

NALCOR ENERGY - OIL AND GAS INC.
FINANCIAL STATEMENTS
December 31, 2017

Independent Auditor's Report

To the Shareholder of Nalcor Energy – Oil and Gas Inc.

We have audited the accompanying financial statements of Nalcor Energy – Oil and Gas Inc. which comprise the statement of financial position as at December 31, 2017 and the statements of profit and comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Nalcor Energy – Oil and Gas Inc. as at December 31, 2017 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte LLP

Chartered Professional Accountants
March 8, 2018

**NALCOR ENERGY - OIL AND GAS INC.
STATEMENT OF FINANCIAL POSITION**

| <i>As at December 31 (thousands of Canadian dollars)</i> | Notes | 2017 | 2016 |
|--|-------|------------------|------------------|
| ASSETS | | | |
| Current assets | | | |
| Cash | | 1,495 | 29,727 |
| Trade and other receivables | 5 | 64,717 | 46,982 |
| Inventory | 6 | 10,082 | 4,213 |
| Prepayments | | 7,173 | 1,226 |
| Derivative assets | 19 | 2,452 | - |
| Total current assets | | 85,919 | 82,148 |
| Non-current assets | | | |
| Property, plant and equipment | 7 | 1,157,733 | 1,102,042 |
| Intangible assets | 8 | 1,359 | 58,421 |
| Other long-term assets | | 821 | 758 |
| Total assets | | 1,245,832 | 1,243,369 |
| LIABILITIES AND EQUITY | | | |
| Current liabilities | | | |
| Trade and other payables | 9 | 24,412 | 57,242 |
| Current portion of deferred revenue | 10 | 700 | 600 |
| Current portion of decommissioning liabilities | 11 | - | 995 |
| Derivative liabilities | 19 | 7,060 | 4,790 |
| Total current liabilities | | 32,172 | 63,627 |
| Non-current liabilities | | | |
| Deferred revenue | 10 | 1,090 | 1,836 |
| Decommissioning liabilities | 11 | 71,145 | 65,996 |
| Long-term payable | | 1,000 | - |
| Employee future benefits | 12 | 1,031 | 893 |
| Total liabilities | | 106,438 | 132,352 |
| Shareholder's equity | | | |
| Share capital | 14 | 110,000 | 110,000 |
| Shareholder contributions | 14 | 906,112 | 887,205 |
| Reserves | 13 | (4,932) | (5,124) |
| Retained earnings | | 128,214 | 118,936 |
| Total equity | | 1,139,394 | 1,111,017 |
| Total liabilities and equity | | 1,245,832 | 1,243,369 |

Commitments and contingencies (Note 21)

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NALCOR ENERGY - OIL AND GAS INC.
STATEMENT OF PROFIT AND COMPREHENSIVE INCOME (LOSS)

| <i>For the year ended December 31 (thousands of Canadian dollars)</i> | Notes | 2017 | 2016 |
|---|-------|-----------------|----------|
| Petroleum and natural gas sales | | 227,720 | 137,279 |
| Royalty expense | 20 | (10,266) | (6,376) |
| Other revenue | | 6,716 | 9,286 |
| Revenue, net | | 224,170 | 140,189 |
| Operating costs | 15 | 8,593 | 8,084 |
| Production, marketing and transportation costs | 16 | 35,433 | 26,332 |
| Depreciation, depletion, amortization and impairment | 7,8 | 151,751 | 48,499 |
| Exploration and evaluation expense | | 814 | 1,482 |
| Net finance expense | 17 | 3,046 | 3,240 |
| Other expense (income) | 18 | 15,255 | (5,052) |
| Expenses | | 214,892 | 82,585 |
| Profit for the year | | 9,278 | 57,604 |
| Other comprehensive income (loss) | | | |
| <i>Total items that may or have been reclassified to profit or loss</i> | | | |
| Net fair value losses on cash flow hedges | 13 | (977) | (5,447) |
| Reclassification adjustments related to: | | | |
| Cash flow hedges recognized in profit or loss | 13 | 1,157 | (6,196) |
| <i>Total items that will not be reclassified to profit or loss</i> | | | |
| Actuarial gain on employee future benefits | 13 | 12 | 37 |
| Other comprehensive income (loss) for the year | | 192 | (11,606) |
| Total comprehensive income for the year | | 9,470 | 45,998 |

See accompanying notes

**NALCOR ENERGY - OIL AND GAS INC.
STATEMENT OF CHANGES IN EQUITY**

| | | Share | Shareholder | Fair Value | Employee | Retained | Total |
|--|-------|----------------|----------------|-----------------|-----------------|----------------|------------------|
| | Notes | Capital | Contributions | Reserve | Benefit Reserve | Earnings | |
| <i>(thousands of Canadian dollars)</i> | | | | | | | |
| Balance at January 1, 2017 | | 110,000 | 887,205 | (4,788) | (336) | 118,936 | 1,111,017 |
| Profit for the year | | - | - | - | - | 9,278 | 9,278 |
| Other comprehensive income (loss) | | | | | | | |
| Net change in the fair value of cash flow hedges | 13 | - | - | (977) | - | - | (977) |
| Net change in the fair value of financial instruments reclassified to profit or loss | 13 | - | - | 1,157 | - | - | 1,157 |
| Actuarial gain on employee future benefits | 13 | - | - | - | 12 | - | 12 |
| Total comprehensive income for the year | | - | - | 180 | 12 | 9,278 | 9,470 |
| Shareholder contributions | 14 | - | 18,907 | - | - | - | 18,907 |
| Balance at December 31, 2017 | | 110,000 | 906,112 | (4,608) | (324) | 128,214 | 1,139,394 |
| | | | | | | | |
| Balance at January 1, 2016 | | 110,000 | 710,712 | 6,855 | (373) | 61,332 | 888,526 |
| Profit for the year | | - | - | - | - | 57,604 | 57,604 |
| Other comprehensive income (loss) | | | | | | | |
| Net change in the fair value of cash flow hedges | 13 | - | - | (5,447) | - | - | (5,447) |
| Net change in the fair value of financial instruments reclassified to profit or loss | 13 | - | - | (6,196) | - | - | (6,196) |
| Actuarial gain on employee future benefits | 13 | - | - | - | 37 | - | 37 |
| Total comprehensive (loss) income for the year | | - | - | (11,643) | 37 | 57,604 | 45,998 |
| Shareholder contributions | 14 | - | 176,493 | - | - | - | 176,493 |
| Balance at December 31, 2016 | | 110,000 | 887,205 | (4,788) | (336) | 118,936 | 1,111,017 |

