



**ALASKA HYDRO CORPORATION**  
(formerly Project Finance Corp.)

**CONSOLIDATED  
INTERIM FINANCIAL STATEMENTS**

**FOR THE THREE AND SIX MONTH PERIODS  
ENDED JUNE 30, 2011 AND 2010**

(Unaudited)

Head Office  
Suite 503-675 West Hastings Street  
Vancouver B.C., V6B 1N2

**NOTICE OF NO AUDITOR REVIEW OF**

**INTERIM FINANCIAL STATEMENTS**

Under National Instrument 51-102, Part 4, subsection 4.3(3) (a), if an auditor has not performed a review of the interim financial statements they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying un-audited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

# Alaska Hydro Corporation (formerly Project Finance Corp.)

## Consolidated Balance Sheets

(in US Funds)

	(Unaudited) June 30 2011	(Audited) December 31 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 29,881	\$ 193,658
Accounts receivable	48,694	35,166
Prepaid expenses and deposits	8,705	13,355
Deferred financing	8,138	-
Property Plant and Equipment (note 4)	17,053	19,954
	<u>\$ 112,471</u>	<u>\$ 262,133</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 270,534	\$ 289,526
Convertible debentures	11,940	-
Due to related party	157,949	96,402
	<u>440,423</u>	<u>385,928</u>
Unearned income	250,000	250,000
Convertible debentures (note 6)	243,870	-
Shareholders' equity:		
Equity component of convertible debenture	33,314	-
Share capital (note 7)	2,825,860	2,825,860
Contributed surplus (note 7)	278,367	272,450
Deficit	(3,959,363)	(3,472,105)
	<u>(821,822)</u>	<u>(373,795)</u>
	<u>\$ 112,471</u>	<u>\$ 262,133</u>

Nature of operations (note 1)

On behalf of the Board:

Signed "Clifford Grandison" Director

Signed "M. E. Hoole" Director

**Alaska Hydro Corporation** (formerly Project Finance Corp.)

## Consolidated Statements of Loss and Deficit

(in US Funds)

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
Hydro project expenditures (note 5)	\$ 153,221	\$ 125,750	\$ 280,224	\$ 230,480
General and administrative:				
Wages and benefits	-	14,925	-	37,346
Professional fees	73,852	-	155,661	-
Stock based compensation	1,292	-	2,571	-
Accretion expense	2,768	-	4,084	-
Interest on convertible debentures	8,018	-	11,827	-
Office administration	8,255	40,166	24,181	67,528
Investor relations	(19)	-	2,124	-
Transfer agent, filing & sustaining fees	5,469	-	13,060	-
Amortization	1,450	984	2,901	1,968
	101,085	56,075	216,409	106,842
Loss before other item	254,306	181,825	496,633	337,322
Other item:				
Interest income & other	123	-	181	-
Foreign exchange (gain)/loss	(2,600)	-	9,194	-
Net loss for the period	(256,783)	(181,825)	(487,258)	(337,322)
Deficit, beginning of period	(3,702,580)	(1,913,764)	(3,472,105)	(1,758,267)
Deficit, end of period	\$ (3,959,363)	\$ (2,095,589)	\$ (3,959,363)	\$ (2,095,589)
Net loss per share - basic and diluted	\$ (0.01)	\$ -	\$ (0.01)	\$ -
Weighted average shares outstanding	37,504,958	-	37,504,958	-
Shares outstanding at end of period	37,504,958	-	37,504,958	-

**Alaska Hydro Corporation** (formerly Project Finance Corp.)

## Consolidated Statements of Comprehensive Loss

*(in US Funds)*

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
Net loss for the period	\$ (256,783)	\$ (181,825)	\$ (487,258)	\$ (337,322)
Currency translation differences	-	-	-	-
Comprehensive loss for the period	\$ (256,783)	\$ (181,825)	\$ (487,258)	\$ (337,322)

**Alaska Hydro Corporation** (formerly Project Finance Corp.)

## Consolidated Statements of Cash Flows

(in US Funds)

