6
Regulatory liabilities (Note 4)	**40.9**	32.8
Asset retirement obligations (Note 8)	**11.4**	-
Long-term related party note payable (Note 18(g))	**25.3**	23.9
Employee future benefits (Note 9)	**48.4**	44.0
	1,526.5	1,443.6
SHAREHOLDER'S EQUITY		
Share capital (Note 10)	**22.5**	22.5
Contributed capital (Note 10)	**115.4**	115.4
	137.9	137.9
Accumulated other comprehensive income (Note 11)	**26.7**	21.0
Retained earnings	**557.5**	566.2
	584.2	587.2
	722.1	725.1
Commitments and contingencies (Note 17)		
Subsequent events (Note 20)	**2,248.6**	2,168.7

See accompanying notes

On behalf of the Board:

JOHN OTTENHEIMER

GERRY SHORTALL

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

For the year ended December 31 (millions of dollars)	**2010**	2009
Revenue		
Energy sales	**500.1**	504.5
Interest and finance income (Note 14)	**16.1**	16.4
Other revenue	**2.3**	2.2
	518.5	523.1
Expenses		
Fuels	**140.4**	155.2
Power purchased	**48.3**	51.0
Operations and administration	**123.1**	120.8
Interest and finance charges (Note 14)	**103.4**	100.5
Amortization	**43.8**	41.7
Other gains and losses	**2.6**	(0.7)
	461.6	468.5
Income from operations	**56.9**	54.6
Other income		
Equity in net income of Churchill Falls (Note 6)	**16.6**	7.9
Preferred dividends from Churchill Falls	**10.2**	3.9
	26.8	11.8
Net income	**83.7**	66.4
Retained earnings, beginning of year	**566.2**	544.3
	649.9	610.7
Dividends	**92.4**	44.5
Retained earnings, end of year	**557.5**	566.2

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31 (millions of dollars)	**2010**	2009
Net income	**83.7**	66.4
Other comprehensive income		
Change in fair value of available for sale financial instruments	**20.5**	9.0
Change in fair value of derivatives designated as cash flow hedges	**1.1**	9.2
Amounts recognized in net income	**(15.9)**	(13.1)
Comprehensive income	**89.4**	71.5

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31 (millions of dollars)	**2010**	2009
Cash provided by (used in)		
Operating activities		
Net income	**83.7**	66.4
Adjusted for items not involving a cash flow		
Amortization	**43.8**	41.7
Accretion of long-term debt	**0.4**	0.4
Loss on disposal of property, plant and equipment	**0.7**	1.3
Unrealized losses (gains) on derivative instruments	**0.3**	(0.8)
Equity in net income of Churchill Falls	**(16.6)**	(7.9)
	112.3	101.1
Changes in non-cash operating working capital balances (Note 15)	**74.5**	93.4
	186.8	194.5
Financing activities		
Repayment of long-term debt	**-**	(0.1)
Decrease in promissory notes	**-**	(163.0)
Dividends paid to Nalcor	**(92.4)**	(44.5)
Contributed capital	**-**	100.0
(Increase) decrease in long-term receivables	**(1.5)**	1.5
Increase in long-term related party note payable	**1.4**	23.9
Decrease in deferred capital contribution	**(0.1)**	(2.0)
	(92.6)	(84.2)
Investing activities		
Additions to property, plant and equipment	**(55.5)**	(54.1)
Increase in sinking funds	**(23.4)**	(22.0)
Decrease (increase) in short-term investments	**11.0**	(20.0)
Proceeds on disposal of property, plant and equipment	**0.5**	1.2
	(67.4)	(94.9)
Net increase in cash	**26.8**	15.4
Cash position, beginning of year	**10.9**	(4.5)
Cash position, end of year	**37.7**	10.9
Cash position is represented by		
Cash (bank indebtedness)	**37.7**	(4.1)
Cash equivalents	**-**	15.0
	37.7	10.9

Supplementary cash flow information (Note 15)

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and is exempt from paying income taxes under Section 149 (1)(d) of the Income Tax Act. The principal activity of Hydro is the development, generation and sale of electricity.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
These financial statements have been prepared in accordance with the significant accounting polices set out below. These financial statements differ materially from Canadian generally accepted accounting principles (GAAP) because they are non-consolidated. Hydro's investments in its subsidiary and jointly controlled companies have been accounted for using the equity method of accounting. Consolidated financial statements for the same period have been prepared for presentation to the Lieutenant-Governor in Council of the Province.

Use of Estimates
Preparation of these financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, amortization and property, plant and equipment, environmental and asset retirement obligations, and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB), and these differences could be material.

Rates and Regulations
Hydro's revenues from its electricity sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.4% (2009 - 7.4%). Hydro applies certain accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation, these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 4.

Cash and Cash Equivalents and Short-term Investments
Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and Banker's Acceptances (BA). Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. The short-term investments bear interest rates of 1.07% to 1.08% (2009 - 0.26% to 0.65%). Cash and cash equivalents and short-term investments are measured at fair value.

Inventory
Inventory is recorded at the lower of average cost and net realizable value.

Property, Plant and Equipment
Property, plant and equipment is recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction, and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)
Construction in progress includes the costs incurred in engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to Hydro's weighted average cost of capital.

Contributions in aid of construction are funds received from customers and governments toward the cost of property, plant and equipment. Contributions are recorded as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

Gains and losses on the disposal of property, plant and equipment are recognized in income as incurred.

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on distribution system and other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution system	30 years
Other	3 to 50 years

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

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators, and conductors.

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

Impairment of Long-Lived Assets
Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Asset Retirement Obligations
The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, is recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. Accretion of asset retirement obligations is included in net income through Amortization. Differences between the recorded asset retirement obligation and the actual retirement costs incurred are recorded as a gain or loss in the settlement period.

Employee Future Benefits
Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of cumulative net actuarial gains and losses over 10% of the accrued benefit obligation is amortized over the expected average remaining service life of the employee group.

Revenue Recognition
Revenue is recognized on the accrual basis, as power and energy deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB, whereas sales to certain major industrial customers and export sales are either at rates under the terms of the applicable contracts, or at market rates.

Foreign Currency Translation
Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At the date of settlement and at each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income, except gains or losses on purchases of fuel which are included in the cost of fuel inventory.

Financial Instruments and Hedging Activities
Financial Instruments
Financial assets and financial liabilities are recognized on the balance sheet when Hydro becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Hydro has classified each of its financial instruments into the following categories: financial assets and liabilities held for trading; loans and receivables; financial assets held to maturity; financial assets available for sale; and other financial liabilities.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Financial Instruments and Hedging Activities (cont'd.)

Financial Instruments (cont'd.)
Hydro has classified its financial instruments as follows:

Cash and cash equivalents	Held for trading
Short-term investments	Available for sale
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held to maturity
Sinking funds - other investments	Available for sale
Derivative assets	Held for trading
Long-term receivables	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Accrued interest	Other liabilities
Long-term debt	Other liabilities
Derivative liabilities	Held for trading
Long-term related party note payable	Other liabilities

Each of these financial instruments is measured at amortized cost, except for cash and cash equivalents, short-term investments and sinking fund – other investments which are measured at fair value.

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short-term investments which are expensed as incurred, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Derivative Instruments and Hedging Activities
Derivative instruments are utilized by Hydro to manage market risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Hydro may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Hydro formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

Hydro has designated foreign exchange forward contracts as cash flow hedges (Note 13). In a cash flow hedge relationship, the portion of unrealized gains or losses on the hedging item that is determined to be an effective hedge is recognized in Other Comprehensive Income (OCI), while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income.

Hydro had no fair value hedges in place at December 31, 2010 or 2009.

Future Accounting Changes
In October 2009, the Accounting Standards Board (AcSB) issued a third and final Omnibus Exposure Draft confirming that publically accountable enterprises in Canada will be required to apply International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), in full and without modification, for interim and annual financial statements beginning on or after January 1, 2011. As a result of recent changes to Part 1 of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting, by the AcSB, certain rate-regulated entities can defer the adoption of IFRS by one year to January 1, 2012. Hydro meets the AcSB's criteria for the deferral and has chosen to adopt IFRS effective January 1, 2012.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Future Accounting Changes (cont'd.)

The IASB has deferred its work on rate-regulated activities accounting project and has not provided interim guidance for the recognition and measurement of regulatory assets and liabilities. Accordingly, Hydro continues to assess existing IFRS guidance to determine the impact of differences that will apply to accounting for rate-regulated activities upon adoption of IFRS on January 1, 2012.

Hydro is continuing to assess the financial reporting impacts of the adoption of IFRS; however, the impact of IFRS will depend on the IFRS standards in effect at the time of conversion on January 1, 2012 and the accounting elections made.

3. PROPERTY, PLANT AND EQUIPMENT

	Property Plant and Equipment In Service	**Contributions In Aid of Construction**	**Accumulated Amortization**	**Construction In Progress**	**Net Book Value**
(millions of dollars)			**2010**		
Generation plant					
Hydroelectric	**853.5**	**20.5**	**66.6**	**3.2**	**769.6**
Thermal	**273.8**	**0.8**	**201.6**	**3.2**	**74.6**
Diesel	**68.0**	**5.8**	**35.3**	**2.2**	**29.1**
Transmission and distribution	**717.5**	**61.0**	**220.6**	**5.3**	**441.2**
Other	**223.3**	**9.2**	**145.6**	**3.1**	**71.6**
	2,136.1	**97.3**	**669.7**	**17.0**	**1,386.1**

(millions of dollars)			2009		
Generation plant					
Hydroelectric	847.7	20.5	61.3	1.2	767.1
Thermal	255.8	0.8	196.0	0.2	59.2
Diesel	64.6	5.9	33.5	2.8	28.0
Transmission and distribution	701.6	60.9	205.7	2.2	437.2
Other	212.8	8.7	135.6	4.2	72.7
	2,082.5	96.8	632.1	10.6	1,364.2

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

4. REGULATORY ASSETS AND LIABILITIES

(millions of dollars)	**2010**	2009	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Foreign exchange losses	**66.9**	68.9	31.0
Deferred major extraordinary repairs	**2.2**	4.9	1.8
Deferred study costs	**-**	0.1	1.0
Deferred energy conservation costs	**0.6**	0.2	n/a
Total regulatory assets	**69.7**	74.1	
Less current portion	**3.8**	4.8	
	65.9	69.3	
Regulatory liabilities			
Rate stabilization plan	**159.2**	122.0	n/a
Deferred purchased power savings	**0.6**	0.6	16.5
Total regulatory liabilities	**159.8**	122.6	
Less current portion	**118.9**	89.8	
	40.9	32.8	

Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. Amounts deferred as regulatory assets and liabilities are subject to PUB approval. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities is no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event.

Rate Stabilization Plan
On January 1, 1986, Hydro, having received the approval of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Balances accumulating in the RSP, including financing charges, are to be recovered or refunded in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian GAAP would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2010, $23.3 million was recognized (2009 - $42.3 million) in the RSP and $2.3 million (2009 – 18.3 million) was recovered through rates and included in energy sales, with the corresponding cost amortized in fuels expenses.

4. REGULATORY ASSETS AND LIABILITIES (cont'd.)

Deferred Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding, to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of $2.1 million annually, is included in interest expense (Note 14).

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $0.5 million, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (HTGS). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset to be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In the absence of rate regulation, Canadian GAAP would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year incurred. In 2010, $2.6 million (2009 - $2.7 million) of amortization was recognized in Operations and administration expense.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004), the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three-year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the cost of these studies in operating costs in the year incurred. In 2010, $0.1 million in amortization (2009 - $0.1 million) was recognized in Operations and administration expense.

Deferred Energy Conservation Costs

Pursuant to Order No. P.U. 14 (2009), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include this program as operating costs in the year incurred. In 2010, $0.4 million (2009 – $0.2 million) was deferred.

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer and amortize the benefits of a reduced initial purchased power rate over a 30-year period. These savings in the amount of $0.6 million (2009 - $0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

4. REGULATORY ASSETS AND LIABILITIES (cont'd.)

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2010, Hydro's AFUDC of 7.6% (2009 - 7.6%) is higher than its cost of debt of 7.2% (2009 – 7.2%) and the amount capitalized is higher and interest expense is lower by $0.1 million (2009 - $0.1 million) than that which would be permitted under Canadian GAAP in the absence of rate regulation.

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method. During 2010, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2009. Based on the results of this study, management currently estimates that switching from the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets, as well as changing from unit based amortization to a group based method on a remaining life basis, will result in an immaterial change in the annual amortization expense.

5. LONG-TERM RECEIVABLES

Included in long-term receivables are two refundable deposits in the amount of $24.1 million (2009 - $23.9 million) associated with an application for transmission service into Québec, bearing interest at one-year Guaranteed Income Certificate (GIC) rates, a $0.1 million (2009 – nil) deposit associated with an application for transmission service in New Brunswick, bearing interest at the Prime Rate, and two refundable deposits in the amount of $1.2 million (2009 – nil) associated with an application for transmission service into Nova Scotia, bearing interest at the Prime Rate less 1%.

6. INVESTMENTS

(millions of dollars)	Ownership Interest	**2010**	2009
Churchill Falls (Labrador) Corporation	65.8%		
Shares, at cost		**167.2**	167.2
Equity in retained earnings at beginning of year		**200.5**	192.6
Equity in net income for the year		**16.6**	7.9
		384.3	367.7

Effective June 18, 1999, the two shareholders of Churchill Falls, Hydro and Hydro-Québec, entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to joint approval by representatives of Hydro and Hydro-Québec.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

7. LONG-TERM DEBT

Details of long-term debt are as follows:

Series	Face Value	Coupon Rate%	Year of Issue	Year of Maturity		
(millions of dollars)					**2010**	2009
V *	125.0	10.50	1989	2014	**124.6**	124.5
X *	150.0	10.25	1992	2017	**149.3**	149.2
Y *	300.0	8.40	1996	2026	**293.3**	293.1
AB *	300.0	6.65	2001	2031	**306.7**	306.8
AD *	125.0	5.70	2003	2033	**123.6**	123.6
AE	225.0	4.30	2006	2016	**223.8**	223.7
Total debentures	1,225.0				**1,221.3**	1,220.9
Less sinking fund investments in own debentures					**76.4**	71.1
					1,144.9	1,149.8
Less: payments due within one year					**8.2**	8.2
					1,136.7	1,141.6

* Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures, which are intended to be held to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are in accordance with bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 3.86% to 9.86% (2009 - 4.50% to 9.86%).

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments by the Province. The Province charges Hydro a guarantee fee of one percent annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31. For the years ended 2010 and 2009, the guarantee fee was waived by the Province.

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2010 there were no promissory notes outstanding (2009 – nil).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year-end there were no amounts drawn on the facility (2009 – nil). Advances may take the form of a Prime Rate advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year-end, Hydro had 24 letters of credit outstanding (Note 17(e)) reducing the availability of the credit facility by $18.9 million (2009 - $7.5 million).

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

(millions of dollars)	2011	2012	2013	2014	2015
Sinking fund requirement	8.2	8.2	8.2	8.2	8.2
Long-term debt repayment	-	-	-	125.0	-
	8.2	8.2	8.2	133.2	8.2

8. ASSET RETIREMENT OBLIGATIONS

During the year ended December 31, 2010, Hydro recognized a liability associated with the retirement of portions of the HTGS. The reconciliation of the beginning and ending carrying amount of asset retirement obligations is as follows:

(millions of dollars)	**2010**	2009
Asset retirement obligation, beginning of year	**-**	-
Liabilities incurred	**11.4**	-
Liabilities settled	**-**	-
Accretion	**-**	-
Asset retirement obligation, end of year	**11.4**	-

The total undiscounted estimated cash flows required to settle the obligations at December 31, 2010 is $20.5 million (2009 – nil). Payments to settle the liability are expected to occur between 2021 and 2029. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit-adjusted risk-free rate of 4.1% (2009 – nil).

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

9. EMPLOYEE FUTURE BENEFITS

Pension Plan
Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $4.1 million (2009 - $3.8 million) are expensed as incurred.

Other Benefits
Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2010, cash payments to beneficiaries for its unfunded other employee future benefits was $1.8 million (2009 - $2.2 million). An actuarial valuation was performed on December 31, 2009 and extrapolated to December 31, 2010. The next actuarial valuation will be performed as at December 31, 2012.

(millions of dollars)	**2010**	2009
Accrued benefit obligation		
Balance at beginning of year	**58.0**	43.1
Transfer to Nalcor Energy	**-**	(0.5)
Current service cost	**1.7**	1.1
Interest cost	**3.8**	3.2
Actuarial loss	**7.6**	13.3
Benefits paid	**(1.8)**	(2.2)
Balance at end of year	**69.3**	58.0

9. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits (cont'd.)

Plan deficit	**69.3**	58.0
Unamortized actuarial loss	**(20.7)**	(13.8)
Unamortized past-service cost	**(0.2)**	(0.2)
Accrued benefit liability at end of year	**48.4**	44.0

(millions of dollars)	**2010**	2009
Components of benefit cost		
Current service cost	**1.7**	1.1
Interest cost	**3.8**	3.2
Actuarial loss	**7.6**	13.3
	13.1	17.6
Difference between actuarial loss and amount recognized	**(6.9)**	(13.3)
Benefit expense	**6.2**	4.3

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

	2010	2009
Discount rate – benefit cost	**6.50%**	7.50%
Discount rate – accrued benefit obligation	**5.75%**	6.50%
Rate of compensation increase	**3.50%**	3.50%

Assumed healthcare trend rates:

	2010	2009
Initial health care expense trend rate	**7.50%**	7.50%
Cost trend decline to	**5.00%**	5.00%
Year that rate reaches the rate it is assumed to remain at	**2016**	2016

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

Increase	**2010**	2009
Current service and interest cost	**0.9**	0.7
Accrued benefit obligation	**11.7**	8.9

Decrease	**2010**	2009
Current service and interest cost	**(0.7)**	(0.5)
Accrued benefit obligation	**(9.2)**	(7.0)

10. SHAREHOLDER'S EQUITY

Share Capital

(millions of dollars)	**2010**	2009
Common shares of par value $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5

Contributed Capital

(millions of dollars)	**2010**	2009
Total contributed capital	**115.4**	115.4

There were no contributions by Nalcor during 2010 (2009 - $100.0 million).

11. ACCUMULATED OTHER COMPREHENSIVE INCOME

(millions of dollars)	**2010**	2009
Balance, beginning of year	**21.0**	15.9
Change in fair value of available for sale financial instruments	**20.5**	9.0
Change in fair value of derivatives designated as cash flow hedges	**1.1**	9.2
Amount recognized in net income	**(15.9)**	(13.1)
Balance, end of year	**26.7**	21.0

12. CAPITAL MANAGEMENT

Hydro's principal business requires ongoing access to capital in order to maintain the continued delivery of safe and reliable service to its customers. Therefore, Hydro's primary objective when managing capital is to ensure ready access to capital at a reasonable cost.

The capital managed by Hydro is comprised of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

A summary of the capital structure is outlined below:

(millions of dollars)	**2010**		2009	
Debt				
Long-term debt	**1,136.7**		1,141.6	
Current portion of long-term debt	**8.2**		8.2	
Sinking funds	**(208.4)**		(179.6)	
	936.5	**56.5%**	970.2	57.2%
Equity				
Share capital	**22.5**		22.5	
Contributed capital	**115.4**		115.4	
Accumulated other comprehensive income	**26.7**		21.0	
Retained earnings	**557.5**		566.2	
	722.1	**43.5%**	725.1	42.8%
Total debt and equity	**1,658.6**	**100.0%**	1,695.3	100.0%

12. CAPITAL MANAGEMENT (cont'd.)

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

For the regulated portion of Hydro's operations a capital structure comprised of 75% debt and 25% common equity is maintained, a ratio which management believes to be optimal with respect to its cost of capital. This capital structure is maintained by a combination of dividend policy, contributed equity and debt issuance. The issuance of any new debt with a term greater than one year requires prior approval of Hydro's regulator, the PUB.

Per legislation, the total of the short-term loans issued by Hydro and outstanding at any time, shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short-term loans are those loans issued with a term not exceeding two years. The current limit is set at $300 million. The balance outstanding as at December 31, 2010 was nil (2009 -nil). Issuance of long-term and short-term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both long and short-term debt, to $1.6 billion at any point in time.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value

The estimated fair values of financial instruments as at December 31, 2010 and 2009 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions.

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

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
(millions of dollars)	**2010**		2009	
Financial assets				
Cash and cash equivalents	**37.7**	**37.7**	10.9	10.9
Short-term investments	**9.0**	**9.0**	20.0	20.0
Accounts receivable	**70.3**	**70.3**	69.8	69.8
Sinking funds – investments in same Hydro issue	**76.4**	**93.6**	71.1	85.2
Sinking funds – other investments	**208.4**	**208.4**	179.6	179.6
Derivative assets (including current portion)	**2.0**	**2.0**	7.0	7.0
Long-term receivable [(1)]	**25.4**	**n/a**	23.9	n/a
Financial liabilities				
Accounts payable and accrued liabilities	**107.6**	**107.6**	74.4	74.4
Accrued interest	**28.7**	**28.7**	28.7	28.7
Long-term debt including amount due within one year (before sinking funds)	**1,221.3**	**1,589.7**	1,220.9	1,440.6
Derivative liabilities	**0.3**	**0.3**	-	-
Long-term related party note payable [(1)]	**25.3**	**n/a**	23.9	n/a

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Fair Value (cont'd.)

The fair value of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities, accrued interest and due to related parties approximates their carrying values due to their short-term maturity.

