YUKON DEVELOPMENT CORPORATION

FINANCIAL STATEMENTS

December 31, 2012

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MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of Yukon Development Corporation are the responsibility of management, and have been prepared in accordance with Canadian generally accepted accounting principles consistently applied and appropriate in the circumstances. The preparation of financial statements necessarily involves the use of estimates and approximations, which have been made using careful judgement. In management's opinion, the consolidated financial statements have been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized in the consolidated financial statements.

Management maintains systems of internal controls designed to provide reasonable assurance that assets are safeguarded and that reliable financial information is available on a timely basis. These systems include formal written policies and procedures, the careful selection and training of qualified personnel, and an organizational structure that provides for the appropriate delegation of authority and segregation of responsibilities.

The financial statements have been examined by an independent external auditor. The external auditor's responsibility is to express an opinion on whether the consolidated financial statements, in all material respects, fairly present the Corporation's financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles. In addition, the external auditor reports on whether proper books of account have been kept by the Corporation, the consolidated financial statements are in agreement therewith, and the transactions coming to their notice have, in all significant respects, been in accordance with specified authorities. The Auditor's Report, which follows, outlines the scope of this examination and the auditor's opinion.

The Corporation's Board of Directors, through its Audit and Finance Committee, oversees management's responsibilities for financial reporting. The Audit and Finance Committee meets with management and the independent external auditor to discuss auditing and financial matters, to gain assurance that management is carrying out its responsibilities and to review and approve the consolidated financial statements. The auditor has full and free access to the Audit and Finance Committee, with and without the presence of management.

Greg Komaromi
Chief Executive Officer

Blaine Anderson, C.A.
Chief Financial Officer

Whitehorse, Yukon
August 23, 2013

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of the Yukon Development Corporation

Report on the Consolidated Financial Statements

I have audited the accompanying consolidated financial statements of the Yukon Development Corporation, which comprise the consolidated balance sheet as at 31 December 2012, and the consolidated statement of operations, comprehensive income and retained earnings and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Yukon Development Corporation as at 31 December 2012, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Report on Other Legal and Regulatory Requirements

As required by the *Yukon Development Corporation Act,* I report that, in my opinion, Canadian generally accepted accounting principles have been applied on a basis consistent with that of the preceding year.

Further, in my opinion, proper books of account have been kept by the Yukon Development Corporation and its wholly-owned subsidiary and the consolidated financial statements are in agreement therewith. In addition, the transactions of the Yukon Development Corporation and its wholly-owned subsidiary that have come to my notice during my audit of the consolidated financial statements have, in all significant respects, been in accordance with the *Financial Administration* Act of Yukon and regulations, the *Yukon Development Corporation Act* and regulations, the *Public Utilities Act* and regulations, the *Business Corporations Act* and regulations and the articles and by-laws of the Yukon Development Corporation and its wholly-owned subsidiary.

Terrance DeJong, CA
Assistant Auditor General
for the Auditor General of Canada

23 August 2013
Edmonton, Canada

Yukon Development Corporation

Consolidated Balance Sheet

As at December 31, (in thousands of dollars)	**2012**	2011
Assets		
Current assets		
Cash (note 5)	$ 9,690	$ 9,325
Accounts receivable (note 6)	12,504	25,847
Materials and supplies	2,791	2,830
Prepaid expenses	553	614
	25,538	38,616
Direct financing leases (note 7)	**162**	162
Property, plant and equipment (note 8)	**382,817**	368,243
Deferred uninsured losses (note 9)	**152**	576
Deferred charges and intangible assets (note 10)	**27,279**	25,273
	$ 435,948	$ 432,870
Liabilities		
Current liabilities		
Bank indebtedness (note 11)	$ -	$ 4,782
Accounts payable and accrued liabilities (note 12)	16,730	27,472
Derivative related liability (note 26)	666	824
Current portion of long-term debt (note 15)	4,260	3,826
	21,656	36,904
Faro Mine dewatering deferral revenue (note 13)	**-**	397
Long-term pension liability (note 22)	**1,047**	1,137
Long-term debt (note 15)	**127,870**	121,089
Contributions in aid of construction (note 16)	**110,096**	108,895
Future removal and site restoration costs (note 17)	**7,233**	4,711
Diesel contingency fund (note 14)	**4,628**	902
	272,530	274,035
Equity		
Contributed capital	**41,501**	41,501
Retained earnings	**121,917**	117,334
	163,418	158,835
	$ 435,948	$ 432,870

Commitments and Contingencies (notes 23 and 24)

The accompanying notes are an integral part of the financial statements.

Approved by the Board:

Joanne Fairlie

Chair

Collin Young

Director

Yukon Development Corporation

Consolidated Statement of Operations, Comprehensive Income and Retained Earnings

For the year ended December 31, (in thousands of dollars)	**2012**	2011
Revenue		
Sales of power (note 18)	$ 36,508	$ 33,782
Government of Yukon (note 1)	5,727	4,357
Allowance for funds used during construction	798	555
Amortization of capital assistance from Government of Yukon	451	428
Other income	306	254
Interest income	52	557
Finance income	12	24
	43,854	39,957
Expenses		
Administration (note 19)	11,156	9,155
Operations and maintenance (note 20)	9,646	10,288
Amortization of property, plant and equipment	5,996	6,232
Interest on long-term debt	6,047	6,267
Amortization of deferred charges	2,717	915
Amortization of intangible assets	648	528
Provision for uninsured losses (note 9)	226	100
	36,436	33,485
Net income before other items	**7,418**	6,472
Interim electrical rebate program (note 1)	**(2,993)**	(2,926)
Unrealized gain (loss) on interest rate swaps (note 26)	**158**	(388)
Net income	**4,583**	3,158
Other comprehensive income	**-**	-
Comprehensive income	**4,583**	3,158
Retained earnings, beginning of year	**117,334**	114,176
Retained earnings, end of year	**$ 121,917**	$ 117,334

The accompanying notes are an integral part of the financial statements.

Yukon Development Corporation

Consolidated Statement of Cash Flows

For the year ended December 31, (in thousands of dollars)	**2012**	2011
Operating activities		
Cash receipts from customers	$ 43,188	$ 38,700
Cash paid to employees and suppliers	(24,308)	(20,656)
Interest paid	(6,047)	(6,267)
Interest received	64	582
Cash provided by operating activities	**12,897**	12,359
Financing activities		
Repayment of long-term debt	(3,785)	(4,263)
Proceeds from long-term debt	11,000	98
Contributions in aid of construction	24,284	38,174
Cash provided by financing activities	**31,499**	34,009
Investing activities		
Additions to property, plant and equipment	(34,277)	(85,840)
Additions to deferred charges and intangible assets	(4,972)	(7,456)
Proceeds from investments	-	414
Proceeds from long-term receivable	-	17,424
Cash used in investing activities	**(39,249)**	(75,458)
Net increase (decrease) in cash	**5,147**	(29,090)
Cash, beginning of year	**4,543**	33,633
Cash, end of year	**$ 9,690**	$ 4,543
Cash includes:		
Cash (note 5)	$ 9,690	$ 9,325
Bank indebtedness	-	$ (4,782)
Total	$ 9,690	$ 4,543

The accompanying notes are an integral part of the financial statements.