	Three months ended		Six months ended	
	June 30		June 30	
	2011	2010	2011	2010
Cash flows provided by (used in):				
Operating activities:				
Loss for the period	\$ (256,783)	\$ (181,825)	\$ (487,258)	\$ (337,322)
Item not affecting cash:				
Amortization	1,450	984	2,901	1,968
Stock-based compensation	1,292	-	2,571	-
Accrued interest on convertible debentures	8,018	-	11,827	2,578
	(246,023)	(180,841)	(469,959)	(332,776)
Changes in non-cash working capital items:				
Accounts receivable and prepaid	(4,212)	-	(8,878)	-
Refundable deposits	-	5,000	-	15,000
Accounts payable and accrued liabilities	153,292	134,568	42,668	150,008
Cash used in operating activities	(96,943)	(41,273)	(436,169)	(167,768)
Financing Activities:				
Warrants issued for services	3,346	-	3,346	-
Proceeds from convertible debentures	14,651	-	277,184	119,671
Advance from related party	-	41,086	-	33,586
Deferred financing	(3,346)	-	(8,138)	-
Cash provided by financing activities	14,651	41,086	272,392	153,257
Change in cash and cash equivalents during the period	\$ (82,292)	\$ (187)	\$ (163,777)	\$ (14,511)
Cash and cash equivalents - beginning of period	\$ 112,173	\$ 10,326	\$ 193,658	\$ 24,650
Cash and cash equivalents - end of period	\$ 29,881	\$ 10,139	\$ 29,881	\$ 10,139

**Alaska Hydro Corporation** (formerly Project Finance Corp.)Consolidated Statements of Changes in Equity  
(in US Funds)

	Six months ended June 30	
	2011	2010
<b>Equity component of convertible debenture</b>		
Beginning of period	\$ -	\$ 5,455
Issued	33,314	21,758
Other adjustment	-	-
End of period	33,314	27,213
<b>Share capital (note 7)</b>		
Beginning of period	2,825,860	1,447,703
Shares Issued on conversion of debentures	-	-
Shares issued for non-brokered PP	-	-
Shares issued for brokered PP	-	-
Share issue costs	-	-
Agents and corporate finance warrants	-	-
End of period	2,825,860	1,447,703
<b>Contributed surplus (note 7)</b>		
Beginning of period	272,450	-
Stock based compensation	2,571	-
Warrants issues for services	3,346	-
End of period	278,367	-
<b>Deficit</b>		
Beginning of period	(3,472,105)	(1,758,267)
Loss	(487,258)	(337,322)
Other adjustment	-	-
End of period	(3,959,363)	(2,095,589)
Total equity	\$ (821,822)	\$ (620,673)

# **Alaska Hydro Corporation** (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

For the Three and Six Months ended June 30, 2011 and 2010

(In US Dollars)

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## **1. NATURE OF OPERATIONS AND GOING CONCERN**

Alaska Hydro Corporation, formerly Project Finance Corp., (the “Company” or “Alaska Hydro”) was incorporated on October 16, 2006 under the British Columbia Business Corporations Act. Prior to September 3, 2010, the Company was a Capital Pool Company (“CPC”) as defined in Policy 2.4 of the TSX Venture Exchange (the “Exchange”). On September 3, 2010 the Company completed its Qualifying Transaction (the “Qualifying Transaction”) pursuant to the rules and policies of the Exchange by acquiring the net assets and operations of Cascade Creek LLC. (“Cascade”), a development stage hydro electric project. On that date the Company also changed its name to Alaska Hydro Corporation. The Company commenced trading on the Exchange as a Tier 2 Issuer on September 8, 2010 under its new name and trading symbol “AKH”. As disclosed in Note 2, this transaction has been accounted for as a reverse asset acquisition of the Company by Cascade. The balances and transactions reported for 2010 are comprised of Cascade’s operations for 2010 and those of Alaska Hydro (formerly Project Finance Corp.) for the period from September 3, 2010 to December 31, 2010.

The Company incurred a net loss of \$487,258 (2010 - \$337,322) for the six months ended June 30, 2011, and had an accumulated deficit of \$3,959,363 (2010 - \$2,095,589) at June 30, 2011 which has been funded primarily by the issuance of equity. The Company is in the development stage and its ability to continue as a going concern is dependent upon its ability to develop its Cascade Creek hydro electric project, to raise sufficient financing and to obtain the required licenses from the US Federal Energy Regulatory Commission (“FERC”). Upon receiving the FERC license, the Company may proceed to complete and construct its Cascade Creek hydro electric project and to ultimately generate income and cash flows from operations of the project. The outcome of these matters cannot be predicted at this time and in the event they do not occur, the carrying value of the Company’s assets may be adversely affected.