(1) The fair value of the long-term receivable and long-term related party note payable is subject to uncertainty regarding the timing of future cash flows and as such, the fair value of the long-term receivable cannot be determined at December 31, 2010 and 2009.

Establishing Fair Value

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

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

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

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

The following table presents Hydro's fair value hierarchy for financial assets and liabilities as at December 31. There were no transfers between Level 1 and Level 2 during the year:

(millions of dollars)	Level 1	Level 2	Total
		2010	
Financial assets			
Cash and cash equivalents	**37.7**	**-**	**37.7**
Short-term investments	**9.0**	**-**	**9.0**
Accounts receivable	**70.3**	**-**	**70.3**
Sinking funds – investments in same Hydro issue	**-**	**93.6**	**93.6**
Sinking funds – other investments	**-**	**208.4**	**208.4**
Derivative assets	**-**	**2.0**	**2.0**
Financial liabilities			
Accounts payable and accrued liabilities	**107.6**	**-**	**107.6**
Accrued interest	**28.7**	**-**	**28.7**
Long-term debt including amount due within one year (before sinking funds)	**-**	**1,589.7**	**1,589.7**
Derivative liabilities	**-**	**0.3**	**0.3**

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Fair Value (cont'd.)

Establishing Fair Value (cont'd.)

	Level 1	Level 2	Total
	2009		
Financial assets			
Cash and cash equivalents	10.9	-	10.9
Short-term investments	20.0	-	20.0
Accounts receivable	69.8	-	69.8
Sinking funds – investments in same Hydro issue	-	85.2	85.2
Sinking funds – other investments	-	179.6	179.6
Derivative assets	-	7.0	7.0
Financial liabilities			
Accounts payable and accrued liabilities	74.4	-	74.4
Accrued interest	28.7	-	28.7
Long-term debt including amount due within one year (before sinking funds)	-	1,440.6	1,440.6

There were no financial assets or liabilities valued using Level 3 of the fair value hierarchy as at December 31, 2010 and 2009.

Risk Management

In January and February of 2010, Hydro entered into 28 swap contracts, with terms ranging from 2 to 11 months, to hedge the commodity price risk on electricity sales in the amount of $24.7 million.

Exposure to credit risk, liquidity risk and market risk arises in the normal course of Hydro's business.

Credit Risk

Hydro is exposed to credit risk in the event of non-performance by counterparties to its financial instruments. The majority of the receivables are from regulated utilities which minimizes credit risk. There is risk that Hydro will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments which arise in the normal course of business do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Hydro manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers. As at December 31, 2010 security deposits of $0.1 million (2009 - $0.1 million) are included in accounts payable and accrued liabilities.

Hydro's three largest customers account for 80% (2009 – 76%) of total energy sales and 67% (2009 - 72%) of accounts receivable. These customers are comprised of rate regulated organizations or organizations with an investment grade rating.

Hydro does not have any significant amounts that are past due and uncollectable for which a provision has not been recognized at December 31, 2010.

Hydro manages its investment credit risk exposure by restricting its investments to high-quality securities such as Canada Treasury Bills, Bankers' Acceptances drawn on Schedule 1 Canadian Chartered Banks and Term Deposits issued by Schedule 1 Canadian Chartered Banks. Additionally, the investments held within the portfolios of Churchill Falls do not exceed 10% with any one institution with the exception of the Government of Canada.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management

Liquidity Risk

Hydro is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. This risk is managed by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cash flows.

Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations, a $300.0 million promissory note program and credit facilities.

Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues with the exception of Series AE.

The following are the contractual maturities of Hydro's financial liabilities, including principal and interest, as at December 31, 2010:

(millions of dollars)	**<1 Year**	**1-3 Years**	**3-5 years**	**> 5 Years**	**Total**
Accounts payable and accrued liabilities	**107.6**	**-**	**-**	**-**	**107.6**
Accrued interest	**28.7**	**-**	**-**	**-**	**28.7**
Derivative liabilities	**0.3**	**-**	**-**	**-**	**0.3**
Long-term debt including amount due within one year	**-**	**-**	**125.0**	**1,100.0**	**1,225.0**
Interest	**61.8**	**180.9**	**161.2**	**752.5**	**1,156.4**
	198.4	**180.9**	**286.2**	**1,852.5**	**2,518.0**

Market Risk

Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates. Nalcor has a formal financial risk management policy that outlines the risks associated with the operations of Nalcor and its subsidiaries outlining approaches and guidelines to be followed in the management of those risks. This policy is reviewed by the Board annually or more frequently if there is a material change to Nalcor's financial risks. The Audit Committee provides oversight on behalf of the Board with the exception of any items that specifically require Board approval.

Interest Rates

Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management includes the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Hydro attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Hydro is exposed to interest rate risk related to the short-term debt portfolio, the sinking fund investment portfolios and reserve fund investment portfolios. Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures. The following table illustrates Hydro's exposure to a 100 basis point (1%) change in interest rates:

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

Market Risk (cont'd.)

	Net Income		Other Comprehensive Income	
(millions of dollars)	1% decrease	1 % increase	1% decrease	1% increase
Interest on short-term investments	**(0.1)**	**0.1**	**-**	**-**
Interest on sinking funds	**-**	**-**	**29.3**	**(10.3)**
	(0.1)	**0.1**	**29.3**	**(10.3)**

Foreign Currency and Commodity Exposure
The fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar. Hydro's primary exposure to both foreign exchange and commodity price risk arises within Hydro from its purchases of No. 6 fuel for consumption at the HTGS and certain electricity sales both of which are denominated in USD.

During 2010, Hydro had total purchases of No. 6 fuel of $104.1 million (2009 - $87.5 million) denominated in USD. Exposure to both the foreign exchange and commodity price risk associated with these fuel purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in fuel prices including exchange rates, as compared to that approved in Hydro's most recent cost of service study, are captured in the RSP and are either refunded to or collected from customers through rate adjustments. Hydro also employs the periodic use of forward currency contracts to manage exposure to exchange rates on a particular day.

During 2010, total electricity sales denominated in USD were $72.8 million (2009 - $41.8 million). Hydro mitigates this risk through the use of commodity swaps and foreign currency forward contracts.

During 2009, Hydro entered into a series of 24 monthly foreign exchange forward contracts, in the amount of $87.8 million USD at an average exchange rate of 1.17 to hedge 75% of Hydro's forecasted USD electricity sales, the last of which expires in April 2011. These contracts have been designated as part of a hedging relationship.

During 2010, Hydro entered into 28 commodity swap contracts totalling $24.7 million, the last of which expired in December 2010. These contracts swapped floating market rates for fixed rates which ranged from $26 USD/MWh to $50 USD/MWh. These contracts have not been designated as part of a hedging relationship. During 2010, 24 of these settled. The fair value of the four contracts outstanding as at December 31, 2010 is a liability of $0.3 million and $3.4 million in losses from these contracts is included in Other gains and losses.

Effect of Hedge Accounting on Financial Statements

	Net Gains Included in Net Income	**Unrealized Gains Included in OCI**	Net Gains Included in Net Income	Unrealized Gains Included in OCI
(millions of dollars)	**2010**		2009	
Ineffective portion	**0.2**	**-**	0.5	-
Effective portion	**5.9**	**1.3**	2.4	6.2

The ineffective portion of hedging gains and losses is included in net income through Other gains and losses.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

14. INTEREST AND FINANCE INCOME /CHARGES

(millions of dollars)	**2010**	2009
Interest and finance income		
Interest on sinking fund	**15.2**	13.9
Other interest income	**0.9**	2.5
	16.1	16.4
Interest and finance charges		
Long-term debt	**90.5**	90.5
Interest on RSP	**10.2**	7.0
Accretion of long-term debt	**0.4**	0.4
Amortization of foreign exchange losses	**2.1**	2.2
Other	**1.4**	1.2
	104.6	101.3
Interest capitalized during construction	**(1.2)**	(0.8)
	103.4	100.5

15. SUPPLEMENTARY CASH FLOW INFORMATION

(millions of dollars)	**2010**	2009
Accounts receivable	**(0.5)**	(0.3)
Inventory	**(3.4)**	(7.0)
Prepaid expenses	**(0.8)**	(0.3)
Regulatory assets	**4.4**	5.5
Regulatory liabilities	**37.2**	68.8
Accounts payable and accrued liabilities	**33.2**	24.6
Employee future benefits	**4.4**	2.1
Changes to non-cash operating working capital balances	**74.5**	93.4
Interest received	**0.3**	0.7
Interest paid	**90.5**	91.3

16. SEGMENT INFORMATION

Geographic Information

Revenues by geographic area:

(millions of dollars)	**2010**	2009
Newfoundland and Labrador	**446.7**	469.4
Québec	**-**	13.6
Nova Scotia	**11.1**	36.6
New Brunswick	**60.7**	3.5
	518.5	523.1

All of Hydro's physical assets are located in the Province.

NEWFOUNDLAND AND LABRADOR HYDRO
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16. SEGMENT INFORMATION (cont'd.)

Hydro operates in three business segments. Regulated electricity encompass sales of power and energy to most customers within the Province, non-regulated activities are primarily engaged in energy project development and energy marketing encompasses sales to markets outside the Province. The designation of segments has been based on regulatory status and management accountability. The segments' accounting policies are the same as those previously described in Note 2.

(millions of dollars)	Hydro Regulated	Non-Regulated Activities	Energy Marketing	Total
		2010		
Revenue				
Energy sales	**417.1**	**5.5**	**77.5**	**500.1**
Interest and finance income	**16.1**	**-**	**-**	**16.1**
Other revenue	**2.3**	**-**	**-**	**2.3**
	435.5	**5.5**	**77.5**	**518.5**
Expenses				
Fuels	**140.3**	**0.1**	**-**	**140.4**
Power purchased	**44.2**	**-**	**4.1**	**48.3**
Operations and administration	**97.8**	**3.9**	**21.4**	**123.1**
Interest and finance charges	**102.9**	**-**	**0.5**	**103.4**
Amortization	**43.8**	**-**	**-**	**43.8**
Other gains and losses	**-**	**-**	**2.6**	**2.6**
	429.0	**4.0**	**28.6**	**461.6**
Net income from operations	**6.5**	**1.5**	**48.9**	**56.9**
Equity in net income of Churchill Falls	**-**	**16.6**	**-**	**16.6**
Preferred dividends	**-**	**10.2**	**-**	**10.2**
Net income	**6.5**	**28.3**	**48.9**	**83.7**
Capital expenditures	**55.5**	**-**	**-**	**55.5**
Total assets	**1,831.5**	**409.7**	**7.4**	**2,248.6**

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

16. SEGMENT INFORMATION (cont'd.)

	Hydro Regulated	Non-Regulated Activities	Energy Marketing	Total
		2009		
Revenue				
Energy sales	443.8	6.0	54.7	504.5
Interest and finance income	16.4	-	-	16.4
Other revenue	2.2	-	-	2.2
	462.4	6.0	54.7	523.1
Expenses				
Fuels	155.2	-	-	155.2
Power purchased	46.8	-	4.2	51.0
Operations and administration	100.9	3.3	16.6	120.8
Interest and finance charges	99.9	-	0.6	100.5
Amortization	41.7	-	-	41.7
Other gains and losses	-	-	(0.7)	(0.7)
	444.5	3.3	20.7	468.5
Net income from operations	17.9	2.7	34.0	54.6
Equity in net income of Churchill Falls	-	7.9	-	7.9
Preferred dividends	-	3.9	-	3.9
Net income	17.9	14.5	34.0	66.4
Capital expenditures	54.1	-	-	54.1
Total assets	1,766.0	392.5	10.2	2,168.7

17. COMMITMENTS AND CONTINGENCIES

(a) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.1 million (2009 - $0.1 million).

(b) One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.8 million (2009 - $21.9 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate outcome of this action cannot be ascertained at this time, in the opinion of Hydro's management, following consultation with its legal counsel, no liability should be recognized.

(c) Outstanding commitments for capital projects total approximately $11.0 million (2009 - $9.2 million).

17. COMMITMENTS AND CONTINGENCIES (cont'd.)

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

Type	Rating	In-service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

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

(millions of dollars)	2011	2012	2013	2014	2015
Power purchases	23.9	24.5	25.1	25.6	26.1

(e) Hydro has issued 23 irrevocable letters of credit to the New Brunswick System Operator totalling $18.6 million as credit support related to applications for point to point transmission service. In addition, Hydro has issued one letter of credit to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement.

(f) Hydro has entered into power sales agreements with third parties with respect to the energy previously sold to Hydro-Québec under a power sales agreement that expired March 31, 2009. To facilitate market access, Hydro has entered into a five-year transmission service agreement with Hydro-Québec TransÉnergie to acquire access to 265 MW of transmission capacity from Labrador through Québec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that competing request.

Pursuant to Hydro's five-year transmission service agreement with Hydro-Québec TransÉnergie, the transmission rental payments to contract maturity are as follows:

2011	$ 19.4 million
2012	$ 19.4 million
2013	$ 19.4 million
2014	$ 4.8 million

(g) Hydro has received funding, in the amount of $3.0 million, from the Atlantic Canada Opportunities Agency in relation to a wind-hydrogen-diesel research development project in the community of Ramea. This funding is repayable in annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2010 there have been no commercial implementations.

18. RELATED PARTY TRANSACTIONS

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

Related Party	Relationship
Nalcor Energy (Nalcor)	Nalcor is a 100% shareholder of Hydro.
The Province	The Province is a 100% shareholder of Nalcor.
Churchill Falls (Labrador) Corporation	Churchill Falls is a jointly controlled subsidiary of Hydro.
Lower Churchill Development Corporation	Lower Churchill Development Corporation is a wholly owned subsidiary of Hydro.
Nalcor Energy – Oil and Gas Inc.	Nalcor Energy – Oil and Gas Inc. is a wholly owned subsidiary of Nalcor.
Nalcor Energy – Bull Arm Fabrication Inc.	Nalcor Energy – Bull Arm Fabrication Inc. is a wholly owned subsidiary of Nalcor.
Gull Island Power Corporation	Gull Island Power Corporation is a wholly owned subsidiary of Nalcor.
Board of Commissioners of Public Utilities	The PUB is an agency of the Province.

The amounts included in the financial statements for related party transactions are as follows:

		Nalcor	**Other Affiliates**	**Total**
(millions of dollars)			**2010**	
Revenue	(e)	**-**	**2.0**	**2.0**
Expenses	(a)(b)(c)(f)	**19.8**	**3.2**	**23.0**
Accounts receivable		**-**	**3.4**	**3.4**
Accounts payable and accrued liabilities	(c)(f)	**40.4**	**0.1**	**40.5**
Deferred capital contribution	(d)	**-**	**0.1**	**0.1**
Long-term related party note payable	(g)	**25.3**	**-**	**25.3**

(millions of dollars)			2009	
Revenue	(e)	-	2.0	2.0
Expenses	(a)(b)(c)(f)	21.1	3.8	24.9
Accounts receivable	(f)	-	0.2	0.2
Accounts payable and accrued liabilities	(c)(f)	20.8	0.7	21.5
Deferred capital contribution	(d)	-	0.2	0.2
Long-term related party note payable	(g)	23.9	-	23.9

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $6.0 million (2009 - $5.9 million) of the power produced by Churchill Falls.

(b) For the year ended December 31, 2010, approximately $2.5 million (2009 - $1.2 million) of operating costs were recovered from Nalcor and $3.4 million (2009 - $2.7 million) from other affiliates for engineering, technical, management and administrative services. During 2010 Hydro incurred $2.1 million (2009 - $1.2 million) of operating costs from Nalcor for engineering, technical, management and administrative services.

18. RELATED PARTY TRANSACTIONS (cont'd.)

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2010, Hydro incurred $0.6 million in costs related to the PUB (2009 - $0.6 million) of which $0.1 million (2009 - $0.1 million) was included in Accounts payable and accrued liabilities.

(d) During 2010, Nalcor advanced $2.3 million (2009 - $1.1 million) as a contribution in aid of construction related to the Ramea Wind-Hydrogen-Diesel Project. Hydro also received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2010, $0.1 million (2009 - $0.2 million) has been recorded as a Deferred capital contribution.

(e) During 2010, Hydro received $0.4 million (2009 - $0.4 million) as a rate subsidy for rural isolated customers from the Province and $1.6 million (2009 - $1.6 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with $0.3 million (2009 - $0.1 million) recorded as Accounts receivable at year-end.

(f) As at December 31, 2010, Hydro has a payable to Nalcor of $40.4 million (2009- $20.8 million) and a receivable from other affiliates for $3.1 million (2009 – $0.6 million payable and $0.1 receivable). This payable/receivable consists of various intercompany operating costs and power purchases.

(g) Hydro has a long-term related party note payable to Nalcor for $25.3 million (2009 – $23.9 million). The note is non-interest bearing and has no set terms of repayment.

19. WATER MANAGEMENT AGREEMENT

In June 2007, the Province passed an amendment to the Electrical Power Control Act, 1994 (EPCA). The amendment requires parties that utilize a common water resource in the province for power production, enter into a water management agreement. The amendment provides that any resulting water management agreement will not adversely affect existing power contracts. Churchill Falls shares the Churchill River with a Nalcor Energy proposed hydro-electric generation development downstream from Churchill Falls. On March 9, 2010, the PUB issued a Board Order establishing a water management agreement between the parties.

20. SUBSEQUENT EVENTS

In January 2011, Hydro entered into nine forward contracts with a notional value of $35.7 million to hedge the foreign exchange risk on USD electricity sales. In February 2011, Hydro also entered into 20 swap contracts with a notional value of $27.8 million to hedge the commodity price risk on electricity sales.

21. COMPARATIVE FIGURES

The comparative figures have been reclassified to conform with the 2010 financial statement presentation including Interest and finance charges, Other gains and losses, Accounts receivable and Accounts payable and accrued liabilities.

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2011

BOARD OF DIRECTORS

CATHY BENNETT (Chairperson)
Chief Executive Officer
Bennett Group of Companies

ED MARTIN
President and Chief Executive Officer
Nalcor Energy

TOM CLIFT
Professor
Memorial University - Faculty of Business

KEN MARSHALL
President
Rogers Cable - Atlantic Region

GERALD SHORTALL
Chartered Accountant
Corporate Director

OFFICERS

CATHY BENNETT (Chairperson)

ED MARTIN
President and Chief Executive Officer

GILBERT BENNETT
Lower Churchill Project Vice President

WAYNE CHAMBERLAIN
General Counsel and Corporate Secretary

JIM HAYNES
Regulated Operations Vice President

ANDY MACNEILL
Churchill Falls Vice President

JOHN MacISAAC
Project Execution and Technical Services Vice President

GERARD MCDONALD
Human Resources and
Organizational Effectiveness Vice President

DERRICK STURGE
Finance Vice President and Chief Financial Officer

PETER HICKMAN
Assistant Corporate Secretary

JAMES MEANEY
Corporate Treasurer

S. KENT LEGGE
Finance and Corporate Services General Manager

HEAD OFFICE
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Independent Auditor's Report

To the Directors of Newfoundland and Labrador Hydro

We have audited the accompanying non-consolidated financial statements of Newfoundland and Labrador Hydro, which comprise the non-consolidated balance sheet as at December 31, 2011, and the non-consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information. The non-consolidated financial statements have been prepared by management based on the financial reporting provisions of Section 59 of The Hydro Corporation Act.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these non-consolidated financial statements in accordance with the financial reporting provisions of Section 59 of The Hydro Corporation Act, and for such internal control as management determines is necessary to enable the preparation of non-consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the non-consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the non-consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the non-consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the non-consolidated 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 non-consolidated financial statements present fairly, in all material respects, the financial position of Newfoundland and Labrador Hydro as at December 31, 2011, and the results of its operations and its cash flows for the year then ended in accordance with the financial reporting provisions of Section 59 of The Hydro Corporation Act.

Basis of Accounting and Restrictions on Distribution and Use

Without modifying our opinion, we draw attention to Note 2 to the non-consolidated financial statements, which describes the basis of accounting. The non-consolidated financial statements are prepared to assist Newfoundland and Labrador Hydro meet the requirements of the Newfoundland and Labrador Board of Commissioners of Public Utilities. As a result, the non-consolidated financial statements may not be suitable for another purpose. Our report is intended solely for Newfoundland and Labrador Hydro and the Newfoundland and Labrador Board of Commissioners of Public Utilities and should not be distributed to or used by parties other than Newfoundland and Labrador Hydro and the Newfoundland and Labrador Board of Commissioners of Public Utilities.

Other Matter

Newfoundland and Labrador Hydro has prepared separate financial statements for the year ended December 31, 2011 in accordance with Canadian generally accepted accounting principles on which we issued a standard auditor's report to the Lieutenant-Governor in Council, Province of Newfoundland and Labrador dated March 23, 2012.