1. Nature of operations

Yukon Development Corporation (the "Corporation") was originally established under the *Yukon Development Corporation Act* to participate with the private sector in the economic development of the Yukon, to make strategic investments to the benefit of the territory and to acquire and operate the assets of Northern Canada Power Commission in the Yukon. In 1993, the Corporation's mandate was changed to restrict its new initiatives to energy-related activities designed to promote the economic development of the Yukon.

The Corporation's wholly-owned subsidiary, Yukon Energy Corporation (the "Utility") was incorporated under the Yukon *Business Corporations Act*. The Utility generates, transmits, distributes and sells electrical energy in the Yukon and is subject to overall regulation by the Yukon Utilities Board (YUB) and specific regulation by the Yukon Territory Water Board. Both of these boards are independent from the Utility. The Utility is also exempt from the Financial Administration Act (Yukon).

Rate regulation

The operations of the Utility are regulated by the YUB pursuant to the *Public Utilities Act (Yukon)*. There is no minimum requirement for the Utility to appear before the YUB to review rates. However, the Utility is not permitted to charge any rate for the supply of power that is not approved by an Order of the YUB. The Utility is subject to a cost of service regulatory mechanism under which the YUB establishes the revenues required (i) to recover the forecast operating costs, including depreciation and amortization, of providing the regulated service, and (ii) to provide a fair and reasonable return on utility investment or rate base. As actual operating conditions may vary from forecast, actual returns achieved can differ from approved returns.

The regulatory hearing process used to establish or change rates typically begins when the Utility makes an application for its proposed electricity rate changes over the next one or two forecast years. The YUB must ensure that its decision, which fixes electricity rates, complies with appropriate principals of rate making, all relevant legislation including the *Public Utilities Act* and directives issued by the Yukon Government through Orders-In-Council that specify how the interests of the customer and Utility are to be balanced.

The YUB typically follows a two-stage decision process. In the first stage, the total costs that the Utility will incur to provide electricity to its customers over the immediate future are reviewed and approved. The approval of these costs determines the total revenues the Utility is allowed to collect from its customers. It is the responsibility of the YUB to examine the legitimacy of three classes of costs:

- the costs to the Utility to run its operations and maintain its equipment (personnel and materials);
- the cost associated with the amortization of all capital equipment; and
- the return on rate base (the costs related to borrowing that portion of the rate base which is financed with debt, and the costs to provide a reasonable rate of return on that portion of the rate base which is financed with equity).

The YUB assesses the prudency of costs added to rate base, which includes an allowance for funds used during construction (AFUDC) charged to capital projects. The YUB also reviews the appropriateness of asset depreciation rates, which are periodically updated by the Utility through depreciation studies.

In the second stage, the YUB approves how the revenue will be raised. This stage essentially determines the electricity rates for the various customer classes in the Yukon: residential, government, commercial and industrial. This process is guided mainly by requirements of Yukon Government Order-in Council 1995/90 and can include a cost-of-service study which allocates the overall Utility's cost of service to the various customer classes on the basis of appropriate costing principles.

Normally, the Utility applies for rates in advance of the applicable years (Note 27).

1. Nature of operations - continued

Water regulation

The Yukon Territory Water Board pursuant to the *Yukon Waters Act* decides if and for how long the Utility will have a water license for the purposes of operating hydro generation stations in the Yukon. The licenses will also indicate terms and conditions for the operation of these facilities.

Capital structure

The Utility's policy is to maintain a capital structure of 60% debt and 40% equity at year end. Annual dividends are declared to the parent and typically loaned back in order to maintain this ratio.

Government of Yukon

In May 2011, the Yukon Government authorized the continuation of the Interim Electrical Rebate program (the "rebate") for 18 months at current levels, to September 30, 2012. The rebate provides subsidies to non-government residential and municipal customers. It was implemented in 1998 after the Faro mine closed to protect customers from significant bill increases that would have resulted from that shutdown. The Yukon Government is providing funding for the rebate to a maximum of $3.35 million per year. In 2012, the Corporation received $3.102 million (2011 - $3.044 million) in funding for the program. The total subsidy payments made by the Corporation during the current year were $2.993 million (2011 - $2.925 million).

The Corporation and the Government of Yukon signed a Memorandum of Understanding for the accounting period starting April 1, 2011 to March 31, 2042 regarding the Mayo B and Carmacks-Stewart Transmission line projects. The Government of Yukon will assist in funding the repayment of a portion of the bond interest costs of up to $2.625 million annually, subject to the Corporation meeting specified terms set out in the agreement.

2. Accounting changes

Future accounting changes

Publically accountable enterprises were required to move from Canadian Generally Accepted Accounting Principles to International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board (IASB) and adopted by the Canadian Institute of Chartered Accountants (CICA), for years beginning on or after January 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures. In February 2013, the CICA Accounting Standards Board announced an extension of the existing deferral for qualifying rate regulated entities to January 1, 2015. This further extension is offered in recognition that the IASB is on track to issue an interim standard by the end of the 2013 year. The Utility has chosen to adopt this deferral and continues to monitor the situation. The deferral also applies to the consolidated financial statements of parents of qualifying entities with rate-regulated activities.

3. Significant accounting policies

Financial statement presentation

The consolidated financial statements of the Corporation have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") and include the accounts of Yukon Development Corporation and its wholly owned subsidiary, Yukon Energy Corporation. All significant inter-company transactions and balances have been eliminated on consolidation.

The consolidated financial statements reflect the rate regulated accounting policies adopted by the Utility which differ from the accounting policies otherwise expected using GAAP. In particular, the timing of the Utility's recognition of certain assets, liabilities, revenues and expenses as a result of regulation differ from that of a non-regulated enterprise.

3. Significant accounting policies - continued

The impact on the financial statements of accounting for rate regulated operations are further described in note 4. The significant accounting policies have been classified accordingly in the notes below:

Rate regulated accounting policies adopted by the Utility

Allowance for funds used during construction
The cost of the Utility's property, plant and equipment and deferred charges includes an allowance for funds used during construction (AFUDC) as allowed by the regulator. The calculation of the estimate is based on the Utility's weighted average cost of debt. The AFUDC rate estimate was 4.237% for 2012 (2011 - 4.483%).

Property, plant and equipment
The gain or loss on the disposal or retirement of property, plant and equipment, with the exception of land and vehicles, is deferred and amortized over the remaining expected useful lives of the assets.

Faro Mine dewatering deferral revenue
Faro mine dewatering deferral revenue represents amounts ordered by the YUB to be held by the Utility on behalf of ratepayers. The YUB has sole discretion to direct disposition of these funds, typically through refunds to customers or applied to ratepayer deficits. As directed by YUB Order 2013-01, the balance in the account as at January 1, 2012 has been transferred to Deferred uninsured losses.

Deferred uninsured losses
The Utility maintains a regulatory account for recording uninsured losses. An annual provision is approved by the YUB and collected through customer rates. Variances between the approved annual provision and actual costs incurred are deferred until the following general rate application or until a specific application is made to the YUB requesting recovery from or refund to customers.

Deferred charges
Deferred charges are recorded at cost and include an AFUDC component as allowed by the regulator.

