City of Richmond

# Report to Committee

| | | | |
|---|---|---|---|
| **To:** | Finance Committee | **Date:** | April 18, 2019 |
| **From:** | John Irving, P.Eng., MPA<br>Acting General Manager, Engineering & Public Works and Chief Executive Officer, Lulu Island Energy Company<br><br>Jerry Chong, CPA, CA<br>Director, Finance and Chief Financial Officer, Lulu Island Energy Company | **File:** | 10-6600-10-01/2019-Vol 01 |
| **Re:** | **2018 Financial Statements for the Lulu Island Energy Company** | | |

### Staff Recommendation

That the Lulu Island Energy Company report titled "2018 Financial Statements for the Lulu Island Energy Company" dated April 18, 2019 from the Chief Executive Officer and Chief Financial Officer, be received for information.

John Irving, P.Eng., MPA
Acting General Manager, Engineering & Public Works and
Chief Executive Officer,
Lulu Island Energy Company
(604-276-4140)

Jerry Chong, CPA, CA
Director, Finance and
Chief Financial Officer,
Lulu Island Energy Company
(604-276-4064)

Att. 1

| REPORT CONCURRENCE | |
|---|---|
| CONCURRENCE OF GENERAL MANAGER | |
| REVIEWED BY SMT | INITIALS: |
| APPROVED BY CAO | |

Richmond

6911 NO. 3 ROAD
RICHMOND, BC V6Y 2C1

# Report

**DATE:** April 3, 2019

**TO:** Board of Directors

**FROM:** Jerry Chong, CPA, CA, Chief Financial Officer

**Re:** **2018 Financial Statements for the Lulu Island Energy Company**

## Staff Recommendation

That the audited financial statements of the Lulu Island Energy Company (LIEC) for the year ending December 31, 2018, be approved, and that any two LIEC directors be authorized to sign the financial statements to confirm that approval.

## Origin

Section 11.3 of the LIEC articles of incorporation requires that an auditor be appointed and audited financial statements prepared at each fiscal year end. It also requires that the audited financial statements are presented annually at an open City of Richmond Council meeting within 150 days of LIEC's fiscal year end. This report presents the 2018 audited financial statements for the LIEC Board's approval.

## Background

LIEC, a corporation wholly-owned by the City of Richmond, was established to provide district energy services for the City. Under direction from Council, and following receipt of the necessary approval from the Inspector of Municipalities, the incorporation of LIEC was completed in August 2013.

In June 2014, the City and LIEC executed a District Energy Utilities Agreement, assigning LIEC the function of establishing and operating district energy systems as well as providing thermal energy services on behalf of the City.

LIEC currently owns and operates the Alexandra District Energy (ADEU) Utilities, Oval Village District Energy (OVDEU), and advances new district energy opportunities. Both the Alexandra and the Oval Village neighbourhoods are experiencing rapid redevelopment, and LIEC has been growing to meet this increased energy demand, while maintaining exceptional reliability and quality of service.

The ADEU system currently provides energy to six residential buildings, the "Central at Garden City" commercial development, the Richmond Jamatkhana temple and Fire Hall No. 3. Over 1,456 residential units and over 1.6 million square feet of floor area are currently receiving energy from the ADEU system.

The OVDEU system is managed through a 30 year concession agreement whereby Corix will design, construct, finance, and maintain infrastructure with LIEC maintaining the ownership of the utility. There are eight residential buildings connected to the OVDEU system with over 1,681 residential units and 1.9 million square feet of floor area receiving energy from the OVDEU system.

The ADEU and OVDEU service areas and the associated operations, assets and liabilities are administered by LIEC. All capital and operating costs are recovered through revenues from meter billings, ensuring that the business is financially sustainable.

The purpose of this report is to present the 2018 Financial Statements to the Board for approval. If approved by the Board, staff will present LIEC's 2018 Financial Statements to Council for information, in conjunction with the City's reporting process.

## Analysis

The preparation of financial statements is the responsibility of management. The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

LIEC's audited financial statements consist of:

- Statement of Financial Position – summary of assets, liabilities and shareholder's equity;
- Statement of Comprehensive Income – summary of revenues, expenses, other activities and net income for the year;
- Statement of Changes in Equity – summary of changes in share capital, contributed surplus and accumulated surplus for the year; and
- Statement of Cash Flows – summary of the sources and uses of cash in the year.

The financial statements have been audited by the independent firm KPMG LLP. Their report precedes the financial statements in Attachment 2.

Financial Position

| | 2018 | 2017 | $ Changes | % Change |
|---|---|---|---|---|
| Current Assets | $ 10,838,195 | $ 7,715,430 | $ 3,122,764 | 40% |
| Non-current Assets | 32,360,749 | 32,032,788 | 327,961 | 1% |
| Total Assets | $ 43,198,944 | $ 39,748,218 | $ 3,450,726 | 9% |
| Current Liabilities | $ 1,922,526 | $ 1,550,345 | $ 372,180 | 24% |
| Non-current Liabilities | 11,496,652 | 9,908,739 | 1,587,914 | 16% |
| Shareholder's Equity | 29,779,765 | 28,289,134 | 1,490,631 | 5% |
| Total Liabilities and Shareholder's Equity | $ 43,198,944 | $ 39,748,218 | $ 3,450,726 | 9% |

The statement of financial position distinguishes current and non-current assets and liabilities. Current assets and liabilities are those expected to be recovered within twelve months; non-current assets and liabilities are those where the recovery is expected to occur more than twelve months from the reporting date. LIEC's overall financial position improved by $3,450,725 in 2018 with total assets of $43,198,943 (2017 - $39,748,218).

Total assets are comprised of current assets (cash, investments, and receivables) totaling $10,838,195 (2017 – $7,715,430) and non-current assets (plant and equipment) of $32,360,749 (2017 - $32,032,788). The current assets increased by $3,122,764, mainly due to income generated from operations and advanced payments from developers for future capital projects. The cash balances are in a provision account for future developments. Plant and equipment increased by $327,961, bringing the total to $32,360,749. The increase is the net result of capital additions of work-in-process infrastructure in the year offset by disposals and amortization expense.