Deloitte & Touche LLP

Chartered Accountants
March 23, 2012

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2011**	2010
ASSETS		
Current assets		
Cash and cash equivalents	**6.7**	37.7
Short term investments	**-**	9.0
Accounts receivable	**83.1**	70.0
Current portion of regulatory assets (Note 4)	**2.8**	3.8
Inventory	**54.2**	53.4
Prepaid expenses	**2.2**	2.3
Derivative assets (Note 13)	**0.2**	2.0
	149.2	178.2
Property, plant and equipment (Note 3)	**1,410.5**	1,386.1
Sinking funds (Notes 7 and 13)	**247.0**	208.4
Regulatory assets (Note 4)	**63.6**	65.9
Long term receivables (Note 5)	**1.6**	25.7
Investments (Note 6)	**399.2**	384.3
	2,271.1	2,248.6
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	**102.1**	107.6
Accrued interest	**28.7**	28.7
Current portion of long term debt (Note 7)	**8.2**	8.2
Current portion of regulatory liabilities (Note 4)	**137.6**	118.9
Deferred capital contribution (Note 18(d))	**3.5**	0.1
Derivative liabilities (Note 13)	**-**	0.3
	280.1	263.8
Long term debt (Note 7)	**1,131.5**	1,136.7
Regulatory liabilities (Note 4)	**33.3**	40.9
Asset retirement obligations (Note 8)	**19.6**	11.4
Long term related party note payable (Note 18(g))	**1.3**	25.3
Employee future benefits (Note 9)	**53.5**	48.4
	1,519.3	1,526.5
SHAREHOLDER'S EQUITY		
Share capital (Note 10)	**22.5**	22.5
Contributed capital (Note 10)	**115.4**	115.4
	137.9	137.9
Accumulated other comprehensive income (Note 11)	**45.1**	26.7
Retained earnings	**568.8**	557.5
	613.9	584.2
	751.8	722.1
Commitments and contingencies (Note 17)		
	2,271.1	2,248.6

See accompanying notes

On behalf of the Board:

ED MARTIN

GERRY SHORTALL

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

For the year ended December 31 (millions of dollars)	**2011**	2010
Revenue		
Energy sales	**543.5**	500.1
Interest and finance income (Note 14)	**18.2**	16.1
Other revenue	**2.3**	2.3
	564.0	518.5
Expenses		
Fuels	**156.7**	140.4
Power purchased	**56.8**	48.3
Operations and administration	**128.8**	122.4
Interest and finance charges (Note 14)	**108.4**	103.4
Amortization	**45.7**	43.8
Other income and expense	**2.7**	3.3
	499.1	461.6
Income from operations	**64.9**	56.9
Other income		
Equity in net income of Churchill Falls (Note 6)	**14.9**	16.6
Preferred dividends from Churchill Falls	**9.5**	10.2
	24.4	26.8
Net income	**89.3**	83.7
Retained earnings, beginning of year	**557.5**	566.2
	646.8	649.9
Dividends	**78.0**	92.4
Retained earnings, end of year	**568.8**	557.5

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31 (millions of dollars)	**2011**	2010
Net income	**89.3**	83.7
Other comprehensive income		
Change in fair value of available for sale financial instruments	**30.4**	20.5
Change in fair value of derivatives designated as cash flow hedges	**0.1**	1.1
Amounts recognized in net income	**(12.1)**	(15.9)
Comprehensive income	**107.7**	89.4

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31 (millions of dollars)	**2011**	2010
Cash provided by (used in)		
Operating activities		
Net income	**89.3**	83.7
Adjusted for items not involving a cash flow		
Amortization	**45.7**	43.8
Accretion of long term debt	**0.5**	0.4
Loss on disposal of property, plant and equipment	**0.9**	0.7
Unrealized losses on derivative instruments	**0.3**	0.3
Equity in net income of Churchill Falls	**(14.9)**	(16.6)
	121.8	112.3
Changes in non-cash working capital balances (Note 15)	**0.2**	74.8
	122.0	187.1
Financing activities		
Dividends paid to Nalcor	**(78.0)**	(92.4)
Decrease (increase) in long term receivables	**24.1**	(1.8)
(Decrease) increase in long term related party note payable	**(24.0)**	1.4
Increase (decrease) in deferred capital contribution	**3.4**	(0.1)
	(74.5)	(92.9)
Investing activities		
Additions to property, plant and equipment	**(63.1)**	(55.5)
Increase in sinking funds	**(24.7)**	(23.4)
Decrease in short term investments	**9.0**	11.0
Proceeds on disposal of property, plant and equipment	**0.3**	0.5
	(78.5)	(67.4)
Net (decrease) increase in cash	**(31.0)**	26.8
Cash position, beginning of year	**37.7**	10.9
Cash position, end of year	**6.7**	37.7
Cash position is represented by		
Cash	**6.7**	37.7
	6.7	37.7

Supplementary cash flow information (Note 15)

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and is exempt from paying income taxes under Section 149 (1)(d) of the Income Tax Act. The principal activity of Hydro is the development, generation and sale of electricity.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
These financial statements have been prepared in accordance with the Canadian generally accepted accounting principles (GAAP). These financial statements differ materially from Canadian GAAP because they are non-consolidated. Hydro's investments in its subsidiary and jointly controlled companies have been accounted for using the equity method of accounting. Consolidated financial statements for the same period have been prepared for presentation to the Lieutenant-Governor in Council of the Province.

Use of Estimates
Preparation of these financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, amortization and property, plant and equipment, environmental and asset retirement obligations, and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB), and these differences could be material.

Rates and Regulations (Excluding Sales by Subsidiaries)
Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.4% (2010 - 7.4%). Hydro applies certain accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the Financial Statements are more fully disclosed in Note 4.

Cash and Cash Equivalents and Short term Investments
Cash and cash equivalents and short term investments consist primarily of Canadian treasury bills and Banker's Acceptances (BA). Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short term investments. There were no short term investments outstanding at December 31, 2011 (2010 - $9.0 million bearing interest rates ranging from 1.07% to 1.08%). Cash and cash equivalents and short term investments are measured at fair value.

Inventory
Inventory is recorded at the lower of average cost and net realizable value.

Property, Plant and Equipment
Property, plant and equipment is recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction, and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)
Construction in progress includes the costs incurred in engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to Hydro's weighted average cost of capital.

Contributions in aid of construction are funds received from customers and governments toward the cost of property, plant and equipment. Contributions are recorded as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

Gains and losses on the disposal of property, plant and equipment are recognized in Other income and expense as incurred.
Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on distribution system and other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution system	30 years
Other	3 to 50 years

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

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators, and conductors.

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

Capitalized Interest
Interest is charged to construction in progress until the project is complete at rates equivalent to the last approved weighted average cost of capital for regulated assets. Capitalized interest cannot exceed actual interest incurred.

Impairment of Long-Lived Assets
Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Asset Retirement Obligations
The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, is recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. Accretion of asset retirement obligations is included in net income through Amortization. Differences between the recorded asset retirement obligation and the actual retirement costs incurred are recorded as a gain or loss in the settlement period.

Employee Future Benefits
Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of cumulative net actuarial gains and losses over 10% of the accrued benefit obligation is amortized over the expected average remaining service life of the employee group.

Revenue Recognition
Revenue is recognized on the accrual basis, as power and energy deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year end. Sales within the Province are primarily at rates approved by the PUB, whereas sales to certain major industrial customers and export sales are either at rates under the terms of the applicable contracts, or at market rates.

Foreign Currency Translation
Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At the date of settlement and at each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income, except gains or losses on purchases of fuel which are included in the cost of fuel inventory.

Financial Instruments and Hedging Activities

Financial Instruments
Financial assets and financial liabilities are recognized on the balance sheet when Hydro becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Hydro has classified each of its financial instruments into the following categories: financial assets and liabilities held for trading; loans and receivables; financial assets held to maturity; financial assets available for sale; and other financial liabilities.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Financial Instruments and Hedging Activities (cont'd.)

Financial Instruments (cont'd.)
Hydro has classified its financial instruments as follows:

Cash and cash equivalents	Held for trading
Short term investments	Available for sale
Accounts receivable	Loans and receivables
Derivative assets	Held for trading
Sinking funds - investments in same Hydro issue	Held to maturity
Sinking funds - other investments	Available for sale
Long term receivables	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Accrued interest	Other liabilities
Derivative liabilities	Held for trading
Long term debt	Other liabilities
Long term related party note payable	Other liabilities

Each of these financial instruments is measured at amortized cost, except for cash and cash equivalents, short term investments and sinking fund – other investments, derivative assets and derivative liabilities which are measured at fair value.

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short term investments which are expensed as incurred through interest and finance charges, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Derivative Instruments and Hedging Activities
Derivative instruments are utilized by Hydro to manage market risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Hydro may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Hydro formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

During the year, Hydro had foreign exchange forward contracts designated as cash flow hedges (Note 13). In a cash flow hedge relationship, the portion of unrealized gains or losses on the hedging item that is determined to be an effective hedge is recognized in Other Comprehensive Income (OCI), while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income. Hydro had no cash flow hedges in place on December 31, 2011.

Hydro had no fair value hedges in place at December 31, 2011 or 2010.

Future Accounting Changes – International Financial Reporting Standards (IFRS)
In October 2010, the Canadian Accounting Standards Board (AcSB) amended the introduction to Part 1 of the CICA Handbook – Accounting to allow qualifying entities with rate-regulated activities to defer the adoption of IFRS to January 1, 2012. Hydro is a qualifying entity and chose to use the deferral option.

Although IFRS and Canadian Generally Accepted Accounting Principles are based on a similar conceptual framework there are a number of differences in recognition, measurement and disclosure. They areas with the highest potential impact on Hydro are property, plant and equipment, regulatory assets and liabilities.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Future Accounting Changes (cont'd.)

The IASB has deferred its work on rate-regulated activities accounting project and has not provided interim guidance for the recognition and measurement of regulatory assets and liabilities. Accordingly, Hydro continues to assess existing IFRS guidance to determine the impact of differences that will apply to accounting for rate-regulated activities upon adoption of IFRS. In December 2011, Hydro applied to the PUB for approval to use IFRS as the basis for regulatory reporting.

Hydro continues to assess the financial reporting impacts of the adoption of IFRS; however, the impact of IFRS will depend on the IFRS standards in effect at the time of conversion on January 1, 2012 and the accounting elections made.

3. PROPERTY, PLANT AND EQUIPMENT

	Property Plant and Equipment In Service	**Contributions In Aid of Construction**	**Accumulated Amortization**	**Construction In Progress**	**Net Book Value**
(millions of dollars)			**2011**		
Generation plant					
Hydroelectric	**859.9**	**20.4**	**71.5**	**0.3**	**768.3**
Thermal	**284.0**	**0.8**	**209.1**	**6.5**	**80.6**
Diesel	**75.6**	**5.7**	**36.8**	**0.5**	**33.6**
Transmission and distribution	**739.2**	**61.4**	**236.3**	**15.5**	**457.0**
Other	**233.3**	**9.8**	**153.4**	**0.9**	**71.0**
	2,192.0	**98.1**	**707.1**	**23.7**	**1,410.5**
(millions of dollars)			2010		
Generation plant					
Hydroelectric	853.5	20.5	66.6	3.2	769.6
Thermal	273.8	0.8	201.6	3.2	74.6
Diesel	68.0	5.8	35.3	2.2	29.1
Transmission and distribution	717.5	61.0	220.6	5.3	441.2
Other	223.3	9.2	145.6	3.1	71.6
	2,136.1	97.3	669.7	17.0	1,386.1

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

4. REGULATORY ASSETS AND LIABILITIES

(millions of dollars)	**2011**	2010	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Foreign exchange losses	**64.7**	66.8	30.0
Deferred major extraordinary repairs	**0.6**	2.3	0.8
Deferred energy conservation costs	**1.1**	0.6	n/a
Total regulatory assets	**66.4**	69.7	
Less current portion	**2.8**	3.8	
	63.6	65.9	
Regulatory liabilities			
Rate stabilization plan	**170.3**	159.2	n/a
Deferred purchased power savings	**0.6**	0.6	15.5
Total regulatory liabilities	**170.9**	159.8	
Less current portion	**137.6**	118.9	
	33.3	40.9	

Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. Amounts deferred as regulatory assets and liabilities are subject to PUB approval. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities is no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event.

Rate Stabilization Plan
On January 1, 1986, Hydro, having received the approval of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Balances accumulating in the RSP, including financing charges, are to be recovered or refunded in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty five percent of the outstanding balance at year end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect. A portion of the RSP balance totaling approximately $100 million has been set aside by the PUB and will be subject to a future regulatory ruling on the allocation between the industrial customers and retail customers. This balance is mainly due to fuel savings at the Holyrood Thermal Generating Station (HTGS) as a result of the shut down of a portion of the pulp and paper industry in the province since 2007.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian GAAP would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2011, $20.9 million was deferred (2010 - $23.3 million recognized) in the RSP and $25.4 million (2010 – $2.3 million) was recovered through rates and included in energy sales, with the corresponding cost amortized in fuels expenses.

4. REGULATORY ASSETS AND LIABILITIES (cont'd.)

Deferred Foreign Exchange Losses
Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding, to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty year period. This amortization, of $2.1 million annually, is included in interest expense (Note 14).

Deferred Major Extraordinary Repairs
In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $0.5 million, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the HTGS. This program was carried out over a three year period. Pursuant to Order No. P.U. 2 (2005), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset to be amortized over the subsequent five year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five year period. In the absence of rate regulation, Canadian GAAP would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year incurred. In 2011, $1.7 million (2010 - $2.6 million) of amortization was recognized in Operations and administration expense.

Deferred Energy Conservation Costs
Pursuant to Order No. P.U. 14 (2009), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include this program as operating costs in the year incurred. In 2011, $0.5 million (2010 - $0.4 million) was deferred.

Deferred Purchased Power Savings
In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer and amortize the benefits of a reduced initial purchased power rate over a 30 year period. These savings in the amount of $0.6 million (2010 - $0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

Property, Plant and Equipment
The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2011, Hydro's AFUDC of 7.6% is lower than its cost of debt of 8.4% and the amount capitalized is lower and interest expense is higher by $0.2 million than that which would be permitted under Canadian GAAP in the absence of rate regulation. In 2010, Hydro's AFUDC of 7.6% is higher than its cost of debt of 7.2% and the amount capitalized is higher and interest expense is lower by $0.1 million than that which would be permitted under Canadian GAAP in the absence of rate regulation.

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method.

4. REGULATORY ASSETS AND LIABILITIES (cont'd.)

Property, Plant and Equipment (cont'd.)

During 2010, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2009. Based on the results of this study, management currently estimates that switching from the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets, as well as changing from unit based amortization to a group based method on a remaining life basis and implementing the recommended service lives; would have resulted in an estimated decrease of $1.0 million in the annual amortization expense. In December 2011, Hydro applied to the PUB requesting approval of these recommended changes. Approval has not yet been received.

5. LONG TERM RECEIVABLES

Included in long term receivables are two refundable deposits in the amount of $1.3 million (2010 - $1.2 million) associated with an application for transmission service into Nova Scotia, bearing interest at the Prime Rate less 1% and a $0.1 million (2010 - $0.1 million) deposit associated with an application for transmission service in New Brunswick, bearing interest at the Prime Rate. During 2011, Hydro-Québec refunded two deposits totalling $24.1 million associated with applications for transmission service through Québec. The remaining balance of $0.2 million (2010 - $0.3 million) is the non-current portion of receivables associated with customer time payment plans and the long term portion of employee purchase programs.

6. INVESTMENTS

(millions of dollars)	**Ownership Interest**	**2011**	2010
Churchill Falls (Labrador) Corporation	65.8%		
Shares, at cost		**167.2**	167.2
Equity in retained earnings at beginning of year		**217.1**	200.5
Equity in net income for the year		**14.9**	16.6
		399.2	384.3

Effective June 18, 1999, the two shareholders of Churchill Falls, Hydro and Hydro-Québec, entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to joint approval by representatives of Hydro and Hydro-Québec.

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7. LONG TERM DEBT

Details of long term debt are as follows:

Series	Face Value	Coupon Rate %	Year of Issue	Year of Maturity		
(millions of dollars)					**2011**	2010
V *	125.0	10.50	1989	2014	**124.7**	124.6
X *	150.0	10.25	1992	2017	**149.4**	149.3
Y *	300.0	8.40	1996	2026	**293.5**	293.3
AB *	300.0	6.65	2001	2031	**306.5**	306.7
AD *	125.0	5.70	2003	2033	**123.6**	123.6
AE	225.0	4.30	2006	2016	**224.0**	223.8
Total debentures	1,225.0				**1,221.7**	1,221.3
Less sinking fund investments in own debentures					**82.0**	76.4
					1,139.7	1,144.9
Less: payments due within one year					**8.2**	8.2
					1,131.5	1,136.7

* Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada, provincial governments or Schedule 1 banks, and have maturity dates ranging from 2013 to 2033. Hydro debentures, which are intended to be held to maturity, are deducted from long term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are in accordance with bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 3.12% to 9.86% (2010 - 3.86% to 9.86%).

Promissory notes, debentures and long term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments by the Province. The Province charges Hydro a guarantee fee of 25 bps annually on total debt (net of sinking funds) with a remaining term to maturity less than ten years and 50 bps annually on total debt (net of sinking funds) with a remaining term to maturity greater than 10 years. This fee was waived for 2010. The fee for 2011 was $3.9 million.

Hydro uses promissory notes to fulfill its short term funding requirements. As at December 31, 2011 there were no promissory notes outstanding (2010 - nil).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured demand operating credit facility with its banker and at year end there were no amounts drawn on the facility (2010 - nil). Advances may take the form of a Prime Rate advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year end, Hydro had 24 letters of credit outstanding (Note 17(e)) reducing the availability of the credit facility by $18.9 million (2010 - $18.9 million).

Required repayments of long term debt and sinking fund requirements over the next five years will be as follows:

(millions of dollars)	2012	2013	2014	2015	2016
Sinking fund requirement	8.2	8.2	8.2	8.2	8.2
Long term debt repayment	-	-	125.0	-	225.0
	8.2	8.2	133.2	8.2	233.2

8. ASSET RETIREMENT OBLIGATIONS

Hydro has recognized liabilities associated with the retirement of portions of the HTGS and disposal of Polychlorinated Biphenyls (PCB). The reconciliation of the beginning and ending carrying amount of asset retirement obligations is as follows:

(millions of dollars)	**2011**	2010
Asset retirement obligation, beginning of year	**11.4**	-
Liabilities incurred	**2.2**	11.4
Revisions	**5.5**	-
Accretion	**0.5**	-
Asset retirement obligation, end of year	**19.6**	11.4

The total undiscounted estimated cash flows required to settle the HTGS obligations at December 31, 2011 are $27.0 million (2010 - $20.5 million). Payments to settle the liability are expected to occur between 2021 and 2024. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rate of 2.9% (2010 - 4.1%).

The total undiscounted estimated cash flows required to settle the PCB obligations at December 31, 2011 are $2.7 million. Payments to settle the liability are expected to occur between 2012 and 2025. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rate of 3.1%.

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

9. EMPLOYEE FUTURE BENEFITS

Pension Plan
Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $4.3 million (2010 - $4.1 million) are expensed as incurred.

Other Benefits
Hydro provides group life insurance and healthcare benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2011, cash payments to beneficiaries for its unfunded other employee future benefits were $2.2 million (2010 - $1.8 million). An actuarial valuation was performed on December 31, 2009 and extrapolated to December 31, 2011. The next actuarial valuation will be performed as at December 31, 2012.

9. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits (cont'd.)

(millions of dollars)	**2011**	2010
Accrued benefit obligation		
Balance at beginning of year	**69.3**	58.0
Current service cost	**2.1**	1.7
Interest cost	**4.0**	3.8
Actuarial loss	**16.1**	7.6
Benefits paid	**(2.2)**	(1.8)
Balance at end of year	**89.3**	69.3
Plan deficit	**89.3**	69.3
Unamortized actuarial loss	**(35.6)**	(20.7)
Unamortized past-service cost	**(0.2)**	(0.2)
Accrued benefit liability at end of year	**53.5**	48.4

(millions of dollars)	**2011**	2010
Components of benefit cost		
Current service cost	**2.1**	1.7
Interest cost	**4.0**	3.8
Actuarial loss	**16.1**	7.6
	22.2	13.1
Difference between actuarial loss and amount recognized	**(14.9)**	(6.9)
Benefit expense	**7.3**	6.2

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

	2011	2010
Discount rate – benefit cost	**5.75%**	6.50%
Discount rate – accrued benefit obligation	**4.55%**	5.75%
Rate of compensation increase	**3.50%**	3.50%

Assumed healthcare trend rates:

	2011	2010
Initial health care expense trend rate	**7.50%**	7.50%
Cost trend decline to	**5.00%**	5.00%
Year that rate reaches the rate it is assumed to remain at	**2016**	2016

9. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits (cont'd.)

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

Increase	**2011**	2010
Current service and interest cost	**1.2**	0.9
Accrued benefit obligation	**17.7**	11.7

Decrease	**2011**	2010
Current service and interest cost	**(0.9)**	(0.7)
Accrued benefit obligation	**(13.5)**	(9.2)

10. SHAREHOLDER'S EQUITY

Share Capital

(millions of dollars)	**2011**	2010
Common shares of par value $1 each		
Authorized: 25,000,000		
Issued and outstanding 22,503,942	**22.5**	22.5

Contributed Capital

(millions of dollars)	**2011**	2010
Total contributed capital	**115.4**	115.4

11. ACCUMULATED OTHER COMPREHENSIVE INCOME

(millions of dollars)	**2011**	2010
Balance, beginning of year	**26.7**	21.0
Change in fair value of available for sale financial instruments	**30.4**	20.5
Change in fair value of derivatives designated as cash flow hedges	**0.1**	1.1
Amount recognized in net income	**(12.1)**	(15.9)
Balance, end of year	**45.1**	26.7

12. CAPITAL MANAGEMENT

Hydro's principal business requires ongoing access to capital in order to maintain the continued delivery of safe and reliable service to its customers. Therefore, Hydro's primary objective when managing capital is to ensure ready access to capital at a reasonable cost.

