

# CAPITAL POWER CORPORATION

Notes to the Consolidated Financial Statements

(Tabular amounts in millions of Canadian dollars, except share and per share amounts)

## 2. Significant accounting policies, continued:

### (t) Provisions, continued:

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under contract. The provision is measured at the present value of the lower of expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Company recognizes any impairment loss on the assets associated with that contract.

### (u) Share-based payments:

The Company operates an equity-settled, share-based compensation plan where each option converts into one common share. The fair value of the employee services received in exchange for the grant of the options is recognized as a compensation expense within staff costs and credited to the employee benefits reserve. The employee benefits reserve is reduced as the options are exercised and the amount initially recorded as a credit in employee benefits reserve is reclassified to share capital. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted.

The Company determines the fair value of stock options using a binomial option pricing model at the date of grant. Measurement inputs include the share price on the measurement date, the exercise price of the instrument, expected volatility, expected term of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

The Company has incorporated an estimated forfeiture rate for stock options that will not vest into its determination of share-based compensation for each period.

The fair values of the amounts payable to employees/directors in respect of the Performance Share Unit (PSU) Plan and the Directors' Deferred Share Unit (DSU) Plan, which are settled in cash, are recognized as expenses with corresponding increases in liabilities, over the period that the employees/directors unconditionally become entitled to payments. The grant date fair values are determined using a binomial lattice valuation, based on a five day weighted average price of the Company's shares immediately prior to the grant, adjusted for estimated forfeitures and discounted using the risk-free interest rate. The liability is re-measured to fair value at each reporting date and at the settlement date. Any changes in the fair value of the liability are recognized in income or loss.

### (v) Earnings per share:

Basic earnings per share is calculated by dividing income available to common shareholders by the weighted average number of common shares outstanding during the period.

Diluted earnings per share is calculated on the treasury stock method, by dividing income available to common shareholders, adjusted for the effects of dilutive securities, by the weighted average number of common shares outstanding during the period and all additional common shares that would have been outstanding had all potential dilutive common shares been issued.

### (w) Future accounting changes:

A number of new standards, and amendments to standards and interpretations, as described below, are not yet effective for the year ended December 31, 2012 and have not been applied in preparing these consolidated financial statements. The Company has completed its preliminary assessment of the effect on its consolidated financial statements of adopting these standards and amendments. For those standards where earlier application is permitted, the Company expects to apply the changes at the effective date.