

**FORTISALBERTA INC.**

**Unaudited Interim Financial Statements  
For the three and six months ended June 30, 2014**

## BALANCE SHEETS (UNAUDITED)

As at (all amounts in thousands of Canadian dollars)	June 30, 2014	December 31, 2013
<b>Assets</b>		
Current assets		
Accounts receivable	\$ 108,970	\$ 127,906
Prepays and deposits	6,011	4,370
Income tax receivable	8,545	-
Deferred income tax	7,194	9,853
Regulatory assets (note 3)	1,966	3,017
	132,686	145,146
Accounts receivable	25	619
Income tax receivable	1,603	1,538
Regulatory assets (note 3)	180,883	158,130
Property, plant and equipment	2,771,041	2,695,211
Intangible assets	46,441	48,745
Transaction costs	10,967	11,174
Goodwill	226,968	226,968
	\$ 3,370,614	\$ 3,287,531
<b>Liabilities and Shareholder's Equity</b>		
Current liabilities		
Short-term borrowings	\$ 329	\$ 24,830
Accounts payable and other current liabilities	162,131	167,758
Current installments of long-term debt	200,000	200,000
Income tax payable	-	100
Regulatory liabilities (note 3)	81,471	41,510
	443,931	434,198
Other liabilities	19,532	19,273
Regulatory liabilities (note 3)	353,622	358,095
Deferred income tax	120,826	101,670
Long-term debt	1,259,008	1,259,000
	2,196,919	2,172,236
<b>Shareholder's Equity</b>		
Share capital, no par value, unlimited authorized shares, 63 shares issued and outstanding (December 31, 2013 - 63)	173,848	173,848
Additional paid-in capital	674,896	639,896
Accumulated other comprehensive loss	(3,060)	(3,187)
Retained earnings	328,011	304,738
	1,173,695	1,115,295
	\$ 3,370,614	\$ 3,287,531

The accompanying notes are an integral part of these interim financial statements.

# STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

(all amounts in thousands of Canadian dollars)	Three Months Ended		Six Months Ended	
	2014	June 30, 2013	2014	June 30, 2013
<b>Revenues</b>				
Electric rate revenue	\$ 124,403	\$ 113,519	\$ 247,893	\$ 226,730
Other revenue	3,710	3,317	7,065	8,647
	128,113	116,836	254,958	235,377
<b>Expenses</b>				
Cost of sales (exclusive of items shown separately below)	41,926	38,411	85,135	78,690
Depreciation	36,046	31,460	71,810	63,320
Amortization	4,981	4,376	9,877	8,572
	82,953	74,247	166,822	150,582
Other income	53	-	1,410	1,729
Income before interest expense and income taxes	45,213	42,589	89,546	86,524
Interest expense	20,163	18,417	39,180	35,195
Income before income taxes	25,050	24,172	50,366	51,329
Income taxes				
Current income tax recovery	(3,718)	(388)	(4,810)	(801)
Deferred income tax expense	3,416	483	4,403	1,285
	(302)	95	(407)	484
<b>Net Income</b>	\$ 25,352	\$ 24,077	\$ 50,773	\$ 50,845
Other comprehensive income				
Reclassification of other post-employment benefit items	64	71	127	143
<b>Comprehensive Income</b>	\$ 25,416	\$ 24,148	\$ 50,900	\$ 50,988

The accompanying notes are an integral part of these interim financial statements.

## STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY (UNAUDITED)

(all amounts in thousands of Canadian dollars)	Three Months Ended		Six Months Ended	
	2014	June 30, 2013	2014	June 30, 2013
<b>Share Capital</b>				
Balance, beginning of period	\$ 173,848	\$ 173,848	\$ 173,848	\$ 173,848
Share capital issued	-	-	-	-
Balance, end of period	\$ 173,848	\$ 173,848	\$ 173,848	\$ 173,848
<b>Additional Paid-in Capital</b>				
Balance, beginning of period	\$ 639,896	\$ 544,896	\$ 639,896	\$ 544,896
Equity contributions	35,000	55,000	35,000	55,000
Balance, end of period	\$ 674,896	\$ 599,896	\$ 674,896	\$ 599,896
<b>Accumulated Other Comprehensive Loss</b>				
Balance, beginning of period	\$ (3,124)	\$ (4,104)	\$ (3,187)	\$ (4,176)
Reclassification of other post-employment benefit items	64	71	127	143
Balance, end of period	\$ (3,060)	\$ (4,033)	\$ (3,060)	\$ (4,033)
<b>Retained Earnings</b>				
Balance, beginning of period	\$ 316,409	\$ 275,274	\$ 304,738	\$ 261,006
Net income	25,352	24,077	50,773	50,845
Dividends	(13,750)	(12,500)	(27,500)	(25,000)
Balance, end of period	\$ 328,011	\$ 286,851	\$ 328,011	\$ 286,851
<b>Total Shareholder's Equity</b>	\$ 1,173,695	\$ 1,056,562	\$ 1,173,695	\$ 1,056,562

The accompanying notes are an integral part of these interim financial statements.

## STATEMENTS OF CASH FLOWS (UNAUDITED)

(all amounts in thousands of Canadian dollars)	Three Months Ended		Six Months Ended	
	2014	June 30, 2013	2014	June 30, 2013
<b>Operating Activities</b>				
Net income	\$ 25,352	\$ 24,077	\$ 50,773	\$ 50,845
Non-cash items included in net income:				
Depreciation	36,046	31,460	71,810	63,320
Amortization	5,195	4,589	10,304	8,995
Deferred income tax	3,416	483	4,403	1,285
Equity component of allowance for funds used during construction	-	-	(1,357)	(1,729)
Gain on sale of property, plant and equipment	(53)	-	(53)	-
Changes in operating assets and liabilities and non-cash working capital balances:				
Current:				
Accounts receivable	9,404	7,682	13,875	5,841
Prepays and deposits	(1,943)	(2,133)	(1,641)	(1,936)
Income tax receivable and payable	(5,574)	(3,127)	(8,645)	(7,804)
Regulatory assets	(1,323)	369	1,051	(5,393)
Accounts payable and other current liabilities	(5,033)	6,060	(1,394)	(58,255)
Regulatory liabilities	16,097	(3,107)	39,928	37,960
Non-current:				
Income tax receivable	(12)	2	(65)	(92)
Regulatory assets	(2,716)	(1,778)	(5,308)	(4,251)
Other liabilities	164	2,561	259	2,444
Regulatory liabilities	(21,783)	(9,290)	(13,742)	(22,653)
Cash from operating activities	57,237	57,848	160,198	68,577
<b>Investing Activities</b>				
Property, plant and equipment	(79,602)	(131,277)	(155,508)	(225,005)
Customer contributions for property, plant and equipment	5,684	13,394	17,828	20,762
Intangible assets	(3,189)	(1,415)	(6,171)	(4,506)
Proceeds from the sale of property, plant and equipment	802	323	1,060	766
Net change in employee loans	193	131	(320)	(226)
Cash used in investing activities	(76,112)	(118,844)	(143,111)	(208,209)
<b>Financing Activities</b>				
Change in short-term borrowings	(2,326)	-	(4,501)	-
Long-term debt issuance costs	(4)	(45)	(37)	(64)
Net borrowings under committed credit facility	(45)	46,000	(20,049)	94,000
Dividends paid	(13,750)	(12,500)	(27,500)	(25,000)
Equity contributions	35,000	55,000	35,000	55,000
Cash from (used in) financing activities	18,875	88,455	(17,087)	123,936
Change in cash and cash equivalents	-	27,459	-	(15,696)
Cash and cash equivalents, beginning of period	-	917	-	44,072
Cash and cash equivalents, end of period	\$ -	\$ 28,376	\$ -	\$ 28,376

Supplemental cash flow information (note 8)

The accompanying notes are an integral part of these interim financial statements.

## NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

### 1. ENTITY DEFINITION AND NATURE OF OPERATIONS

FortisAlberta Inc. (the “Corporation”) is a regulated electricity distribution utility in the Province of Alberta. Its business is the ownership and operation of electricity distribution facilities that distribute electricity generated by other market participants from high-voltage transmission substations to end-use customers. The Corporation does not own or operate generation or transmission assets and is not involved in the direct sale of electricity. It is intended that the Corporation remain a regulated electricity utility for the foreseeable future, focusing on the delivery of safe, reliable and cost-effective electricity services to its customers in Alberta.

The Corporation is regulated by the Alberta Utilities Commission (the “AUC”) pursuant to the *Alberta Utilities Commission Act* (the “AUC Act”). The AUC’s jurisdiction, pursuant to the *Electric Utilities Act* (the “EUA”), the *Public Utilities Act*, the *Hydro and Electric Energy Act* and the *AUC Act*, includes the approval of distribution tariffs for regulated distribution utilities such as the Corporation including the rates and terms and conditions on which service is to be provided by those utilities.

The Corporation is an indirect, wholly-owned subsidiary of Fortis Inc. (“Fortis”), which is a diversified, international electricity and gas distribution utility holding company having investments in distribution, transmission and generation utilities, real estate and hotel operations.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### (a) Basis of Presentation

These financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States (“US GAAP”) as codified in the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”). The preparation of financial statements in accordance with US GAAP requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting periods. Certain estimates are necessary since the regulatory environment in which the Corporation operates often requires amounts to be recorded at estimated values until finalization and adjustments, if any, are determined pursuant to subsequent regulatory decisions or other regulatory proceedings. Significant accounting estimates made by management include income taxes, contingent liabilities due to general litigation, depreciation, amortization, employee future benefits, goodwill impairment, accrued revenue, expense accruals and other items impacted by regulation. Due to the inherent uncertainty in making such estimates, actual results reported in future periods could differ materially from those estimated.

#### (b) Regulation

The Corporation is regulated by the AUC, pursuant to the *EUA*, the *Public Utilities Act*, the *Hydro and Electric Energy Act* and the *AUC Act*. The AUC administers these acts and regulations covering such matters as revenue requirements, customer rates, construction of assets, operations and financing. The timing of recognition of certain assets, liabilities, revenue and expenses as a result of regulation may differ from that otherwise expected using US GAAP for entities not subject to rate regulation.

Effective January 1, 2013, the AUC prescribed that distribution utilities in Alberta, including the Corporation, move to a form of rate regulation referred to as performance-based regulation (“PBR”) for a five-year term. Under PBR, a formula that estimates inflation annually and assumes productivity improvements is used to determine distribution rates on an annual basis. Each year this formula is applied to the preceding year’s distribution rates. The 2012 distribution rates are the base rates upon which the formula was first applied and they were set using a traditional cost-of-service model whereby the AUC established the Corporation’s revenue requirements, being those revenues corresponding to the costs associated with the distribution business, and provided a rate of return on a deemed equity component of capital structure (“ROE”) applied to rate base assets. The Corporation’s ROE for ratemaking purposes was 8.75% for 2012 with a deemed equity capitalization of 41%. For 2013 and 2014, an ROE of 8.75% and a deemed equity capitalization of 41% were established by the AUC on an interim basis.

**(b) Regulation (cont'd)**

The PBR plan includes mechanisms for the recovery or settlement of items determined to flow through directly to customers (“Y factor”) and the recovery of costs related to capital expenditures that are not being recovered through the inflationary factor of the formula (“K factor” or “capital tracker”). The AUC also approved a Z factor, a PBR re-opener and an ROE efficiency carry-over mechanism. The Z factor permits an application for recovery of costs related to significant unforeseen events. The PBR re-opener permits an application to re-open and review the PBR plan to address specific problems with the design or operation of the PBR plan. The use of the Z factor and PBR re-opener mechanisms is associated with certain thresholds. The ROE efficiency carry-over mechanism provides an efficiency incentive by permitting a utility to continue to benefit from any efficiency gains achieved during the PBR term for two years following the end of that term.

**(c) Changes in Accounting Policies**

These unaudited interim financial statements have been prepared following the same accounting policies as those used in preparing the Corporation’s 2013 audited annual financial statements.