The capital managed by Hydro is comprised of debt (long term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

12. CAPITAL MANAGEMENT (cont'd.)

A summary of the capital structure is outlined below:

(millions of dollars)	**2011**		2010	
Debt				
Long term debt	**1,131.5**		1,136.7	
Current portion of long term debt	**8.2**		8.2	
Sinking funds	**(247.0)**		(208.4)	
	892.7	**54.3%**	936.5	56.5%
Equity				
Share capital	**22.5**		22.5	
Contributed capital	**115.4**		115.4	
Accumulated other comprehensive income	**45.1**		26.7	
Retained earnings	**568.8**		557.5	
	751.8	**45.7%**	722.1	43.5%
Total debt and equity	**1,644.5**	**100.0%**	1,658.6	100.0%

Hydro's principal business requires ongoing access to capital in order to maintain the continued delivery of safe and reliable service to its customers. Therefore, Hydro's primary objective when managing capital is to ensure ready access to capital at a reasonable cost.

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

For the regulated portion of Hydro's operations a capital structure comprised of 75% debt and 25% common equity is maintained, a ratio which management believes to be optimal with respect to its cost of capital. This capital structure is maintained by a combination of dividend policy, contributed equity and debt issuance. The issuance of any new debt with a term greater than one year requires prior approval of Hydro's regulator, the PUB.

Per legislation, the total of the short term loans issued by Hydro and outstanding at any time, shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short term loans are those loans issued with a term not exceeding two years. The current limit is set at $300 million. There was no balance outstanding as at December 31, 2011 and 2010. Issuance of long term and short term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both long and short term debt, to $1.6 billion at any point in time.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value

The estimated fair values of financial instruments as at December 31, 2011 and 2010 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Fair Value (cont'd.)

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

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
(millions of dollars)	**2011**		2010	
Financial assets				
Cash and cash equivalents	**6.7**	**6.7**	37.7	37.7
Short term investments	**-**	**-**	9.0	9.0
Accounts receivable	**83.1**	**83.1**	70.0	70.0
Derivative assets	**0.2**	**0.2**	2.0	2.0
Sinking funds - investments in same Hydro issue	**82.0**	**103.7**	76.4	93.6
Sinking funds - other investments	**247.0**	**247.0**	208.4	208.4
Long term receivable [(1)]	**1.6**	**n/a**	25.7	n/a
Financial liabilities				
Accounts payable and accrued liabilities	**102.1**	**102.1**	107.6	107.6
Accrued interest	**28.7**	**28.7**	28.7	28.7
Derivative liabilities	**-**	**-**	0.3	0.3
Long term debt including amount due within one year (before sinking funds)	**1,221.7**	**1,695.3**	1,221.3	1,589.7
Long term related party note payable [(1)]	**1.3**	**n/a**	25.3	n/a

The fair value of cash and cash equivalents, short term investments, accounts receivable, accounts payable and accrued liabilities, accrued interest approximates their carrying values due to their short term maturity.

(1) The fair value of the long term receivable and long term related party note payable is subject to uncertainty regarding the timing of future cash flows and as such, the fair value of the long term receivable cannot be determined at December 31, 2011 and 2010.

Establishing Fair Value

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

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

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

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Fair Value (cont'd.)

Establishing Fair Value (cont'd.)
The following table presents Hydro's fair value hierarchy for financial assets and liabilities as at December 31. There were no transfers between Level 1 and Level 2 during the year:

(millions of dollars)	**Level 1**	**Level 2**	**Total**
	2011		
Financial assets			
Cash and cash equivalents	**6.7**	**-**	**6.7**
Accounts receivable	**83.1**	**-**	**83.1**
Derivative assets	**-**	**0.2**	**0.2**
Sinking funds - investments in same Hydro issue	**-**	**103.7**	**103.7**
Sinking funds - other investments	**-**	**247.0**	**247.0**
Financial liabilities			
Accounts payable and accrued liabilities	**102.1**	**-**	**102.1**
Accrued interest	**28.7**	**-**	**28.7**
Derivative liabilities	**-**	**-**	**-**
Long term debt including amount due within one year (before sinking funds)	**-**	**1,695.3**	**1,695.3**

	Level 1	**Level 2**	**Total**
	2010		
Financial assets			
Cash and cash equivalents	37.7	-	37.7
Short term investments	9.0	-	9.0
Accounts receivable	70.0	-	70.0
Derivative assets	-	2.0	2.0
Sinking funds - investments in same Hydro issue	-	93.6	93.6
Sinking funds - other investments	-	208.4	208.4
Financial liabilities			
Accounts payable and accrued liabilities	107.6	-	107.6
Accrued interest	28.7	-	28.7
Derivative liabilities	-	0.3	0.3
Long term debt including amount due within one year (before sinking funds)	-	1,589.7	1,589.7

There were no financial assets or liabilities valued using Level 3 of the fair value hierarchy as at December 31, 2011 and 2010.

Risk Management
Exposure to credit risk, liquidity risk and market risk arises in the normal course of Hydro's business.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

Credit Risk

Hydro is exposed to credit risk in the event of non-performance by counterparties to its financial instruments. The majority of the receivables are from regulated utilities which minimizes credit risk. There is risk that Hydro will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments which arise in the normal course of business do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Hydro manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers. As at December 31, 2011 security deposits of $0.3 million (2010 - $0.1 million) are included in accounts payable and accrued liabilities.

Hydro's three largest customers account for 78% (2010 - 80%) of total energy sales and 71% (2010 - 67%) of accounts receivable. These customers are comprised of rate regulated organizations or organizations with an investment grade credit rating.

Hydro does not have any significant amounts that are past due and uncollectable for which a provision has not been recognized at December 31, 2011.

Hydro manages its investment credit risk exposure by restricting its investments to high-quality securities such as Canada Treasury Bills, Provincial Treasury Bills, Bankers' Acceptances drawn on Schedule 1 Canadian Chartered Banks and Term Deposits issued by Schedule 1 Canadian Chartered Banks.

Liquidity Risk

Hydro is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. This risk is managed by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cash flows.

Short term liquidity is provided through cash and cash equivalents on hand, funds from operations, a $300.0 million promissory note program and credit facilities.

Long term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues with the exception of Series AE.

The following are the contractual maturities of Hydro's financial liabilities, including principal and interest, as at December 31, 2011:

(millions of dollars)	**< 1 Year**	**1-3 Years**	**3-5 Years**	**> 5 Years**	**Total**
Accounts payable and accrued liabilities	**102.1**	**-**	**-**	**-**	**102.1**
Accrued interest	**28.7**	**-**	**-**	**-**	**28.7**
Long term debt including amount due within one year	**-**	**125.0**	**225.0**	**875.0**	**1,225.0**
Interest	**61.8**	**173.7**	**152.6**	**649.2**	**1,037.3**
	192.6	**298.7**	**377.6**	**1,524.2**	**2,393.1**

Market Risk

Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates. Hydro has a formal financial risk management policy that outlines the risks associated with the operations of Hydro and its subsidiaries outlining approaches and guidelines to be followed in the management of those risks. This policy is reviewed by the Board annually or more frequently if there is a material change to Hydro's financial risks. The Audit Committee provides oversight on behalf of the Board with the exception of any items that specifically require Board approval.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

Market Risk (cont'd.)

Interest Rates
Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management includes the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Hydro attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Hydro is exposed to interest rate risk related to the short term debt portfolio and the sinking fund investment portfolio. Interest rate risk on the long term debt portfolio is mitigated through the use of fixed rate debentures. The following table illustrates Hydro's exposure to a 50 basis point (0.5%) change in interest rates:

	Net Income		Other Comprehensive Income	
(millions of dollars)	0.5% Decrease	0.5 % Increase	0.5% Decrease	0.5% Increase
Interest on sinking funds	-	-	20.0	(2.7)
	-	-	20.0	(2.7)

Foreign Currency and Commodity Exposure
The fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar impact of change in market prices. Hydro's primary exposure to both foreign exchange and commodity price risk arises within Hydro from its purchases of No. 6 fuel for consumption at the HTGS and certain electricity sales both of which are denominated in USD.

During 2011, Hydro had total purchases of No. 6 fuel of $135.1 million (2010 - $104.1 million) denominated in USD. Exposure to both the foreign exchange and commodity price risk associated with these fuel purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in fuel prices including exchange rates, as compared to that approved in Hydro's most recent cost of service study, are captured in the RSP and are either refunded to or collected from customers through rate adjustments. Hydro also employs the periodic use of forward currency contracts to manage exposure to exchange rates on a particular day.

During 2011, total electricity sales denominated in USD were $67.9 million (2010 - $72.8 million). Hydro mitigates the foreign exchange and commodity price risk through the use of commodity swaps and foreign currency forward contracts.

During 2009, Hydro entered into a series of 24 monthly foreign exchange forward contracts with a notional value of $87.9 million USD to hedge foreign exchange risk on approximately 75% of Hydro's USD electricity sales. These contracts had an average exchange rate of $1.17 CAD per USD. These contracts were designated as part of a hedging relationship. The last of these contracts expired in April 2011.

During 2011, Hydro entered into a series of 9 monthly foreign exchange forward contracts with a notional value of $35.7 million USD to hedge foreign exchange risk on approximately 75% of Hydro's USD electricity sale. These contracts had an average exchange rate of $1.00 CAD per USD.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

Market Risk (cont'd.)

Foreign Currency and Commodity Exposure (cont'd.)
In 2011, Hydro also entered into 20 commodity swap contracts with a notional value of $27.8 million USD to hedge commodity price risk on electricity sales. These contracts swapped floating market rates for fixed rates, with Hydro receiving an average fixed rate of $35.37 USD/MWh (2010 - $36.01 USD/MWh). During 2011, $1.9 million in losses from these commodity contracts were included in Other income and expense (2010 - $3.4 million).

Effect of Hedge Accounting on Financial Statements

(millions of dollars)	**Net Gains Included in Net Income**	**Unrealized Gains Included in OCI**	Net Gains Included in Net Income	Unrealized Gains Included in OCI
	2011		2010	
Ineffective portion	**(0.1)**	**-**	0.2	-
Effective portion	**1.5**	**-**	5.9	1.3

The ineffective portion of hedging gains and losses is included in net income through Other income and expense.

14. INTEREST AND FINANCE INCOME /CHARGES

(millions of dollars)	**2011**	2010
Interest and finance income		
Interest on sinking fund	**16.6**	15.2
Other interest income	**1.6**	0.9
	18.2	16.1
Interest and finance charges		
Long term debt	**90.5**	90.5
Interest on RSP	**12.2**	10.2
Accretion of long term debt	**0.5**	0.4
Amortization of deferred foreign exchange losses	**2.1**	2.1
Debt guarantee fee	**3.9**	-
Other	**0.7**	1.4
	109.9	104.6
Interest capitalized during construction	**(1.5)**	(1.2)
	108.4	103.4

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15. SUPPLEMENTARY CASH FLOW INFORMATION

(millions of dollars)	**2011**	2010
Accounts receivable	**(13.1)**	(0.2)
Inventory	**(0.8)**	(3.4)
Prepaid expenses	**0.1**	(0.8)
Regulatory assets	**3.3**	4.4
Regulatory liabilities	**11.1**	37.2
Accounts payable and accrued liabilities	**(5.5)**	33.2
Employee future benefits	**5.1**	4.4
Changes to non-cash working capital balances	**0.2**	74.8
Interest received	**0.5**	0.3
Interest paid	**90.6**	90.5

16. SEGMENT INFORMATION

Hydro operates in three business segments. Hydro Regulated encompasses sales of power and energy to customers within the Province, non-regulated activities are primarily engaged in energy marketing sales outside of the Province. The designation of segments has been based on regulatory status and management accountability. The segments' accounting policies are the same as those previously described in Note 2.

(millions of dollars)	**Hydro Regulated**	**Non-Regulated Activities**	**Energy Marketing**	**Total**
		2011		
Revenue				
Energy sales	**469.2**	**4.6**	**69.7**	**543.5**
Interest and finance income	**17.6**	**-**	**0.6**	**18.2**
Other revenue	**2.3**	**-**	**-**	**2.3**
	489.1	**4.6**	**70.3**	**564.0**
Expenses				
Fuels	**156.7**	**-**	**-**	**156.7**
Power purchased	**52.2**	**-**	**4.6**	**56.8**
Operations and administration	**104.2**	**4.0**	**20.6**	**128.8**
Interest and finance charges	**108.4**	**-**	**-**	**108.4**
Amortization	**45.7**	**-**	**-**	**45.7**
Other income and expense	**0.9**	**-**	**1.8**	**2.7**
	468.1	**4.0**	**27.0**	**499.1**
Net income from operations	**21.0**	**0.6**	**43.3**	**64.9**
Equity in net income of Churchill Falls	**-**	**14.9**	**-**	**14.9**
Preferred dividends	**-**	**9.5**	**-**	**9.5**
Net income	**21.0**	**25.0**	**43.3**	**89.3**
Capital expenditures	**63.1**	**-**	**-**	**63.1**
Total assets	**1,866.6**	**400.6**	**3.9**	**2,271.1**

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

16. SEGMENT INFORMATION (cont'd)

	Hydro Regulated	Non-Regulated Activities	Energy Marketing	Total
		2010		
Revenue				
Energy sales	417.1	5.5	77.5	500.1
Interest and finance income	16.1	-	-	16.1
Other revenue	2.3	-	-	2.3
	435.5	5.5	77.5	518.5
Expenses				
Fuels	140.3	0.1	-	140.4
Power purchased	44.2	-	4.1	48.3
Operations and administration	97.1	3.9	21.4	122.4
Interest and finance charges	102.9	-	0.5	103.4
Amortization	43.8	-	-	43.8
Other income and expense	0.7	-	2.6	3.3
	429.0	4.0	28.6	461.6
Net income from operations	6.5	1.5	48.9	56.9
Equity in net income of Churchill Falls	-	16.6	-	16.6
Preferred dividends	-	10.2	-	10.2
Net income	6.5	28.3	48.9	83.7
Capital expenditures	55.5	-	-	55.5
Total assets	1,831.5	409.7	7.4	2,248.6

Geographic Information

Revenues by geographic area:

(millions of dollars)	**2011**	2010
Newfoundland and Labrador	**495.8**	446.7
New Brunswick	**56.7**	60.7
Nova Scotia	**11.5**	11.1
	564.0	518.5

All of Hydro's physical assets are located in the Province.

17. COMMITMENTS AND CONTINGENCIES

(a) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.1 million (2010 - $0.1 million).

(b) One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.9 million (2010 - $21.8 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate outcome of this action cannot be ascertained at this time, in the opinion of Hydro's management, following consultation with its legal counsel, no liability should be recognized.

(c) Outstanding commitments for capital projects total approximately $18.0 million (2010 - $11.0 million).

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

Type	Rating	In-service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

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

(millions of dollars)	2012	2013	2014	2015	2016
Power purchases	24.8	25.5	26.1	26.8	27.3

(e) Hydro has issued 23 irrevocable letters of credit to the New Brunswick System Operator totalling $18.6 million as credit support related to applications for point to point transmission service. In addition, Hydro has issued one letter of credit to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement.

(f) Hydro has entered into power sales agreements with third parties. To facilitate market access, Hydro has entered into a five year transmission service agreement with Hydro-Québec TransÉnergie to acquire access to 265 MW of transmission capacity from Labrador through Québec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that competing request.

Pursuant to Hydro's five year transmission service agreement with Hydro-Québec TransÉnergie, the transmission rental payments to contract maturity are as follows:

2012	$ 19.0 million
2013	$ 19.0 million
2014	$ 4.8 million

(g) Hydro has received funding, in the amount of $3.0 million, from the Atlantic Canada Opportunities Agency in relation to a wind-hydrogen-diesel research development project in the community of Ramea. This funding is repayable in annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2011 there have been no commercial implementations.

18. RELATED PARTY TRANSACTIONS

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

Related Party	Relationship
Nalcor Energy (Nalcor)	100% shareholder of Hydro.
The Province	100% shareholder of Nalcor.
Churchill Falls (Labrador) Corporation	Jointly controlled subsidiary of Hydro.
Lower Churchill Development Corporation	Wholly owned subsidiary of Hydro.
Nalcor Energy – Oil and Gas Inc.	Wholly owned subsidiary of Nalcor.
Nalcor Energy – Bull Arm Fabrication Inc.	Wholly owned subsidiary of Nalcor.
Gull Island Power Corporation	Wholly owned subsidiary of Nalcor.
Board of Commissioners of Public Utilities	Agency of the Province.

The amounts included in the financial statements for related party transactions are as follows:

		Nalcor	**Other Affiliates**	**Total**
(millions of dollars)			**2011**	
Revenue	(e)	**-**	**2.1**	**2.1**
Expenses	(a)(b)(c)(f)(i)	**25.6**	**7.7**	**33.3**
Accounts receivable	(e)(f)(j)	**-**	**0.7**	**0.7**
Accounts payable and accrued liabilities	(c)(f)(i)	**49.4**	**4.5**	**53.9**
Deferred capital contribution	(d)	**-**	**3.5**	**3.5**
Long term related party note payable	(g)	**1.3**	**-**	**1.3**
(millions of dollars)			2010	
Revenue	(e)	-	2.0	2.0
Expenses	(a)(b)(c)(f)	19.8	3.2	23.0
Accounts receivable	(e)(f)	-	3.4	3.4
Accounts payable and accrued liabilities	(c)(f)	40.4	0.1	40.5
Deferred capital contribution	(d)	-	0.1	0.1
Long term related party note payable	(g)	25.3	-	25.3

(a) Hydro has entered into a long term power contract with Churchill Falls for the purchase of $6.0 million (2010 - $6.0 million) of the power produced by Churchill Falls.

(b) For the year ended December 31, 2011, approximately $2.8 million (2010 - $2.5 million) of operating costs were recovered from Nalcor and $3.4 million (2010 - $3.4 million) from other affiliates for engineering, technical, management and administrative services. During 2011 Hydro incurred $2.8 million (2010 - $2.1 million) of operating costs from Nalcor for engineering, technical, management and administrative services.

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2011, Hydro incurred $1.2 million (2010 - $0.6 million) in costs related to the PUB of which $0.6 million (2010 - $0.1 million) was included in Accounts payable and accrued liabilities.

18. RELATED PARTY TRANSACTIONS (cont'd.)

(d) During 2011, Nalcor advanced $0.7 million (2010 - $2.3 million) as a contribution in aid of construction related to the Ramea Wind-Hydrogen-Diesel Project. Hydro also received contributions in aid of construction from the Province related to wind feasibility studies and as at December 31, 2011, $3.5 million (2010 - $0.1 million) has been recorded as a Deferred capital contribution.

(e) During 2011, Hydro received $0.4 million (2010 - $0.4 million) as a rate subsidy for rural isolated customers from the Province and $1.7 million (2010 - $1.6 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with $0.3 million (2010 - $0.3 million) recorded as Accounts receivable at year end.

(f) As at December 31, 2011, Hydro has a payable to Nalcor of $49.4 million (2010 - $40.4 million) and a net receivable from other affiliates for $0.1 million (2010 - $3.1 million). This payable/receivable consists of various intercompany operating costs and power purchases.

(g) Hydro has a long term related party note payable to Nalcor for $1.3 million (2010 - $25.3 million). The note is non-interest bearing and has no set terms of repayment.

(h) On January 19, 2011, the PUB issued Board Order No. P.U. 1(2011) approving a modification to the RSP rules to reduce the balance owing to industrial customers by $10.0 million. The order also approved Hydro's reimbursement of the amount to the Province. The payment was made to the Province on January 27, 2011.

(i) During 2011, Hydro incurred a debt guarantee fee from the Province of $3.9 million (2010 - nil). This amount remains payable at December 31, 2011.

(j) Hydro has an amount receivable from the Department of Natural Resources of $0.3 million (2010 - nil) related to Coastal Labrador Efficiency Project.

19. COMPARATIVE FIGURES

The comparative figures have been reclassified to conform with the 2011 financial statement presentation including Operations and administration, Other income and expense, Accounts receivable and Long term receivables.

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012

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Independent Auditor's Report

To the Directors of Newfoundland and Labrador Hydro

We have audited the accompanying non-consolidated financial statements of Newfoundland and Labrador Hydro, which comprise the non-consolidated balance sheet as at December 31, 2012, and the non-consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information. The non-consolidated financial statements have been prepared by management based on the financial reporting provisions of Section 59 of The Hydro Corporation Act.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these non-consolidated financial statements in accordance with the financial reporting provisions of Section 59 of The Hydro Corporation Act, and for such internal control as management determines is necessary to enable the preparation of non-consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the non-consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the non-consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the non-consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the non-consolidated 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 non-consolidated financial statements present fairly, in all material respects, the financial position of Newfoundland and Labrador Hydro as at December 31, 2012, and the results of its operations and its cash flows for the year then ended in accordance with the financial reporting provisions of Section 59 of The Hydro Corporation Act.

Basis of Accounting and Restrictions on Distribution and Use

Without modifying our opinion, we draw attention to Note 2 to the non-consolidated financial statements, which describes the basis of accounting. The non-consolidated financial statements are prepared to assist Newfoundland and Labrador Hydro meet the requirements of the Newfoundland and Labrador Board of Commissioners of Public Utilities. As a result, the non-consolidated financial statements may not be suitable for another purpose. Our report is intended solely for Newfoundland and Labrador Hydro and the Newfoundland and Labrador Board of Commissioners of Public Utilities and should not be distributed to or used by parties other than Newfoundland and Labrador Hydro and the Newfoundland and Labrador Board of Commissioners of Public Utilities.