The Company does not generate cash flows from operations and accordingly the Company will need to raise additional funds through future issuance of securities or debt financing. Although the Company has been successful in raising funds in the past, there can be no assurance the Company will be able to raise sufficient funds in the future, in which case the Company may be unable to meet its obligations as they come due in the normal course of business. It is not possible to predict whether financing efforts will be successful or if the Company will attain a profitable level of operations.

The current cash resources are not adequate to pay our accounts payable and to meet our minimum commitments at the date of this MD&A, including planned corporate and administrative expenses, the Hydro Project programme, and other Project implementation costs. To complete the development of the Cascade Creek Hydro Project beyond the date of these Consolidated Financial Statements, we will need to raise additional funds. The availability of funds to develop the Cascade Creek Hydro Project is not guaranteed and will be contingent upon a number of factors including the condition of the equity and debt markets at the time they are required. If the Company is unable to raise additional funds it may have to joint venture, sell or abandon its interest in the Cascade Creek project and/or cease operations.

These financial statements do not give effect to adjustments that would be necessary to the carrying amounts and classifications of assets and liabilities should the Company be unable to continue as a going concern.

## **2. REVERSE ASSET ACQUISITION**

On September 3, 2010 Alaska Hydro acquired all of the outstanding capital of Cascade from its owners, through the issuance of an aggregate of 23,761,458 common shares and 6,238,542 special warrants of Alaska Hydro, resulting in Alaska Hydro owning all of Cascade. Each special warrant is convertible into one common share for no additional consideration. Concurrent with this acquisition the Company completed a brokered financing and a non-brokered financing (Note 7).



# Alaska Hydro Corporation (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

For the Three and Six Months ended June 30, 2011 and 2010

(In US Dollars)

## 2. REVERSE ASSET ACQUISITION (continued)

Although the transaction resulted in Cascade becoming a wholly-owned subsidiary of Alaska Hydro, the transaction constitutes a reverse asset acquisition of Alaska Hydro and was accounted for as a capital transaction rather, than a business combination, in accordance with Canadian Institute of Chartered Accountants (“CICA”) Emerging Issues Committee Abstract No. 10 – *Reverse Takeover Accounting*.

These financial statements are deemed to be a continuation of the assets, operations, and capital of Cascade and they have been presented as if Cascade had acquired the net assets of Alaska Hydro in a capital transaction followed by a financing transaction. The share capital presented reflects the capital of Cascade prior to the acquisition together with the share structure of the Company after the transaction.

The net assets and obligations assumed on September 3, 2010 for financial statement presentation purposes were as follows:

Assets acquired		
Amounts receivable	\$	13,892
Other current assets		10,870
		<hr/>
		24,762
Liabilities assumed		
Accounts payable and accrued liabilities		(42,791)
Net obligations assumed	\$	<hr/>
		(18,029)

The net obligations assumed were charged to deficit on the acquisition date.

## 3. SIGNIFICANT ACCOUNTING POLICIES

### a) Basis of Presentation and Consolidation

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants (“CICA Handbook”). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards (“IFRS”), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, we have commenced reporting on this basis in these consolidated financial statements. In these consolidated financial statements, the term “Canadian GAAP” refers to Canadian GAAP before the adoption of IFRS.

These consolidated financial statements are expressed in US dollars and include the accounts of the Company, and its wholly owned subsidiary, Cascade Creek LLC (“Cascade”). All inter-company transactions have been eliminated.

These unaudited consolidated interim financial statements should be read in conjunction with our Canadian GAAP audited annual consolidated financial statements for the year ended December 31, 2010. These unaudited consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to the preparation of interim financial statements including IAS 34, Interim Financial Reporting (“IAS 34”) and IFRS 1 First-Time adoption of International Reporting Standards (“IFRS 1”). In the opinion of management, all adjustments considered necessary for fair presentation have been included. Operating results for the three and six month periods ended June 30, 2011 and 2010 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2011.