See accompanying notes

NALCOR ENERGY - OIL AND GAS INC.
STATEMENT OF CASH FLOWS

| <i>For the year ended December 31 (thousands of Canadian dollars)</i> | Notes | 2017 | 2016 |
|---|-------|------------------|-----------|
| Operating activities | | | |
| Profit for the year | | 9,278 | 57,604 |
| Adjusted for items not involving a cash flow: | | | |
| Depreciation, depletion, amortization and impairment | 7,8 | 151,751 | 48,499 |
| Accretion | 17 | 2,845 | 3,358 |
| Settlement of decommissioning liabilities | 11 | (995) | (17) |
| Loss on disposal of property, plant and equipment | 18 | 11,578 | 214 |
| Other | | 85 | (176) |
| | | 174,542 | 109,482 |
| Changes in non-cash working capital balances | 23 | (44,177) | (19,472) |
| Net cash provided from operating activities | | 130,365 | 90,010 |
| Investing activities | | | |
| Additions to property, plant and equipment | 7 | (123,310) | (208,208) |
| Additions to intangible assets | 8 | (37,476) | (28,079) |
| Proceeds on disposal of property, plant and equipment | | 1,132 | 56 |
| Change in non-cash working capital balances | 23 | (18,850) | (17,856) |
| Net cash used in investing activities | | (178,504) | (254,087) |
| Financing activities | | | |
| Increase in long-term payable | | 1,000 | - |
| Increase in shareholder contributions | 14 | 18,907 | 176,493 |
| Net cash provided from financing activities | | 19,907 | 176,493 |
| Net (decrease) increase in cash | | (28,232) | 12,416 |
| Cash, beginning of year | | 29,727 | 17,311 |
| Cash, end of year | | 1,495 | 29,727 |
| Interest received | | 15 | 58 |
| Interest paid | | 216 | 181 |

See accompanying notes

NALCOR ENERGY - OIL AND GAS INC.
NOTES TO FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

Nalcor Energy - Oil and Gas Inc. (Oil and Gas or the Company) was incorporated under the Corporations Act of Newfoundland and Labrador (the Province). Oil and Gas has a mandate to engage in the upstream and downstream sectors of the oil and gas industry. Upstream includes exploration, development, and production activities while downstream includes transportation and processing activities. Oil and Gas is a 100% owned subsidiary of Nalcor Energy (Nalcor). Substantially all of Oil and Gas' activities are conducted jointly with others and, accordingly, these statements reflect only Oil and Gas' proportionate interest in such activities. Oil and Gas' head office is located at 500 Columbus Drive, St. John's, Newfoundland and Labrador, A1B 0C9, Canada.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Statement of Compliance and Basis of Measurement

These annual audited financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). Oil and Gas has adopted accounting policies which are based on the IFRS applicable as at December 31, 2017, and includes individual IFRS, International Accounting Standards (IAS), and interpretations made by the IFRS Interpretations Committee and the Standing Interpretations Committee.

These annual audited financial statements have been prepared on a historical cost basis, except for financial instruments at fair value through profit or loss (FVTPL) and financial instruments used for hedging which have been measured at fair value. The annual audited financial statements are presented in Canadian Dollars and all values rounded to the nearest thousand, except when otherwise noted. These annual audited financial statements were approved by the Oil and Gas' Board of Directors (the Board) on March 1, 2018.

2.2 Cash and Cash Equivalents

Cash and cash equivalents consist of amounts on deposit with a Schedule 1 Canadian Chartered bank, as well as highly liquid investments with maturities of three months or less. Investments with maturities greater than three months and less than twelve months are classified as short-term investments. At December 31, 2017, there were no cash equivalents (2016 - \$nil). Cash and cash equivalents are measured at cost which approximates fair value while short-term investments are measured at fair value.

2.3 Inventories

Inventories are carried at the lower of cost and net realizable value. Inventory costs include expenditures directly and indirectly incurred in bringing the inventory to its existing condition and location.

2.4 Property, Plant and Equipment

(i) Development and Production Costs

Items of property, plant and equipment, which include petroleum and natural gas development and production assets, are carried at cost less accumulated depreciation, depletion and impairment. Development and production assets are grouped into cash generating units (CGUs) for impairment testing.

Expenditures on the construction, installation or completion of infrastructure facilities such as processing facilities and the drilling of development wells, including unsuccessful development or delineation wells, are capitalized within property, plant and equipment, as long as it is technically feasible and economically viable to extract identified reserves.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the decommissioning costs and, for qualifying assets, borrowing costs. The purchase price or constructed cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

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NOTES TO FINANCIAL STATEMENTS

Capitalized petroleum and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis.

Gains and losses on disposal of an item of property, plant and equipment, including petroleum and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recorded in other expense (income).

(ii) Subsequent Costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the asset will flow to Oil and Gas and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Routine repairs and maintenance costs are charged to profit or loss during the period in which they are incurred.

(iii) Depletion

The net carrying value of development and production assets is depleted using the unit of production method by reference to the ratio of production in the year to the related proved and probable reserves, and considering estimated future development costs necessary to bring those reserves into production. Future development costs are estimated, taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers, at least annually.

Proved and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate, with a specified degree of certainty, to be recoverable in future years from known reservoirs and which are considered commercially viable. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves.

Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all (or substantially all) the expected petroleum and natural gas production; and
- evidence that the necessary production, transshipment and transportation facilities are available or can be made available.

(iv) Other Assets

Office equipment and computer hardware are carried at cost less accumulated depreciation. Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful life of five years. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

2.5 Exploration and Evaluation Assets

Pre-license exploration and evaluation costs are recognized in profit or loss as incurred. Costs of exploring for and evaluating licensed petroleum and gas properties are capitalized and the resulting intangible exploration and evaluation assets are tested for impairment in accordance with IFRS 6 and IAS 36.

Exploration and evaluation costs related to each license/prospect are initially capitalized with "Exploration and Evaluation Assets". Such exploration and evaluation costs may include costs of license acquisition, technical services and studies, exploration drilling and testing, directly attributable overhead and administrative expenses and the projected costs of retiring the assets. General prospecting or evaluation costs incurred prior to having obtained the legal rights to explore an area are expensed directly to profit or loss as they are incurred.

Exploration and evaluation assets are not depleted and are carried forward until technical feasibility and commercial viability of extracting a mineral resource is considered to be determined. The technical feasibility and commercial viability of extracting a mineral resource is considered to be determined when proved reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proved reserves have been discovered.

Upon determination of proved reserves, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to property, plant and equipment. As at December 31, 2017, there were no exploration and evaluation assets recorded.

2.6 Intangible Assets

Intangible assets that are expected to generate future economic benefit and are measurable, including computer software costs, costs of technical services, studies and seismic data acquisitions are capitalized as intangible assets in accordance with IAS 38.

Intangible assets with finite useful lives are carried at cost less accumulated amortization and accumulated impairment losses. The estimated useful life and amortization method are reviewed at the end of each year, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives are carried at cost less accumulated impairment losses.

Amortization is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

| | |
|---------------------------|----------|
| Computer software | 10 years |
| Seismic data acquisitions | 6 years |

2.7 Impairment of Non-Financial Assets

At the end of each reporting period, Oil and Gas reviews the carrying amounts of its non-financial assets, except for exploration and evaluation assets, to determine whether there is any indication that those assets may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Exploration and evaluation assets are assessed for impairment when they are reclassified to property, plant and equipment and also if there are indicators that suggest that the carrying amount exceeds the recoverable amount.