LIEC's current liabilities of $1,922,526 (2017 -$1,550,345) consist of outstanding invoices and payables due within twelve months. LIEC's non-current liabilities consist of deferred contributions and concession liabilities. The non-current liabilities increased by $1,587,913 to $11,496,652 (2017 - $9,908,739), mainly due to developer contributions for capital projects. The deferred contributions are the fees received from developers to recover the cost of the initial connection, including installation of the energy transfer station infrastructure. In accordance with IFRS, the contributions are recognized over the useful life of equipment at 25 years from the available to use date. Therefore, unrecognized contributions are deferred and recognized as non-current liabilities of the company. The concession liabilities are linked to the 30 year concession agreement between LIEC and Corix Utilities Inc. (Corix), where Corix designs, constructs, finances, and maintains the infrastructure for the OVDEU. The concession liabilities are the anticipated cash outflow for future obligations under the agreement for the capital and operating costs of the assets.

The shareholder's equity represents the net worth of the company. It is equal to the total assets minus its total liabilities and measures the company's financial health. In 2018, LIEC's shareholder equity was $29,779,765 (2017 - $28,289,134), which indicates that the company's value has increased by $1,490,631, showing good financial health of the company.

Income Statement

| | 2018 | 2017 | $ Changes | % Change |
|---|---|---|---|---|
| **Revenues** | | | | |
| Metered Billings | $ 3,419,028 | $3,028,769 | $390,259 | 13% |
| Service fee | 934,215 | 915,000 | 19,215 | 2% |
| | 4,353,243 | 3,943,769 | 409,474 | 10% |
| **Cost of Sales** | | | | |
| Contracts | 501,682 | 503,967 | (2,285) | 0% |
| Utilities | 627,270 | 609,423 | 17,847 | 3% |
| Amortization | 1,045,228 | 1,131,384 | 31,682 | 2% |
| | 2,174,180 | 2,136,129 | 38,051 | 2% |
| **Gross Margin** | **2,179,063** | **1,807,640** | **371,423** | **21%** |
| **General and Administration Expenses** | | | | |
| Salaries and benefits | 615,338 | 607,347 | 7,991 | 1% |
| Administration expenses | 90,676 | 60,600 | 30,076 | 50% |
| Insurance | 65,761 | - | 65,761 | 100% |
| Professional fees | 31,346 | 45,930 | (14,585) | (32%) |
| | 803,121 | 713,878 | 89,243 | 13% |
| **Net Income Before Other Items** | 1,375,942 | 1,093,763 | 282,179 | 26% |
| **Contributions and Financing Expense** | | | | |
| Developer contributions | 106,761 | 99,974 | 6,787 | 7% |
| Energy modeling review fee | 151,083 | 115,280 | 35,802 | 31% |
| Net finance cost | (143,154) | (267,462) | 124,309 | (46%) |
| | 114,690 | (52,208) | 166,898 | (320%) |
| **Net Income** | **$ 1,490,632** | **$1,041,554** | **$449,077** | **43%** |

| **Earnings before interest, taxes and amortization (EBITA)** | | | | |
|---|---|---|---|---|
| Net income per above | 1,490,632 | 1,041,554 | 449,077 | 43% |
| Financing expense | 420,009 | 332,644 | 87,365 | 26% |
| Amortization expense | 1,045,288 | 1,022,738 | 22,490 | 2% |
| **EBITA** | 2,955,868 | 2,396,936 | 558,932 | 23% |

The income statement provides a summary of the company's revenues, expenses and profits over the fiscal year of 2018. It reports the financial performance of the company.

*Year over Year Change*

The metered billings reflect the first full year of energy sales to the number of buildings which were connected partway through 2017. The actual sales are based on the actual customers' energy usage and consumption. The metered billings increased by $390,259 over 2017 mainly due to:

- An increase of $283,336 in OVDEU metered billings due to annual utility rate increase and full year service of existing buildings (Amacon Tempo, Onni Riva 3, and ASPAC 9); and
- An increase of $106,923 in ADEU metered billings due to annual utility rate increase and full year service of an existing building (Fire Hall #3).

The service fee of $934, 215 (2017 - $915,000) is for LIEC services of advancing district energy opportunities in the City, which results in the numerous benefits to the City and the local community. Staff and specialty consultants working on low carbon district energy initiatives are covered by the Service Fee. With or without LIEC, the City would need to fund these costs in order to successfully implement district energy initiatives for the City and position itself at the forefront of tackling local and global environmental challenges our world faces.

The cost of sales includes contract services, utilities (electricity and natural gas) and amortization expenses. The total cost of sales increased by $38,051 to $2,174,180 (2017 - $2,135,129). The increase is due to more energy sales to customers. The amortization expense increased due to capital assets additions.

The general and administration expenses are expenditures that LIEC incurs to engage in business development activities and includes salaries and benefits, administration expenses, insurance, professional fees. The general and administration expenses increased by $89,243 over 2017, mainly due to:

- Insurance – With district energy assets under LIEC, this is the first year that LIEC set up its own insurance program, resulting in an insurance expense of $65,761 (2017 – Nil). The DEU assets were insured under the City policy in 2017; and
- Administration expenses – A fee of $59,758 (2017 - $ 48,152), paid by LIEC to the City of Richmond for the support provided by the City.

The earnings before interest, taxes and amortization (EBITA) is a common industry benchmark to evaluate financial performance. The EBITA increased from $2,396,936 to $ 2,955,868. The increase in EBITA is due to an increase in customer base and efficient operations.

Overall, LIEC's revenues exceeded expenses resulting in a net income of $1,490,632. Compared to 2017, the net income has increased by $449,007 showing positive financial results of operations.

LIEC's financial sustainability and future growth must be taken into consideration when reviewing its EBITA and net income. LIEC's success is dependent upon developing in house expertise and securing funds for the future capital replacement as the existing infrastructure components reach end of life. Other important factors are the planning of future projects, which includes research and development, and exploratory reviews on future technology and opportunities. The net income will be set aside in LIEC's equity to build a reserve fund for future capital replacement and in order to ensure long term rate stability for rate payers.

Budget Variance
(See Attachment 1 for 2018 budget to actual comparison)

*Revenues*

The metered billings are the total energy sales of both ADEU and OVDEU service areas. The metered billings revenue was $1,820,981 from the Alexandra District Energy Utility (ADEU) and $1,598,048 from the Oval Village District Energy Utility (OVDEU). Overall, 2018 actual revenues of $3,419,028 are in line with the projected revenues, 1% above budget.