# **Alaska Hydro Corporation** (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

For the Three and Six Months ended June 30, 2011 and 2010

(In US Dollars)

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## **3. SIGNIFICANT ACCOUNTING POLICIES (continued)**

### First-time Adoption Exemptions Applied

IFRS 1, which governs the first-time adoption of IFRS, generally requires accounting policies to be applied retrospectively to determine the opening balance sheet on our transition date of January 1, 2010, and allows certain exemptions on the transition to IFRS. The elections Alaska has chosen to apply considered significant to the company are:

- to not restate previous business combinations and the accounting thereof;
- to not apply IAS 21, The effects of changes in Foreign Exchange rates;

We have applied IFRS 1 in preparing these first IFRS consolidated interim financial statements. The statements include policies necessary to meet IFRS requirements. The effects of the transition are presented in Note 13 CDN GAAP to IFRS.

### **b) Equipment**

Equipment is recorded at cost and is amortized over the useful life of the equipment of 5 years, on a straight-line basis, except in the year of acquisition, when one half of the rate is used.

### **c) Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand and bank deposits with original maturity dates of three months or less

### **d) Power Project Development Costs**

Power project development costs, incurred prior to the determination of the economic feasibility of the power project and a decision to proceed with development are charged to operations as incurred.

If a project is deemed to be economically feasible and a decision to proceed with the project is made by the Company, costs associated with the development of the project are capitalized and subsequently amortized over the life of the project. Capitalized costs of unsuccessful projects are written off as impaired in the period that a project is abandoned or when recovery of the costs is no longer regarded as assured.

### **e) Foreign Currency Translation**

The functional currency of Alaska Hydro Corporation, the parent entity, is the Canadian dollar. The presentation currency of our consolidated financial statements is USD which represents the primary economic environment of the consolidated entity.

The functional currency for our subsidiary is the currency of the primary economic environment in which the entity operates. Transactions in foreign currencies are translated to the functional currency of the entity at the exchange rate in existence at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated at the period end date exchange rates. Non-monetary items which are measured using historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Foreign operations are translated from their functional currencies into United States dollars on consolidation. Items in the statement of income are translated using weighted average exchange rates that reasonably approximate the exchange rate at the transaction date. Items in the balance sheet are translated at the closing spot exchange rate. Exchange differences on the translation of the net assets of entities with functional currencies other than the United States dollar, are recognized in a separate component of equity through other comprehensive income.

# **Alaska Hydro Corporation** (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

For the Three and Six Months ended June 30, 2011 and 2010

(In US Dollars)

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## **3. SIGNIFICANT ACCOUNTING POLICIES (continued)**

### **f) Long-lived Assets and Impairment**

Long-lived assets are reviewed by management for possible impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. An impairment loss is recognized when the carrying amount of an asset exceeds the estimated undiscounted future cash flow expected to result from the use of the asset and its eventual disposition. As at June 30, 2011, there was no impairment of the Company's long-lived assets.

### **g) Income Taxes**

Prior to December 31, 2009, under the provisions of the US Internal Revenue Code and applicable state laws, Cascade was not directly subject to US income taxes as Cascade was treated as a flow through entity for U.S. tax purposes. As a result, no provision for income taxes has been included in these financial statements for that period.

Effective January 1, 2010 Cascade was granted status as an association taxable as a corporation. As a result, income taxes are accounted for using the liability method subsequent to January 1, 2010. Under this method current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of assets and liabilities. Future income tax assets and liabilities are measured using substantially enacted tax rates that apply for the years in which the temporary differences are expected to be recovered or settled. A valuation allowance is recorded against any future income tax asset if it is not more likely than not that the asset will be realized.

### **h) Loss per Share**

Loss per share is calculated using the weighted average number of shares outstanding during the reporting period. The Company uses the treasury stock method for computing diluted loss per share. This method assumes that any proceeds obtained upon exercise of outstanding options or warrants would be used to purchase common shares at the average market price during the period. As the Company has recorded a net loss in the six months ending June 30, 2011, basic and diluted net loss per share are the same because the outstanding options and warrants are anti-dilutive.

No loss per share information has been presented for the 2010 comparative period as these figures represent the assets and operations of Cascade Creek LLC, which did not have share capital separated into discrete shares.