All deferred charges are amortized to earnings on a straight-line basis over terms approved by the Yukon Utilities Board.

Cost of feasibility studies and infrastructure planning which did not result in a capital project are amortized over terms ranging between five and ten years.

IFRS costs are associated with the accounting conversion from Canadian Generally Accepted Accounting Principles to International Financial Reporting Standards.

Deferred customer service costs are amortized over twelve years.

The deferred hearing cost account is used to record the deferral of costs associated with preparation and defense of applications to the YUB. The periods of amortization range from 10 to 45 years.

Regulatory provision for future removal and site restoration costs
The Utility maintains a provision for the future removal of property, plant and equipment and the costs of site restoration related to those assets. The provision includes a regulatory component as well as a component relating to the future decommissioning of the Minto Mine spur line. Per YUB Order 2005-12 no additional provision is permitted to the regulatory component.

December 31, 2012 (tabular amounts in thousands of dollars)

3. Significant accounting policies - continued

The provision for the decommissioning of the Minto Mine spur line accrues interest at the rate equal to the three month Canadian dollar LIBOR. This account provides for the costs of demolishing, dismantling, tearing down, or otherwise disposing of an asset and any site restoration costs, net of actual recoveries. This account is not used when the costs relate to an asset retirement obligation.

Deferred insurance proceeds
Deferred insurance proceeds represents a gain on fire insurance proceeds received related to a fire at the Whitehorse Rapids Generating Station in 1997. The proceeds are being amortized to income on the same basis as the replacement assets.

Diesel contingency fund
The Diesel Contingency Fund (DCF) was established by YUB Order 1996-6 through the Negotiated settlement process. The DCF is used to reimburse the Utility for costs associated with the diesel generation required when there is not sufficient water for hydraulic generation to meet demand. The DCF attracts interest based upon short-term bond rates. Any negative balance attracts interest at the lowest short-term borrowing rate available to the Utility through its line of credit. The Utility is required to file an annual report with the YUB on the DCF's activity. The DCF policy is under review by the YUB. See Note 4 for further explanation.

Generally Accepted Accounting Principles ("GAAP") adopted by the Corporation and Utility

Revenue recognition
All revenues are recognized in the period earned. Revenue from the sale of power is recognized based on cyclical meter readings. Sales of power includes an accrual for electricity deliveries not yet billed.

Materials and supplies
Diesel fuel, materials and supplies are recorded at the lesser of average cost and net realizable value. Obsolete materials and supplies are recorded at salvage value in the period when obsolescence is determined. Major spare parts are recorded in the Utility's books as property and equipment.

Property, plant and equipment
Property, plant and equipment is stated at cost, other than the AFUDC component which is recorded under rate regulated accounting. Cost includes materials, direct labour, a proportionate share of directly attributable administration overhead, and, if applicable, direct finance charges capitalized during construction, less accumulated amortization. Amortization is based on the straight-line method over the estimated economic life of the assets as follows:

Generation	
Hydro-electric plants	30 to 103 years
Diesel plants	25 to 72 years
Wind turbines	30 years
Transmission	40 to 65 years
Distribution	30 to 55 years
Buildings	20 to 55 years
Financial Information System	5 to 10 years
Transportation	7 to 25 years
Other equipment	5 to 20 years

3. Significant accounting policies - continued

Property, plant and equipment - continued
The estimated service lives and removal costs of the assets is based upon depreciation studies conducted periodically by the Utility. A depreciation study was completed in 2012 in which the useful lives of a number of asset classes was extended. This change in estimate was applied prospectively effective January 1, 2012 in accordance with the YUB's decision on the Utility's GRA for 2012 and 2013 (note 4).

Asset retirement obligations
On an annual basis the Utility identifies legal obligations associated with the retirement of tangible long-lived assets. Where a reasonable estimate of the fair value of these obligations can be determined, the total retirement costs are to be recorded as a liability at fair value, with a corresponding increase to property, plant and equipment.

The Utility has determined that it has tangible long lived assets with associated future legal obligations for retirement. As the Utility anticipates using the assets for an indefinite period, the date of removal of these assets cannot be reasonably determined, and therefore an asset retirement obligation has not been recorded. When the timing and amount of the retirement can be reasonably estimated, an asset retirement obligation and the corresponding increase in property, plant and equipment asset will be recognized.

Direct financing leases
Investments in direct finance leases are carried at the lower of cost and net realizable value.

Contributions in aid of construction
Certain property, plant and equipment additions are made with the assistance of cash contributions from customers or government. These contributions are deferred upon receipt and are amortized to income on the same basis as the assets to which they relate. Amortization of contributions from customers and the Government of Canada is netted on the statement of operations against amortization expense while amortization of capital assistance from the Yukon Government is disclosed separately under Amortization of contributions from the Government of Yukon.

Deferred licensing costs
Costs related to obtaining water license renewals are deferred and amortized to earnings on a straight line basis over the term of the license. The Utility operates its hydro generation facilities under three separate water licenses, with terms ranging from 17 to 25 years. Diesel generation air emission permits have a term of three years. These costs are treated as intangible assets and are measured at initial cost and amortized over the life of the license.

Employee pension plan
The Utility sponsors an employee defined benefit pension plan which provides benefits based on the length of service and average salaries for the five highest paid consecutive years of service. Employees joining the Utility after January 1, 2002 are not eligible to participate in the defined pension plan. Effective January 1, 2011, the Utility also sponsors an executive defined benefit pension plan and supplemental executive retirement plan. The Utility contributes amounts to the pension plans as recommended by an independent actuary.

The cost of pension benefits is actuarially determined using the projected benefits method, prorated on service, and reflects management's best estimates of investment returns, wage and salary increases, and age at retirement. Pension costs include the adjustments resulting from plan enhancements, actuarial gains and losses, and changes in assumptions which are amortized over the expected average remaining service period of active employees. The excess of the net unrecognized actuarial gains and losses over 10% of the greater of the accrued benefit obligation and the fair value of the plan assets is amortized on a straight line basis over the expected average remaining service period of active employees, which is currently 8 years for the employee plan (2011 - 9 years) and 4 years for the executive plan (2011 - 5 years). The transitional asset (liability) arising when these policies are first applied is amortized over the average remaining service period of active employees when the amendment is recognized, which is 18 years for the employee plan and 5 years for the executive plan. The expected return on plan assets is based on the fair value of these assets.

3. Significant accounting policies - continued

Financial instruments
Financial assets and financial liabilities are recognized on the Corporation's balance sheet when the Corporation becomes party to the contractual provisions of the instrument.

Cash
Cash is comprised of cash on hand and in bank accounts less bank indebtedness.

Accounts receivable
Accounts receivable, classified as loans and receivables, are initially measured at fair value. Subsequent to initial recognition, accounts receivable are measured at amortized cost less any impairment.

Accounts payable and accrued liabilities
Accounts payable and accrued liabilities, classified as other financial liabilities, are measured at amortized cost.

Long-term debt
Long-term debt, classified as other financial liabilities, is initially recognized at fair value. Subsequent to initial recognition, long-term debt is measured at amortized cost.