*Cost of Sales*

The Cost of Sales is the accumulated total of expenses attributable to the metered billing revenue, which includes contract services, utilities (electricity and natural gas), and amortization expenses. The contract expense is below budget by 23% mainly due to less unscheduled repairs and maintenance. The utility expenses are below the budget by 14%. The main driver is lower projected use of electricity and natural gas in the ADEU service area. Because ADEU is designed to maximize the use of renewable energy sources and peaking boilers are only used when renewable capacity is exceeded, electricity and natural gas use are greatly affected by seasonal heating demand. Moderate winter conditions in 2018 resulted in ADEU being able to meet practically all heating demand using renewable sources, resulting in very low utility consumption. Overall, the cost of sales of $2,174,180 is below the budget by 14%.

*General and Administration Expenses*

The general and administration expenses are expenditures that LIEC will incur to engage in business activities such as salaries and benefits, administration expense, professional fees, insurance expense, etc. Overall, there is a favourable variance with respect to expenses. The total general and administration expense of $803,121 is below the budget by 9%.

*Contributions and Financing Expense*

The contributions and financing expense section represents other sources of income and costs:

- Asset contributions (ETS fee) – this revenue refers to all the distribution piping system, energy transfer station and construction costs inside the property line of connected developments. These costs are paid by developers. In accordance to IFRS, the revenue of asset contributions (ETS fee) will be recognized over the useful life of the energy transfer stations from the date a section is available for use;

- Energy modeling review fee – The increase of $131,083 is due to very active developments in Richmond and more building permits being reviewed. The amount of the review fee is to cover district energy review costs and is based on the overall construction value of the project;
- Net finance cost – It is the net result of the finance cost on concession liabilities in the year offset by interest income and other recoveries. The finance cost on concession liabilities was in line with the budget. The interest income was above the budget due to earned higher interest on existing cash balances. The advanced payments received from developers for future developments resulted in higher cash balances in 2018. With the growing interest rate in 2018, the interest earned was higher than expected. The net finance cost was reduced by the recovery of administration cost as a result from successful negotiation with OVDEU concessionaire. Overall, the net financing cost of $143,154 was below the budget by 63%.

LIEC's overall financial performance exceeded the budget. Although LIEC is still in start-up phase, the financial statements show that LIEC's financial position is very good.

### Financial Impact

None.

### Conclusion

The Auditor's Report states that these financial statements present fairly, in all material respects, the financial position of Lulu Island Energy Company Ltd. as at December 31, 2018 and the financial performance, the changes in equity, and cash flows for the year then ended in accordance with International Financial Reporting standards.

Helen Zhao, CPA, CA
Controller
Lulu Island Energy Company
(604-276-4053)

Attachment 1: 2018 Actual and Budget Comparison
Attachment 2: 2018 Audited Financial Statements

## Attachment 1: 2018 Actual and Budget Comparison

| | Actual | Budget | $ Changes | % Change |
|---|---|---|---|---|
| **Revenues** | | | | |
| Metered Billings | $ 3,419,028 | $3,379,124 | $ 39,905 | 1% |
| Service fee | 934,215 | 934,215 | - | 0% |
| | 4,353,243 | 4,313,339 | 39,905 | 1% |
| **Cost of Sales** | | | | |
| Contracts | 501,682 | 655,569 | (153,887) | (23%) |
| Utilities | 627,270 | 732,313 | (105,043) | (14%) |
| Amortization | 1,045,228 | 1,131,384 | (86,156) | (8%) |
| | 2,174,180 | 2,519,266 | (345,086) | (14%) |
| **Gross margin** | **2,179,063** | **1,794,073** | **384,991** | **21%** |
| **General and Administration Expenses** | | | | |
| Salaries and benefits | 615,338 | 615,393 | (55) | 0% |
| Administration expenses | 90,676 | 133,516 | (42,840) | (32%) |
| Insurance | 65,761 | 65,000 | 761 | 1% |
| Professional Fees | 31,346 | 65,000 | (33,654) | (52%) |
| | 803,121 | 878,909 | (75,788) | (9%) |
| **Net income before other items** | 1,375,942 | 915,164 | 460,778 | 50% |
| **Contributions and Financing expense** | | | | |
| Developer contributions | 106,761 | 86,325 | 20,436 | 24% |
| Energy modeling review fee | 151,083 | 20,000 | 131,083 | 655% |
| Net finance income (cost) | (143,154) | (389,519) | 246,365 | (65%) |
| | 114,690 | (283,194) | 397,884 | (140%) |
| **Net Income** | **$ 1,490,632** | **$ 631,970** | **$ 858,662** | **136%** |

| **Earnings before interest, taxes and amortization (EBITA)** | | | | |
|---|---|---|---|---|
| Net income per above | 1,490,632 | 631,969 | 858,662 | 136% |
| Financing expense | 420,009 | 419,519 | 490 | 0% |
| Amortization expense | 1,045,228 | 1,131,384 | (86,166) | (8%) |
| **EBITA** | 2,955,868 | 2,182,872 | 772,996 | 35% |

## Attachment 2 – 2018 Audited Financial Statements

Financial Statements
(Expressed in Canadian dollars)

# LULU ISLAND ENERGY COMPANY LTD.

Year ended December 31, 2018

KPMG

KPMG LLP
Metro Tower I
4710 Kingsway, Suite 2401
Burnaby BC V5H 4M2
Canada
Telephone (604) 527-3600
Fax (604) 527-3636

# INDEPENDENT AUDITORS' REPORT

To the City of Richmond

## *Opinion*

We have audited the financial statements of Lulu Island Energy Company Ltd. (the Entity), which comprise:

- the statement of financial position as at December 31, 2018
- the statement of profit or loss and other comprehensive income for the year then ended
- the statement of changes in equity for the year then ended
- the statement of cash flows for the year then ended
- and notes to the financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Entity as at December 31, 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

## *Basis for Opinion*

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "Auditors' Responsibilities for the Audit of the Financial Statements" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other responsibilities in accordance with these requirements.