Where it is not possible to estimate the recoverable amount of an individual asset, Oil and Gas estimates the recoverable amount of the CGU to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual CGUs, or otherwise they are allocated to the smallest group of CGUs for which a reasonable and consistent allocation basis can be identified. The recoverable amount is the higher of fair value less costs of disposal and value in use. 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 which the estimates of future cash flows have not been adjusted. Value in use is generally computed by reference to the present value of future cash flows expected to be derived from the non-financial asset.

Exploration and evaluation assets are allocated to the CGUs on a project basis when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their reclassification to property, plant and equipment.

If the recoverable amount of an asset or CGU is estimated to be less than its carrying amount, the carrying amount of the asset or CGU is reduced to its recoverable amount. An impairment loss is recognized immediately in the Statement of Profit and Comprehensive Income (Loss).

2.8 Investments in Joint Arrangements

A joint arrangement is an arrangement of which two or more parties involved have joint control. Control exists when Oil and Gas has the power, directly or indirectly, to govern the financial and operating policies of another entity, so

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as to obtain benefits from its activities. A joint arrangement is either classified as a joint operation or a joint venture based on the rights of the parties involved.

Oil and Gas holds equity stakes in the Hebron, Hibernia South Extension and White Rose Extension projects. These projects are classified as joint operations as multiple parties hold joint control and stakeholders have rights to the project assets and obligations for its liabilities. Oil and Gas accounts for its oil and gas investments by recognizing its share of assets, liabilities and profit or loss in relation to its interest in the joint operation.

2.9 Employee Benefits Liability

(i) Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. Contributions by Oil and Gas to this plan are recognized as an expense when employees have rendered service entitling them to the contributions. The assets and liabilities of this Plan are held by the Province.

(ii) Other Benefits

Oil and Gas provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a retirement allowance.

The cost of providing these benefits is determined using the projected unit credit method, with actuarial valuations being carried out on an annual basis, based on service and Management's best estimate of salary escalation, retirement ages of employees and expected health care costs.

Actuarial gains and losses of Oil and Gas' defined benefit obligation are recognized in reserves in the period in which they occur. Past service costs are recognized in operating costs as incurred.

The retirement benefits obligation recognized in the Statement of Financial Position represents the present value of the defined benefit obligation.

2.10 Provisions

A provision is a liability of uncertain timing or amount. A provision is recognized if Oil and Gas has a present legal obligation or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognized for future operating losses. The provision is measured at the present value of the best estimate of the expenditures expected to be required to settle the obligation using a discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. Provisions are remeasured at each Statement of Financial Position date using the current discount rate.

2.11 Decommissioning, Restoration and Environmental Liabilities

Legal and constructive obligations associated with the retirement of property, plant and equipment are recorded as liabilities when those obligations are incurred and are measured as the present value of the expected costs to settle the liability, discounted at a rate specific to the liability. The liability is accreted up to the date the liability will be incurred with a corresponding charge to net finance expense. The carrying amount of decommissioning, restoration and environmental liabilities is reviewed annually with changes in the estimates of timing or amount of cash flows added to or deducted from the cost of the related asset or expensed in the Statement of Profit and Comprehensive Income (Loss) if the liability is short-term in nature.

2.12 Revenue Recognition

Revenue from the sale of crude oil is recognized when the amount of revenue can be reasonably measured, the significant risks and rewards of ownership have passed to the buyer and collection is reasonably assured. This typically occurs when the oil has been produced and delivered to the transshipment facility.

Revenue from properties in which Oil and Gas has an interest with other producers is recognized on the basis of Oil and Gas' net working interest of petroleum and natural gas produced (the entitlement method). Under this method,

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crude oil produced below or above Oil and Gas' net working interest results in an under-lift or over-lift position. Under-lift or over-lift positions are measured at market value and recorded as an asset or liability, respectively.

Revenue associated with the sale of geoscientific data is recognized when the terms and conditions governing sales have been met, the amount of revenue can be reliably measured, and recovery of the consideration is probable.

2.13 Net Finance (Income) Expense

For all financial instruments measured at amortized cost and interest bearing financial assets classified as available-for-sale (AFS), interest income or expense is recorded using the effective interest rate.

2.14 Foreign Currencies

Transactions in currencies other than Oil and Gas' functional currency (foreign currencies) are recognized using the exchange rate in effect at the date of transaction, approximated by the prior month end close rate. At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates of exchange in effect at the period end date. Foreign exchange gains and losses are included in the Statement of Profit and Comprehensive Income (Loss) as other expense (income).

2.15 Income Taxes

Oil and Gas is exempt from paying income taxes under Section 149(1) (d.2) of the Income Tax Act.

2.16 Financial Instruments

Financial assets and financial liabilities are recognized in the Statement of Financial Position when Oil and Gas becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Financial instruments are classified into the following specified categories: financial assets at FVTPL, AFS financial assets, loans and receivables, held to maturity investments, financial liabilities at FVTPL, financial instruments used for hedging and other financial liabilities. The classification depends on the nature and purpose of the financial instruments and is determined at the time of initial recognition.

Classification of Financial Instruments

Oil and Gas has classified each of its financial instruments into the following categories: loans and receivables, financial instruments used for hedging and other financial liabilities.

| <u>Financial Instrument</u> | <u>Category</u> |
|-----------------------------|--|
| Cash and cash equivalents | Loans and other receivables |
| Trade and other receivables | Loans and other receivables |
| Trade and other payables | Other financial liabilities |
| Derivative instruments | Financial instruments used for hedging |

(i) Effective Interest Method

The effective interest method is a method of calculating the amortized cost of a financial instrument and allocating interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial instrument, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Income or expense is recognized on an effective interest basis for financial instruments other than those financial assets and liabilities classified as at FVTPL.

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Financial Assets

(ii) Loans and Receivables

Trade receivables, loans and other receivables with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate method, except for short-term receivables when the recognition of interest would be immaterial.

Financial Liabilities and Equity Instruments

(iii) Other Financial Liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

(iv) Derivative Instruments and Financial Instruments Used for Hedging

Derivative instruments are utilized by Oil and Gas to manage risk. Oil and Gas' policy is not to utilize derivative instruments for speculative purposes. Derivatives are initially measured at fair value at the date the derivative contracts are entered into and are subsequently measured at their fair value at the end of each reporting period. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as a hedging relationship.

Oil and Gas may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between the price movements in the derivative instruments and the hedged items. Oil and Gas formally documents all hedges and the related risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

Hedges which meet the strict criteria for hedge accounting are accounted for as follows:

Cash Flow Hedges

The effective portion of the gain or loss on the hedging instrument is recognized directly in other comprehensive income, while any ineffective portion is recognized immediately in the Statement of Profit and Comprehensive Income (Loss) for the year.

Amounts recognized as other comprehensive income are transferred to the Statement of Profit and Comprehensive Income (Loss) for the period when the hedged transaction affects profit or loss, such as when the hedged financial income or financial expense is recognized or when a forecast sale occurs.

2.17 Derecognition of Financial Instruments

Oil and Gas derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If Oil and Gas neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, its retained interest in the asset and an associated liability for amounts it may have to pay is recognized. If Oil and Gas retains substantially all the risks and rewards of ownership of a transferred financial asset, it continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received. Oil and Gas derecognizes financial liabilities when, and only when, its obligations are discharged, cancelled or they expire.