### **i) Share Issue Costs**

Professional, consulting, regulatory and other costs directly attributable to financing transactions are recorded as deferred financing costs until the financing transactions are completed, if the completion of the transaction is considered likely; otherwise they are expensed as incurred. Share issue costs are charged to share capital when the related shares are issued. Deferred financing costs related to financing transactions that are not completed are charged to expenses.

### **j) Convertible Debentures**

The value recorded for convertible debentures is separated into debt and equity based on the characteristics of this compound financial instrument. The Company uses the "residual valuation" method to determine the debt and equity components of the convertible debenture. Under the residual valuation method, the debt component is determined by estimating the present value of the future cash payments discounted at a rate of interest which the Company would be charged by the market for similar debt without the conversion option. The difference between the proceeds of the loan and the debt component is recorded as the equity component.

# **Alaska Hydro Corporation** (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

For the Three and Six Months ended June 30, 2011 and 2010

(In US Dollars)

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## **3. SIGNIFICANT ACCOUNTING POLICIES (continued)**

### **k) Use of Estimates**

The preparation of financial statements in conformity with IFRS requires management to make certain estimates and assumptions. These estimates affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates include the assessment of recoverability and valuation of assets, the determination of the amortization period of equipment, expected future tax rates and the utilization of future income tax assets, fair value measurements for financial instruments, the estimated amount of accrued liabilities, estimation of debt and equity components of compound financial instruments, allocation of purchase consideration to net assets acquired and the measurement of stock-based compensation transactions. Financial results as determined by actual events could differ from those estimates.

### **l) Financial Instruments**

All financial instruments are required to be measured at fair value on initial recognition, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held for trading, available for sale, held to maturity, loans and receivables, or other financial liabilities.

Financial assets and liabilities classified as held for trading are measured at fair value, with gains and losses recognized in net earnings. Available for sale financial assets with quoted market prices are measured at fair value, with unrealized gains and losses recognized in other comprehensive income. Investments in equity instruments classified as available for sale that do not have quoted market prices in an active market are measured at cost.

Financial assets classified as held to maturity and loans and receivables are measured at amortized cost using the effective interest rate method of amortization. Financial liabilities classified as other financial liabilities are measured at amortized cost using the effective interest method of amortization.

The Company has classified its financial instruments as follows:

- a) Cash and cash equivalents are classified as held-for-trading; and
- b) Accounts payable and amounts due to related parties are classified as other financial liabilities.

### **m) Comparative Figures**

Certain of the 2010 figures presented for comparative purposes have been reclassified to conform to the presentation adopted in the current year.

### **n) Recent Accounting Pronouncements - International Financial Reporting Standards (“IFRS”)**

The Canadian Accounting Standards Board confirmed that publicly accountable entities will be required to prepare financial statements in accordance with IFRS for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. Companies will have to provide comparative IFRS information for the previous fiscal year.

The transition from Canadian GAAP to IFRS is applicable for the Company for the first quarter of 2011, in which the Company reported both the current and comparative information using IFRS.

# Alaska Hydro Corporation (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

For the Three and Six Months ended June 30, 2011 and 2010

(In US Dollars)

## 3. SIGNIFICANT ACCOUNTING POLICIES (continued)

### o) Recent Accounting Pronouncements - Business Combinations and Consolidated Financial Statements

In January 2009, the CICA issued Section 1582, Business Combinations, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combination and related disclosures. The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier adoption permitted. The Company does not expect that the adoption of this standard will have a material impact on the Company's financial statements.

In January 2009, the CICA issued Section 1601, Consolidated Financial Statements, and 1602, Non-controlling interests, which replaces existing guidance. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period on or after January 2011 with earlier adoption permitted. The Company does not expect that the adoption of this standard will have a material impact on the Company's financial statements.

## 4. EQUIPMENT

	Cost \$	Accumulated Amortization \$	Net Book Value \$
June 30, 2011			
Equipment	29,012	11,959	17,053
December 31, 2010			
Equipment	29,012	9,058	19,954

## 5. POWER PROJECT DEVELOPMENT COSTS

The Cascade Creek project is comprised of a proposed 70 MW lake syphon hydro electric facility connecting Swan Lake to a powerhouse and a transmission line to a location near Petersburg, Alaska, USA. The project is estimated to generate an approximate average of 204 GW.h per year of renewable energy plus some storage capacity. The Cascade Creek project is part of the Thomas Bay project initiative, which consists of three potential hydro electric facility sites – Cascade Creek, Ruth Lake, and Scenery Lake that would all share transmission lines from Thomas Bay to Petersburg, Alaska.