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

## *Responsibilities of Management and Those Charged with Governance for the Financial Statements*

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

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

## *Auditors' Responsibilities for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG LLP

Chartered Professional Accountants

Burnaby, Canada
April 18, 2019

# LULU ISLAND ENERGY COMPANY LTD.

Statement of Financial Position

December 31, 2018, with comparative information for 2017

| | | 2018 | | 2017 |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ | 1,640,019 | $ | 710,775 |
| Accounts receivable (note 6) | | 2,242,644 | | 1,487,917 |
| Other investments (note 7) | | 6,955,532 | | 5,516,738 |
| | | 10,838,195 | | 7,715,430 |
| Non-current assets: | | | | |
| Plant and equipment (note 8) | | 32,360,749 | | 32,032,788 |
| | $ | 43,198,944 | $ | 39,748,218 |
| **Liabilities and Shareholder's Equity** | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued liabilities | $ | 414,437 | $ | 256,582 |
| Current portion of deferred developer contributions (note 9) | | 106,761 | | 106,761 |
| Current portion of concession liability (note 10) | | 1,401,328 | | 1,187,000 |
| | | 1,922,526 | | 1,550,343 |
| Non-current liabilities: | | | | |
| Deferred developer contributions (note 9) | | 5,267,876 | | 3,521,677 |
| Concession liability (note 10) | | 6,228,776 | | 6,387,064 |
| | | 13,419,178 | | 11,459,084 |
| Shareholder's equity: | | | | |
| Share capital and contributed surplus (note 14) | | 27,397,115 | | 27,397,115 |
| Retained earnings | | 2,382,651 | | 892,019 |
| | | 29,779,766 | | 28,289,134 |
| | $ | 43,198,944 | $ | 39,748,218 |

See accompanying notes to financial statements.

Approved on behalf of the Board:

Director

Director

# LULU ISLAND ENERGY COMPANY LTD.

Statement of Profit or Loss and Other Comprehensive Income

Year ended December 31, 2018, with comparative information for 2017

| | 2018 | 2017 |
|---|---|---|
| Revenue (note 13) | $ 4,353,243 | $ 3,943,769 |
| Cost of sales: | | |
| Operating expenses | 1,128,952 | 1,113,391 |
| Depreciation | 1,045,228 | 1,022,738 |
| | 2,174,180 | 2,136,129 |
| Gross profit | 2,179,063 | 1,807,640 |
| General and administrative expenses | 803,121 | 713,878 |
| Net income before undernoted items | 1,375,942 | 1,093,762 |
| Developer contributions, other income and net finance cost: | | |
| Developer contributions | 106,761 | 99,974 |
| Other income (note 13) | 151,083 | 115,280 |
| Net finance cost (note 5) | (143,154) | (267,462) |
| | 114,690 | (52,208) |
| Net income and comprehensive income | $ 1,490,632 | $ 1,041,554 |

See accompanying notes to financial statements.

# LULU ISLAND ENERGY COMPANY LTD.

Statement of Changes in Equity

Year ended December 31, 2018, with comparative information for 2017

| | Share capital | Contributed surplus | Retained earnings (deficit) | Shareholder's equity |
|---|---|---|---|---|
| Balance, January 1, 2017 | $ 1 | $ 23,157,226 | $ (149,535) | $ 23,007,692 |
| Issuance of common shares | 4 | - | - | 4 |
| Net income and comprehensive income | - | - | 1,041,554 | 1,041,554 |
| Contributed surplus (note 13(a)) | - | 4,239,884 | - | 4,239,884 |
| Balance, December 31, 2017 | 5 | 27,397,110 | 892,019 | 28,289,134 |
| Net income and comprehensive income | - | - | 1,490,632 | 1,490,632 |
| Balance, December 31, 2018 | $ 5 | $ 27,397,110 | $ 2,382,651 | $ 29,779,766 |

See accompanying notes to financial statements.

# LULU ISLAND ENERGY COMPANY LTD.

Statement of Cash Flows

Year ended December 31, 2018, with comparative information for 2017

| | 2018 | 2017 |
|---|---|---|
| Cash provided by (used in): | | |
| Operations: | | |
| Net income | $ 1,490,632 | $ 1,041,554 |
| Adjustments for: | | |
| Depreciation | 1,045,228 | 1,022,738 |
| Recognition of deferred contributions | (106,761) | (99,974) |
| Finance expense | 420,009 | 332,643 |
| Change in non-cash working capital: | | |
| Accounts receivable | (754,727) | (844,989) |
| Accounts payable and accrued liabilities | 157,855 | 171,616 |
| Deferred developer contributions | 1,852,960 | 826,977 |
| Net change in cash from operating activities | 4,105,196 | 2,450,565 |
| Investments: | | |
| Additions to plant and equipment | (1,065,437) | (359,428) |
| Purchase of investments | (1,438,794) | (5,516,738) |
| Net change in cash from investing activities | (2,504,231) | (5,876,166) |
| Financing: | | |
| Issuance of common shares | - | 4 |
| Contributed surplus | - | 4,198,040 |
| Concession liability | (671,721) | (232,026) |
| Net change in cash from financing activities | (671,721) | 3,966,018 |
| Net change in cash | 929,244 | 540,417 |
| Cash and cash equivalents, beginning of year | 710,775 | 170,358 |
| Cash and cash equivalents, end of year | $ 1,640,019 | $ 710,775 |
| Non-cash items: | | |
| Transfer of plant and equipment from shareholder | $ - | $ 41,844 |

See accompanying notes to financial statements.

## 1. Incorporation and nature of business:

The Lulu Island Energy Company Ltd. (the "Company") was incorporated on August 19, 2013 under the Business Corporations Act of British Columbia as a municipal corporation wholly-owned by the City of Richmond (the "City"). The address of the Company's registered office is 6911 No. 3 Road, Richmond, British Columbia, V6Y 2C1.

The business of the Company is to develop, manage and operate district energy utilities in the City, including but not limited to energy production, generation or exchange, transmission, distribution, maintenance, marketing and sale to customers, customer service, profit generation and financial management. The Company also provides advisory services for energy and infrastructure.

## 2. Basis of presentation:

(a) Statement of compliance:

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") as issued by the International Accounting Standards Board ("IASB").

The financial statements were approved and authorized for issue by the Board of Directors April 18, 2019.

(b) Basis of measurement:

The financial statements have been prepared on the historical cost basis and on a going concern basis.

(c) Presentation of financial statements:

The Company uses a classified statement of financial position. The statement of financial position distinguishes between current and non-current assets and liabilities. Current assets and liabilities are those expected to be recovered within twelve months from the reporting date and non-current assets and liabilities are those where the recovery is expected to occur more than twelve months from the reporting date. The Company classifies the statement of comprehensive income using the function of expense method, which classifies expenses according to their functions, such as cost of sales and general and administrative expenses.