Transaction costs
Transaction costs are presented as a reduction from the carrying value of the related debt and are amortized using the effective interest rate method over the terms of the debts to which they relate. Transaction costs include fees paid to agents, brokers and advisors but exclude debt discounts and direct financing costs.

Derivative financial instruments
Derivative financial instruments are financial contracts that derive their value from changes in an underlying variable. The Corporation has entered into interest rate swaps to manage interest rate risk. The Corporation's interest rate swaps are designated as held for trading and are thus recognized at fair value on the date the contract has been entered into with any subsequent unrealized gains and losses reported in net income during the period in which the fair value movement occurred.

Fair value estimation
The carrying value of the accounts receivable, accounts payable and accrued liabilities approximate their fair value due to the immediate or short-term maturity of these financial instruments. The fair value of the long-term receivable and the long-term debt is estimated by discounting the future cash flows using current rates for financial instruments subject to similar risks and maturities. The fair value of derivative financial instruments is estimated using standard market valuation techniques and is provided to the Corporation by the financial institution that is the counterparty to the transactions.

Environmental liabilities
Environmental liabilities consist of the estimated costs related to the remediation of environmentally contaminated sites. The Utility will accrue a liability and record an expense, related to present or past activities of the Utility, when there is a legal obligation to remediate the contamination and the costs can be reasonably estimated. If the likelihood of the Utility's obligation to incur these costs is either not determinable or the costs cannot be reasonably estimated, the contingency is disclosed in the notes to the financial statements. The Corporation reviews its estimates of future environmental liabilities on an ongoing basis as described in note 26.

3. Significant accounting policies - continued

Measurement uncertainty
The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates include those for revenue, accounts receivable, property, plant and equipment, asset retirement obligations, employee pension obligations and rate regulated assets and liabilities. Actual results could differ by a significant amount from these estimates.

Management's estimates and assumptions, especially those affecting the reported amounts of regulated assets and the Utility's ability to recover the cost of these assets through future rates, are subject to decisions of the YUB as described in note 4.

4. Financial statement effects of rate regulation

General Rate Application
In April 2012, the Utility filed a GRA for the years 2012 and 2013 requesting rate increases of 6.4% and 6.5% respectively. After two rounds of interrogatories, an oral public hearing was held in November of 2012. On June 24, 2013, the YUB approved on-going rate riders of 11.01% for non-industrial customers and 7.36% for industrial firms to reflect the cumulative rate increases for 2012 and 2013. In addition, a one year rider of 3.62% was approved to collect approved utility revenue requirement for 2012 and 2013.

These financial statements reflect the approved rate increase for 2012 and all other directives issued by the YUB which affected the Utility's financial statements for 2012, including the directive issued regarding the DCF and the Energy Reconciliation Adjustment (ERA) (see below).

Diesel Contingency Fund and Energy Reconciliation Adjustment
As part of the 2012/13 GRA, the Utility filed for changes to the DCF and ERA provisions of the Wholesale Primary rate schedule. The YUB deferred a decision on these two issues pending further consultation with affected utilities and a separate proceeding to review the impacts of proposed changes. Management expects this process will be complete in 2013. In accordance with the YUB's directive, the Utility has deferred the recognition of the additional $3,716,000 collected from rate payers under the proposed DCF policy (Note 15) and the $1,172,000 in additional revenues under the proposed ERA adjustment (Note 5 & 10) pending the final resolution of these two matters.

Regulatory Accounts
Certain items in these consolidated financial statements are accounted for differently than they would be in the absence of rate regulation.

Where regulatory decisions dictate, the Utility defers certain costs or revenues as assets or liabilities on the balance sheet and records them as expenses or revenues on the statement of operations as it collects or refunds amounts through future customer rates. Any adjustments to these deferred amounts are recognized in income in the period that the YUB renders a subsequent decision. Regulatory assets represent future revenues associated with certain costs, incurred in the current period or in prior periods, which 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.

December 31, 2012 (tabular amounts in thousands of dollars)

4. Financial statement effects of rate regulation - continued

In the absence of rate regulation the Utility's net income would have decreased by $584,000 in 2012 (2011 - decreased by $4,923,000). The following describes each of the circumstances in which rate regulation affects the accounting for a transaction or event:

	2012	2011	Expected remaining recovery/ settlement (years)	For 2012 In the absence of Rate Regulation the Utility's Net Income would have increased (decreased) by:
Regulatory assets				
Deferred charges (note 11), net book value				
Feasibility studies and infrastructure planning	$ 17,313	$ 14,884	5 to 10	$ (2,429)
Deferred customer service costs	507	571	10	64
Hearing costs	2,950	2,376	10 to 45	(574)
Dam safety review	72	95	5	23
IFRS planning	468	566	Indeterminate	98
Deferred uninsured losses (note 10)	152	178	Indeterminate	26
	21,462	18,670		(2,792)
Regulatory liabilities:				
Deferred insurance proceeds (note 16)	6,276	6,546	25	(270)
Regulatory provision for future removal and site restoration costs	4,711	4,711	Indeterminate	-
Diesel contingency fund (note 8)	4,628	902	Indeterminate	3,726
	15,615	12,159		3,456
Net impact of assets and liabilities	$ **5,847**	$ 6,511		$ 664
Impact of other items through income statement				
Fuel Price Adjustment				(80)
Total effect				584

Regulatory assets

(a) Deferred charges

Deferred charges represent costs which have been deferred and are being amortized over various periods. In the absence of rate regulation, GAAP would require such costs to be recognized as expenses in the year incurred.

Feasibility studies and infrastructure planning

The Utility undertakes certain projects whose objective is to determine the feasibility of a range of solutions. While in progress, the costs of these feasibility projects are included in these accounts. As well, if the feasibility project determines there is not a viable solution, these projects are closed out and amortized to income over a prescribed number of years. These values are also included in the feasibility accounts. The cost of feasibility projects that result in a capital project are transferred to the cost of the resultant project. In the absence of rate regulation, expenses in 2012 would have been $2,429,000 higher (2011 - $3,421,000 higher expenses).

Deferred Customer Service Costs

The costs associated with negotiating terms of service with a new industrial customer. In the absence of rate regulation, expenses in 2012 would have been $64,000 lower (2011 - $64,000 lower expenses).

4. Financial statement effects of rate regulation - continued

Hearing costs
These costs are associated with the YUB regulatory proceedings. The costs consist primarily of various rate and project review proceedings. The Utility is directed to defer and amortize the costs over terms at the discretion of the YUB. In the absence of rate regulation, expenses in 2012 would have been $574,000 higher (2011 - $741,000 higher expenses).

Dam safety review
The Utility has a program of conducting reviews of the safety of its dams in accordance with standards set by the Canadian Dam Association. External consultants are hired every five years with intermittent costs incurred in the interim periods. These costs are amortized over five years as approved by the Utility's 1991/92 General Rate Application and reconfirmed in YUB Order 2005-12 and YUB 2009-8. In the absence of rate regulation, expenses in 2012 would have been $23,000 lower (2011 - $24,000 lower expenses).

IFRS planning
These costs are associated with the accounting conversion from Canadian Generally Accepted Accounting Principles to International Financial Reporting Standards. In the absence of rate regulation, expenses in 2012 would have been $98,000 higher (2011 - $132,000 higher expenses).