Other Matter

Newfoundland and Labrador Hydro has prepared separate consolidated financial statements for the year ended December 31, 2012 in accordance with Canadian generally accepted accounting principles on which we issued an unmodified auditor's report to the Lieutenant-Governor in Council, Province of Newfoundland and Labrador dated March 28, 2013.

Deloitte LLP
Chartered Accountants
April 23, 2013

BOARD OF DIRECTORS

TERRANCE STYLES
Business Owner

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Mayor, Happy Valley Goose Bay

ALLAN HAWKINS
Mayor, Grand Falls Windsor

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Lawyer

ED MARTIN
President and Chief Executive Officer

TOM CLIFT
Professor
Memorial University - Faculty of Business Administration

KEN MARSHALL
President - Atlantic Region
Rogers Cable

GERALD SHORTALL
Chartered Accountant
Corporate Director

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Vice President, Lower Churchill Project

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Vice President, Regulated Operations

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Vice President, Finance and Chief Financial Officer

GERARD McDONALD
Vice President, Human Resources and Organizational Effectiveness

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Vice President, Project Execution and Technical Services

WAYNE CHAMBERLAIN
General Counsel and Corporate Secretary

PETER HICKMAN
Assistant Corporate Secretary

JAMES MEANEY
Corporate Treasurer

S. KENT LEGGE
General Manager, Finance and Corporate Services

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NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	Notes	**2012**	2011
ASSETS			
Current assets			
Cash and cash equivalents		**2.5**	6.7
Accounts receivable		**83.7**	83.1
Current portion of regulatory assets	5	**2.2**	2.8
Inventory		**51.7**	54.2
Prepaid expenses		**3.0**	2.2
Derivative assets		**-**	0.2
		143.1	149.2
Property, plant and equipment	4	**1,440.6**	1,411.4
Sinking funds	6	**263.3**	247.0
Regulatory assets	5	**62.8**	63.6
Long-term receivables	7	**0.2**	1.6
Investments	8	**417.4**	399.2
		2,327.4	2,272.0
LIABILITIES			
Current liabilities			
Short-term borrowings	9	**52.0**	-
Accounts payable and accrued liabilities		**72.1**	130.8
Current portion of long-term debt	9	**8.2**	8.2
Current portion of regulatory liabilities	5	**169.0**	137.6
Deferred credits		**1.9**	3.5
		303.2	280.1
Long-term debt	9	**1,125.9**	1,131.5
Regulatory liabilities	5	**33.2**	33.3
Asset retirement obligations	10	**23.9**	19.6
Long-term payable	20	**-**	1.3
Employee future benefits	11	**56.9**	52.3
		1,543.1	1,518.1
SHAREHOLDER'S EQUITY			
Share capital	12	**22.5**	22.5
Contributed capital	12	**115.4**	115.4
		137.9	137.9
Accumulated other comprehensive income	12	**41.6**	45.1
Retained earnings		**604.8**	570.9
		646.4	616.0
		784.3	753.9
		2,327.4	2,272.0

Commitments and contingencies (Note 19)
Subsequent events (Note 21)

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

For the year ended December 31 (millions of dollars)	Notes	**2012**	2011
Revenue			
Energy sales		**572.9**	547.9
Other revenue		**2.1**	2.3
		575.0	550.2
Expenses			
Fuels		**182.4**	154.9
Power purchased		**64.7**	56.8
Operating costs	13	**135.2**	129.0
Net finance expense	16	**74.1**	72.9
Amortization		**47.5**	43.2
Other income and expense		**5.2**	2.3
Regulatory adjustments	5	**30.0**	24.1
		539.1	483.2
Income from operations		**35.9**	67.0
Other income			
Equity in net income of Churchill Falls	8	**18.2**	14.9
Preferred dividends from Churchill Falls		**10.1**	9.5
		28.3	24.4
Net income		**64.2**	91.4
Retained earnings at beginning of year		**570.9**	557.5
		635.1	648.9
Dividends		**30.3**	78.0
Retained earnings at end of year		**604.8**	570.9

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31 (millions of dollars)	Notes	**2012**	2011
Net income		**64.2**	91.4
Other comprehensive (loss) income		**(3.5)**	18.4
Comprehensive income		**60.7**	109.8

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31 (millions of dollars)	Notes	**2012**	2011
Cash provided by (used in)			
Operating activities			
Net income		**64.2**	91.4
Adjusted for items not involving a cash flow			
Amortization		**47.5**	43.2
Accretion of long-term debt		**0.5**	0.5
Loss on disposal of property, plant and equipment		**4.0**	1.7
Employee future benefits		**4.6**	3.9
Equity in net income of Churchill Falls		**(18.2)**	(14.9)
Other		**0.4**	0.3
		103.0	126.1
Changes in non-cash working capital balances	17	**(24.9)**	(4.9)
		78.1	121.2
Financing activities			
Dividends paid to Nalcor		**(30.3)**	(78.0)
Increase in short-term borrowings		**52.0**	-
Decrease in long-term receivables		**1.4**	24.1
Decrease in long-term payable		**(1.3)**	(24.0)
(Decrease) increase in deferred credits		**(1.6)**	3.4
		20.2	(74.5)
Investing activities			
Additions to property, plant and equipment		**(77.6)**	(62.3)
Increase in sinking funds		**(26.1)**	(24.7)
Decrease in short-term investments		**-**	9.0
Proceeds on disposal of property, plant and equipment		**1.2**	0.3
		(102.5)	(77.7)
Net decrease in cash		**(4.2)**	(31.0)
Cash position at beginning of year		**6.7**	37.7
Cash position at end of year		**2.5**	6.7
Cash position is represented by			
Cash		**2.5**	6.7
Cash equivalents		**-**	-
		2.5	6.7

Supplementary cash flow information (Note 17)

See accompanying notes

1. DESCRIPTION OF BUSINESS

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and is exempt from paying income taxes under Section 149 (1)(d) of the Income Tax Act. The principal activity of Hydro is the development, generation and sale of electricity. Hydro's operations include both regulated and non-regulated activities. Hydro's head office is located in St. John's, Newfoundland and Labrador.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of Presentation

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). These financial statements differ materially from Canadian GAAP because they are non-consolidated. Hydro's investments in its subsidiary and jointly controlled companies have been accounted for using the equity method of accounting. Consolidated financial statements for the same period have been prepared for presentation to the Lieutenant-Governor in Council of the Province.

2.2 Use of Estimates

Preparation of these financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, amortization and property, plant and equipment, environmental and asset retirement obligations, and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB), and these differences could be material.

2.3 Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.4% (2011 - 7.4%). Hydro applies certain accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the Financial Statements are more fully disclosed in Note 5.

2.4 Cash and Cash Equivalents and Short-Term Investments

Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and Banker's Acceptances (BAs). Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. There were no short-term investments outstanding at December 31, 2012 (2011 - nil). Cash and cash equivalents and short-term investments are measured at fair value.

2.5 Inventory

Inventory is recorded at the lower of average cost and net realizable value.

2.6 Property, Plant and Equipment

Property, plant and equipment is recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.6 Property, Plant and Equipment (cont'd.)

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment or the fair value of assets contributed. Contributions are recorded as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

Gains and losses on the disposal of property, plant and equipment are recognized in Other income and expense as incurred.

Electricity Generation, Transmission and Distribution

Construction in progress includes the costs incurred in engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to Hydro's weighted average cost of debt.

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

Generation Plant	
Hydroelectric	45 to 100 years
Thermal	35 and 65 years
Diesel	25 to 55 years
Transmission	
Lines	30 and 65 years
Terminal stations	40 to 55 years
Distribution system	30 to 55 years

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

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Switching station assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators, and conductors.

Other Assets

Other assets include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment which are carried at cost less accumulated amortization. Amortization is calculated on a straight-line basis over estimated useful lives ranging from 5 to 55 years. Amortization methods, useful lives and residual values are reviewed at each reporting date.

2.7 Capitalized Interest

Interest is charged to construction in progress at rates equivalent to the last approved weighted average cost of debt until the project is complete. Capitalized interest cannot exceed actual interest incurred.

2.8 Impairment of Long-Lived Assets

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.9 Asset Retirement Obligations

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, is recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. Accretion of asset retirement obligations is included in net income through Amortization. Differences between the recorded asset retirement obligation and the actual retirement costs incurred are recorded as a gain or loss in the settlement period.

2.10 Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of cumulative net actuarial gains and losses over 10% of the accrued benefit obligation is amortized over the expected average remaining service life of the employee group.

2.11 Revenue Recognition

Revenue is recognized on the accrual basis, as power and energy deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year end. Sales within the Province are primarily at rates approved by the PUB, whereas sales to certain major industrial customers and export sales are either at rates under the terms of the applicable contracts, or at market rates.

2.12 Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At the date of settlement and at each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income, except gains or losses on purchases of fuel which are included in the cost of fuel inventory.

2.13 Financial Instruments and Hedging Activities

Financial Instruments

Financial assets and financial liabilities are recognized on the balance sheet when Hydro becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Hydro has classified each of its financial instruments into the following categories: financial assets and liabilities held for trading; loans and receivables; financial assets held to maturity; financial assets available for sale; and other financial liabilities.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.13 Financial Instruments and Hedging Activities (cont'd.)

Financial Instruments (cont'd.)
Hydro has classified its financial instruments as follows:

Cash and cash equivalents	Held for trading
Accounts receivable	Loans and receivables
Derivative assets	Held for trading
Sinking funds - investments in same Hydro issue	Held to maturity
Sinking funds - other investments	Available for sale
Long-term receivables	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Long-term debt	Other liabilities
Long-term payable	Other liabilities

Each of these financial instruments is measured at amortized cost, except for cash and cash equivalents, sinking fund – other investments and derivative assets which are measured at fair value.

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short-term investments which are expensed as incurred through interest and finance charges, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Derivative Instruments and Hedging Activities
Derivative instruments are utilized by Hydro to manage market risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Hydro may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Hydro formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges. Hydro had no fair value hedges in place at December 31, 2012 or 2011.

2.14 Future Accounting Changes – International Financial Reporting Standards (IFRS)
The Canadian Accounting Standards Board (AcSB) amended the introduction to Part 1 of the Canadian Institute of Chartered Accounts (CICA) Handbook – Accounting to allow qualifying entities with rate-regulated activities to defer the adoption of IFRS to January 1, 2015. Hydro is a qualifying entity and chose to use the deferral option for the year ended December 31, 2012.

Although IFRS and Canadian GAAP are based on a similar conceptual framework, there are a number of differences in recognition, measurement and disclosure. The areas with the highest potential impact on Hydro are property, plant and equipment and regulatory assets and liabilities.

Hydro continues to assess the financial reporting impacts of the adoption of IFRS; however, the impact of IFRS will depend on the IFRS standards in effect at the time of conversion and the accounting elections made.

3. CHANGE IN ACCOUNTING POLICY

During 2012, Hydro adopted new accounting policies as approved by the PUB in Order No P.U. 13(2012). These policy changes were applied retroactive to January 1, 2011. The policy changes are as follows:

Capitalization of Property, Plant and Equipment
Previously, Hydro capitalized certain general overhead costs and training costs and included the costs of asset overhauls and major inspections as an operating expense. Hydro's revised policy is to expense general overheads and training costs as incurred and to capitalize costs associated with asset overhauls and major inspections. These changes resulted in a decrease in net income of $1.3 million for the year ended December 31, 2011.

Employee Future Benefits
Previously, Hydro accounted for employee future benefits under the corridor method whereby the excess of gains and losses over 10% of the accrued benefit obligation was amortized to income over the expected average remaining service life of the employee group. Hydro's revised policy is to defer the amortization of actuarial gains and losses recognized in employee future benefits expense through regulatory adjustments. This change resulted in an increase in net income of $1.2 million for the year ended December 31, 2011.

Amortization of Property, Plant and Equipment
Previously, Hydro amortized hydroelectric generating assets and transmission assets using the sinking fund method. Hydro's new policy is to calculate amortization using straight-line methodology. As part of the methodology change, Hydro also changed its estimate of service lives effective January 1, 2011. In the absence of regulatory approval, this change would have been applied retroactively resulting in a decrease in retained earnings as at January 1, 2011 of $210.7 million. Pursuant to Order No. P.U. 13 (2012), the PUB approved the use of the carrying value of property, plant and equipment under Canadian GAAP as deemed cost at January 1, 2011. As the deemed cost of Hydro's regulated property, plant and equipment is recoverable through future rates, no adjustment to opening retained earnings is necessary. These changes resulted in an increase in net income of $2.2 million for the year ended December 31, 2011.

4. PROPERTY, PLANT AND EQUIPMENT

	Property Plant and Equipment in Service	**Contributions in Aid of Construction**	**Accumulated Amortization**	**Construction in Progress**	**Net Book Value**
(millions of dollars)			**2012**		
Generation plant					
Hydroelectric	**775.1**	-	**31.6**	**3.5**	**747.0**
Thermal	**98.1**	-	**12.5**	**8.5**	**94.1**
Diesel	**37.9**	-	**2.7**	**0.3**	**35.5**
Transmission and distribution	**504.6**	**11.6**	**28.5**	**20.0**	**484.5**
Other	**94.9**	**2.5**	**13.5**	**0.6**	**79.5**
	1,510.6	**14.1**	**88.8**	**32.9**	**1,440.6**
(millions of dollars)			2011		
Generation plant					
Hydroelectric	773.0	-	15.8	0.2	757.4
Thermal	81.5	-	5.5	6.4	82.4
Diesel	35.9	-	1.2	0.5	35.2
Transmission and distribution	458.1	0.7	13.9	15.1	458.6
Other	83.7	0.7	6.1	0.9	77.8
	1,432.2	1.4	42.5	23.1	1,411.4

5. REGULATORY ASSETS AND LIABILITIES

(millions of dollars)	**2012**	2011	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Foreign exchange losses	**62.6**	64.7	29.0
Deferred major extraordinary repairs	**-**	0.6	-
Deferred energy conservation costs	**2.4**	1.1	n/a
Total regulatory assets	**65.0**	66.4	
Less current portion	**2.2**	2.8	
	62.8	63.6	
Regulatory liabilities			
Rate stabilization plan (RSP)	**201.7**	170.3	n/a
Deferred purchased power savings	**0.5**	0.6	14.5
Total regulatory liabilities	**202.2**	170.9	
Less current portion	**169.0**	137.6	
	33.2	33.3	

5.1 Regulatory Adjustments Recorded in the Statement of Income

(millions of dollars)	**2012**	2011
RSP recovery	**60.4**	25.4
Rural rate adjustment	**7.0**	4.4
RSP fuel deferral	**(49.3)**	(20.9)
RSP interest	**13.2**	12.2
Amortization of deferred foreign exchange losses	**2.1**	2.1
Deferred foreign exchange (losses) gains on fuel	**(0.4)**	0.2
Employee future benefit actuarial losses	**(2.3)**	(1.2)
Amortization of deferred major extraordinary repairs	**0.6**	1.7
Deferred energy conservation	**(1.4)**	(0.5)
Insurance proceeds	**0.2**	0.8
Deferred purchased power savings	**(0.1)**	(0.1)
	30.0	24.1

Hydro has operations that are regulated by the PUB.

Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. Amounts deferred as regulatory assets and liabilities are subject to PUB approval. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities is no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event.

5.2 Rate Stabilization Plan

On January 1, 1986, Hydro, having received the approval of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

5. REGULATORY ASSETS AND LIABILITIES (cont'd.)

5.2 Rate Stabilization Plan (cont'd.)

Balances accumulating in the RSP, including financing charges, are to be recovered or refunded in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of 25% of the outstanding balance at year end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect. A portion of the RSP balance totaling approximately $135.0 million (2011 - $102.0 million) has been set aside by the PUB and will be subject to a future regulatory ruling on the allocation between the industrial customers and retail customers. This balance is mainly due to fuel savings at the Holyrood Thermal Generating Station (HTGS) as a result of the shutdown of a portion of the pulp and paper industry in the Province since 2007.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian GAAP would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2012, $49.3 million was deferred (2011 - $20.9 million) in the RSP and $60.4 million (2011 - $25.4 million) was recovered through rates and included in energy sales.

Hydro's rural rates on the Island Interconnected and Isolated systems are primarily based upon retail electricity rates. Therefore, when a rate adjustment for retail rates has been approved by the PUB, Hydro's rural customers receive the same rate change. In 2012, the rural rate adjustment reduced income and increased the RSP liability by $7.0 million (2011 - $4.4 million). In the absence of rate regulation, the rate adjustment would have been recorded in income.

Hydro is required to charge or pay interest on balances accumulating in the RSP at a rate equal to Hydro's weighted average cost of capital. As a result, Hydro recognized interest expense of $13.2 million in 2012 (2011 - $12.2 million).

5.3 Deferred Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding, to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty year period. This amortization, of $2.1 million annually, is included in regulatory adjustments.

5.4 Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $0.5 million, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the HTGS. This program was carried out over a three year period. Pursuant to Order No. P.U. 2 (2005), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset to be amortized over the subsequent five year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five year period. In the absence of rate regulation, Canadian GAAP would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year incurred. In 2012, $0.6 million (2011 - $1.7 million) of amortization was recognized in Operating costs.

5. REGULATORY ASSETS AND LIABILITIES (cont'd.)

5.5 Deferred Energy Conservation Costs

Pursuant to Order No. P.U. 14 (2009), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include this program as operating costs in the year incurred. In 2012, $1.4 million (2011 - $0.5 million) was deferred.

5.6 Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer and amortize the benefits of a reduced initial purchased power rate over a 30 year period. The remaining unamortized savings in the amount of $0.5 million (2011 - $0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

5.7 Property, Plant and Equipment

Pursuant to Order No P.U. 13 (2012), the PUB approved the use of the carrying amount of property, plant and equipment under Canadian GAAP as the deemed cost at January 1, 2011.

During 2010, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2009. Based on the results of this study and PUB approval, amortization previously calculated using the 'sinking fund' method under Canadian GAAP is now calculated on a straight-line basis. In addition, the service lives for certain assets have also been revised.

The PUB permits major inspections to be included in the cost of capital and amortized over the average expected period of the next major inspection. In 2012, $6.8 million (2011 - $0.9 million) was recognized as property, plant and equipment. In the absence of rate regulation, Canadian GAAP would require that Hydro include the major inspections as operating costs in the year incurred.

5.8 Foreign Exchange Gains and Losses

Hydro purchases a significant amount of fuel in US dollars. The RSP allows Hydro to defer variances in fuel prices (including foreign exchange fluctuations). During 2012, Hydro deferred foreign exchange losses on fuel purchases of $0.4 million (2011 - gain of $0.2 million). In the absence of rate regulation, Canadian GAAP would require that Hydro include gains and losses on foreign currencies in Net finance expense in the period incurred.

5.9 Insurance Proceeds

Pursuant to Order No. P.U. 13 (2012), Hydro records net insurance proceeds in excess of $50,000 against the capital costs of the related assets. During 2012, Hydro recorded net insurance proceeds of $0.2 million (2011 - $0.8 million) against costs of the related assets.

5.10 Employee Future Benefits

Pursuant to Order No. P.U. 13 (2012), Hydro defers the amortization of actuarial gains and losses. During 2012, Hydro deferred actuarial gains and losses of $2.3 million (2011 - $1.2 million).

6. SINKING FUNDS

As at December 31, 2012, sinking funds include $263.3 million (2011 - $247.0 million) related to repayment of Hydro's long-term debt. Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada, provincial governments or Schedule 1 banks, and have maturity dates ranging from 2013 to 2041.

6. SINKING FUNDS (cont'd.)

Hydro debentures, which are intended to be held to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are in accordance with bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 2.57% to 9.86% (2011 - 3.12% to 9.86%).

(millions of dollars)	**2012**	2011
Sinking funds at beginning of year	**247.0**	208.2
Contributions	**8.2**	8.2
Earnings	**11.7**	11.0
Valuation adjustment	**(3.6)**	19.6
Sinking funds at end of year	**263.3**	247.0

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

(millions of dollars)	2013	2014	2015	2016	2017
Sinking fund instalments	8.2	8.2	8.2	8.2	6.7

7. LONG-TERM RECEIVABLES

The balance of $0.2 million (2011 - $0.2 million) is the non-current portion of receivables associated with customer time payment plans and the long-term portion of employee purchase programs. During 2012, refundable deposits associated with applications for transmission service into Nova Scotia and New Brunswick were settled (2011 - $1.4 million). During 2011, Hydro-Quebec refunded two deposits totaling $24.1 million associated with applications for transmission service through Quebec.

8. INVESTMENTS

(millions of dollars)	**Ownership Interest**	**2012**	2011
Churchill Falls (Labrador) Corporation	65.8%		
Shares, at cost		**167.2**	167.2
Equity in retained earnings at beginning of year		**232.0**	217.1
Equity in net income for the year		**18.2**	14.9
		417.4	399.2

Effective June 18, 1999, the two shareholders of Churchill Falls, Hydro and Hydro-Quebec, entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to joint approval by representatives of Hydro and Hydro-Quebec.