(d) Functional and presentation currency:

The financial statements are presented in Canadian dollars, which is the Company's functional currency.

**2. Basis of presentation (continued):**

(e) Use of estimates and judgments:

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

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

Note 9 - recognition of deferred developer contributions

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are included in the following notes:

Note 8 - useful lives of plant and equipment

Note 12 - determination of the future minimum obligations and commitments for the concession liability.

**3. Significant accounting policies:**

The accounting policies set out below have been applied consistently to all years presented in these financial statements, unless otherwise indicated.

(a) Plant and equipment:

(*i*) Recognition and measurement:

Items of plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes amounts that are directly attributable to acquisition, construction, development, or betterment of the asset. The cost of self-constructed assets include the cost of materials and direct labor, any other costs directly attributable to bringing the assets to a working condition for their intended use and borrowing costs on qualifying assets.

**3. Significant accounting policies (continued):**

(a) Plant and equipment (continued):

(*i*) Recognition and measurement (continued):

Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

When parts of an item of plant and equipment have different useful lives, they are accounted for as separate items (major components) of plant and equipment.

Gains and losses on disposal of an item of plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of plant and equipment, and are recognized net within other income in profit and loss.

(*ii*) Subsequent costs:

The cost of replacing a part of an item of plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The cost of the day-to-day servicing of plant and equipment are recognized in profit or loss as incurred.

(*iii*) Depreciation:

Depreciation is calculated over the depreciable amount, which is the cost of an asset less its residual value.

Depreciation of plant and equipment commences when the asset is deemed available for use and is recognized in profit and loss on a straight-line basis over the estimated useful lives of each part of an item of plant and equipment as follows:

| Asset | Useful life - years |
|---|---|
| Energy plant center | 75 |
| Distribution piping | 50 |
| General equipment | 25 |

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

**3. Significant accounting policies (continued):**

(b) Revenue recognition:

The Company adopted IFRS 15, *Revenue from Contracts with Customers* on January 1, 2018. IFRS 15 replaced IAS 11 *Construction Contracts,* IAS 18 *Revenue* and related interpretations ("IAS 18").

The Company has adopted IFRS 15 using the cumulative effect method (without practical expedients), with the effect of initially applying this standard recognized at the date of initial application, January 1, 2018. Accordingly, the information presented for 2017 has not been restated. It is presented, as previously reported, under IAS 18 and related interpretations.

The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. There was no impact as a result of adoption of the standard.

The Company recognizes revenue for the provision of energy and supply of other services. Revenue for the provision of energy is based on meter readings and is billed on a cyclical basis. Revenue is accrued for energy delivered but not yet billed. Revenue for other services is recognized upon completion of service. Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured, regardless of when payment is made. Revenue is measured at the fair value of the consideration received or receivable.

(c) Public-private partnership project:

Public-private partnership ("P3") projects are delivered by private sector partners selected to design, build, finance, and maintain the assets. The cost of the assets under construction are recorded at cost, based on construction progress billings and also includes other costs, if any, incurred directly by the Company.

When deemed available for use, the project assets are amortized over their estimated useful lives. Correspondingly, an obligation for the cost of capital and financing received to date, net of the developer contributions received and repayments, is recorded under concession liabilities (note 10).

(d) Income taxes:

Under Section 149(1) (d) of the Income Tax Act, the Company is exempt from income and capital taxes by virtue of the fact that it is a wholly owned subsidiary of the City. Accordingly, no provision for such taxes has been made in financial statements.

(e) Cash and cash equivalents:

Cash and cash equivalents comprise cash balances and call deposits with original maturities of three months or less. At December 31, 2018 all cash and cash equivalents related to cash balances (2017 – cash balances).

**3. Significant accounting policies (continued):**

(f) Finance income and finance cost:

Finance income comprises interest on funds invested. Interest income is recognized as it accrues in profit or loss, using the effective interest method.

Finance costs comprise interest expense on borrowings and impairment losses recognized on financial assets. Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognized in profit or loss using the effective interest method.

(g) Financial instruments:

The Company adopted IFRS 9, *Financial Instruments* on January 1, 2018.

The Company had adopted IFRS 9 with retrospective application taking exemption from restatement of financial assets and financial liabilities already derecognized on initial application.

IFRS 9 sets out requirements for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39").

(*i*) Classification and measurement of financial assets and financial liabilities:

IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities at amortized cost using the effective interest method. However, it eliminates the previous IAS 39 categories for financial assets of held to maturity, loans and receivables and available for sale.

The adoption of IFRS 9 has not had a significant effect on the Company's accounting policies related to financial liabilities. The impact of IFRS 9 on the classification and measurement of financial assets is set out below.

Under IFRS 9, on initial recognition, a financial asset is classified as measured at: amortized cost, fair value through other comprehensive income ("FVOCI") - debt instrument, FVOCI - equity instrument, or fair value through profit or loss ("FVTPL"). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics.

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

**3. Significant accounting policies (continued):**

(g) Financial instruments (continued):

(*i*) Classification and measurement of financial assets and financial liabilities (continued):

A debt investment is measured at FVOCI if it meets both of the following conditions and is not designated as FVTPL:

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Company may irrevocably elect to present subsequent changes in the investment's fair value in OCI. This election is made on an investment-by-investment basis.

All financial assets not classified as measured at amortized cost or FVOCI as described above are measured at FVTPL. On initial recognition, the Company may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized costs or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

A financial asset (unless it is a trade receivable without a significant financing component that is initially measured at the transaction price) is initially measured at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition.

The following accounting policies apply to subsequent measurement of financial assets:

- Financial assets at FVTPL: these assets are subsequent measured at fair value. Net gains and losses, including any interest or dividend income, are recognized in profit or loss.
- Financial assets at amortized cost: these assets are subsequently measured at amortized costs using the effective interest method. The amortized cost is reduced by impairment losses (see note 3(g)(ii)). Interest income and impairment are recognized in profit or loss. Any gain or loss on derecognition is recognized in profit or loss.
- Debt investments at FVOCI: these assets are subsequently measured at fair value. Interest income calculated using the effective interest method and impairment are recognized in profit or loss. Other net gains are recognized in OCI. On derecognition, gains and losses accumulated in OCI are reclassified to profit or loss.
- Equity investments at FVOCI: these assets are subsequently measured at fair value. Dividends are recognized as income in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment. Other net gains and losses are recognized in OCI and are never reclassified to profit or loss.