### Cascade Creek

During the first quarter of 2011, the Company announced that Cascade, its wholly owned subsidiary, issued its Draft License Application (“DLA”) for the proposed 70MW Cascade Creek Hydroelectric Project at Thomas Bay, Alaska. Issuance of the DLA initiates the 90-day review period as required by the FERC licensing process, whereby resource agencies, native groups, and other interested parties have an opportunity to review and comment on the application.

The Company had a preliminary permit for a three-year-period from February 1<sup>st</sup>, 2008 for priority on the development application for this site. This project is now in the licensing phase of the application process with FERC. The preliminary permit expired on February 1<sup>st</sup>, 2011 and the Company subsequently filed a another preliminary permit application with FERC to further protect the Company's status with respect to the FERC process until issuance of a FERC license for the project.

# Alaska Hydro Corporation (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

For the Three and Six Months ended June 30, 2011 and 2010

(In US Dollars)

## 5. POWER PROJECT DEVELOPMENT COSTS (continued)

During the second quarter Cascade received timely comments from regulatory agencies including FERC regarding the DLA, and the Preliminary Draft Environmental Assessment (“PDEA”), both submitted February 2011. The comments received provide clear direction for remaining study requirements. Cascade has met with agencies in mid-June and will develop and implement remaining field studies, and complete environmental investigations necessary for the final license application preparation. The issues and extent of studies requested are typical of those required for projects in southeast Alaska and do not reflect any surprises or special circumstance that may negatively affect the Cascade Creek project. Concurrently, the public comment period closed May 15, 2011 on the company’s new preliminary permit application to FERC with no competitive application filed by any other entity.

### Ruth Lake

The Company’s preliminary permit for Ruth Lake expired on February 23, 2009. A subsequent preliminary permit was issued by FERC to the City of Angoon, Alaska on November 5, 2009. On October 5, 2009, a development agreement between the City of Angoon and the Company was reached in which the Company is to provide permitting and design, construction, and operational management services to the City of Angoon for this 20 MW, 70 GW.h project. This agreement is intended to last for an extended period of time, depending on subsequent license renewals. No work is currently being carried out on Ruth Lake.

### Scenery Lake

The Company’s preliminary permit for Scenery Lake expired on February 23, 2009. A subsequent preliminary permit was issued by FERC to the City of Angoon, Alaska on October 1, 2009. On October 5, 2009, a development agreement between the City of Angoon and the Company was reached in which the Company is to provide permitting and design, construction, and operational management services to the City of Angoon for this 30 MW, 130 GW.h project. This agreement is intended to last for an extended period of time, depending on subsequent license renewals. No work is currently being carried out on Scenery Lake.

The Company has incurred the following costs related to these power projects, all of which have been expensed in accordance with the Company’s accounting policy outlined in Note 3(d):

	Cascade Creek	Ruth Lake	Scenery Lake	Total
	\$	\$	\$	\$
<b>Year ended December 31, 2007</b>				
Consulting	156,437	46,752	31,168	234,357
Engineering Project Costs				
Power Sales	115,200	-	-	115,200
Pre-Application Document and Notice of Intent	90,871	-	-	90,871
Preliminary Design	12,698	-	-	12,698
Preliminary Feasibility Study	129,600	-	-	129,600
Study Planning	10,268	-	-	10,268
Transmission Interconnectivity	273,600	-	-	273,600
Travel	4,430	-	-	4,430
	793,104	46,752	31,168	871,024

**Alaska Hydro Corporation** (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

For the Three and Six Months ended June 30, 2011 and 2010

(In US Dollars)