(b) Deferred uninsured losses
The YUB has approved the use of a deferral account for uninsured damages and injuries as a means of self-insurance. The account is maintained through an annual provision approved the YUB. In order to eliminate the deficit rate payers owed as a result of uninsured losses, the Utility was directed by YUB Order 2013-01 to transfer the balance of $397,000 in the Faro mine dewatering deferral revenue account a at January 1, 2012 to Deferred uninsured losses and to amortize the remaining negative balance in the account of $180,000 over a five-year period. In addition, the Utility was directed by YUB Order 2013-01 to record an annual provision of $190,000 in 2012 and each subsequent year. In the absence of rate regulation, GAAP would require costs to be expensed as incurred and, therefore, expenses in 2012 would have been lower by $26,000 (2011 - $144,000 higher expenses). The period over which the provision will be recovered is dependent on the magnitude of future actual losses incurred and cannot be estimated.

Regulatory liabilities

(c) Faro Mine dewatering deferral revenue
As directed by YUB Order 1998-5, all revenues, less any incremental costs to provide the service, collected from the Faro Mine under Rate Schedule 34 (Faro Mine Firm Shutdown Power) prior to December 31, 2004, were deferred for the benefit of ratepayers pending direction from the YUB. YUB Order 2005-12 confirmed that effective January 1, 2005 the Faro minesite would be charged the General Service - Government rate so there will be no further increases to Faro Mine dewatering deferral revenue account.

As directed by YUB Order 2013-01, the balance in the account of $397,000 as at January 1, 2012 has been transferred to Deferred uninsured losses.

(d) Deferred insurance proceeds
The deferred insurance proceeds relates to a fire at the Whitehorse Rapids Generating Station in 1997 which, pursuant to YUB Order 2000-3, is being amortized to income at the same rate as the replacement assets. In the absence of rate regulation, GAAP would have required the gain to have been completely recognized as income in the year received. As a result, the Utility's net income in 2012 would have been lower by the amount of the amortization of $270,000 (2011 - $270,000 lower).

4. Financial statement effects of rate regulation - continued

(e) Future removal and site restoration costs

Pursuant to amortization rates approved by the YUB in the Utility's previous general rate applications the Utility has maintained a reserve for future removal and site restoration costs. As a result of the YUB Order 2005-12, effective January 1, 2005, the Utility is required to maintain this reserve as a regulatory provision in addition to any asset retirement obligations.

The provision is not to exceed the cumulative value of the provision at December 31, 2004 of $5,757,000. YUB Order 2005-12 also directs the Utility to notify interveners and interested parties when the balance of the provision reaches $2,000,000.

Costs of dismantling capital assets, including site remediation, will be applied to this regulatory liability if they do not otherwise relate to an asset retirement obligation. In a non-regulated industry, future removal and site restoration costs would be limited to asset retirement obligations, and the removal and site restoration costs would be expensed in the year incurred if they did not relate to an asset retirement obligation. In the absence of rate regulation, the Utility's 2012 expenses would have been higher by the amount of actual removal and site restoration costs incurred in the year of $0 (2011 expenses - $53,000 higher). The period over which the provision will be settled is dependent on the future costs of demolishing, dismantling, tearing down, or otherwise disposing of the asset, and site restoration net of actual recoveries, and is, therefore, indeterminate.

(f) Diesel contingency fund

In the absence of regulation, GAAP would have required any interest earned or incurred related to the DCF to be included in the Utility's net income in the year in which they occurred. In the absence of rate regulation, the Utility's income and expenses in 2012 would have been higher by $3,716,000 (2011 - income higher by $11,000).

(g) Fuel price adjustment

OIC 1998/90 directs the YUB to permit the Utility to adjust electricity rates to reflect fluctuations in the price of diesel fuel. The amount by which actual fuel prices vary from the YUB approved rates is deferred and recovered from or refunded to customers in a future period.

In the absence of rate regulation, GAAP would require that actual diesel fuel expenses be included in the operating results of the year that they are incurred. In 2012, fuel expenses were recovered and consequently higher by $80,000 (2011 fuel expense higher by $250,000).

Other items affected by rate regulation

It is the Utility's policy to charge to income, in the year of disposal, any gain or loss upon retirement or disposal of land or vehicles. As approved by the YUB, the gain or loss on all other property, plant and equipment is deferred and amortized over the expected life of the remaining pool of similar assets. In the absence of rate regulation, GAAP would require the gain or loss on the disposal or retirement of all property, plant and equipment to be included in income in the period of disposal or retirement.

The Utility's policy of maintaining a constant capital structure of 60% debt and 40% equity is reviewed by the YUB as part of the rate setting process and in the determination of the return on rate base. In the absence of rate regulation, the Utility would determine the appropriate capital structure solely based on decisions by the Board of Directors of the Utility, which may differ from the current policy.

December 31, 2012 (tabular amounts in thousands of dollars)

4. Financial statement effects of rate regulation - continued

All amounts maintained as regulatory assets and liabilities are expected to be recovered or settled over the periods noted above. However, there are risks and uncertainties associated with the recovery or settlement related to potential future decisions of the regulator which could result in material adjustments to these assets and liabilities.

5. Cash

The cash balance includes an amount of $1,709,508 (2011 - $7,235,404) that is restricted for the payment of a contractor holdback and an amount of $4,628,000 (2011 - $902,000) which is limited for the purpose of supporting the DCF liability.

6. Accounts receivable

	2012	2011
Wholesale energy sales	$ 5,924	$ 2,615
Other	2,258	1,980
Green Infrastructure funding (Note 16)	2,130	19,724
Retail energy sales	2,192	1,528
	$ 12,504	$ 25,847

Included in Accounts Receivable - Wholesale energy sales in an amount equal to $1,172,000 representing ERA revenues deferred by Order of YUB. See Note 4 for further explanation

7. Direct financing leases

The Corporation's investments in direct financing leases are summarized as follows:

	2012	2011
Direct financing leases	$ 162	$ 162
Less: current portion	-	-
	$ 162	$ 162

In 2003, the Corporation financed an electric boiler system for the Yukon Hospital Corporation for a total cost of $595,898. The repayment terms on this lease stipulate that one half of the energy cost savings resulting from the boiler usage during the year will be repaid against the investment. Interest on this investment is earned at the rate of 7.5% per annum and is recognized as finance income. The investment balance was $162,090 in 2012 (2011 - $162,090).