**3. Significant accounting policies (continued):**

(g) Financial instruments (continued):

(*i*) Classification and measurement of financial assets and financial liabilities (continued):

The following table show the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Company's financial assets as at January 1, 2018.

| | New classification Under IFRS 9 | Original classification under IAS 39 |
|---|---|---|
| **Financial assets** | | |
| Cash and cash equivalents | Amortized cost | Loans and receivables |
| Accounts receivable | Amortized cost | Loans and receivables |
| Other investments | Amortized cost | Loans and receivables |
| **Financial liabilities** | | |
| Accounts payable and accrued liabilities | Other financial liabilities | Other financial liabilities |
| Concession liability | Other financial liabilities | Other financial liabilities |

On adoption of IFRS 9, no changes in the carrying amounts of the financial assets have been recorded.

(*ii*) Measurement categories:

The following table shows the carrying values of assets and liabilities for each of these categories at December 31, 2018, and 2017. Unless otherwise noted, the fair values on the instruments approximate their carrying amount due to their short-term nature and / or due to application of market rates of interest.

| | 2018 | 2017 |
|---|---|---|
| **Financial Assets:** | | |
| Financial assets at amortized cost: | | |
| Cash and cash equivalents | $ 1,640,019 | $ 710,775 |
| Accounts receivable | 2,242,644 | 1,487,917 |
| Other investments | 6,955,532 | 5,516,738 |
| | $ 10,838,195 | $ 7,715,430 |
| **Financial Liabilities:** | | |
| Financial liabilities at amortized cost: | | |
| Accounts payable and accrued liabilities | $ 414,437 | $ 256,582 |
| Concession liability | 7,630,104 | 7,574,064 |
| | $ 8,044,541 | $ 7,830,646 |

**3. Significant accounting policies (continued):**

(h) Impairment:

(*i*) Financial assets:

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' ("ECL") model. The new impairment model applies to financial assets measured at amortized cost, contract assets and debt investments at FVOCI, but not to investments in equity instruments. Under IFRS 9, credit losses are recognized earlier than under IAS 39.

The financial assets at amortized cost consist of cash and cash equivalents, accounts receivable and other investments.

Under IFRS 9, loss allowances are measured on either of the following bases:

- 12-month ECLs: these are ECLs that result from possible default events within the 12 months after the reporting date; and
- Lifetime EFLs: these are ECLs that result from all possible default events over the expected life of a financial instrument.

The Company measures loss allowances at an amount equal to lifetime ECLs. The Company has elected to measure loss allowances for accounts receivable at an amount equal to lifetime ECLs.

Measurement of ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Company expects to receive).

On adoption of IFRS 9, there was no change to the impairment of the Company's financial assets.

(*ii*) Non-financial assets:

The carrying amounts of the Company's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit, or CGU").

**3. Significant accounting policies (continued):**

(h) Impairment (continued):

(*ii*) Non-financial assets (continued):

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

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(i) Pension benefits:

The Company and its employees participate in the Municipal Pension Plan, a multi-employer defined benefit plan. Defined contribution plan accounting is applied to this plan because separate information for the Company is unable to be provided to apply defined benefit accounting. The expenses associated with this plan are equal to the actual contributions required by the Company during the reporting period.

(j) Standards issued but not yet effective:

(*i*) IFRS 16 Leases:

On January 13, 2016 the IASB issued IFRS 16 Leases. The new standard is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial adoption of IFRS 16. IFRS 16 will replace IAS 17 Leases.

This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments.

This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors.

Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided.

The Company intends to adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2019. The Company has evaluated the standard and the impact of adoption is not expected to have a material impact on the financial statements of the Company.

## 4. Personnel expenses:

| | 2018 | 2017 |
|---|---|---|
| Wages and salaries | $ 611,625 | $ 578,697 |
| Other payroll expenses | 3,713 | 28,650 |
| | $ 615,338 | $ 607,347 |

## 5. Net finance cost:

| | 2018 | 2017 |
|---|---|---|
| Finance income: | | |
| Investment interest | $ 149,435 | $ 55,587 |
| Bank interest | 29,520 | 6,902 |
| Other | 97,900 | 2,692 |
| | 276,855 | 65,181 |
| Finance cost: | | |
| Finance expense on concession liability | (420,009) | (332,643) |
| Net finance cost | $ (143,154) | $ (267,462) |

## 6. Accounts receivable:

| | 2018 | 2017 |
|---|---|---|
| Trade receivables (note 13) | $ 1,375,799 | $ 373,929 |
| Unbilled trade receivables | 852,840 | 1,094,777 |
| Sales tax receivable | 14,005 | 19,211 |
| | $ 2,242,644 | $ 1,487,917 |

## 7. Other investments:

Investments represent cash term deposits as follows:

| Purchase date | Maturity date (interest rate) | 2018 |
|---|---|---|
| May 12, 2018 | May 12, 2019 (2.80%) | $ 2,072,391 |
| June 5, 2018 | June 5, 2019 (2.80%) | 1,016,033 |
| Aug 23, 2018 | Aug 23, 2019 (2.85%) | 1,515,226 |
| Nov 28, 2018 | Feb 26, 2019 (2.30%) | 302,442 |
| Nov 28, 2018 | Nov 28, 2019 (3.00%) | 1,548,656 |
| Dec 07, 2018 | June 5, 2019 (2.60%) | 500,784 |
| | | $ 6,955,532 |

## 8. Plant and equipment:

| | Energy plant centre | General equipment | Distribution piping | Total |
|---|---|---|---|---|
| *Cost:* | | | | |
| Balance as at January 1, 2017 | $ 5,031,915 | $ 20,043,182 | $ 6,463,548 | $ 31,538,645 |
| Additions | - | 703,368 | 1,096,236 | 1,799,604 |
| Balance as at December 31, 2017 | $ 5,031,915 | $ 20,746,550 | $ 7,559,784 | $ 33,338,249 |
| Additions | - | 764,247 | 608,942 | 1,373,189 |
| Balance as at December 31, 2018 | $ 5,031,915 | $ 21,510,797 | $ 8,168,726 | $ 34,711,438 |
| *Accumulated depreciation:* | | | | |
| Balance as at January 1, 2017 | $ - | $ 237,203 | $ 45,520 | $ 282,723 |
| Depreciation | 67,092 | 812,936 | 142,710 | 1,022,738 |
| Balance as at December 31, 2017 | $ 67,092 | $ 1,050,139 | $ 188,230 | $ 1,305,461 |
| Depreciation | 67,092 | 828,882 | 149,254 | 1,045,228 |
| Balance as at December 31, 2018 | $ 134,184 | $ 1,879,021 | $ 337,484 | $ 2,350,689 |
| *Net book value:* | | | | |
| At January 1, 2017 | $ 5,031,915 | $ 19,805,979 | $ 6,418,028 | $ 31,255,922 |
| At December 31, 2017 | 4,964,823 | 19,696,411 | 7,371,554 | 32,032,788 |
| At December 31, 2018 | 4,897,731 | 19,631,776 | 7,831,242 | 32,360,749 |