**Future Accounting Pronouncement**

**Revenue from Contracts with Customers**

In May 2014 FASB issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers*. The amendments in this update create ASC Topic 606, *Revenue from Contracts with Customers*, and supersede the revenue recognition requirements in ASC Topic 605, *Revenue Recognition*, including most industry-specific revenue recognition guidance throughout the codification. This update completes a joint effort by FASB and the International Accounting Standards Board to improve financial reporting by creating common revenue recognition guidance for US GAAP and International Financial Reporting Standards that clarifies the principles for recognizing revenue and that can be applied consistently across various transactions, industries and capital markets. This update is effective for annual and interim periods beginning on or after December 15, 2016 and is to be applied on a full retrospective or modified retrospective basis. Early adoption is not permitted. The Corporation is assessing the impact that the adoption of this standard will have on its financial statements.

**3. REGULATORY ASSETS AND LIABILITIES**

Based on previous, existing or expected AUC decisions, the Corporation has recorded the following amounts that are expected to be recovered from, or refunded to, customers in future periods.

	June 30, 2014	December 31, 2013
<b>Regulatory assets</b>		
Deferred income taxes	\$ 127,922	\$ 110,477
Deferred overhead	48,416	43,061
Regulatory defined benefit pension deferrals	4,732	4,766
A1 rider deferral	1,347	885
Y factor deferrals	432	1,136
2013 distribution adjustment rider deferral	-	822
<b>Total regulatory assets</b>	<b>182,849</b>	<b>161,147</b>
<b>Less: current portion</b>	<b>1,966</b>	<b>3,017</b>
<b>Long-term regulatory assets</b>	<b>\$ 180,883</b>	<b>\$ 158,130</b>

### 3. REGULATORY ASSETS AND LIABILITIES (cont'd)

	June 30, 2014	December 31, 2013
<b>Regulatory liabilities</b>		
Non-asset retirement obligation removal cost provision	\$ 332,061	\$ 322,793
Alberta Electric System Operator charges deferral	98,177	73,281
A1 rider deferral	2,269	36
Y factor deferrals	1,981	2,850
Deferred income taxes	605	572
K factor deferral	-	73
<b>Total regulatory liabilities</b>	<b>435,093</b>	<b>399,605</b>
<b>Less: current portion</b>	<b>81,471</b>	<b>41,510</b>
<b>Long-term regulatory liabilities</b>	<b>\$ 353,622</b>	<b>\$ 358,095</b>

A detailed description of the nature of the Corporation's regulatory assets and liabilities was provided in Note 4 of the Corporation's 2013 audited annual financial statements.

### 4. EMPLOYEE FUTURE BENEFITS

#### Costs Recognized

For defined benefit pension plans, the difference between the expense recognized under US GAAP and that recovered in current rates is subject to deferral treatment and is expected to be recovered or refunded in future rates. For the other post-employment benefit ("OPEB") plan the difference between the expense recognized under US GAAP and that recovered in current rates is not subject to deferral treatment.

#### Components of Net Periodic Costs

Three months ended June 30	Defined Benefit Pension Plans		OPEB Plan	
	2014	2013	2014	2013
Service cost	\$ 232	\$ 270	\$ 139	\$ 141
Interest cost	423	318	113	95
Expected return on plan assets	(306)	(273)	-	-
Amortizations:				
Past service cost	3	20	64	39
Actuarial loss	279	421	-	32
Net benefit cost recognized	631	756	316	307
Regulatory adjustments	(311)	(187)	-	-
Net benefit cost recognized in financial statements	320	569	316	307
Defined contribution cost	1,886	1,635	-	-
<b>Total employee future benefit cost</b>	<b>\$ 2,206</b>	<b>\$ 2,204</b>	<b>\$ 316</b>	<b>\$ 307</b>