December 31, 2012 (tabular amounts in thousands of dollars)

8. Property, plant and equipment

	Cost	Accumulated Amortization	2012 Net Book Value	2011 Net Book Value
Generation	$ 286,982	$ 63,812	$ 223,170	$ 215,611
Transmission	141,409	20,932	120,477	110,576
Buildings and other equipment	23,484	9,839	13,645	11,268
Distribution	29,142	10,900	18,242	18,666
Construction-in-progress	3,325	-	3,325	8,056
Transportation	4,367	1,520	2,847	2,954
Financial information system	1,303	1,303	-	-
Land and land rights	1,111	-	1,111	1,112
	$ 491,123	**$ 108,306**	**$ 382,817**	$ 368,243

9. Deferred uninsured losses

	2012	2011
Balance, beginning of year	$ 576	$ 432
Provision	(226)	(100)
Transfer from Faro mine dewatering deferral revenue (note 13)	(397)	-
Losses incurred - Asset replacement	199	244
Balance, end of year	**$ 152**	$ 576

In order to eliminate the deficit rate payers owed as a result of uninsured losses, the Utility was directed by YUB Order 2013-01 to transfer the balance of $397,000 in the Faro mine dewatering deferral revenue account as at January 1, 2012 to Deferred uninsured losses and to amortize the remaining negative balance in the account of $180,000 over a five-year period. In addition, the Utility was directed by YUB Order 2013-01 to record an annual provision of $190,000 in 2012 and each subsequent year.

10. Deferred charges and intangible assets

	Cost	Accumulated Amortization	2012 Net Book Value	2011 Net Book Value
Intangible assets:				
Deferred water licensing costs	$ 11,544	$ 5,697	$ 5,847	$ 5,747
Deferred charges:				
Feasibility studies and infrastructure planning	21,996	4,583	17,413	15,361
IFRS planning	581	113	468	566
Hearing costs	6,291	3,341	2,950	2,900
Deferred customer service costs	769	262	507	571
Dam safety review	332	260	72	95
Deferred financing costs	110	88	22	33
	$ 41,623	**$ 14,344**	**$ 27,279**	$ 25,273

December 31, 2012 (tabular amounts in thousands of dollars)

11. Bank indebtedness

The Corporation has access to a $17.5 million line of credit. The account accrues interest on withdrawals at prime less .25%. At December 31, 2012, the balance of this line of credit was $0 (2011 - $4,782,352).

12. Accounts payable and accrued liabilities

	2012	2011
Trade payables	$ 14,856	$ 27,239
Other	1,538	14
Employee compensation	336	219
	$ 16,730	$ 27,472

Included in Other accounts payable is an amount equal to $1,172,000 representing ERA revenues deferred by Order of YUB. See Note 4 for further explanation.

13. Faro Mine dewatering deferral revenue

	2012	2011
Faro Mine dewatering deferral revenue account		
Opening balance	$ 397	$ 397
Transfer to deferred uninsured losses (note 9)	(397)	-
Closing balance	**$ -**	$ 397

14. Diesel contingency fund

	2012	2011
Balance, beginning of year	$ 902	$ 891
Transfers (Note 4)	3,716	-
Interest	10	11
Balance, end of year	**$ 4,628**	$ 902

December 31, 2012 (tabular amounts in thousands of dollars)

15. Long-term debt

The Corporation's long-term debt is summarized as follows:

	2012	2011
Bond The Corporation issued a bond at a fixed interest rate of 5.0% per annum. Interest is payable semi-annually. Principal payment is due when the bond expires on June 29, 2040.	$ 98,226	$ 98,197
The Toronto Dominion Bank The Corporation entered into an interest rate swap to convert the interest rate on the Bankers' Acceptances amounts from a variable interest rate based on the Bankers' Acceptances rates to a fixed rate of 2.92% per annum. Principal drawdowns are monthly with the balance due on December 27, 2017.	9,443	11,171
The Toronto Dominion Bank The Corporation entered into an interest rate swaps to convert the interest rate on the Bankers' Acceptances amounts from a variable interest rate based on the Bankers' Acceptances rates to a fixed rate of 4.82% per annum. Principal drawdowns are quarterly with the balance due on March 30, 2017.	4,556	5,535
The Toronto Dominion Bank The Utility entered into an interest rate swap to convert the interest rate on the Bankers' Acceptances amounts from a variable interest rate based on the Bankers' Acceptances rates to a fixed rate of 2.69% per annum. Principal drawdowns are monthly with the balance due on December 28, 2022.	11,000	-
TD Canada Trust $12,400,000 term note bearing interest at 4.02% payable in monthly installments of $94,406 interest and principal, with the balance due September 30, 2016. The note is guaranteed by the Yukon Government. The terms of the note were renewed October 3, 2011.	3,939	4,891
Tr'ondek Hwech'in First Nation liability Long-term liability payable to the First Nation related to the construction of the Carmacks Stewart Transmission Line. This loan is repayable in equal annual principal repayments of $125,000 with the final payment due in 2049. The interest rate at 6.56% is a blended rate based on the cost of debt and the actual rate of return earned by the Utility.	4,625	4,750
Carmacks Stewart First Nation liability Long-term liability payable to several First Nations related to the construction of the Carmacks Stewart Transmission Line. These are non interest bearing repayable in varying instalments, due in 2028.	341	371
Total	**$ 132,130**	$ 124,915

December 31, 2012 (tabular amounts in thousands of dollars)

15. Long-term debt - continued

The Corporation's long-term debt is summarized as follows:

	2012	2011
Total - balance forward	**$ 132,130**	$ 124,915
Less current portion	4,260	3,826
	$ 127,870	$ 121,089

Long-term debt repayment
Scheduled repayments for all long-term debt are as follows:

2013	$ 4,260
2014	4,403
2015	4,547
2016	4,411
2017	2,771
Thereafter	111,738
	$ 132,130

Fair value
Fair value at December 31, 2012 of $156 million (2011 - $151 million) for all long-term debt including current portions was estimated using discounted cash flows based on an estimate of the Corporation's current borrowing rate for similar borrowing arrangements.

Bond
The Corporation issued a bond in 2010 for the face value of $100 million. The interest rate is 5% and the bond matures June 29, 2040. There are no principal payments due until the bond matures and interest is payable semi annually. The bond was issued at a discount of $0.7 million which will be amortized over the period of the related debt using the effective interest rate. Transaction costs were $1.2 million and includes fees paid to agents and advisors and are presented as a reduction from the carrying value of the related debt and are amortized over the period of the related debt using the effective interest rate.

16. Contributions in aid of construction

	Cost	Accumulated Amortization	**2012** Net Book Value	2011 Net Book Value
Contributions from Canada (Note 6)	71,000	1,066	69,934	67,129
Contributions from customers since 1998	$ 23,114	$ 5,265	$ 17,849	$ 19,076
Government of Yukon contributions	17,925	2,161	15,764	15,840
Pre - 1998 contributions	1,739	1,162	577	621
Deferred insurance proceeds	11,122	5,150	5,972	6,229
	$ 124,900	**$ 14,804**	**$ 110,096**	$ 108,895

December 31, 2012 (tabular amounts in thousands of dollars)

16. Contributions in aid of construction - continued

The Utility has entered into a contribution agreement with the Government of Canada for Green Infrastructure Funding for Stage 2 of the Carmacks to Stewart Crossing Transmission Line and the Mayo B Hydro Enhancement projects. The Utility is entitled to reimbursement of 50% of eligible costs to a maximum of $71 million during the period May 2009 to March 2014.

The sources of contributions received prior to 1998 were not recorded separately.