9. LONG-TERM DEBT

Details of long-term debt are as follows:

Series	Face Value	Coupon Rate %	Year of Issue	Year of Maturity		
(millions of dollars)					**2012**	2011
V *	125.0	10.50	1989	2014	**124.8**	124.7
X *	150.0	10.25	1992	2017	**149.4**	149.4
Y *	300.0	8.40	1996	2026	**293.8**	293.5
AB *	300.0	6.65	2001	2031	**306.3**	306.5
AD *	125.0	5.70	2003	2033	**123.7**	123.6
AE	225.0	4.30	2006	2016	**224.2**	224.0
Total debentures	1,225.0				**1,222.2**	1,221.7
Less sinking fund investments in own debentures					**88.1**	82.0
					1,134.1	1,139.7
Less: payments due within one year					**8.2**	8.2
					1,125.9	1,131.5

* Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 25 basis points annually on the total debt (net of sinking funds) with a remaining term to maturity less than 10 years and 50 basis points annually on total debt (net of sinking funds) with a remaining term to maturity greater than 10 years. The fee for 2012 was $3.7 million (2011 - $3.9 million).

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2012, there was $52.0 million in short-term borrowings outstanding (2011 - nil).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured demand operating credit facility with its banker and at year end there were no amounts drawn on the facility (2011 - nil). Advances may take the form of a Prime Rate Advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year end, Hydro had 24 letters of credit outstanding, reducing the availability of the credit facility by $18.9 million (2011 - $18.9 million).

Required repayments of long-term debt over the next five years will be as follows:

(millions of dollars)	2013	2014	2015	2016	2017
Long-term debt repayment	-	125.0	-	225.0	150.0

10. ASSET RETIREMENT OBLIGATIONS

Hydro has recognized liabilities associated with the retirement of portions of the HTGS and disposal of Polychlorinated Biphenyls (PCB). The reconciliation of the beginning and ending carrying amounts of asset retirement obligations is as follows:

(millions of dollars)	**2012**	2011
Asset retirement obligation at beginning of year	**19.6**	11.4
Liabilities incurred	-	2.2
Revisions	**3.7**	5.5
Accretion	**0.7**	0.5
Settlements	**(0.1)**	-
Asset retirement obligation at end of year	**23.9**	19.6

The total estimated undiscounted cash flows required to settle the HTGS obligations at December 31, 2012 are $32.1 million (2011 - $27.0 million). Payments to settle the liability are expected to occur between 2020 and 2024. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rate of 2.8% (2011 - 2.9%).

The total estimated undiscounted cash flows required to settle the PCB obligations at December 31, 2012 are $2.7 million (2011 - $2.7 million). Payments to settle the liability are expected to occur between 2013 and 2025. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rate of 3.1% (2011 - 3.1%).

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

11. EMPLOYEE FUTURE BENEFITS

11.1 Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $4.4 million (2011 - $4.3 million) are expensed as incurred.

11.2 Other Benefits

Hydro provides group life insurance and health care benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2012, cash payments to beneficiaries for its unfunded other employee future benefits were $2.3 million (2011 - $2.2 million). An actuarial valuation was performed as at December 31, 2012.

11. EMPLOYEE FUTURE BENEFITS (cont'd.)

11.2 Other Benefits (cont'd.)

(millions of dollars)	**2012**	2011
Accrued benefit obligation		
Balance at beginning of year	**88.1**	69.3
Current service cost	**2.9**	2.1
Interest cost	**4.1**	4.0
Actuarial (gain) loss	**(3.4)**	16.1
Regulatory adjustments	**(2.3)**	(1.2)
Benefits paid	**(2.3)**	(2.2)
Balance at end of year	**87.1**	88.1
Plan deficit	**87.1**	88.1
Unamortized actuarial loss	**(30.0)**	(35.6)
Unamortized past-service cost	**(0.2)**	(0.2)
Accrued benefit liability at end of year	**56.9**	52.3

(millions of dollars)	**2012**	2011
Components of benefit cost		
Current service cost	**2.9**	2.1
Interest cost	**4.1**	4.0
Actuarial (gain) loss	**(3.4)**	16.1
	3.6	22.2
Difference between actuarial gain or loss and amount recognized	**5.6**	(14.9)
Benefit expense	**9.2**	7.3

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

	2012	2011
Discount rate – benefit cost	**4.55%**	5.75%
Discount rate – accrued benefit obligation	**4.00%**	4.55%
Rate of compensation increase	**3.50%**	3.50%

Assumed health care trend rates:

	2012	2011
Initial health care expense trend rate	**6.00%**	7.50%
Cost trend decline to	**4.50%**	5.00%
Year that rate reaches the rate it is assumed to remain at	**2020**	2016

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

Increase	**2012**	2011
Current service and interest cost	**1.6**	1.2
Accrued benefit obligation	**17.0**	17.7

Decrease	**2012**	2011
Current service and interest cost	**(1.2)**	(0.9)
Accrued benefit obligation	**(13.0)**	(13.5)

12. SHAREHOLDER'S EQUITY

12.1 Share Capital

(millions of dollars)	**2012**	2011
Common shares of par value $1 each		
Authorized: 25,000,000		
Issued and outstanding 22,503,942	**22.5**	22.5

12.2 Contributed Capital

(millions of dollars)	**2012**	2011
Total contributed capital	**115.4**	115.4

12.3 Accumulated Other Comprehensive Income

(millions of dollars)	**2012**	2011
Balance at beginning of year	**45.1**	26.7
Other comprehensive (loss) income	**(3.5)**	18.4
Balance at end of year	**41.6**	45.1

13. OPERATING COSTS

(millions of dollars)	**2012**	2011
Salaries and benefits	**76.0**	72.4
Maintenance and materials	**19.9**	19.6
Transmission rental	**19.7**	18.7
Professional services	**10.1**	7.6
Other operating costs	**9.5**	10.7
Total	**135.2**	129.0

14. CAPITAL MANAGEMENT

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

The capital managed by Hydro is comprised of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

14. CAPITAL MANAGEMENT (cont'd.)

A summary of the capital structure is outlined below:

(millions of dollars)	**2012**		2011	
Debt				
Long-term debt	**1,125.9**		1,131.5	
Short-term borrowings	**52.0**		-	
Current portion of long-term debt	**8.2**		8.2	
Sinking funds	**(263.3)**		(247.0)	
	922.8	**54.1%**	892.7	54.2%
Equity				
Share capital	**22.5**		22.5	
Contributed capital	**115.4**		115.4	
Accumulated other comprehensive income	**41.6**		45.1	
Retained earnings	**604.8**		570.9	
	784.3	**45.9%**	753.9	45.8%
Total Debt and Equity	**1,707.1**	**100.0%**	1,646.6	100.0%

Hydro's unsecured demand operating facility has covenants restricting the issuance of debt such that the debt to total capitalization ratio cannot exceed 70%. The covenants further stipulate that the Debt Service Coverage Ratio should at all times be greater than 1.5 to 1.0. As at December 31, 2012, Hydro was in compliance with these covenants.

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

For the regulated portion of Hydro's operations a capital structure comprised of 75% debt and 25% equity is maintained, a ratio which management believes to be optimal with respect to its cost of capital. This capital structure is maintained by a combination of dividend policy, contributed equity and debt issuance. The issuance of any new debt with a term greater than one year requires prior approval of the PUB.

Legislation stipulates that the total of the short-term loans issued by Hydro and outstanding at any time shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short-term loans are those loans issued with a term not exceeding two years. The current limit is set at $300.0 million. There was $52.0 million outstanding as at December 31, 2012 (2011 - nil). Issuance of long-term and short-term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both long and short-term debt, to $1.6 billion at any point in time.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

15.1 Fair Value

The estimated fair values of financial instruments as at December 31, 2012 and 2011 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions.

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

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

15.1 Fair Value (cont'd.)

Establishing Fair Value

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

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

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

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. The following table presents Hydro's fair value hierarchy for financial assets and liabilities.

		Carrying Value	**Fair Value**	Carrying Value	Fair Value
(millions of dollars)	Level	**2012**		2011	
Financial assets					
Cash and cash equivalents	1	**2.5**	**2.5**	6.7	6.7
Accounts receivable	1	**83.7**	**83.7**	83.1	83.1
Derivative assets	2	**-**	**-**	0.2	0.2
Sinking funds - investments in same Hydro issue	2	**88.1**	**107.3**	82.0	103.7
Sinking funds - other investments	2	**263.3**	**263.3**	247.0	247.0
Long-term receivable	2	**0.2**	**0.2**	1.6	1.6
Financial liabilities					
Accounts payable and accrued liabilities	1	**72.1**	**72.1**	130.8	130.8
Short-term borrowings	1	**52.0**	**52.0**	-	-
Long-term debt including amount due within one year (before sinking funds)	2	**1,222.2**	**1,668.6**	1,221.7	1,695.3
Long-term payable	2	**-**	**-**	1.3	1.3

The fair value of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximates their carrying values due to their short-term maturity.

There were no financial assets or liabilities valued using Level 3 of the fair value hierarchy as at December 31, 2012 and 2011.

15.2 Risk Management

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

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

15.2 Risk Management (cont'd.)

Credit Risk

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

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

Credit risk on short-term investments is minimized by limiting holdings to high-quality, investment grade securities issued by Federal and Provincial governments, as well as Bankers' Acceptances and term deposits issued by Canadian Schedule 1 Chartered Banks.

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

	Issuer Credit Rating	**Fair Value of Portfolio (%)**	**Issuer Credit Rating**	**Fair Value of Portfolio (%)**
	2012		2011	
Provincial Governments	**AA- to AAA**	**4.07%**	AA- to AAA	4.19%
Provincial Governments	**A- to A+**	**55.95%**	A- to A+	57.75%
Provincially owned utilities	**A- to A+**	**33.96%**	A- to A+	32.43%
Schedule 1 Canadian banks	**A- to A+**	**1.89%**	A- to A+	1.31%
Provincially owned utilities	**BBB+**	**4.13%**	BBB+	4.32%
		100.00%		100.00%

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

Hydro's exposure to credit risk on its energy sales and associated accounts receivable is determined by the credit quality of its customers. Hydro's three largest customers account for 83.1% (2011 - 80.0%) of total energy sales and 78.4% (2011 - 68.8%) of accounts receivable. These customers are comprised of rate regulated entities or organizations with investment grade credit ratings.

Hydro does not have any significant amounts that are past due and uncollectable for which a provision has not been recognized at December 31, 2012.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

15.2 Risk Management (cont'd.)

Liquidity Risk

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

Short-term liquidity is mainly provided through cash and cash equivalents on hand, funds from operations, and a $300.0 million promissory note program. In addition, Hydro maintains a $50.0 million (2011 – $50.0 million) unsecured demand operating facility with its primary banker in order to meet any requirements beyond those forecasted for a given period.

Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2013 to 2033. Sinking funds have been established for these issues, with the exception of the issue maturing in 2016.

The following are the contractual maturities of Hydro's financial liabilities, including principal and interest, as at December 31, 2012:

(millions of dollars)	**< 1 Year**	**1-3 Years**	**3-5 Years**	**> 5 Years**	**Total**
Accounts payable and accrued liabilities	72.1	-	-	-	72.1
Short-term borrowings	52.0	-	-	-	52.0
Long-term debt	-	125.0	375.0	725.0	1,225.0
Interest	61.8	160.6	135.7	588.7	946.8
	185.9	285.6	510.7	1,313.7	2,295.9

Market Risk

In the course of carrying out its operating, financing and investing activities, Hydro is exposed to possible market price movements that could impact expected future cash flow and the carrying value of certain financial assets and liabilities. Market price movements to which Hydro has significant exposure include those relating to prevailing interest rates, foreign exchange rates, most notably the USD/CAD dollar, and current commodity prices, most notably the spot prices for diesel fuel, electricity, and No. 6 fuel. These exposures were addressed as part of the Financial Risk Management Strategy.

Interest Rates

Changes in prevailing interest rates will impact the fair value of financial assets and liabilities classified as held for trading or available for sale, which includes Hydro's cash and cash equivalents, short-term investments and sinking funds. Expected future cash flows associated with those financial instruments can also be impacted. The impact of a 0.5% change in interest rates on net income and other comprehensive income associated with cash and cash equivalents, debt and short-term debt was negligible throughout 2012 due to the short time period to maturity.

The table below shows the impact of a 50 basis point change in interest rates on net income and other comprehensive income associated with the sinking funds at the balance sheet date:

	Net Income		**Other Comprehensive Income**	
(millions of dollars)	**0.5% Decrease**	**0.5% Increase**	**0.5% Decrease**	**0.5% Increase**
Interest on sinking fund	-	-	10.9	(10.2)

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

15.2 Risk Management (cont'd.)

Market Risk (cont'd.)

Foreign Currency and Commodity Exposure
Hydro's primary exposure to both foreign exchange and commodity price risk arises from its purchases of No. 6 fuel for consumption at the HTGS and USD denominated electricity sales. These exposures are addressed in accordance with the board-approved Financial Risk Management Policy. Tactics to address these exposures include the use of forward rate agreements and fixed price commodity swaps.

During 2012, total electricity sales denominated in USD were $33.8 million (2011 - $67.9 million). In 2012 Hydro mitigated foreign exchange risk on these sales through the use of foreign currency forward contracts. In March of 2012, Hydro entered into a series of ten monthly foreign exchange forward contracts with a notional value of $39.1 million USD to hedge foreign exchange risk on 75% of Hydro's planned USD electricity sales for the year. These contracts had an average exchange rate of $1.00 CAD per USD. In 2012, management elected not to implement commodity price hedges aimed at addressing electricity price risk due to depressed market pricing conditions. During 2012, $0.1 million in gains from these derivative contracts were included in other income and expense (2011 - $1.9 million loss).

16. NET FINANCE EXPENSE

(millions of dollars)	**2012**	2011
Finance income		
Interest on sinking fund	**18.0**	16.6
Other interest income	**0.8**	4.4
	18.8	21.0
Finance expense		
Long-term debt	**90.5**	90.5
Accretion	**0.5**	0.5
Debt guarantee fee	**3.7**	3.9
Other	**0.9**	0.6
	95.6	95.5
Interest capitalized during construction	**(2.7)**	(1.6)
	92.9	93.9
Net finance expense	**74.1**	72.9

17. SUPPLEMENTARY CASH FLOW INFORMATION

(millions of dollars)	**2012**	2011
Accounts receivable	**(0.6)**	(13.1)
Inventory	**2.5**	(0.8)
Prepaid expenses	**(0.8)**	0.1
Regulatory assets	**1.4**	3.3
Regulatory liabilities	**31.3**	11.1
Accounts payable and accrued liabilities	**(58.7)**	(5.5)
Changes to non-cash working capital balances	**(24.9)**	(4.9)
Interest received	**0.3**	0.5
Interest paid	**91.4**	90.6

18. SEGMENT INFORMATION

Hydro operates in three business segments. Hydro Regulated encompasses sales of electricity to customers within the Province, non-regulated activities encompasses other non-regulated activities and Energy Marketing activities include the sale of electricity to markets outside the Province. The designation of segments has been based on regulatory status and management accountability. The segments' accounting policies are the same as those previously described in Note 2.

(millions of dollars)	**Hydro Regulated**	**Non-Regulated Activities**	**Energy Marketing**	**Total**
		2012		
Revenue				
Energy sales	**520.7**	**-**	**52.2**	**572.9**
Other revenue	**2.1**	**-**	**-**	**2.1**
	522.8	**-**	**52.2**	**575.0**
Expenses				
Fuels	**182.4**	**-**	**-**	**182.4**
Power purchased	**57.0**	**-**	**7.7**	**64.7**
Operations and administration	**109.5**	**0.6**	**25.1**	**135.2**
Net finance expense	**74.0**	**-**	**0.1**	**74.1**
Amortization	**47.5**	**-**	**-**	**47.5**
Other income and expense	**5.3**	**-**	**(0.1)**	**5.2**
Regulatory adjustments	**30.0**	**-**	**-**	**30.0**
	505.7	**0.6**	**32.8**	**539.1**
Net income (loss) from operations	**17.1**	**(0.6)**	**19.4**	**35.9**
Equity in net income of Churchill Falls	**-**	**18.2**	**-**	**18.2**
Preferred dividends	**-**	**10.1**	**-**	**10.1**
Net income	**17.1**	**27.7**	**19.4**	**64.2**
Capital expenditures	**77.6**	**-**	**-**	**77.6**
Total assets	**1,906.4**	**417.5**	**3.5**	**2,327.4**

(millions of dollars)				
		2011		
Revenue				
Energy sales	473.6	-	74.3	547.9
Other revenue	2.3	-	-	2.3
	475.9	-	74.3	550.2
Expenses				
Fuels	154.9	-	-	154.9
Power purchased	52.2	-	4.6	56.8
Operations and administration	104.4	1.3	23.3	129.0
Net finance expense	73.5	-	(0.6)	72.9
Amortization	43.2	-	-	43.2
Other income and expense	0.5	-	1.8	2.3
Regulatory adjustments	24.1	-	-	24.1
	452.8	1.3	29.1	483.2
Net income (loss) from operations	23.1	(1.3)	45.2	67.0
Equity in net income of Churchill Falls	-	14.9	-	14.9
Preferred dividends	-	9.5	-	9.5
Net income	23.1	23.1	45.2	91.4
Capital expenditures	62.3	-	-	62.3
Total assets	1,867.5	400.6	3.9	2,272.0

19. COMMITMENTS AND CONTINGENCIES

(a) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.2 million (2011 - $0.1 million).

(b) One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.9 million (2011 - $21.9 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate outcome of this action cannot be ascertained at this time, in the opinion of Hydro's management, following consultation with its legal counsel, no liability should be recognized.

(c) Outstanding commitments for capital projects total approximately $18.5 million as at December 31, 2012 (2011 - $29.2 million).

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

Type	Rating	In-service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

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

(millions of dollars)	2013	2014	2015	2016	2017
Power purchases	24.9	24.5	24.7	24.9	25.2

(e) Hydro has issued 23 irrevocable letters of credit to the New Brunswick System Operator totaling $18.6 million as credit support related to applications for point to point transmission services. In addition Hydro has issued one letter of credit to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement.

(f) Hydro has entered into power sales agreements with third parties. To facilitate market access, Hydro has entered into a transmission service agreement with Hydro-Quebec TransEnergie, which concludes in 2014, to acquire access to 265 MW of transmission capacity from Labrador through Quebec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that competing request.

Pursuant to Hydro's five-year transmission service agreement with Hydro-Quebec TransEnergie, the transmission rental payments to contract maturity are as follows:

2013	$18.9 million
2014	$ 4.7 million

19. COMMITMENTS AND CONTINGENCIES (cont'd.)

(g) Hydro has received funding, in the amount of $3.0 million, from the Atlantic Canada Opportunities Agency in relation to a wind-hydrogen-diesel research development project in the community of Ramea. This funding is repayable in annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2012 there have been no commercial implementations.

20. RELATED PARTY TRANSACTIONS

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

Related Party	Relationship
Nalcor Energy (Nalcor)	100% shareholder of Hydro.
The Province	100% shareholder of Nalcor.
Churchill Falls (Labrador) Corporation	Jointly controlled subsidiary of Hydro.
Nalcor Energy – Oil and Gas	Wholly owned subsidiary of Nalcor.
Nalcor Energy – Bull Arm Fabrication	Wholly owned subsidiary of Nalcor.
Board of Commissioners of Public Utilities	Agency of the Province.

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $6.1 million (2011 - $6.0 million) of the power produced by Churchill Falls.

(b) Hydro is required to contribute to the cost of operations of the PUB as well as the cost of hearings and applications costs. During 2012, Hydro incurred $1.5 million (2011 - $1.2 million) in costs related to the PUB of which $0.6 million (2011 - $0.6 million) was included in Accounts payable and accrued liabilities.

(c) As at December 31, 2012, Hydro has a payable to Nalcor of $1.7 million (2011 - $49.4 million) and a receivable from other affiliates for $0.1 million (2011 - $0.1 million). This payable/receivable consists of various intercompany operating costs and power purchases.

(d) The 2012 debt guarantee fee payable to the Province was $3.7 million (2011 - $3.9 million). Both the 2012 and 2011 debt guarantee fees were paid in full in March 2012.

(e) Hydro received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2012, $1.9 million (2011 - $3.5 million) has been recorded in Deferred credits.

(f) During 2012, Hydro repaid the $1.3 million long-term related party note payable to Nalcor in full. The note was non-interest bearing and had no set terms of repayment.

21. SUBSEQUENT EVENTS

Forward Contracts
On January 29, 2013, Hydro entered into a total of 12 forward contracts with a notional value of US $23.0 million to mitigate a portion of the USD exposure on recall sales through to the end of 2013. The average rate on these forward contracts was $1.01 CAD per USD.

Cancellation of letters of credit
On February 15, 2013, Hydro cancelled 23 letters of credit related to the New Brunswick System Operator totaling $18.6 million.

22. COMPARATIVE FIGURES

The comparative figures have been reclassified to conform to the 2012 financial statement presentation of regulatory accounting adjustments.