2.18 Impairment of Financial Assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

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Evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- the borrower, more probable than not, entering into bankruptcy or financial re-organization.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include Oil and Gas' past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, as well as observable changes in national or local economic conditions that correlate with defaults on receivables.

For financial assets carried at amortized cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognized in other comprehensive income are reclassified to profit or loss in the period.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

2.19 Government Grants

Government grants are recognized when there is reasonable assurance that Oil and Gas will comply with the associated conditions and that the grants will be received.

Government grants are recognized in profit or loss on a systematic basis over the periods in which Oil and Gas recognizes as expenses the related costs for which the grants are intended to compensate. Specifically, government grants whose primary condition is that Oil and Gas should purchase, construct or otherwise acquire non-current assets are recognized as deferred revenue in the Statement of Financial Position and transferred to the Statement of Profit and Comprehensive Income (Loss) on a systematic and rational basis over the useful lives of the related assets.

Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to Oil and Gas with no future related costs are recognized in the Statement of Profit and Comprehensive Income (Loss) in the period in which they become receivable.

3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the annual audited financial statements in conformity with IFRS requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Actual results may differ materially from these estimates. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the period in which the estimate is reviewed if the revision affects only that period or future periods.

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3.1 Use of Judgments

(i) Property, Plant and Equipment

Oil and Gas' accounting policy relating to property, plant and equipment is described in Note 2.4. In applying this policy, judgment is used in determining whether certain costs are additions to the carrying amount of the property, plant and equipment as opposed to repairs and maintenance. If an asset has been developed, judgment is required to identify the point at which the asset is capable of being used as intended. Judgment is also used in determining the appropriate componentization structure for Oil and Gas' property, plant and equipment.

(ii) Determination of CGUs

Oil and Gas' accounting policy relating to impairment of non-financial assets is described in Note 2.7. In applying this policy, Oil and Gas groups assets into the smallest identifiable groups for which cash flows are largely independent of the cash flows from other assets or groups of assets. Judgment is used in determining the level at which cash flows are largely independent of other assets or groups of assets.

(iii) Asset Impairment and Reversals

Oil and Gas applies judgment in evaluating impairment and impairment reversal indicators based on various internal and external factors.

The recoverable amount of a CGU or asset is determined based on the higher of fair value less cost of disposal and its value in use. Management uses factors including expected future oil prices and proved and probable reserves from third party specialists and discount rates to determine the recoverable amount, as well as, judgments regarding the occurrence of future events. Changes in these factors will affect the recoverable amount of CGUs and assets, which may result in a material adjustment to their carrying value.

(iv) Functional Currency

Functional currency was determined by evaluating the primary economic environment in which Oil and Gas operates. As Oil and Gas enters into transactions in multiple currencies, judgment is used in determining the functional currency. Management considered factors regarding currency of sales, costs incurred, operating and financing activities and determined the functional currency to be Canadian Dollars.

(v) Discount rates

Certain of Oil and Gas' financial liabilities are discounted using discount rates that are subject to Management's judgment.

3.2 Use of Estimates

(i) Property, Plant and Equipment

Amounts recorded for depreciation are based on the useful lives of Oil and Gas' assets. The useful lives of property, plant and equipment are determined by independent specialists and reviewed annually by Oil and Gas. These useful lives are Management's best estimate of the service lives of these assets. Changes to these lives could materially affect the amount of depreciation recorded.

(ii) Intangible Assets

Amounts recorded for amortization are based on the useful lives of Oil and Gas' assets. These useful lives are Management's best estimate of the service lives of these assets. Changes to these lives could materially affect the amount of amortization recorded.

(iii) Oil and Natural Gas Reserves

Oil and natural gas reserves are evaluated by independent reserve engineers. Reserve estimates are used in calculating depletion, impairment and decommissioning liabilities. Estimates of recoverable reserves are based upon variable factors and assumptions regarding historical production, production rates, ultimate reserve recovery, marketability of petroleum and natural gas and timing and amount of future cash expenditures. Changes to these amounts could materially affect these calculations.

(iv) Decommissioning Liabilities

Oil and Gas recognizes a liability for the fair value of the future expenditures required to settle obligations associated with the retirement of property, plant and equipment. Decommissioning liabilities are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. Accretion of decommissioning liabilities is included in the Statement of Profit and Comprehensive Income (Loss) through net finance expense. Differences between the recorded decommissioning liability and the actual retirement costs incurred are recorded as a gain or loss in the settlement period.

(v) Employee Benefits

Oil and Gas provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee benefits is accounted for on an accrual basis, and has been actuarially determined using the projected unit credit method prorated on service, and Management's best estimate of salary escalation, retirement ages of employees, and expected health care costs.

4. FUTURE CHANGES IN ACCOUNTING POLICIES

IAS 7 – *Disclosure Initiative* became effective for the accounting period commencing on January 1, 2017 and did not have a material impact on Oil and Gas's annual audited financial statements.

The following is a list of standards/interpretations that have been issued and are effective for accounting periods commencing on January 1, 2018 or January 1, 2019, as specified.

Oil and Gas has not applied the following new and revised standards that have been issued but are not yet effective:

- *IFRS 9 – Financial Instruments*¹
- *IFRS 15 – Revenue from Contracts with Customers*¹
- *IFRIC 22 – Foreign Currency Transactions and Advance Consideration*¹
- *IFRS 16 – Leases*²

¹Effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

²Effective for annual periods beginning on or after January 1, 2019, with earlier application permitted.

4.1 IFRS 9 - Financial Instruments

In July 2014, the IASB finalized the reform of financial instruments accounting and issued IFRS 9 (as revised in 2014), which contains the requirements for a) the classification and measurement of financial assets and financial liabilities, b) impairment methodology, and c) general hedge accounting. IFRS 9 (as revised in 2014) will supersede IAS 39 - Financial Instruments: Recognition and Measurement upon its effective date.

Phase 1: Classification and measurement of financial assets and financial liabilities

With respect to classification and measurement, the number of categories of financial assets under IFRS 9 has been reduced; all recognized financial assets that are currently within the scope of IAS 39 will be subsequently measured at either amortized cost or fair value under IFRS 9.

IFRS 9 also contains requirements for the classification and measurement of financial liabilities and derecognition requirements. One major change from IAS 39 relates to the presentation of changes in the fair value of a financial liability designated as at FVTPL attributable to changes in the credit risk of that liability. Under IFRS 9, such changes are presented in other comprehensive income, unless the presentation of the effect of the change in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss.

Phase 2: Impairment of financial assets

The impairment model under IFRS 9 reflects expected credit losses, as opposed to incurred credit losses under IAS 39. Under the impairment approach in IFRS 9, it is no longer necessary for a credit event to have occurred before credit losses are recognized. Instead, an entity always accounts for expected credit losses and changes in those expected credit losses. The amount of expected credit losses should be updated at each reporting date to reflect changes in credit risk since initial recognition.

Phase 3: Hedge accounting

The general hedge accounting requirements of IFRS 9 retain the three types of hedge accounting mechanisms in IAS 39. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is no longer required. Far more disclosure requirements about an entity's risk management activities have been introduced.