17. Future removal and site restoration costs

	2012	2011
Regulatory provision	$ 4,711	$ 4,711
Provision for decommissioning of Minto spur line	2,522	-
	$ 7,233	$ 4,711

18. Sales of power

	2012	2011
Wholesale	$ 25,875	$ 24,170
Industrial	5,086	4,599
General service	3,627	3,342
Residential	1,661	1,535
Secondary sales	165	46
Sentinal and street lights	94	90
	$ 36,508	$ 33,782

19. Administration expenses

	2012	2011
Wages and benefits	$ 5,179	$ 4,735
General office	1,593	1,367
Insurance and taxes	1,205	1,083
Regulatory loss	1,377	248
Information systems	646	583
Environmental	536	325
Training, recruitment and development	344	474
Material management and contracting	157	26
Board of Directors	119	314
	$ 11,156	$ 9,155

December 31, 2012 (tabular amounts in thousands of dollars)

20. Operations and maintenance expenses

	2012	2011
Wages and benefits	$ 4,765	$ 4,005
Maintenance		
- lines and substations	1,620	898
- hydro, diesel and wind	1,177	1,297
- building and vehicle	1,020	1,205
Fuel and purchased power	827	2,727
Water level measurement	237	156
	$ 9,646	$ 10,288

21. Related party transactions

The Corporation is related in terms of common ownership to all Government of Yukon (YG) departments, agencies and Crown Corporations. Transactions with these entities are entered into in the normal course of operations. All transactions with the Utility are recorded at rates set out by the YUB.

The following table summarizes the related party transactions for the year:

	2012	2011
Contributions from YG for Interim Electrical Rebate program	$ 3,050	$ 3,044
Contributions from YG for Bond interest expense	2,625	1,313
Account receivable YG	562	750
Program cost reimbursement from YG	100	-
Capital contributions from YG for Aishihik Hydro third turbine	-	500
Account payable YG	183	20

22. Pension costs and obligations

An actuarial valuation for funding purposes of the employee defined benefit plan was performed as of January 1, 2012. The next valuation for funding purposes will be conducted as of January 1, 2013. An actuarial valuation for funding purposes of the executive employee defined benefit plan and supplemental executive retirement plan was performed as of January 1, 2011. The next valuation for funding purposes will be conducted as of January 1, 2014. The pension costs and obligations were based on the data used in these funding valuations and have been projected to December 31, 2012 in accordance with generally accepted actuarial standards.

The fair value of the plan assets is based on market values as reported by the plans' custodians as at December 31, 2012. The distribution of assets by major asset class is as follows: equities - 47.3% (2011 - 45.9%), fixed income securities - 41.3% (2011 - 43.5%); and real estate - 11.4% (2011 - 10.6%).

December 31, 2012 (tabular amounts in thousands of dollars)

22. Pension costs and obligations - continued

Information about the Utility's defined benefit plan as at December 31, in aggregate, is as follows:

	2012	2011
Accrued benefit obligation determined by actuarial valuation	$ 17,490	$ 13,568
Fair value of plan assets	11,174	9,665
Funded status - plan deficit	$ 6,316	$ 3,903
Unrecognized amounts:		
- Transitional asset (liability)	(132)	(192)
- Net accumulated actuarial losses	(5,137)	(2,573)
Accrued benefit liability	$ 1,047	$ 1,138
Pension costs	$ 771	$ 561
Employer contributions	$ 863	$ 596
Employee contributions	$ 119	$ 111
Benefits paid	$ 183	$ 137
Significant assumptions for employee defined benefit plan:		
Discount rate - accrued benefit obligation	4.50%	5.25%
Discount rate - pension costs	5.25%	5.75%
Expected long-term rate of return on plan assets	6.25%	6.50%
Assumed rate of salary escalation	3.00%	3.00%
Significant assumptions for executive pension plans:		
Discount rate - accrued benefit obligation	4.25%	4.50%
Discount rate - pension costs	5.25%	5.75%
Expected long term rate of return on plan assets	5.50%	5.50%
Assumed rate of salary escalation	3.50%	3.50%

The accrued benefit liability has been recorded by the Utility and is separately shown on the balance sheet.

Employees joining after January 1, 2002 are not eligible to participate in the defined benefit plan. The Utility makes contributions to a Registered Retirement Savings Plan ("RRSP") on behalf of these employees and to employees hired before January 1, 2002 who belonged to the defined benefit plan and elected to opt out of that plan. The RRSP is a defined contribution plan. The costs recognized for the period are equal to the Utility's contribution to the plan. During 2012 these were $285,000 (2011 - $306,000).

Total cash payments for employee future benefits for 2012, consisting of cash contributed by the Utility to its funded defined benefit pension plan and cash contributed directly to the RRSP were $1,148,000 (2011 - $902,000).

23. Commitments

Aishihik water license

The Yukon Territory Water Board issued a water use license in 2002, valid until December 31, 2019, for the Utility's Aishihik Lake facility. In addition to maintaining a minimum and maximum water level, this license commits the Utility to meet a number of future requirements including annual fish monitoring programs.

Fish monitoring programs are also required under an authorization provided by the Federal Government Department of Fisheries and Oceans, which is valid until December 31, 2019. The costs of meeting these requirements are accounted for as water license costs in the year they are paid.

Contractual obligations

The Utility has entered into contracts to purchase products or services for which the liability has not been incurred as at December 31 2012 as the product or service had not been provided. The commitment at year end is $6,429,000 (2011 - $4,356,000).

24. Contingencies

Carmacks to Stewart Crossing Transmission Project

The Utility completed the construction of the Carmacks to Stewart Crossing Transmission Line project during 2011. In April 2011, the line construction contractor notified the Utility of a potential claim under the contract alleging increased costs of $1,800,000 due to scheduling delays and change in scope caused by the Utility. The outcome of the potential claim is not determinable at this time and no amount has been recognized in the financial statements.

Aishihik Third Turbine Project

This project was commissioned into service in December 2011. On March 2, 2012, the general contractor filed a claim with the Supreme Court of Yukon for $4,000,000 plus interest and costs alleging the Utility has not paid for work performed. The Utility has informed the contractor of claims for incomplete contract scope, uncorrected deficiencies and other claims. The outcome of the claim is not determinable at this time and no amount has been recognized in the financial statements.

25. Environmental liabilities

The Utility's activities are subject to various federal and territorial laws and regulations governing the protection of the environment or to minimize any adverse impact thereon. The Utility conducts its operations so as to protect public health and the environment and believes its operations are materially in compliance with all applicable laws and regulations.

The Utility has conducted environmental assessments at all its diesel plant sites. At sites where environmental contamination was found and a legal obligation to remediate the site existed, the Utility has conducted a full remediation. As at December 31, 2012 no environmental liabilities, for which a legal obligation exists to remediate, has been identified by the Utility. The Utility will continue to use its Environmental Management System to monitor and assess previous and potential existing environmental liabilities on an ongoing basis.

26. Risk management and financial instruments

At December 31, 2012, the Corporation's and Utility's financial instruments included cash, accounts receivable, short-term and long-term receivable, bank indebtedness, accounts payable and accrued liabilities, long and short-term debt and interest rate swaps.

26. Risk management and financial instruments - continued

The fair value of cash, accounts receivable, bank indebtedness, accounts payable and accrued liabilities and construction financing approximate their carrying value due to the immediate or short-term maturity of these financial instruments.