Included in plant and equipment is $1,494,780 (2017 - $127,055) of assets under construction being $788,741 (2017 - $29,957) general equipment and $706,039 (2017 - $97,098) distribution piping. For the year ended December 31, 2018, capitalized borrowing costs related to the construction of the distribution system amounted to be nil (2017 - $43,935).

## 9. Deferred developer contributions:

The Company defers contribution amounts received from developers related to the cost of initial connection, including installation of the energy transfer station. The developer contributions are recognized over the useful life of the associated general equipment from the date the respective building is deemed available to use.

The following table summarizes the amounts recognized as at year end:

| | 2018 | 2017 |
|---|---|---|
| Deferred developer contributions, beginning of year | $ 3,628,438 | $ 2,785,654 |
| Developer contributions received | 1,852,960 | 1,011,793 |
| Recognized revenue from developer contributions | (106,761) | (169,009) |
| | 5,374,637 | 3,628,438 |
| Less: current portion of deferred developer contributions | 106,761 | 106,761 |
| Non-current deferred developer contributions | $ 5,267,876 | $ 3,521,677 |

## 10. Oval Village District Energy Utility ("OVDEU") Concession Agreement:

On October 30, 2014, the Corporation and the OVDEU developer ("the Concessionaire") entered into a 30 year Concession Agreement, which is a public-private partnership project ("P3"), where the Concessionaire will design, construct, finance, operate and maintain the infrastructure for the district energy utility at the Oval Village community. The total estimated concession liability to finance the construction of the OVDEU at full build out is $38,344,000 (2017 - $31,931,000) and will be accrued over time as the services are rendered.

The Concession Agreement is payable monthly in accordance with the Concession Agreement terms. Required concession liability payment obligations are disclosed in note 12.

OVDEU Concession Agreement liability:

| | 2018 | 2017 |
|---|---|---|
| Concession Agreement liability – capital | $ 6,605,178 | $ 6,548,070 |
| Concession Agreement liability – non-capital | 1,024,926 | 1,025,994 |
| | 7,630,104 | 7,574,064 |
| Less: current capital portion of concession liability | 609,742 | 551,617 |
| Less: current non-capital portion of concession liability | 791,586 | 635,383 |
| Non-current portion of concession liability | $ 6,228,776 | $ 6,387,064 |

The average finance cost on the concession liability is 5.50% for the year ended December 31, 2018 (2017 - 5.50%).

**10. Oval Village District Energy Utility ("OVDEU") Concession Agreement (continued):**

The concession liability is repayable as follows:

| | |
|---|---|
| 2019 | $ 1,401,328 |
| 2020 | 1,457,381 |
| 2021 | 1,515,676 |
| 2022 | 1,576,303 |
| 2023 and thereafter | 1,679,416 |
| Total | $ 7,630,104 |

The following tables summarizes the changes in the concession liability due to financing cash flows and liability related charges:

| | |
|---|---|
| Balance January 1, 2018 | $ 7,574,064 |
| Additions | 307,755 |
| Finance expense | 420,009 |
| Net repayment | (671,724) |
| Balance December 31, 2018 | $ 7,630,104 |

**11. Limited Guarantee Agreement:**

On October 30, 2014, the Concessionaire and the City entered into a Limited Guarantee Agreement. The City is the Guarantor and guarantees the performance of some of the Company's obligations under the Concession Agreement to a maximum of $18.2 million (2017 - $18.2 million).

**12. Commitments and contingencies:**

*Public-private partnership commitments:*

Payments to the Concessionaire under the Concession Agreement are based on the Concessionaire's Annual Revenue Requirement, which is based on the utility cost of service rate-setting principles in British Columbia utilizing forward test years. The Annual Revenue Requirement is a combination of Capital and Operating charges. The Capital charge is comprised of capital expenditures and depreciation, and Operating charge is comprised of services costs, financing costs, income and other taxes and return on equity.

**12. Commitments and contingencies (continued):**

*Public-private partnership commitments (continued):*

The information presented below shows the expected committed cash outflow for the next year under the Concession Agreement for the capital and operating costs of the assets. As construction progresses the asset values are recorded as plant and equipment and the corresponding liabilities are recorded as concession agreement liabilities as disclosed in note 10.

| | Capital commitment | Operating commitment | Total commitment |
|---|---|---|---|
| 2018 | $ 609,742 | $ 791,586 | $ 1,401,328 |

**13. Related party transactions:**

Included in these financial statements are transactions with various Crown corporations, ministries, agencies, boards and commissions related to the Company by virtue of common control by the City, the Province of British Columbia or the Government of Canada. The Company has applied the modified disclosure requirements under IAS 24, *Related Party Disclosures*, which is only applicable for government-related entities.

(a) Transactions with City of Richmond

During 2018, the Company received and recognized in revenues $934,215 (2017 - $915,000) for its services of advancing district energy opportunities in the City. Staff and advanced design activities on low carbon district energy initiatives are covered by this fee. With or without the Company, the City would need to fund these costs in order to successfully implement district energy initiatives for the City and position itself at the forefront of tackling local and global environmental challenges our world faces.

In addition, included in revenue for 2018 is $33,482 (2017 – $29,972) for district energy utility services rendered by the Company to the City.

During 2018, the Company received and recognized energy model review fees into other income of $151,083 (2017 - $115,280) relating to district energy permit fees collected by the City for in-building district energy related equipment reviews performed by the Company.

During 2018, $157,085 (2017 – $93,560) of salary and benefit expenses were charged to the City for the costs incurred due to Company staff being assigned to perform project management duties for the City projects. These costs have been charged to the City on a cost recovery basis and are included as a reduction to general and administrative expenses.