Transitional provisions

IFRS 9 (as revised in 2014) is effective for annual periods beginning on or after January 1, 2018 with earlier application permitted. Management has elected to adopt the standard as of the effective date, and although the classifications of existing financial instruments and related disclosures will change, there will be no material adjustments to the amounts reported in Oil and Gas's annual audited financial statements

4.2 IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. It will supersede the following revenue standards and interpretations upon its effective date:

- IAS 18 Revenue;
- IAS 11 Construction Contracts;
- IFRIC 13 Customer Loyalty Programs;
- IFRIC 15 Agreements for the Construction of Real Estate;
- IFRIC 18 Transfers of Assets from Customers; and
- SIC 31 Revenue-Barter Transactions Involving Advertising Services

As suggested by the title of the new revenue standard, IFRS 15 will only cover revenue arising from contracts with customers. Under IFRS 15, a customer of an entity is a party that has contracted with the entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration. Unlike the scope of IAS 18, the recognition and measurement of interest income and dividend income from debt and equity investments are no longer within the scope of IFRS 15. Instead, they are within the scope of IAS 39 (or IFRS 9 if it is early adopted).

As mentioned above, the new standard has a single model to deal with revenue from contracts with customers. Its core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Specifically, the standard introduces a five-step approach to revenue recognition:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Extensive disclosures are also required by the new standard.

IFRS 15, together with clarifications thereto issued in April 2016, is effective for reporting periods beginning on or after January 1, 2018 with earlier application permitted. Management has elected to adopt the standard as of the effective date and although the related disclosures will change, there will be no material adjustments to the amounts

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reported in Oil and Gas's annual audited financial statements.

4.3 IFRIC 22 Foreign Currency Transactions and Advance Consideration

IFRIC 22 addresses how to determine the 'date of transaction' for the purpose of determining the exchange rate to use on initial recognition of an asset, expense or income, when consideration for that item has been paid or received in advance in a foreign currency which resulted in the recognition of a non-monetary asset or non-monetary liability (for example, a non-refundable deposit or deferred revenue).

The Interpretation is effective for annual periods beginning on or after January 1, 2018 with earlier application permitted. Entities can apply the Interpretation either retrospectively or prospectively. Specific transition provisions apply to prospective application. Management has elected to apply the interpretation on the effective date and the application of these amendments to IFRIC 22 will not have a material impact on Oil and Gas's annual audited financial statements.

4.4 IFRS 16 - Leases

IFRS 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. It will supersede the following lease standard and interpretations upon its effective date:

- IAS 17 Leases;
- IFRIC 4 Determining Whether an Arrangement contains a Lease;
- SIC-15 Operating Leases – Incentives; and
- SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

IFRS 16 applies a control model to the identification of leases, distinguishing between leases and service contracts on the basis of whether there is an identified asset controlled by the customer.

The standard introduces significant changes to lessee accounting, it removes the distinction between operating and finance leases under IAS 17 and requires a lessee to recognize a right-of-use asset and a lease liability at lease commencement for all leases, except for short-term leases and leases of low value assets.

In contrast to lessee accounting, the IFRS 16 lessor accounting requirements remain largely unchanged from IAS 17, which continue to require a lessor to classify a lease as either an operating lease or a finance lease.

IFRS 16 is effective for reporting periods beginning on or after January 1, 2019 with early application permitted for entities that apply IFRS 15 at or before the date of initial application of IFRS 16. A lessee can apply IFRS 16 either by a full retrospective approach or a modified retrospective approach. If the latter approach is selected, an entity is not required to restate the comparative information and the cumulative effect of initially applying IFRS 16 must be presented as an adjustment to opening retained earnings.

Management anticipates that the application of IFRS 16 in the future may have a material impact on the amounts reported and disclosures made in Oil and Gas's annual audited financial statements. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 16 until Management completes its assessment of the impacts.

5. TRADE AND OTHER RECEIVABLES

| <i>As at December 31(thousands of Canadian dollars)</i> | 2017 | 2016 |
|---|---------------|--------|
| Trade receivables | 41,498 | 42,089 |
| Other receivables | 1,479 | 4,888 |
| Due from related parties | 21,740 | 5 |
| | 64,717 | 46,982 |

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| <i>As at December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|--|---------------|--------|
| 0-60 days | 59,665 | 38,906 |
| 60+ days | 5,052 | 8,076 |
| | 64,717 | 46,982 |

As at December 31, 2017, trade and other receivables included balances of \$37.0 million (2016 – \$42.0 million) denominated in USD. In addition, at December 31, 2017, Oil and Gas had \$5.1 million (2016 - \$8.1 million) in accounts receivable as past due but not impaired.

6. INVENTORY

As at December 31, 2017, inventory consists entirely of materials and supplies to be consumed during production at Oil and Gas' petroleum and natural gas properties.

7. PROPERTY, PLANT AND EQUIPMENT

| <i>(thousands of Canadian dollars)</i> | Petroleum and Natural Gas Assets | Other | Total |
|---|-------------------------------------|--------------|------------------|
| Cost | | | |
| Balance at January 1, 2016 | 1,115,405 | 1,434 | 1,116,839 |
| Additions | 207,634 | 574 | 208,208 |
| Disposals | (269) | (24) | (293) |
| Decommissioning liability additions and revisions | (10,301) | - | (10,301) |
| Balance at December 31, 2016 | 1,312,469 | 1,984 | 1,314,453 |
| Additions | 122,706 | 604 | 123,310 |
| Transfers | - | (258) | (258) |
| Disposals | (12,585) | (189) | (12,774) |
| Decommissioning liability revisions | 2,304 | - | 2,304 |
| Balance at December 31, 2017 | 1,424,894 | 2,141 | 1,427,035 |
| Depreciation, depletion and impairment | | | |
| Balance at January 1, 2016 | 171,829 | 583 | 172,412 |
| Depreciation and depletion | 39,912 | 110 | 40,022 |
| Disposals | - | (23) | (23) |
| Balance at December 31, 2016 | 211,741 | 670 | 212,411 |
| Depreciation and depletion | 56,748 | 207 | 56,955 |
| Disposals | - | (64) | (64) |
| Balance at December 31, 2017 | 268,489 | 813 | 269,302 |
| Carrying value | | | |
| Balance at January 1, 2016 | 943,576 | 851 | 944,427 |
| Balance at December 31, 2016 | 1,100,728 | 1,314 | 1,102,042 |
| Balance at December 31, 2017 | 1,156,405 | 1,328 | 1,157,733 |

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8. INTANGIBLE ASSETS

| <i>(thousands of Canadian dollars)</i> | Exploration Assets | Computer Software | Total |
|--|-----------------------|----------------------|----------------|
| Cost | | | |
| Balance at January 1, 2016 | 40,583 | 2,544 | 43,127 |
| Additions | 28,068 | 11 | 28,079 |
| Balance at December 31, 2016 | 68,651 | 2,555 | 71,206 |
| Additions | 37,209 | 267 | 37,476 |
| Transfers | - | 258 | 258 |
| Balance at December 31, 2017 | 105,860 | 3,080 | 108,940 |
| Amortization and impairment | | | |
| Balance at January 1, 2016 | 3,058 | 1,250 | 4,308 |
| Amortization | 8,267 | 210 | 8,477 |
| Balance at December 31, 2016 | 11,325 | 1,460 | 12,785 |
| Amortization | 13,554 | 261 | 13,815 |
| Impairment | 80,981 | - | 80,981 |
| Balance at December 31, 2017 | 105,860 | 1,721 | 107,581 |
| Carrying value | | | |
| Balance at January 1, 2016 | 37,525 | 1,294 | 38,819 |
| Balance at December 31, 2016 | 57,326 | 1,095 | 58,421 |
| Balance at December 31, 2017 | - | 1,359 | 1,359 |

As at December 31, 2017 intangible assets includes an impairment expense of \$80,981 related to seismic and geoscientific data acquisition costs previously capitalized as Management assessed the costs as having no short or medium term future economic benefit to Oil and Gas.