## 4. EMPLOYEE FUTURE BENEFITS (cont'd)

### Components of Net Periodic Costs (cont'd)

Six months ended June 30	Defined Benefit Pension Plans		OPEB Plan	
	2014	2013	2014	2013
Service cost	\$ 464	\$ 540	\$ 278	\$ 282
Interest cost	845	637	225	189
Expected return on plan assets	(612)	(547)	-	-
Amortizations:				
Past service cost	5	40	127	79
Actuarial loss	559	843	-	64
Net benefit cost recognized	1,261	1,513	630	614
Regulatory adjustments	(530)	(372)	-	-
Net benefit cost recognized in financial statements	731	1,141	630	614
Defined contribution cost	4,701	4,247	-	-
<b>Total employee future benefit cost</b>	<b>\$ 5,432</b>	<b>\$ 5,388</b>	<b>\$ 630</b>	<b>\$ 614</b>

### Pension Plan Contributions

The Corporation made total contributions to the defined benefit pension plans of \$0.3 million and \$0.7 million for the three and six months ended June 30, 2014, respectively. The Corporation estimates that total contributions of \$1.6 million will be made towards the defined benefit pension plans and \$0.7 million towards the OPEB plan in 2014.

## 5. FAIR VALUE MEASUREMENTS

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement is required to reflect the assumptions that market participants would use in pricing a financial asset or financial liability based on the best available information. These assumptions include the risks inherent in a particular valuation technique, such as a pricing model, and the risks inherent in the inputs to the model. A fair value hierarchy exists which prioritizes the inputs used to measure fair value.

The three levels of the fair value hierarchy are defined as follows:

Level 1: Fair value determined using unadjusted quoted prices in active markets;

Level 2: Fair value determined using pricing inputs that are observable; and

Level 3: Fair value determined using unobservable inputs only when relevant observable inputs are not available.

The fair values of the Corporation's financial instruments reflect a point-in-time estimate based on current and relevant market information about the instruments as at the balance sheet dates. The estimates cannot be determined with precision as they involve uncertainties and matters of judgment; therefore, they may not be relevant in predicting the Corporation's future earnings or cash flows.

The following table represents the fair value measurements of the Corporation's financial instruments:

Long-term debt (including current installments)	June 30, 2014	December 31, 2013
Fair value <sup>(1)</sup>	\$ 1,697,364	\$ 1,618,054
Carrying value	1,459,008	1,459,000

Note:

<sup>(1)</sup> The fair value of the long-term debt was estimated using level 2 inputs based on the indicative prices for the same or similarly rated issues for debt of the same remaining maturities.

The carrying value of financial instruments included in current assets, long-term accounts receivable, short-term borrowings and current liabilities on the balance sheet approximate their fair value, which reflects the short-term maturity, normal trade credit terms and/or nature of these financial instruments.

## 6. FINANCIAL RISK MANAGEMENT

Exposure to credit risk, interest rate risk and liquidity risk arises in the normal course of the Corporation's business.

### Credit Risk

The Corporation has a concentration of credit risk as a result of its distribution service billings being to a relatively small group of retailers, or counterparties. Counterparty credit risk is the financial risk associated with the non-performance of contractual obligations by counterparties. The Corporation extends credit to select counterparties in the normal course of business.

The Corporation monitors its credit exposure in accordance with the Terms and Conditions of Distribution Access Service as approved by the AUC. The following table provides information on the counterparties that the Corporation extends credit to with respect to its distribution tariff billings as at June 30, 2014.

Credit Rating	Number of Counterparties	Gross Exposure	Net Exposure
AAA to AA (low)	2	\$ 1,553	\$ -
A (high) to A (low)	9	36,771	-
BBB (high) to BBB (low)	8	9,519	-
Not rated	34	64,757	1,834
<b>Total</b>	<b>53</b>	<b>\$ 112,600</b>	<b>\$ 1,834</b>

Gross exposure represents the projected value of retailer billings over a 37-day period. The Corporation is required to minimize its net exposure to retailer billings by obtaining an acceptable form of prudential, which includes a cash deposit, bond, letter of credit, an investment grade credit rating from a major rating agency, or a financial guarantee from an entity with an investment grade credit rating.