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013

DIRECTORS

TERRANCE STYLES*
Business Owner

LEO ABBASS
Corporate Director

ALLAN HAWKINS
Mayor, Grand Falls Windsor

ERIN BREEN
Partner, Simmons+ Partners Defence

ED MARTIN
President and Chief Executive Officer

TOM CLIFT
Professor
Faculty of Business Administration
Memorial University of Newfoundland and Labrador

KEN MARSHALL
President - Atlantic Region
Rogers Cable

GERALD SHORTALL
Chartered Accountant
Corporate Director

OFFICERS

TERRANCE STYLES*
Chairperson

ED MARTIN
President and Chief Executive Officer

GILBERT BENNETT
Vice President, Lower Churchill Project

ROB HENDERSON
Vice President, Newfoundland and Labrador Hydro

PAUL HUMPHRIES
Vice President, System Operations and Planning

DERRICK STURGE
Vice President, Finance and Chief Financial Officer

GERARD McDONALD
Vice President, Human Resources and Organizational Effectiveness

JOHN MacISAAC
Vice President, Project Execution and Technical Services

WAYNE CHAMBERLAIN
General Counsel and Corporate Secretary

PETER HICKMAN
Assistant Corporate Secretary

SCOTT PELLEY
Corporate Treasurer

S. KENT LEGGE**
General Manager, Finance and Corporate Services

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*Resigned February 28, 2014
**Resigned January 31, 2014

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INDEPENDENT AUDITOR'S REPORT

To the Directors of Newfoundland and Labrador Hydro

We have audited the accompanying non-consolidated financial statements of Newfoundland and Labrador Hydro, which comprise the non-consolidated balance sheet as at December 31, 2013, and the non-consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information. The non-consolidated financial statements have been prepared by management based on the financial reporting provisions of Section 59 of the Hydro Corporation Act.

Management's Responsibility for the Non-consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these non-consolidated financial statements in accordance with the financial reporting provisions of Section 59 of the Hydro Corporation Act, and for such internal control as management determines is necessary to enable the preparation of non-consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the non-consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the non-consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the non-consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the non-consolidated 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 non-consolidated financial statements present fairly, in all material respects, the financial position of Newfoundland and Labrador Hydro as at December 31, 2013 and the results of its operations and its cash flows for the year then ended in accordance with the financial reporting provisions of Section 59 of the Hydro Corporation Act.

Basis of Accounting and Restrictions on Distribution and Use

Without modifying our opinion, we draw attention to Note 2 to the non-consolidated financial statements, which describes the basis of accounting. The non-consolidated financial statements are prepared to assist Newfoundland and Labrador Hydro meet the requirements of the Newfoundand and Labrador Board of Commissioners of Public Utilities. As a result, the non-consolidated financial statements may not be suitable for another purpose. Our report is intended solely for Newfoundland and Labrador Hydro and the Newfoundland and Labrador Board of Commissioners of Public Utilities and should not be distributed to or used by parties other than Newfoundland and Labrador Hydro and the Newfoundland and Labrador Board of Commissioners of Public Utilities.

Other Matter

Newfoundland and Labrador Hydro has prepared separate consolidated financial statements for the year ended December 31, 2013 in accordance with Canadian generally accepted accounting principles on which we issued an unmodified auditor's report to the Lieutenant-Governor in Council, Province of Newfoundland and Labrador dated March 25, 2014.

Deloitte LLP

Chartered Accountants
March 25, 2014

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	Notes	2013	2012
ASSETS			
Current assets			
Cash and cash equivalents		**6.7**	2.5
Accounts receivable		**90.1**	83.7
Current portion of regulatory assets	4	**2.2**	2.2
Inventory		**64.0**	51.7
Prepaid expenses		**3.4**	3.0
Derivative assets		**0.2**	-
Current portion of sinking funds	5	**65.4**	-
		232.0	143.1
Property, plant and equipment	3	**1,463.1**	1,440.6
Sinking funds	5	**202.2**	263.3
Regulatory assets	4	**62.2**	62.8
Long-term receivables	6	**0.2**	0.2
Investments	7	**430.7**	417.4
		2,390.4	2,327.4
LIABILITIES			
Current liabilities			
Short-term borrowings	8	**41.0**	52.0
Accounts payable and accrued liabilities		**98.1**	72.1
Current portion of long-term debt	8	**82.2**	8.2
Current portion of regulatory liabilities	4	**214.0**	169.0
Deferred credits	19	**0.7**	1.9
Derivative liabilities		**0.4**	-
		436.4	303.2
Long-term debt	8	**1,046.6**	1,125.9
Regulatory liabilities	4	**40.3**	33.2
Asset retirement obligations	9	**24.1**	23.9
Employee future benefits	10	**61.6**	56.9
		1,609.0	1,543.1
SHAREHOLDER'S EQUITY			
Share capital	11	**22.5**	22.5
Contributed capital	11	**115.4**	115.4
		137.9	137.9
Accumulated other comprehensive income	11	**23.4**	41.6
Retained earnings		**620.1**	604.8
		643.5	646.4
		781.4	784.3
		2,390.4	2,327.4

Commitments and contingencies (Note 18)

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

For the year ended December 31 (millions of dollars)	Notes	**2013**	2012
Revenue			
Energy sales		**609.8**	572.9
Other revenue		**2.3**	2.1
		612.1	575.0
Expenses			
Fuels		**190.9**	182.4
Power purchased		**67.1**	64.7
Operating costs	12	**142.7**	135.2
Net finance expense	15	**73.8**	74.1
Amortization		**51.7**	47.5
Other (income) and expense		**(0.7)**	5.2
Regulatory adjustments	4	**55.6**	30.0
		581.1	539.1
Income from operations		**31.0**	35.9
Other income			
Equity in net income of Churchill Falls	7	**13.9**	18.2
Preferred dividends from Churchill Falls		**9.3**	10.1
		23.2	28.3
Net income		**54.2**	64.2
Retained earnings at beginning of year		**604.8**	570.9
		659.0	635.1
Dividends		**38.9**	30.3
Retained earnings at end of year		**620.1**	604.8

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31 (millions of dollars)	Notes	**2013**	2012
Net income		**54.2**	64.2
Other comprehensive loss			
Change in fair value of available for sale financial instruments		**(4.9)**	8.0
Amounts recognized in net income		**(13.3)**	(11.5)
Comprehensive income		**36.0**	60.7

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NON-CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31 (millions of dollars)	Notes	**2013**	2012
Cash provided by (used in)			
Operating activities			
Net income		**54.2**	64.2
Adjusted for items not involving a cash flow			
Amortization		**51.7**	47.5
Accretion of long-term debt		**0.5**	0.5
(Gain) loss on disposal of property, plant and equipment		**(2.0)**	3.8
Employee future benefits	10	**6.4**	6.9
Equity in net income of Churchill Falls	7	**(13.9)**	(18.2)
Regulatory adjustments		**55.6**	30.0
Other		**0.1**	1.0
		152.6	135.7
Changes in non-cash working capital balances	16	**6.9**	(57.6)
		159.5	78.1
Financing activities			
Dividends paid to Nalcor		**(38.9)**	(30.3)
(Decrease) increase in short-term borrowings	8	**(11.0)**	52.0
Decrease in long-term receivables		**-**	1.4
Decrease in long-term payable		**-**	(1.3)
Decrease in deferred credits		**(1.2)**	(1.6)
		(51.1)	20.2
Investing activities			
Additions to property, plant and equipment	3	**(80.6)**	(77.6)
Increase in sinking funds	5	**(27.6)**	(26.1)
Proceeds on disposition of property, plant and equipment		**4.0**	1.2
		(104.2)	(102.5)
Net increase (decrease) in cash position		**4.2**	(4.2)
Cash position at beginning of year		**2.5**	6.7
Cash position at end of year		**6.7**	2.5
Cash position is represented by			
Cash		**6.7**	2.5
		6.7	2.5

Supplementary cash flow information (Note 16)

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (the Province). The principal activity of Hydro is the generation, transmission and sale of electricity. Hydro's operations include both regulated and non-regulated activities. Hydro's head office is located in St. John's, Newfoundland and Labrador.

Hydro holds interests in the following subsidiary and jointly controlled companies:

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

Twin Falls Power Corporation (Twin Falls) is incorporated under the laws of Canada and has developed a 225 MW hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Lower Churchill Development Corporation (LCDC) is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the lower Churchill River. LCDC is inactive.

Hydro and its subsidiary and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of Presentation

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP), with the exception that they are non-consolidated. Hydro's investments in its subsidiary and jointly controlled companies have been accounted for using the equity method of accounting. Consolidated financial statements for the same period have been prepared for presentation to the Lieutenant-Governor in Council of the Province.

2.2 Use of Estimates

Preparation of these financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these financial statements and related notes. Key areas where Management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, amortization of property, plant and equipment, environmental and asset retirement obligations, and other employee future benefits. Actual results may differ materially from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB).

2.3 Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed range on rate of return on rate base is 7.4% (2012 - 7.4%) +/- 15 basis points. Hydro applies certain accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally, these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future customer rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on these financial statements are more fully disclosed in Note 4.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.4 Cash and Cash Equivalents

Cash and cash equivalents consist primarily of Canadian treasury bills and Banker's Acceptances (BAs). Those with original maturities at date of purchase of three months or less are classified as cash equivalents. Cash and cash equivalents are measured at fair value.

2.5 Inventory

Inventory is recorded at the lower of average cost and net realizable value.

2.6 Property, Plant and Equipment

Property, plant and equipment is recorded at cost, which comprises materials, labour, contracted services and other costs directly related to construction costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment in progress is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment or the fair value of assets contributed. Contributions are recorded as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

Gains and losses on the disposal of property, plant and equipment are recognized in other income and expense as incurred.

Electricity Generation, Transmission and Distribution

Construction in progress includes the costs incurred in engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to Hydro's embedded cost of debt.

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

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

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

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Switching station assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators, and conductors.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.6 Property, Plant and Equipment (cont'd.)

Other Assets

Other assets include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment which are carried at cost less accumulated amortization. Amortization is calculated on a straight-line basis over estimated useful lives ranging from 5 to 55 years.

Amortization methods, useful lives and residual values are reviewed at each reporting date.

2.7 Capitalized Interest

Interest is charged to construction in progress at rates equivalent to the embedded cost of debt until the project is complete. Capitalized interest cannot exceed actual interest incurred.

2.8 Impairment of Long-Lived Assets

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

2.9 Asset Retirement Obligations

The fair value of future expenditures required to settle obligations associated with the retirement of property, plant and equipment, is recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. Accretion of asset retirement obligations is included in net income through amortization. Differences between the recorded asset retirement obligations and the actual retirement costs incurred are recorded as a gain or loss in the settlement period.

2.10 Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and Management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of cumulative net actuarial gains and losses over 10% of the accrued benefit obligation is amortized over the expected average remaining service life of the employee group.

2.11 Revenue Recognition

Revenue is recognized on the accrual basis, as power and energy deliveries are made. Sales within the Province are primarily at rates approved by the PUB, whereas sales to certain major industrial customers and export sales are either at rates under the terms of the applicable contracts, or at market rates.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.12 Foreign Currency Translation

Foreign currency transactions are translated into their CAD equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At the date of settlement and at each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income, except gains or losses on purchases of fuel which are included in the cost of fuel inventory and reflected in income when fuel is used.

2.13 Financial Instruments and Hedging Activities

Financial Instruments

Financial assets and financial liabilities are recognized on the balance sheet when Hydro becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Hydro has classified each of its financial instruments into the following categories: financial assets and liabilities held for trading; loans and receivables; financial assets held to maturity; financial assets available for sale; and other financial liabilities.

Hydro has classified its financial instruments as follows:

Cash and cash equivalents	Held for trading
Accounts receivable	Loans and receivables
Derivative assets	Held for trading
Sinking funds - investments in same Hydro issue	Held to maturity
Sinking funds - other investments	Available for sale
Long-term receivables	Loans and receivables
Short-term borrowings	Other financial liabilities
Accounts payable and accrued liabilities	Other financial liabilities
Derivative liabilities	Held for trading
Long-term debt	Other financial liabilities

Each of these financial instruments is measured at amortized cost, except for cash and cash equivalents, sinking fund – other investments and derivative assets and liabilities which are measured at fair value.

Transaction costs related to financial instruments are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short-term investments which are expensed as incurred through interest and finance charges, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Derivative Instruments and Hedging Activities

Derivative instruments are utilized by Hydro to manage market risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Hydro may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Hydro formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges. Hydro had no cash flow or fair value hedges in place at December 31, 2013 or 2012.

2.14 Future Accounting Changes – International Financial Reporting Standards (IFRS)

The Canadian Accounting Standards Board (AcSB) amended the introduction to Part 1 if the Canadian Institute of Chartered Professional Accountants (CICPA) Handbook – Accounting to allow qualifying entities with rate-regulated activities to defer the adoption of IFRS to January 1, 2015. Hydro is a qualifying entity and has chosen to avail of the deferral option for the year ended December 31, 2013.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.14 Future Accounting Changes – International Financial Reporting Standards (IFRS) (cont'd.)

Although IFRS and Canadian GAAP are based on a similar conceptual framework, there are a number of differences in recognition, measurement and disclosure. The areas with the highest potential impact on Hydro are property, plant and equipment, regulatory assets and liabilities. In January 2014, the IASB issued interim standard *IFRS 14 Regulatory Deferral Accounts*, which will be applicable to rate-regulated entities who have not yet converted to IFRS. The purpose of the interim standard is to enhance the comparability of financial reporting by entities that are engaged in rate-regulated activities. The interim standard is effective for first-time adopters of IFRS for a period beginning on or after January 1, 2016 with early adoption permitted.

Hydro continues to assess the financial reporting impacts of the adoption of IFRS; however, the impact will depend on the IFRS standards in effect at the time of conversion and the accounting elections made.

3. PROPERTY, PLANT AND EQUIPMENT

	Property Plant and Equipment in Service	**Contributions in Aid of Construction**	**Accumulated Amortization**	**Construction in Progress**	**Net Book Value**
(millions of dollars)			**2013**		
Generation plant					
Hydroelectric	**787.3**	**-**	**47.6**	**1.5**	**741.2**
Thermal	**126.8**	**-**	**20.6**	**3.8**	**110.0**
Diesel	**40.2**	**-**	**4.4**	**2.5**	**38.3**
Transmission and distribution	**546.6**	**12.5**	**44.4**	**4.8**	**494.5**
Other	**102.5**	**3.3**	**21.3**	**1.2**	**79.1**
	1,603.4	**15.8**	**138.3**	**13.8**	**1,463.1**
(millions of dollars)			2012		
Generation plant					
Hydroelectric	775.1	-	31.6	3.5	747.0
Thermal	98.1	-	12.5	8.5	94.1
Diesel	37.9	-	2.7	0.3	35.5
Transmission and distribution	504.6	11.6	28.5	20.0	484.5
Other	94.9	2.5	13.5	0.6	79.5
	1,510.6	14.1	88.8	32.9	1,440.6

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

4. REGULATORY ASSETS AND LIABILITIES

(millions of dollars)	**2013**	2012	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Foreign exchange losses	**60.5**	62.6	28.0
Deferred energy conservation costs	**3.9**	2.4	n/a
Total regulatory assets	**64.4**	65.0	
Less current portion	**2.2**	2.2	
	62.2	62.8	
Regulatory liabilities			
Rate stabilization plan (RSP)	**253.8**	201.7	n/a
Deferred purchased power savings	**0.5**	0.5	13.5
Total regulatory liabilities	**254.3**	202.2	
Less current portion	**214.0**	169.0	
	40.3	33.2	

4.1 Regulatory Adjustments Recorded in the Statement of Income

(millions of dollars)	**2013**	2012
RSP recovery	**58.9**	60.4
Rural rate adjustment	**11.4**	7.0
RSP fuel deferral	**(35.3)**	(49.3)
RSP interest	**17.1**	13.2
Amortization of deferred foreign exchange losses	**2.1**	2.1
Deferred foreign exchange losses on fuel	**-**	(0.4)
Employee future benefit actuarial losses	**(1.7)**	(2.3)
Amortization of deferred major extraordinary repairs	**-**	0.6
Deferred energy conservation	**(1.5)**	(1.4)
Insurance proceeds	**4.6**	0.2
Deferred purchased power savings	**-**	(0.1)
	55.6	30.0

Hydro has operations that are regulated by the PUB.

Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. Amounts deferred as regulatory assets and liabilities are subject to PUB approval. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities is no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following sections describe each of the circumstances in which rate regulation affects the accounting for a transaction or event.

4. REGULATORY ASSETS AND LIABILITIES (cont'd.)

4.2 Rate Stabilization Plan

On January 1, 1986, Hydro, having received the approval of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Balances accumulating in the RSP, including financing charges, are to be recovered or refunded in the following year, with the exception of hydraulic variations, which will be recovered or refunded at a rate of 25% of the outstanding balance at year end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect. A portion of the RSP balance totaling $134.4 million has been set aside with $115.3 million to be refunded to retail customers, $10.9 million to be used to phase in Island Industrial rate increases and $8.2 million subject to a future regulatory ruling. This balance is mainly due to fuel savings at the Holyrood Thermal Generating Station (HTGS) as a result of the shutdown of a portion of the pulp and paper industry in the Province in 2007.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian GAAP would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2013, $35.3 million was deferred (2012 - $49.3 million) as an RSP fuel deferral and $58.9 million (2012 - $60.4 million) was recovered through rates and included in energy sales.

Hydro's rural rates on the Island Interconnected and Isolated systems are primarily based upon rates ordered by the PUB. Therefore, when a rural rate electricity adjustment has been approved by the PUB, Hydro's rural customers are charged the approved rate change. In 2013, Hydro recognized in regulatory adjustments a rural rate adjustment that reduces income and increases the RSP liability by $11.4 million (2012 - $7.0 million). In the absence of rate regulation, the rural rate adjustment would have been recorded in income.

Hydro is required to charge or pay interest on balances accumulating in the RSP at a rate equal to Hydro's weighted average cost of capital. As a result, Hydro recognized in regulatory adjustments an RSP interest expense of $17.1 million in 2013 (2012 - $13.2 million).

4.3 Deferred Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding, to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a 40 year period. This amortization, of $2.1 million (2012 - $2.1 million), is included in regulatory adjustments.

4. REGULATORY ASSETS AND LIABILITIES (cont'd.)

4.4 Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $0.5 million, subject to PUB approval on a case-by-case basis. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs were amortized over a five year period. In the absence of rate regulation, Canadian GAAP would require that Hydro expense the boiler tube repairs in the year incurred. In 2013, there was amortization of $nil (2012 - $0.6 million) as a regulatory adjustment.

4.5 Deferred Energy Conservation Costs

Pursuant to Order No. P.U. 35 (2013), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include this program as operating costs in the year incurred. In 2013, Hydro recognized $1.5 million (2012 - $1.4 million) in regulatory adjustments. Discharge of the balance will be dealt with as part of the General Rate Application currently before the PUB.

4.6 Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Quebec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer and amortize the benefits of a reduced initial purchased power rate over a 30 year period. The remaining unamortized savings in the amount of $0.5 million (2012 - $0.5 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

4.7 Property, Plant and Equipment

The PUB permits major inspections and overhauls to be included in the cost of capital and amortized over the average expected period of the next major inspection. In 2013, $3.5 million (2012 - $6.8 million) was recognized as property, plant and equipment. In the absence of rate regulation, Canadian GAAP would require that Hydro include the major inspections as operating costs in the year incurred.

4.8 Foreign Exchange Gains and Losses

Hydro purchases a significant amount of fuel for HTGS in USD. The RSP allows Hydro to defer variances in fuel prices (including foreign exchange fluctuations). During 2013, Hydro deferred, in regulatory adjustments, foreign exchange losses on fuel purchases of $nil (2012 - loss of $0.4 million). In the absence of rate regulation, Canadian GAAP would require that Hydro include gains and losses on foreign currencies in net finance expense in the period incurred.

4.9 Insurance Proceeds

Pursuant to Order No. P.U. 13 (2012), Hydro records net insurance proceeds in excess of $50,000 against the capital costs of the related assets. During 2013, Hydro recorded, in regulatory adjustments, net insurance proceeds of $4.5 million (2012 - $0.2 million) with an offset against costs of the related assets. In the absence of rate regulation, Canadian GAAP would require Hydro to include insurance proceeds in net income.

4.10 Employee Future Benefits

Pursuant to Order No. P.U. 13 (2012), Hydro defers the amortization of employee future benefit actuarial losses. During 2013, Hydro recorded in, regulatory adjustments a deferral of actuarial gains and losses of $1.7 million (2012 - $2.3 million). In the absence of rate regulation, Canadian GAAP would require Hydro include employee future benefits gains and losses in net income.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

5. SINKING FUNDS

As at December 31, 2013, sinking funds include $267.6 million (2012 - $263.3 million) related to repayment of Hydro's long-term debt. Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada, provincial governments or Schedule 1 banks, and have maturity dates ranging from 2014 to 2033.

Hydro debentures, which are intended to be held to maturity, are deducted from debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are in accordance with bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 1.17% to 9.86% (2012 - 2.57% to 9.86%).

(millions of dollars)	**2013**	2012
Sinking funds at beginning of year	**263.3**	247.0
Contributions	**8.2**	8.2
Earnings	**13.6**	11.7
Valuation adjustment	**(17.5)**	(3.6)
Sinking funds at end of year	**267.6**	263.3
Current portion of sinking funds	**65.4**	-
	202.2	263.3

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

(millions of dollars)	2014	2015	2016	2017	2018
Sinking fund instalments	8.1	8.1	8.1	6.7	6.7

6. LONG-TERM RECEIVABLES

The balance of $0.2 million (2012 - $0.2 million) is the non-current portion of receivables associated with customer time payment plans and the long-term portion of employee purchase programs.