**5. POWER PROJECT DEVELOPMENT COSTS (continued)**

	Cascade Creek \$	Ruth Lake \$	Scenery Lake \$	Total \$
<b>Year ended December 31, 2008</b>				
Consulting	205,729	26,490	11,451	243,670
Dues and Licenses	1,717	-	-	1,717
Engineering Project Costs				
Environmental Studies	75,960	-	-	75,960
Pre-Application Document and Notice of Intent	5,030	-	-	5,030
Preliminary Design	1,042	-	-	1,042
Scoping	5,150	-	-	5,150
Study Planning	49,000	-	-	49,000
	343,628	26,490	11,451	381,569
<b>Year ended December 31, 2009</b>				
Consulting	39,427	20,560	3,810	63,797
Dues and Licenses	1,113	-	-	1,113
Engineering Project Costs				
Environmental Studies	40,607	-	-	40,607
Preliminary Design	3,345	-	-	3,345
Scoping	84,941	-	-	84,941
Study Planning	15,298	-	-	15,298
	184,731	20,560	3,810	209,101
<b>Year ended December 31, 2010</b>				
Consulting	2,755	575	375	3,705
Engineering Project Costs				
Environmental Studies	813,694	-	-	813,694
Preliminary Design	135,238	-	-	135,238
Scoping	32,874	-	-	32,874
Study Planning	75,138	-	-	75,138
License application	132,620	-	-	132,620
	1,192,319	575	375	1,193,269
<b>Period ended June 30, 2011</b>				
Consulting	-	-	-	-
Engineering Project Costs				
Environmental Studies	159,954	-	-	159,954
Preliminary Design	-	-	-	-
Scoping	-	-	-	-
Study Planning	-	-	-	-
License application	120,270	-	-	120,270
	280,224	-	-	280,224
<b>Total at June 30, 2011</b>	<b>2,794,006</b>	<b>94,377</b>	<b>46,804</b>	<b>2,935,187</b>

# Alaska Hydro Corporation (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

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## 6. CONVERTIBLE DEBENTURES

The Company issued convertible debentures totalling \$30,000 in 2009. It also issued an additional \$119,671 in convertible debentures in 2010. All of these debentures were to mature approximately nine months following their issue date, were interest bearing at 10% compounded and payable semi-annually, and were unsecured. The conversion feature allowed the debenture holders to convert the debenture to common shares of the Company at the time of closing the transaction described in Note 2, at a conversion price which resulted in an additional 1,875,000 shares being issued to the debenture holders as outlined in the table in Note 7(b). The conversion feature for the debenture outstanding at December 31, 2009 was estimated to be \$5,455 using the residual method, and this amount has been recognized as a separate component of share holders' equity at December 31, 2010.

During the six months ending June 30, 2011 the Company issued an aggregate of C\$264,000 of Convertible Debentures in several tranches. The Convertible Debentures will mature on the date that is three years from the date of issuance and bear interest at 12% per annum, payable semi-annually. The principal amount of the Convertible Debentures is convertible into common shares of the Company, at any time from the date of issuance until the maturity date, at a price equal to C\$0.16 per common share. The Company may elect to pay accrued interest by the issuance of common shares, at a price per share equal to the market price of the common shares at the date of issuance. In addition, the Company may elect to redeem the Convertible Debentures at any time prior to the Maturity Date.

The Company paid finder's fees and commissions in connection with these Convertible Debentures of \$8,138 which includes 29,063 warrants with a two year term, exercisable at C\$0.16.

## 7. SHARE CAPITAL

(a) **Authorized:** 100,000,000 common shares without par value.

(b) **Issued and Outstanding:**

	Number of Shares	Share Capital	Contributed Surplus
Balance December 31, 2008	–	\$ 1,105,238	\$ –
Members' Contributions	–	342,465	–
Balance December 31, 2009	–	1,447,703	–
Recognition of Alaska Hydro share structure	4,260,000	–	–
Shares issued on conversion of Cascade debentures	1,875,000	149,671	–
(1) Shares issued on reverse takeover by Cascade	21,886,458	–	–
(2) Shares issued for non-brokered private placement of units at \$0.1537 (C\$0.16) per unit	2,500,000	384,209	–
(3) Shares issued for brokered private placement	6,983,500	1,073,249	–
(3) Share issue costs	–	(161,910)	–
(3) Agents' and corporate finance warrants	–	(67,062)	67,062
Options granted (Note 6(e))	–	–	205,388
Balance December 31, 2010	37,504,958	\$ 2,825,860	\$ 272,450
Options granted (Note 6(e))	–	–	2,571
Finders warrants issued	–	–	3,346
Balance June 30, 2011	37,504,958	\$ 2,825,860	\$ 278,367