Retailers with investment grade credit ratings have the net exposure shown as nil since the credit rating serves to reduce the amount of prudential. For retailers that do not have an investment grade credit rating, the net exposure is calculated as the projected value of billings over a 37-day period less the prudential held by the Corporation. The Corporation assesses non-retailer billings on an individual basis for collectability and these billings are not subject to obtaining prudential.

Factors such as volatility in the global capital markets and a slowdown in the Alberta economy could cause a reduction in the credit quality of some of the Corporation's customers. In the event that the prudential obtained by the Corporation is not sufficient to cover a loss due to non-payment from the Corporation's counterparties, the Corporation would review all other options available to collect the non-payment; however, these options would not ensure that a loss could be avoided.

### Interest Rate Risk

Interest rate risk is the financial risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Corporation's debentures bear fixed interest expense which is recovered in current distribution rates, thereby minimizing cash flow variability due to interest rate exposures. Any new issues of fixed rate debentures by the Corporation within the five-year PBR term would be exposed to cash flow variability to the extent that the inflation and productivity factor of the PBR formula may not fully provide for the interest expense. The fair value of the Corporation's current fixed rate debentures fluctuates as market interest rates change; however, the Corporation plans to hold these debentures until maturity thereby mitigating the risk of these fluctuations. The drawings under the Corporation's committed credit facility are at current market short-term interest rates, exposing the Corporation to some cash flow risk, but minimal fluctuations in fair value.

The Corporation's committed credit facility has interest rate and fee components that are sensitive to the Corporation's credit ratings. The Corporation is rated by DBRS and Standard and Poor's ("S&P") and a change in rating by either of these rating agencies could potentially increase or decrease the interest expense of the Corporation. As at June 30, 2014, the Corporation's debentures were rated by DBRS at A (low) and by S&P at A-. In February 2014, DBRS revised its outlook on the Corporation and changed the trend to positive from stable, reflecting DBRS's view of the Corporation having financial metrics consistently in the A rating range. In December 2013, S&P placed the Corporation's credit rating on credit watch with negative implications as a result of the announcement by Fortis that it had entered into an agreement to acquire UNS Energy Corporation.

## 6. FINANCIAL RISK MANAGEMENT (cont'd)

### Liquidity Risk

Liquidity risk is the financial risk that the Corporation will encounter challenges in meeting obligations associated with financial liabilities. The Corporation anticipates it will be able to meet interest payments on outstanding indebtedness from internally generated funds but expects to rely upon the proceeds of new indebtedness to meet the principal obligations when due. The number of years to maturity of the principal outstanding and interest payments on the Corporation's long-term debt as at December 31, 2013 were summarized in Note 9 of the Corporation's 2013 audited annual financial statements.

The Corporation's financial position could be adversely affected if it fails to arrange sufficient and cost-effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. The ability to arrange sufficient and cost-effective financing is subject to numerous factors, including the results of operations and financial position of the Corporation, conditions in the capital and bank credit markets, ratings assigned by rating agencies and general economic conditions.

To mitigate this risk, the Corporation has a \$250 million unsecured committed credit facility to support short-term financing of capital expenditures and seasonal working capital requirements. As at June 30, 2014, the Corporation had no drawings on this facility.

## 7. COMMITMENTS AND CONTINGENCIES

A detailed description of the nature of the Corporation's commitments and contingencies was provided in Note 16 of the Corporation's 2013 audited annual financial statements. There have been no material changes to the nature or amounts of these items.

## 8. SUPPLEMENTAL CASH FLOW INFORMATION

<b>As at June 30</b>	<b>2014</b>	<b>2013</b>
Non-cash working capital – investing activities:		
Additions to property, plant and equipment and intangible assets included in current liabilities	\$ 53,641	\$ 49,176
Customer contributions for property, plant and equipment included in current assets	1,087	9,876

## 9. SUBSEQUENT EVENTS

In July 2014, the Corporation renegotiated and amended its syndicated credit facility, extending the maturity date of the facility to August 2019 from August 2018. The amended agreement contains substantially similar terms and conditions as the previous agreement.

These financial statements and notes reflect the Company's evaluation of events occurring subsequent to the balance sheet date through July 22, 2014, the date the financial statements were available for issuance.