9. TRADE AND OTHER PAYABLES

| <i>As at December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|--|---------------|--------|
| Trade payables and other accruals | 23,668 | 55,803 |
| Due to related parties | 744 | 1,439 |
| | 24,412 | 57,242 |

As at December 31, 2017, trade and other payables included balances of \$3.7 million (2016 – \$11.2 million) denominated in USD and \$0.9 million (2016 - \$nil) denominated in Euros.

10. DEFERRED REVENUE

Oil and Gas has received funding from the Province towards two initiatives. The first is the Petroleum Exploration Enhancement Program (PEEP) which is designed to boost new petroleum exploration in Western Newfoundland through acquisition and assessment of seismic data. The second is the Offshore Geoscience Data Project (OGDP) which is designed to encourage new offshore petroleum exploration in Newfoundland and Labrador through the acquisition and assessment of seismic data. The funding is recognized as other revenue when the related expenditures are incurred. Deferred revenue also includes the over-lift position associated with Oil and Gas' net working interest of petroleum and natural gas produced, and the fair value of oil inventory held at the Newfoundland Transshipment site.

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| <i>As at December 31, 2017 (thousands of Canadian dollars)</i> | OGDP | PEEP | Other | Total |
|--|-------|-------|-------|-------|
| Deferred revenue, beginning of year | 659 | 993 | 784 | 2,436 |
| Additions | - | - | 37 | 37 |
| Recognized in profit or loss | (441) | (242) | - | (683) |
| Deferred revenue, end of year | 218 | 751 | 821 | 1,790 |
| Less: current portion | - | (700) | - | (700) |
| | 218 | 51 | 821 | 1,090 |

11. DECOMMISSIONING LIABILITIES

Oil and Gas' decommissioning liabilities result from net ownership interests in petroleum and natural gas properties and related well sites. The total undiscounted estimated cash flows required to settle the obligations, including a rate of inflation of 2%, at December 31, 2017 are \$131.3 million (2016 - \$116.8 million). Payments to settle the liabilities are expected to occur between 2028 and 2033. The fair value of the decommissioning liabilities was determined using the present value of future cash flows discounted at rates ranging from 3.9% to 4.2% (2016 - 4.0% to 4.3%). The reconciliation of the beginning and ending carrying amounts of decommissioning liabilities is as follows:

| <i>As at December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|--|--------|----------|
| Decommissioning liabilities, beginning of year | 66,991 | 74,193 |
| Accretion | 2,845 | 3,116 |
| Liabilities settled | (995) | (17) |
| Revisions | 2,304 | (10,301) |
| Decommissioning liabilities, end of year | 71,145 | 66,991 |
| Less: current portion of decommissioning liabilities | - | (995) |
| | 71,145 | 65,996 |

12. EMPLOYEE FUTURE BENEFITS

12.1 Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of \$365,100 (2016 - \$312,200) were expensed as incurred.

12.2 Other Benefits

Oil and Gas provides group life insurance and health care benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a retirement allowance. In 2016 and 2017, there were no cash payments to beneficiaries for its unfunded other employee future benefits plans. An actuarial valuation was performed as at December 31, 2017.

| <i>As at December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|--|-------|------|
| Accrued benefit obligation, beginning of year | 893 | 858 |
| Current service cost | 135 | 43 |
| Interest cost | 40 | 29 |
| Transfers | (25) | - |
| Actuarial gain | (12) | (37) |
| Accrued benefit obligation, end of year | 1,031 | 893 |

| <i>For the year ended December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|---|------|------|
| Components of benefit cost | | |
| Current service cost | 135 | 43 |
| Interest cost | 40 | 29 |
| Total benefit expense for the year | 175 | 72 |

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

| | 2017 | 2016 |
|--|--------------|-------|
| Discount rate - benefit cost | 3.90% | 4.10% |
| Discount rate - accrued benefit obligation | 3.55% | 3.90% |
| Rate of compensation increase | 3.50% | 3.50% |

Assumed healthcare trend rates:

| | 2017 | 2016 |
|---|--------------|-------|
| Initial healthcare expense trend rate | 6.00% | 5.85% |
| Cost trend decline to | 4.50% | 4.50% |
| Year that rate reaches that rate it is assumed to remain at | 2028 | 2025 |

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

| <i>Increase (thousands of Canadian dollars)</i> | 2017 | 2016 |
|---|-------------|------|
| Current service and interest cost | 46 | 43 |
| Accrued benefit obligation | 217 | 187 |

| <i>Decrease (thousands of Canadian dollars)</i> | 2017 | 2016 |
|---|--------------|-------|
| Current service and interest cost | (31) | (30) |
| Accrued benefit obligation | (154) | (133) |

13. ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of, and changes in, accumulated other comprehensive loss are as follows:

Items that will not be reclassified to profit or loss:

| <i>(thousands of Canadian dollars)</i> | 2017 | 2016 |
|--|--------------|-------|
| Employee benefit reserve | | |
| Balance at January 1 | (336) | (373) |
| Net actuarial gains on defined benefit plans | 12 | 37 |
| Balance at December 31 | (324) | (336) |

Items that may or have been reclassified to profit or loss:

| <i>(thousands of Canadian dollars)</i> | 2017 | 2016 |
|--|----------------|---------|
| Fair value reserve | | |
| Balance at January 1 | (4,788) | 6,855 |
| Fair value losses during the year | (977) | (5,447) |
| Amounts reclassified to profit or loss | 1,157 | (6,196) |
| Balance at December 31 | (4,608) | (4,788) |

14. SHAREHOLDER'S EQUITY

14.1 Share Capital

| <i>As at December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|--|----------------|---------|
| Common shares without nominal or par value | | |
| Authorized - unlimited | | |
| Issued, fully paid and outstanding - 100 | 110,000 | 110,000 |

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14.2 Shareholder Contributions

| <i>As at December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|--|----------------|---------|
| Total shareholder contributions | 906,112 | 887,205 |

During 2017, Nalcor made contributions to Oil and Gas totaling \$18.9 million (2016 - \$176.5 million). These contributions were used to fund Oil and Gas' investment activities.