The long-term debt is accounted for at amortized cost using the effective interest rate method. The fair value of the long-term debt is estimated by discounting the future cash flows using current rates for debt instruments subject to similar risks and maturities as disclosed in Note 15.

Interest rate swaps are financial contracts that derive their value from changes in an underlying variable. The Utility's interest rate swaps are designated as held for trading and are thus recognized at their fair value on the date the contract has been entered into with any subsequent unrealized gains and losses reported in net income during the period in which the fair value movement occurred. The fair value of the interest rate swaps is estimated using standard market valuation techniques and is provided to the Utility by the financial institution that is the counterparty to the transactions. The Utility did not engage in any other hedging transactions.

Interest rate risk
Interest rate risk is the risk that future cash flows or the fair value of a financial instrument will fluctuate due to changes in market interest rates. The Corporation has debt for which variable and fixed interest rates apply. The Corporation has entered into interest rate swap agreements to mitigate its cash flow exposure to changes in interest rates on its variable rate debt. The Corporation is exposed to fair value risk due to changes in interest rates on its fixed rate debt, including the variable rate debt which has been converted from variable to fixed through the use of interest rate swap agreements.

As at December 31, 2012, the Corporation had three interest rate swap agreements in place with notional principal amounts of $16 million, $11 million and $8 million. The agreements effectively change the Corporation's interest rate exposure on these notional amounts from floating rates to fixed rates of 2.92%, 2.69% and 4.82% respectively.

The fair value of the interest rate swap agreements at December 31, 2012 was a liability of $666,000. (2011 - $824,000). The interest rate swap agreements cover the notional debt amounts until 2017 at the fixed interest rates noted above. Fair values for interest rate swaps are provided by the financial institution with whom the swaps are held. A 100 basis point decrease/increase in the interest rate assumption would have resulted in an increase/decrease in the interest swap agreements fair value of $310,000 and $321,000 respectively at December 31, 2012 (2011 - $449,480 and $439,387 respectively). During the year the Corporation paid $6.047 million of interest. (2011 - $6.267 million)

Credit risk
Credit risk is the risk of failure of a debtor or counterparty to honour its contractual obligations resulting in financial loss to the Corporation. Financial assets, which potentially subject the Corporation to concentrations of credit risk consist principally of cash, accounts receivable and long-term receivable. The maximum credit risk at December 31, 2012 is the fair value of these assets which totals $22.356 million (2011 - $35.334 million).

The credit risk related to cash is minimized as these assets are held with a Canadian chartered bank.

Accounts receivable are considered for impairment when they are past due or when objective evidence is received that a customer will default. Management has assessed that the credit risk for accounts receivable is minimal since its primary customer which makes up 47.4% (2011 - 10.1%) of the accounts receivable at December 31, 2012, is a regulated utility which has had a history of positive cash flow and no impairment and 17.0% (2011 - 76.3%) of accounts receivable balance is due from the Government of Canada. Consistent with prior years there were no balances owing that are older than 90 days and thus the Corporation did not recognize an allowance for doubtful accounts. There is no history of impairment.

December 31, 2012 (tabular amounts in thousands of dollars)

26. Risk management and financial instruments - continued

Credit risk - continued

In order to minimize the credit risk on the long-term receivable, management obtained the security of assets for the loan and reviews the recoverable amount at each balance sheet date to ensure that adequate impairment losses are made for unrecoverable amounts. Management has considered the customer's credit worthiness by analysis of the entity's financial statements as at December 31, 2012. Based on this analysis, management expected to collect the amount of the loan in its entirety.

Liquidity risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they fall due. The Corporation's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Corporation's reputation through active management of the assets and liabilities and cash flows. The carrying amount of accounts payable and accrued liabilities, and long term debt represents the maximum exposure to liquidity risk. At December 31, 2012, the Corporation's accounts payable and accrued liabilities had a carrying value of $16.7 million (2011 - $27.4 million).

At December 31, 2012, the Corporation's long term debt had a carrying value of $132.13 million (2011 - $124.92 million) and nil is due in 2012 (2011 - nil), $3.939 million is due in 2016 (2011 - $4.891 million), $13.999 million is due in 2017 (2011 - $16.706 million), $11 million is due in 2022 (2011 - nil), $0.341 million due in 2028 (2011 - $0.371 million), $98.226 million due in 2040 (2011 - $98.197 million) and $4.625 million is due in 2049 (2011 - $4.75 million).

The Corporation had $17.5 million (2011 - $22.7 million) in undrawn credit facilities at its disposal to further reduce liquidity risk.

Fair values

The following table illustrates the fair value hierarchy of the Corporation's financial instruments as at December 31, 2012:

	Quoted prices in active markets (Level 1)	Other observable inputs (Level 2)	Unobservable inputs (Level 3)	Total
Derivative related liability	-	$ 666	-	$ 666

The fair value of the derivative related liability in 2011 was $824,000 and was classified as level 2.

27. Capital management

The Corporation and the Utility's capital is their equity which is comprised of share capital and accumulated funds in the form of retained earnings. The Corporation and the Utility manage their equity by managing revenues, expenses, assets and liabilities to ensure their objectives are effectively achieved while remaining a going concern.

Corporation's Capital Management Policy

The Corporation's policy is to minimize debt from operations to the maximum extent possible with available cash flows without impairing the working capital needs of the Corporation. The Corporation has no set debt to capital target, nor are there any loan agreements which impose any capital requirements on the Corporation.

December 31, 2012 (tabular amounts in thousands of dollars)

27. Capital management - continued

Utility's Capital Management Policy
The Utility monitors its capital on the basis of the ratio of total debt to total capitalization. Debt is calculated as total borrowings which is comprised of long-term debt, including the portion of long-term debt due within one year. Short term debt related to assets under construction at the balance sheet date is excluded from the debt calculation, as the assets are similarly excluded from the determination of rate base. In addition the provision for decommissioning of the Minto Mine spur line has been added. Total capitalization is calculated as total debt plus total shareholder's equity as shown on the balance sheet. The Utility maintains a balance in retained earnings as an indicator of the Utility's equity position.

The Utility has a policy which defines its capital structure at a ratio of 60% debt and 40% equity. This policy has been reviewed and accepted by the YUB.

The table below summarizes the Utility's total debt to total capitalization position:

(thousands of dollars)	**2012**	2011
Long-term debt due within one year	$ 5,356	$ 4,974
Long-term debt	125,841	120,227
Total debt	131,197	125,201
Add provision for decommissioning of Minto Mine spur line	2,522	-
Total debt to include in the calculation	$ 133,719	$ 125,201
Share capital	$ 39,000	$ 39,000
Contributed surplus	14,600	14,600
Retained earnings	35,044	29,612
Total equity	88,644	83,212
Total capitalization	$ 223,363	$ 208,413
Total debt to total capitalization	60 %	60 %

There were no changes in the Corporation's or the Utility's approach to capital management during the period.

28. Non-consolidated financial information

The nature and size of operations of the Corporation and its subsidiary, Yukon Energy Corporation differ substantially. Audited financial statements of Yukon Energy Corporation for the year ended December 31, 2012 are also prepared.

29. Comparative figures

Certain 2011 figures, which are presented for comparative purposes, have been reclassified to conform with the current year's presentation.