The total amount due from City of Richmond as a result of the above transactions as at December 31, 2018 is $1,375,799 (2017 – $360,766) and is included within trade receivables in accounts receivable.

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.

**13. Related party transactions (continued):**

(b) Key management personnel:

The Company did not enter into any transactions with key management personnel in the year ended December 31, 2018 (2017 - none).

No key management personnel are remunerated by the Company. A fee of $59,758 (2017 - $48,152), included in general and administration expenses, was paid to the City for the day-to-day support that the Company received from the City staff over the year. These costs have been charged to the Company on a cost recovery basis and include an element of re-charge for City key management personnel.

**14. Share capital:**

At December 31, 2018, the authorized share capital comprised 10,000 (2017 - 10,000) common shares without par value.
As at December 31, 2018, the Company has issued 450 common shares (2017- 450) at $0.01 per share totaling $4.50 (2017 - $4.50) and contributed surplus of $27,397,110 (2017 - $27,397,110).

**15. Fair values:**

The Company uses the following hierarchy to determine and disclose fair value of financial instruments:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities; and
- Level 2 - inputs other than quoted prices that are observable for asset or liability, either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability might be categorized in different levels of fair value hierarchy, then the fair value measurement is categorized in its entirely in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

(a) Financial assets and liabilities not measured at fair value:

The carrying amounts for cash and cash equivalents, accounts receivable, other investments, accounts payable and accrued liabilities approximate their fair values due to their short-term nature.

(b) Non-current financial liabilities:

Subsequent to initial recognition the concession liability is accounted for at amortized cost using the effective interest method. The carrying amount of the concession liability approximates its fair value due to the nature of liabilities accrued and benchmark market rate of interest rate applied (level 3 inputs).

**16. Financial risk management and financial instruments:**

(a) Overview:

The Company has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk (interest rate risk).

(b) Risk management framework:

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The management reports regularly to the Board of Directors on its activities.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. The Company, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

(c) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Such risks arise principally from certain financial assets held by the Company consisting of its cash and cash equivalents, trade accounts receivables and other investments. The Company assesses these financial assets on a continuous basis for any amounts that are not collectible or realizable. It is management's opinion that the Company is not exposed to significant credit risk from its financial instruments.

(*i*) Trade and unbilled trade receivables:

The Company trades mainly with recognized and creditworthy third parties. It is the Company's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Company's exposure to bad debts is not significant.

The Company establishes an allowance for doubtful accounts that represents its estimate of incurred losses in respect of trade and other receivables based upon factors surrounding the credit risk of specific accounts, historical trends and other information.

At December 31, 2018 and 2017 all trade and other receivables were neither past due (current) nor impaired and related to end-user customers in the City's geographic region or services provided to the City.

(*ii*) Other investments:

Credit risk arising from other financial assets of the Company comprises cash and cash equivalents and other investments. The Company's exposure to credit risk arises from default of the counterparties. The Company manages credit risk through investing only in cash term deposits with established financial institutions which are considered to be low risk.

## 16. Financial risk management and financial instruments (continued):

(d) Liquidity risk:

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Company's approach to managing liquidity is continually monitoring actual and forecasted cash flows from operations and anticipated investing and financing activities 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 Company's reputation.

The Company's terms of business require amounts to be paid from customers within 30-days of the date of invoice. The accounts payable and accrued liabilities and due from the City are in the normal course of operations and paid within the following fiscal year. The commitments under the concession liability are disclosed in note 12.

The information presented below shows the undiscounted contractual maturities of the concession liability, including estimated interest payments.

| | Carrying amount | Contractual cash flow | Less than 1 year | 1 – 2 years | 2 – 5 years |
|---|---|---|---|---|---|
| December 31, 2018 | $ 7,630,104 | $ 8,793,982 | $ 1,439,485 | $ 1,579,702 | $ 5,774,795 |
| December 31, 2017 | 7,574,064 | 8,713,553 | 1,219,206 | 1,598,346 | 5,896,001 |

(e) Market risk:

Market risk is the risk that changes in market prices, such as interest rates and other rate risks, will affect the Company's income or the value of its holdings of financial instruments.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

Interest rate risk is the risk that the fair value of future cash flow of a financial instrument will fluctuate because of changes in the market interest rate.

It is management's opinion that the Company is not exposed to significant market (interest rate) risk from its financial instruments.

## 17. Capital management:

The Company's objective when managing capital is to maintain a strong capital base to sustain future development of the business, so that it can provide return for the shareholder and benefits for other stakeholders.

The Company considers the items included in shareholder's equity and the concession liability as capital. The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may request additional investment from its shareholder. The Company is not required to meet any debt covenants. The Company is not subject to externally imposed capital requirements. There were no changes in the Company's approach to capital management during the year (2017 - no changes).

## 18. Pension plan:

The Company and its employees contribute to the Municipal Pension Plan (a jointly trusteed pension plan). The board of trustees, representing plan members and employers, is responsible for administering the plan, including investment of assets and administration of benefits. The plan is a multi-employer defined benefit pension plan. Basic pension benefits are based on a formula. As at December 31, 2017, the plan has about 197,000 active members and approximately 95,000 retired members. Active members include approximately 39,000 contributors from local governments.

Every three years, an actuarial valuation is performed to assess the financial position of the plan and adequacy of plan funding. The actuary determines an appropriate combined employer and member contribution rate to fund the plan. The actuary's calculated contribution rate is based on the entry- age normal cost method, which produces the long-term rate of member and employer contributions sufficient to provide benefits for average future entrants to the plan. This rate may be adjusted for the amortization of any actuarial funding surplus and will be adjusted for the amortization of any unfunded actuarial liability.

The most recent valuation for the Municipal Pension Plan as at December 31, 2015, indicated a $2,224 million funding surplus for basic pension benefits on a going concern basis. As a result of the 2015 basic account actuarial valuation surplus and pursuant to the joint trustee agreement, $1,927 million was transferred to the rate stabilization account and $297 million of the surplus ensured the required contribution rates remained unchanged.

The Company paid $63,598 (2017 - $40,148) for employer contributions to the Plan in 2018.
The next valuation will be at December 31, 2018, with results available in 2019. Employers participating in the plan record their pension expense as the amount of employer contributions made during the fiscal year (defined contribution pension plan accounting).

## 19. Comparative information:

Certain 2017 comparative information has been reclassified to conform to the financial statement presentation adopted for 2018.