15. OPERATING COSTS

| <i>For the year ended December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|---|--------------|-------|
| Salaries and benefits | 2,929 | 3,492 |
| Advertising, donations and community involvement | 1,576 | 244 |
| Insurance | 1,276 | 1,298 |
| Professional services | 1,270 | 1,695 |
| Other operating costs | 1,542 | 1,355 |
| | 8,593 | 8,084 |

16. PRODUCTION, MARKETING AND TRANSPORTATION COSTS

| <i>For the year ended December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|---|---------------|--------|
| Project operating costs | 21,818 | 16,014 |
| Processing and marketing | 8,770 | 6,105 |
| Transportation and transshipment | 4,845 | 4,213 |
| | 35,433 | 26,332 |

17. NET FINANCE EXPENSE

| <i>For the year ended December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|---|--------------|-------|
| Finance income | | |
| Other interest income | (15) | (58) |
| Finance costs | | |
| Accretion | 2,845 | 3,358 |
| Other finance costs | 216 | 182 |
| | 3,061 | 3,540 |
| Interest capitalized during construction | - | (242) |
| | 3,061 | 3,298 |
| Net finance expense | 3,046 | 3,240 |

18. OTHER EXPENSE (INCOME)

| <i>For the year ended December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|---|---------------|---------|
| Settlement of commodity swaps | 1,885 | (6,196) |
| Settlement of foreign exchange forward contracts | (728) | - |
| Hedge ineffectiveness | (2) | 2 |
| Loss on disposal of property, plant and equipment | 11,578 | 214 |
| Realized foreign exchange loss (gain) | 2,427 | (109) |
| Unrealized foreign exchange loss | 95 | 1,037 |
| Other expense (income) | 15,255 | (5,052) |

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19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

19.1 Fair Value

The estimated fair values of financial instruments as at December 31, 2017 and December 31, 2016 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Oil and Gas might receive or incur in actual market transactions.

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

Establishing Fair Value

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

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

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

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. For assets and liabilities that are recognized at fair value on a recurring basis, the Company determines whether transfers have occurred between levels in the hierarchy by reassessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period. There were no transfers between Level 1, 2 and 3 fair value measurements for the years ended December 31, 2017 and December 31, 2016.

As at December 31, 2017 and December 31, 2016, the Company did not have any Level 3 instruments.

| | Level | Carrying Value | Fair Value | Carrying Value | Fair Value |
|--|-------|-------------------|------------|-------------------|------------|
| | | December 31, 2017 | | December 31, 2016 | |
| <i>(thousands of Canadian dollars)</i> | | | | | |
| Financial assets | | | | | |
| Derivative assets | 2 | 2,452 | 2,452 | - | - |
| Financial liabilities | | | | | |
| Derivative liabilities | 2 | 7,060 | 7,060 | 4,790 | 4,790 |

The fair values of cash and cash equivalents, trade and other receivables, and trade and other payables approximate their carrying values due to their short-term maturity.

The fair values of Level 2 financial instruments are determined using quoted prices in active markets, which, in some cases, are adjusted for factors specific to the asset or liability. Level 2 derivative instruments are valued based on observable commodity future curves, broker quotes or other publicly available data. Level 2 fair values of other risk management assets and liabilities are determined using observable inputs other than unadjusted quoted prices, such as interest rate yield curves and currency rates.

19.2 Risk Management

Oil and Gas is exposed to certain credit, liquidity and market price risks through its operating, financing and investing activities. Financial risk is managed in accordance with a Board-approved policy, which outlines the objectives and strategies for the management of financial risk, including the use of derivative contracts. Permitted financial risk management strategies are aimed at minimizing the volatility of Oil and Gas' expected future cash flows.

Credit Risk

Oil and Gas' expected future cash flows are exposed to credit risk through its operating activities, primarily through the potential for non-performance by its customers. The degree of exposure to credit risk on cash and cash equivalents and the sale of crude oil, including the associated accounts receivable, is determined by the financial capacity and stability of those customers and counterparties. The maximum exposure to credit risk on these financial instruments is represented by their carrying values on the Statement of Financial Position at the reporting date.

Credit risk on cash and cash equivalents is minimal, as Oil and Gas' cash deposits are held by a Canadian Schedule 1 Chartered Bank with a rating of A+ (Standard and Poor's). Receivables resulting from oil sales are from a major oil and gas company whose creditworthiness was appropriately assessed prior to execution of the related oil marketing agreement.

Liquidity Risk

Oil and Gas is exposed to liquidity risk with respect to its contractual obligations and financial liabilities, including any derivative liabilities related to hedging activities. Oil and Gas' activities around liquidity risk management are directed to ensuring cash is available to meet those obligations as they become due. Short-term liquidity is mainly provided through cash and cash equivalents on hand, funds from operations and a \$30.0 million (2016 - \$30.0 million) unsecured demand operating facility with the Company's bank. As at December 31, 2017, Oil and Gas had no borrowings outstanding on the credit facility (2016 - \$nil) and \$5.4 million of the borrowing limit has been used to issue two irrevocable letters of credit (2016 - \$0.5 million).

In April 2017, Oil and Gas issued an irrevocable letter of credit in the amount of \$4.9 million to the Canada-Newfoundland and Labrador Offshore Petroleum Board (C-NLOPB). The purpose of this letter was to provide proof of financial responsibility with respect to the Hebron project. An irrevocable letter of credit in the amount of \$1.5 million that was issued to the C-NLOPB in July 2017 was cancelled in November 2017 as it was no longer required.

As at December 31, 2017, Nalcor, on behalf of Oil and Gas, had \$25.7 million in outstanding letters of credit, issued to ensure compliance with regulations relating to petroleum and natural gas exploration and production activities.

Market Risk

In the course of carrying out its operating, financing and investing activities, Oil and Gas is exposed to possible market price movements that could impact expected future cash flow and the carrying value of certain financial assets and liabilities. Market price movements to which Oil and Gas has significant exposure include those relating to foreign exchange rates, most notably USD/CAD, and commodity prices, most notably the spot prices for oil.

Foreign Exchange and Commodity Exposure

Oil and Gas is exposed to foreign exchange and commodity price risk on its sales, which are denominated in USD and based on prevailing market oil prices. Exposures on USD denominated oil sales are addressed through the use of fixed price commodity swaps and foreign exchange exposure on sales is partially offset by USD denominated capital expenditures and foreign exchange forward contracts.

During 2017, total oil sales denominated in USD were \$168.6 million (2016 - \$93.6 million). While Oil and Gas has exposure to fluctuations in the USD/CAD exchange rate on those sales, a significant portion of Oil and Gas' planned capital expenditures for 2017 were denominated in USD, which mitigated this exposure.

The table below shows the impact of a 5% change in foreign exchange rates on trade and other receivables and trade and other payables as at December 31, 2017.

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| <i>(thousands of Canadian dollars)</i> | 5% Decrease | 5% Increase |
|--|----------------|----------------|
| Trade and other receivables | (1,852) | 1,852 |
| Trade and other payables | (228) | 228 |

On November 30, 2016, Oil and Gas entered into a series of commodity price swap contracts to hedge commodity price risk on approximately 25% of anticipated production. These contracts had a notional value of \$32.3 million USD and an average price of \$52.09 per barrel. During 2017, \$1.9 million in realized losses (2016 - \$6.2 million in gains) from commodity price swap contracts, designated under hedge accounting, were included in other expense (income). As these contracts have been designated as hedging instruments, changes in fair value have been recorded in other comprehensive income (loss).