7. INVESTMENTS

(millions of dollars)	**Ownership Interest**	**2013**	2012
Churchill Falls	65.8%		
Shares, at cost		**167.2**	167.2
Equity in retained earnings at beginning of year		**249.6**	232.0
Equity in net income for the year		**13.9**	18.2
		430.7	417.4

Effective June 18, 1999, the two shareholders of Churchill Falls, Hydro and Hydro-Quebec, entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to joint approval by representatives of Hydro and Hydro-Quebec.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

8. LONG-TERM DEBT

Details of long-term debt are as follows:

Series	Face Value	Coupon Rate %	Year of Issue	Year of Maturity		
(millions of dollars)					**2013**	2012
V *	125.0	10.50	1989	2014	**125.0**	124.8
X *	150.0	10.25	1992	2017	**149.5**	149.4
Y *	300.0	8.40	1996	2026	**294.0**	293.8
AB *	300.0	6.65	2001	2031	**306.1**	306.3
AD *	125.0	5.70	2003	2033	**123.7**	123.7
AE	225.0	4.30	2006	2016	**224.4**	224.2
Total debentures	1,225.0				**1,222.7**	1,222.2
Less sinking fund investments in own debentures					**93.9**	88.1
					1,128.8	1,134.1
Less: payments due within one year					**82.2**	8.2
					1,046.6	1,125.9

* Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 25 basis points annually on the total debt (net of sinking funds) with a remaining term to maturity less than 10 years and 50 basis points annually on total debt (net of sinking funds) with a remaining term to maturity greater than 10 years. The fee for 2013 was $3.7 million (2012 - $3.7 million).

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2013, there was $41.0 million in short-term borrowings outstanding (2012 - $52.0 million).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured demand operating credit facility with its banker and at year end there were no amounts drawn on the facility (2012 - $nil). Advances may take the form of a Prime Rate Advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year end, Hydro has one letter of credit outstanding, reducing the availability of the credit facility by $0.3 million (2012 - $18.9 million).

Required repayments of long-term debt over the next five years will be as follows:

(millions of dollars)	2014	2015	2016	2017	2018
Long-term debt repayment	125.0	-	225.0	150.0	-

9. ASSET RETIREMENT OBLIGATIONS

Hydro has recognized liabilities associated with the retirement of portions of the HTGS and disposal of Polychlorinated Biphenyls (PCB). The reconciliation of the beginning and ending carrying amounts of asset retirement obligations is as follows:

(millions of dollars)	**2013**	2012
Asset retirement obligation at beginning of year	**23.9**	19.6
Revisions	**(0.7)**	3.7
Accretion	**0.9**	0.7
Settlements	**-**	(0.1)
Asset retirement obligation at end of year	**24.1**	23.9

The total estimated undiscounted cash flows required to settle the HTGS obligations at December 31, 2013 are $32.1 million (2012 - $32.1 million). Payments to settle the liability are expected to occur between 2020 and 2024. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rate of 2.8% (2012 - 2.8%). Hydro has recorded $22.6 million (2012 - $ 21.8 million) related to HTGS obligations.

The total estimated undiscounted cash flows required to settle the PCB obligations at December 31, 2013 are $2.0 million (2012 - $2.7 million). Payments to settle the liability are expected to occur between 2014 and 2025. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rate of 3.1% (2012 - 3.1%). Hydro has recorded $1.5 million (2012 - $ 2.1 million) related to PCB obligations.

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

10. EMPLOYEE FUTURE BENEFITS

10.1 Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $4.7 million (2012 - $4.4 million) are expensed as incurred.

10.2 Other Benefits

Hydro provides group life insurance and health care benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2013, cash payments to beneficiaries for its unfunded other employee future benefits were $2.4 million (2012 - $2.3 million). An actuarial valuation was performed as at December 31, 2012, with an extrapolation to December 31, 2013. The next actuarial valuation will be performed at December 31, 2015.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

10. EMPLOYEE FUTURE BENEFITS (cont'd.)

10.2 Other Benefits (cont'd.)

(millions of dollars)	**2013**	2012
Accrued benefit obligation		
Balance at beginning of year	**90.6**	89.3
Current service cost	**3.3**	2.9
Interest cost	**3.7**	4.1
Actuarial gain	**(7.3)**	(3.4)
Benefits paid	**(2.2)**	(2.3)
Balance at end of year	**88.1**	90.6
Plan deficit	**88.1**	90.6
Unamortized actuarial loss	**(21.1)**	(30.0)
Unamortized past-service cost	**(0.2)**	(0.2)
Regulatory adjustments	**(5.2)**	(3.5)
Accrued benefit liability at end of year	**61.6**	56.9

(millions of dollars)	**2013**	2012
Components of benefit cost		
Current service cost	**3.3**	2.9
Interest cost	**3.7**	4.1
Actuarial gain	**(7.3)**	(3.4)
	(0.3)	3.6
Difference between actuarial gain or loss and amount recognized	**9.0**	5.6
Benefit expense	**8.7**	9.2

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

	2013	2012
Discount rate – benefit cost	**4.00%**	4.55%
Discount rate – accrued benefit obligation	**5.00%**	4.00%
Rate of compensation increase	**3.50%**	3.50%

Assumed health care trend rates:

	2013	2012
Initial health care expense trend rate	**6.00%**	6.00%
Cost trend decline to	**4.50%**	4.50%
Year that rate reaches the rate it is assumed to remain at	**2020**	2020

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

Increase	**2013**	2012
Current service and interest cost	**1.7**	1.6
Accrued benefit obligation	**16.5**	17.0

Decrease	**2013**	2012
Current service and interest cost	**(1.2)**	(1.2)
Accrued benefit obligation	**(12.7)**	(13.0)

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11. SHAREHOLDER'S EQUITY

11.1 Share Capital

(millions of dollars)	**2013**	2012
Common shares of par value $1 each		
Authorized: 25,000,000		
Issued and outstanding 22,503,942	**22.5**	22.5

11.2 Contributed Capital

(millions of dollars)	**2013**	2012
Total contributed capital	**115.4**	115.4

11.3 Accumulated Other Comprehensive Income

(millions of dollars)	**2013**	2012
Balance at beginning of year	**41.6**	45.1
Other comprehensive loss	**(18.2)**	(3.5)
Balance at end of year	**23.4**	41.6

12. OPERATING COSTS

(millions of dollars)	**2013**	2012
Salaries and benefits	**80.2**	76.0
Maintenance and materials	**22.7**	19.9
Transmission rental	**20.5**	19.7
Professional services	**9.6**	10.1
Other operating costs	**9.7**	9.5
Total	**142.7**	135.2

13. CAPITAL MANAGEMENT

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

The capital managed by Hydro is comprised of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

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13. CAPITAL MANAGEMENT (cont'd.)

A summary of the capital structure is outlined below:

(millions of dollars)	**2013**		2012	
Debt				
Long-term debt	**1,046.6**		1,125.9	
Short-term borrowings	**41.0**		52.0	
Current portion of long-term debt	**82.2**		8.2	
Sinking funds	**(267.6)**		(263.3)	
	902.2	**53.6%**	922.8	54.1%
Equity				
Share capital	**22.5**		22.5	
Contributed capital	**115.4**		115.4	
Accumulated other comprehensive income	**23.4**		41.6	
Retained earnings	**620.1**		604.8	
	781.4	**46.4%**	784.3	45.9%
Total Debt and Equity	**1,683.6**	**100.0%**	1,707.1	100.0%

Hydro's unsecured demand operating facility has covenants restricting the issuance of debt such that the debt to total capitalization ratio cannot exceed 70%. The covenants further stipulate that the debt service coverage ratio should at all times be greater than 1.5. As at December 31, 2013, Hydro was in compliance with these covenants.

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

For the regulated portion of Hydro's operations a capital structure comprised of 75% debt and 25% equity is maintained, a ratio which Management believes to be optimal with respect to its cost of capital. This capital structure is maintained by a combination of dividend policy, contributed equity and debt issuance. The issuance of any new debt with a term greater than one year requires prior approval of the PUB.

Legislation stipulates that the total of the short-term loans issued by Hydro and outstanding at any time shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short-term loans are those loans issued with a term not exceeding two years. The current limit is set at $300.0 million. There was $41.0 million outstanding as at December 31, 2013 (2012 - $52.0 million). Issuance of long-term and short-term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both long and short-term debt, to $1.6 billion at any point in time.

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14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

14.1 Fair Value

The estimated fair values of financial instruments as at December 31, 2013 and 2012 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions.

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

Establishing Fair Value

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

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

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

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. The following table presents Hydro's fair value hierarchy for financial assets and liabilities.

		Carrying Value	**Fair Value**	Carrying Value	Fair Value
(millions of dollars)	Level	**2013**		2012	
Financial assets					
Cash and cash equivalents	1	**6.7**	**6.7**	2.5	2.5
Accounts receivable	2	**90.1**	**90.1**	83.7	83.7
Derivative assets	2	**0.2**	**0.2**	-	-
Sinking funds - investments in same Hydro issue	2	**93.9**	**105.1**	88.1	107.3
Sinking funds - other investments including amount due within one year	2	**267.6**	**267.6**	263.3	263.3
Long-term receivable	2	**0.2**	**0.2**	0.2	0.2
Financial liabilities					
Accounts payable and accrued liabilities	2	**98.1**	**98.1**	72.1	72.1
Short-term borrowings	1	**41.0**	**41.0**	52.0	52.0
Derivative liabilities	2	**0.4**	**0.4**	-	-
Long-term debt including amount due within one year (before sinking funds)	2	**1,222.7**	**1,545.5**	1,222.2	1,668.6

The fair value of cash and cash equivalents approximates their carrying values due to their short-term maturity.

There were no financial assets or liabilities valued using Level 3 of the fair value hierarchy as at December 31, 2013 and 2012.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

14.2 Risk Management

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

Credit Risk

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

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

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

	Issuer Credit Rating	**Fair Value of Portfolio (%)**	**Issuer Credit Rating**	**Fair Value of Portfolio (%)**
	2013		2012	
Provincial Governments	**AA- to AAA**	**2.72%**	AA- to AAA	4.07%
Provincial Governments	**A- to A+**	**38.84%**	A- to A+	55.95%
Provincially owned utilities	**AA- to AAA**	**13.99%**	AA- to AAA	-
Provincially owned utilities	**A- to A+**	**41.34%**	A- to A+	33.96%
Schedule 1 Canadian banks	**AA- to AAA**	**1.07%**	AA- to AAA	-
Schedule 1 Canadian banks	**A- to A+**	**2.04%**	A- to A+	1.89%
Provincially owned utilities	**BBB+**	**-**	BBB+	4.13%
		100.00%		100.00%

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

Hydro's exposure to credit risk on its energy sales and associated accounts receivable is determined by the credit quality of its customers. Hydro's three largest customers account for 84.9% (2012 - 83.1%) of total energy sales and 78.3% (2012 - 78.4%) of accounts receivable. These customers are comprised of rate regulated entities or organizations with investment grade credit ratings.

Hydro does not have any significant amounts that are past due and uncollectable for which a provision has not been recognized at December 31, 2013.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

14.2 Risk Management (cont'd.)

Liquidity Risk

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

Short-term liquidity is mainly provided through cash and cash equivalents on hand, funds from operations, and a $300.0 million promissory note program. In addition, Hydro maintains a $50.0 million (2012 - $50.0 million) unsecured demand operating facility with its primary banker in order to meet any requirements beyond those forecasted for a given period.

Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues, with the exception of the issue maturing in 2016.

The following are the contractual maturities of Hydro's financial liabilities, including principal and interest, as at December 31, 2013:

(millions of dollars)	**< 1 Year**	**1-3 Years**	**3-5 Years**	**> 5 Years**	**Total**
Accounts payable and accrued liabilities	98.1	-	-	-	98.1
Short-term borrowings	41.0	-	-	-	41.0
Long-term debt	125.0	225.0	150.0	725.0	1,225.0
Interest	83.3	152.6	112.8	536.4	885.1
	347.4	377.6	262.8	1,261.4	2,249.2

Market Risk

In the course of carrying out its operating, financing and investing activities, Hydro is exposed to possible market price movements that could impact expected future cash flow and the carrying value of certain financial assets and liabilities. Market price movements to which Hydro has significant exposure include those relating to prevailing interest rates, foreign exchange rates, most notably the USD/CAD, and current commodity prices, most notably the spot prices for diesel fuel, electricity, and No. 6 fuel. These exposures were addressed as part of the Financial Risk Management Strategy.

Interest Rates

Changes in prevailing interest rates will impact the fair value of financial assets and liabilities classified as held for trading or available-for-sale, which includes Hydro's cash and cash equivalents, short-term investments and sinking funds. Expected future cash flows associated with those financial instruments can also be impacted. The impact of a 0.5% change in interest rates on net income and other comprehensive income associated with cash and cash equivalents, debt and short-term debt was negligible throughout 2013 due to the short time period to maturity.

The table below shows the impact of a 50 basis point change in interest rates on net income and other comprehensive income associated with the sinking funds at the balance sheet date:

	Net Income		**Other Comprehensive Income**	
(millions of dollars)	**0.5% Decrease**	**0.5% Increase**	**0.5% Decrease**	**0.5% Increase**
Interest on sinking fund	-	-	5.3	(21.2)

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

14.2 Risk Management (cont'd.)

Market Risk (cont'd.)

Foreign Currency and Commodity Exposure
Hydro's primary exposure to both foreign exchange and commodity price risk arises from its purchases of No. 6 fuel for consumption at the HTGS, and USD denominated electricity sales. These exposures are addressed in accordance with the board-approved Financial Risk Management Policy. Tactics include the use of forward rate agreements and fixed price commodity swaps.

During 2013, total electricity sales denominated in USD were $54.7 million (2012 - $33.8 million). In 2013, Hydro mitigated foreign exchange risk on these sales through the use of foreign currency forward contracts. In January of 2013, Hydro entered into a series of 12 monthly foreign exchange forward contracts with a notional value of $23.0 million USD to hedge foreign exchange risk on a portion of Hydro's planned USD electricity sales for the year. These contracts had an average exchange rate of $1.01 CAD per USD. In April of 2013, Hydro entered into a series of 10 monthly foreign exchange forward contracts with a notional value of $14.4 million USD to hedge foreign exchange risk on a portion of Hydro's planned USD electricity sales for the year. These contracts had an average exchange rate of $1.03 CAD per USD. In 2013, Management elected not to implement commodity price hedges aimed at addressing electricity price risk due to depressed market pricing conditions. During 2013, $0.1 million in gains from these derivative contracts was included in other income and expense (2012 - $0.1 million in gains).

In December of 2013, Hydro entered into a series of 12 monthly foreign exchange forward contracts with a notional value of $38.5 million USD to hedge foreign exchange risk on a portion of Hydro's planned USD electricity sales to the end of 2014. These contracts have an average exchange rate of $1.08 CAD per USD. Hydro also entered into a series of 12 electricity price forward contracts with a notional value of $14.2 million USD. The average price of these contracts was USD $38.74 per MWh (On Peak) and USD $28.42 per MWh (Off Peak). At December 31, 2013, $0.3 million in losses from these derivative contracts was recognized in other income and expense.

These forward contracts impact other income and expense by a net of $0.2 million in losses for 2013 (2012 - $0.1 million gain).

15. NET FINANCE EXPENSE

(millions of dollars)	**2013**	2012
Finance income		
Interest on sinking fund	**19.4**	18.0
Other interest income	**0.7**	0.8
	20.1	18.8
Finance expense		
Interest on long-term debt	**90.5**	90.5
Accretion	**0.5**	0.5
Debt guarantee fee	**3.7**	3.7
Other	**1.4**	0.9
	96.1	95.6
Interest capitalized during construction	**(2.2)**	(2.7)
	93.9	92.9
Net finance expense	**73.8**	74.1

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16. SUPPLEMENTARY CASH FLOW INFORMATION

(millions of dollars)	**2013**	2012
Accounts receivable	**(6.4)**	(0.6)
Inventory	**(12.3)**	2.5
Prepaid expenses	**(0.4)**	(0.8)
Accounts payable and accrued liabilities	**26.0**	(58.7)
Changes in non-cash working capital balances	**6.9**	(57.6)
Interest received	**0.5**	0.3
Interest paid	**90.8**	91.4

17. SEGMENT INFORMATION

Hydro operates in three business segments. Hydro Regulated activities encompasses sales of electricity to customers within the Province, Non-regulated activities encompasses other Non-regulated activities and Energy Marketing activities include the sale of electricity to markets outside the Province. The designation of segments has been based on regulatory status and management accountability. The segments' accounting policies are the same as those previously described in Note 2.

	Hydro Regulated	**Non-Regulated Activities**	**Energy Marketing**	**Total**
(millions of dollars)		**2013**		
Revenue				
Energy sales	**543.1**	**-**	**66.7**	**609.8**
Other revenue	**2.3**	**-**	**-**	**2.3**
	545.4	**-**	**66.7**	**612.1**
Expenses				
Fuels	**190.9**	**-**	**-**	**190.9**
Power purchased	**59.4**	**-**	**7.7**	**67.1**
Operations and administration	**114.7**	**0.9**	**27.1**	**142.7**
Net finance expense	**73.5**	**-**	**0.3**	**73.8**
Amortization	**51.7**	**-**	**-**	**51.7**
Other income and expense	**(0.9)**	**-**	**0.2**	**(0.7)**
Regulatory adjustments	**55.6**	**-**	**-**	**55.6**
	544.9	**0.9**	**35.3**	**581.1**
Net income (loss) from operations	**0.5**	**(0.9)**	**31.4**	**31.0**
Equity in net income of Churchill Falls	**-**	**13.9**	**-**	**13.9**
Preferred dividends	**-**	**9.3**	**-**	**9.3**
Net income	**0.5**	**22.3**	**31.4**	**54.2**
Capital expenditures	**80.6**	**-**	**-**	**80.6**
Total assets	**1,954.0**	**430.7**	**5.7**	**2,390.4**

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17. SEGMENT INFORMATION (cont'd.)

	Hydro Regulated	Non-Regulated Activities	Energy Marketing	Total
(millions of dollars)		2012		
Revenue				
Energy sales	520.7	-	52.2	572.9
Other revenue	2.1	-	-	2.1
	522.8	-	52.2	575.0
Expenses				
Fuels	182.4	-	-	182.4
Power purchased	57.0	-	7.7	64.7
Operations and administration	109.5	0.6	25.1	135.2
Net finance expense	74.0	-	0.1	74.1
Amortization	47.5	-	-	47.5
Other income and expense	5.3	-	(0.1)	5.2
Regulatory adjustments	30.0	-	-	30.0
	505.7	0.6	32.8	539.1
Net income (loss) from operations	17.1	(0.6)	19.4	35.9
Equity in net income of Churchill Falls	-	18.2	-	18.2
Preferred dividends	-	10.1	-	10.1
Net income	17.1	27.7	19.4	64.2
Capital expenditures	77.6	-	-	77.6
Total assets	1,906.4	417.5	3.5	2,327.4

18. COMMITMENTS AND CONTINGENCIES

(a) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, Management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.1 million (2012 - $0.2 million).

(b) One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $22.0 million (2012 - $21.9 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate outcome of this action cannot be ascertained at this time, in the opinion of Hydro's Management, following consultation with its legal counsel, no liability should be recognized.

(c) Outstanding commitments for capital projects total approximately $11.9 million as at December 31, 2013 (2012 - $18.5 million).

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

Type	Rating	In-service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	300 kW	2010	Continual
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

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18. COMMITMENTS AND CONTINGENCIES (cont'd.)

(d) (cont'd.)

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

(millions of dollars)	2014	2015	2016	2017	2018
Power purchases	24.5	24.3	24.5	24.8	25.1

(e) Hydro has issued one irrevocable letter of credit to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement.

(f) Hydro has entered into power sales agreements with third parties. To facilitate market access, Hydro had entered into a transmission service agreement with Hydro-Quebec TransEnergie which concludes in 2024.

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

2014	$19.5 million
2015	$19.7 million
2016	$19.9 million
2017	$20.1 million
2018	$20.3 million

(g) Hydro has received funding, in the amount of $3.0 million, from the Atlantic Canada Opportunities Agency (ACOA) in relation to a wind-hydrogen-diesel research development project in the community of Ramea. This funding is repayable in annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2013 there have been no commercial implementations.

(h) Hydro has entered into a Power Purchase Agreement with Muskrat Falls Corporation (Muskrat Falls) for the purchase of energy and capacity from the Muskrat Falls Plant. The supply period under the agreement is 50 years and commences at the date of commissioning.

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

19. RELATED PARTY TRANSACTIONS

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

Related Party	Relationship
Nalcor Energy (Nalcor)	100% shareholder of Hydro
The Province	100% shareholder of Nalcor
Churchill Falls	Jointly controlled subsidiary of Hydro
Nalcor Energy – Oil and Gas	Wholly owned subsidiary of Nalcor
Nalcor Energy – Bull Arm Fabrication	Wholly owned subsidiary of Nalcor
PUB	Agency of the Province
Labrador-Island Link Limited Partnership	Partnership in which Nalcor owns 75 Class A Units
Muskrat Falls	Wholly owned subsidiary of Nalcor

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $6.1 million (2012 - $6.1 million) of the power produced by Churchill Falls.

(b) Hydro is required to contribute to the cost of operations of the PUB as well as the cost of hearings and applications costs. During 2013, Hydro incurred $0.6 million (2012 - $1.5 million) in costs related to the PUB of which $0.2 million (2012 - $0.6 million) was included in accounts payable and accrued liabilities.

(c) As at December 31, 2013, Hydro has a payable to related parties of $0.8 million (2012 - $2.0 million) and a receivable from related parties for $0.1 million (2012 - $0.2 million). This payable/receivable consists of various intercompany operating costs and power purchases.

(d) The debt guarantee fee for 2013 was $3.7 million. It was paid to the Province in April 2013 (2012 - $3.7 million).

(e) Hydro received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2013, $0.7 million (2012 - $1.9 million) has been recorded in deferred credits.