In December 2016, Oil and Gas entered into a series of foreign exchange forward contracts to hedge foreign exchange risk on approximately 23% of anticipated USD oil sales in 2017. These contracts had a notional value of \$32.3 million USD and an average fixed rate of \$1.33 CAD per USD. During 2017, \$0.7 million in realized gains from foreign exchange forward contracts, designated under hedge accounting, were included in other expense (income). As these contracts have been designated as hedging instruments, changes in fair value have been recorded in other comprehensive income (loss).

On November 27, 2017, Oil and Gas entered into a series of commodity price swaps to hedge commodity price risk on approximately 50% of anticipated 2018 production. These contracts have a notional value of \$97.9 million USD and provide an average fixed price of \$61.36 USD per barrel.

On November 28, 2017, Oil and Gas entered into a series of foreign exchange forward contracts to hedge foreign exchange risk on USD oil sales in 2018. These contracts have a notional value of \$97.9 million USD, and an average fixed rate of \$1.28 CAD per USD. Combined with one remaining contract already in place, Oil and Gas have hedged \$100.6 million in USD energy sales at an average fixed rate of \$1.28 CAD per USD.

As these contracts have been designated as hedging instruments, changes in fair value have been recorded in other comprehensive income (loss). For the year ended December 31, 2017, \$4.6 million in losses (2016 - \$4.8 million in losses) remain in other comprehensive income (loss).

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The components of change impacting the carrying value of financial instruments are as follows:

| | Commodity and | | Total |
|--|-------------------|--------------|-----------------|
| | Forward Contracts | Other* | |
| <i>(thousands of Canadian dollars)</i> | Level II | Level II | Level II |
| Balance at January 1, 2017 | (4,790) | - | (4,790) |
| Purchases | - | - | - |
| Transfers | - | - | - |
| | (4,790) | - | (4,790) |
| Changes to profit (loss) | | | |
| Hedge ineffectiveness | 2 | - | 2 |
| Total | 2 | - | 2 |
| Changes in other comprehensive income | | | |
| Mark-to-market | (977) | - | (977) |
| Settlements realized in profit (loss) | 1,157 | - | 1,157 |
| Total | 180 | - | 180 |
| Balance at December 31, 2017 | (4,608) | - | (4,608) |
| Balance at January 1, 2016 | 6,855 | (7,108) | (253) |
| Purchases | - | - | - |
| Transfers | - | - | - |
| | 6,855 | (7,108) | (253) |
| Changes to profit (loss) | | | |
| Accretion | - | (242) | (242) |
| Mark-to-market | (2) | - | (2) |
| Settlements | - | 7,350 | 7,350 |
| Total | (2) | 7,108 | 7,106 |
| Changes in other comprehensive loss | | | |
| Mark-to-market | (5,447) | - | (5,447) |
| Settlements realized in profit (loss) | (6,196) | - | (6,196) |
| Total | (11,643) | - | (11,643) |
| Balance at December 31, 2016 | (4,790) | - | (4,790) |

* Hebron penalty payable

20. RELATED PARTY TRANSACTIONS

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

| Related Party | Relationship |
|---|-----------------------------------|
| Nalcor | 100% shareholder of Oil and Gas |
| Newfoundland and Labrador Hydro (Hydro) | Wholly-owned subsidiary of Nalcor |
| The Province | 100% shareholder of Nalcor |

Routine operating transactions with related parties are settled at prevailing market prices under normal trade terms. Outstanding balances due to or from related parties are non-interest bearing with no set terms of repayment, unless otherwise stated.

Significant related party transactions and balances are as follows:

- (a) For the year ended December 31, 2017, Oil and Gas was charged \$841,500 (2016 - \$649,000) by Nalcor for intercompany salaries.

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- (b) For the year ended December 31, 2017, Oil and Gas was charged \$380,000 (2016 - \$479,000) by Hydro for management and administrative services received.
- (c) As at December 31, 2017, Oil and Gas had a net receivable from Nalcor of \$21.8 million (2016 - \$0.4 million payable).
- (d) For the year ended December 31, 2017, Oil and Gas expensed \$10.3 million (2016 – \$6.4 million) to the Province for royalties on its oil and gas operations.

20.1 Key Management Personnel Compensation

Compensation for key management personnel, which Oil and Gas defines as its executives who have the primary authority and responsibility in planning, directing and controlling the activities of the entity, includes compensation for senior executives. Salaries and employee benefits include base salaries, performance contract payments, vehicle allowances and contributions to employee benefit plans. Post-employment benefits include contributions to the Province’s Public Service Pension Plan.

| <i>For the year ended December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|---|-------------|------|
| Salaries and employee benefits | 350 | 322 |
| Post-employment benefits | 31 | 29 |
| | 381 | 351 |

21. COMMITMENTS AND CONTINGENCIES

- (a) Oil and Gas has received claims with respect to miscellaneous matters. Although the outcome of such actions cannot be predicted with certainty, Management currently believes Oil and Gas’ exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, is not expected to materially affect the financial position of Oil and Gas.
- (b) Oil and Gas has the following commitments as a result of its joint venture partnerships:

| <i>(millions of Canadian dollars)</i> | Operating | Capital | Total Commitments |
|---------------------------------------|-----------|---------|-------------------|
| 2018 | 15.9 | 7.2 | 23.1 |
| 2019 | 9.3 | - | 9.3 |
| 2020 | 9.3 | - | 9.3 |
| 2021 | 8.7 | - | 8.7 |
| 2022 | 8.5 | - | 8.5 |
| Thereafter | 6.3 | - | 6.3 |

22. CAPITAL MANAGEMENT

Oil and Gas’ objective when managing capital is to maintain the ability to fund operating costs and expenditures related to development and production assets, on a timely basis. Oil and Gas maintains an unsecured demand credit facility, which is used to finance operations in the short-term. Long-term capital includes share capital, shareholder contributions and retained earnings. Oil and Gas’ future requirements for capital are expected to decline as construction on existing joint venture projects decreases. During this time, it is expected that Oil and Gas’ cash flow from operations will be sufficient to fund its capital needs. Additional requirements will be funded through Oil and Gas’ credit facility.

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23. SUPPLEMENTARY CASH FLOW INFORMATION

| <i>For the year ended December 31 (thousands of Canadian dollars)</i> | 2017 | 2016 |
|---|-----------------|----------|
| Trade and other receivables | (17,735) | (21,818) |
| Inventory | (5,869) | (4,213) |
| Prepayments | (5,947) | 405 |
| Trade and other payables | (32,830) | (8,326) |
| Deferred revenue | (646) | (3,376) |
| Changes in non-cash working capital balances | (63,027) | (37,328) |
| Related to: | | |
| Operating activities | (44,177) | (19,472) |
| Investing activities | (18,850) | (17,856) |
| | (63,027) | (37,328) |