# Alaska Hydro Corporation (formerly Project Finance Corp)

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## 7. SHARE CAPITAL (continued)

- (1) On September 3, 2010 23,761,458 common shares and 6,238,542 special warrants were issued for 100% of Cascade. Each warrant is convertible into one common share of the Company for no additional consideration. This transaction resulted in a reverse takeover that was a capital transaction in substance (Note 2). Of the 23,761,458 common shares and 6,238,542 special warrants issued, an aggregate of 28,750,000 common shares and special warrants are subject to escrow agreements pursuant to the policies of the Exchange. Under the escrow agreements, 10% of the common shares were released upon closing of the transaction with the remaining common shares to be released in 15% tranches in 6 month intervals thereafter. Of these securities, 6,000,000 common shares issued to certain of the unit-holders are also subject to a performance escrow agreement.
- (2) On September 3, 2010, the Company closed a non-brokered private placement of 2,500,000 units at \$0.1537 (C\$0.16) per unit. Each unit is comprised of one common share and one common share purchase warrant. Each warrant entitles the holder, on exercise, to acquire one additional common share at an exercise price of \$0.3074 (C\$0.32) until September 3, 2015. No proceeds from the issuance of these units was allocated to the warrants as the warrants did not have intrinsic value at the time the units were issued. The equity financing raised net proceeds of \$384,209. No finder's fees or commissions were paid in connection with this non-brokered private placement. These common shares and any additional common shares issued from exercise of these warrants will be subject to escrow arrangements similar to those outlined in (1) above.
- (3) On September 3, 2010, the Company closed a brokered private placement of 6,983,500 units at a price of \$0.1537 (C\$0.16) per unit for gross proceeds of \$1,073,249. Each unit is comprised of one common share of the Company and one common share purchase warrant. Each warrant entitles the holder, on exercise, to acquire one additional common share at an exercise price of \$0.3074 (C\$0.32) until September 3, 2015. No proceeds from the issuance of these units was allocated to the warrants as the warrants did not have intrinsic value at the time the units were issued. The Company paid share issuance costs of \$161,910 in connection with this placement. The Company also issued 555,080 agents' warrants and 93,750 corporate finance warrants. Each warrant entitles the holder, on exercise, to acquire one additional common share at an exercise price of \$0.1537 (C\$0.16) until September 3, 2012.

### (c) Shares Held in Escrow:

At June 30, 2011, 17,132,021 of the issued and outstanding common shares were held in escrow. See Note 7(b)(1) and 7(b)(2) for escrow terms.

### (d) Warrants:

The current balance of outstanding warrants is as follows:

	Weighted Average Exercise Price (C\$)	Warrants
Balance December 31, 2010	\$ 0.19	16,370,872
Issued	0.16	29,063
Exercised	—	—
Expired	—	—
Balance June 30, 2011	\$ 0.19	16,399,935

# Alaska Hydro Corporation (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

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## 7. SHARE CAPITAL (continued)

The warrants issued and outstanding as at June 30, 2011 are as follows:

Expiration Date	Outstanding		Weighted Average Exercise Price (C\$)
September 3, 2012	648,830	\$	0.16
September 3, 2015	9,483,500		0.32
January 21, 2013	18,125		0.16
February 9, 2013	6,250		0.16
March 22, 2013	4,688		0.16
No expiration	6,238,542		–
Balance June 30, 2011	16,399,935	\$	0.19

On September 3, 2010, 648,830 agents' and corporate finance warrants with an exercise price of \$0.16 and a term of two years were issued as part of the costs of the brokered private placement (Note 7(b)(3)). The fair value of these warrants issued was \$0.11 and was estimated using the Black-Scholes option pricing model, using the following weighted average assumptions and results:

Expected life	2 years
Volatility	137.2%
Risk free interest rate	1.37%
Dividends	0%

### (e) Options:

The Company grants stock options to directors, officers, employees and consultants as compensation for services, pursuant to its incentive Share Option Plan (the "Plan") options issued must have an exercise price greater than or equal to the "Discounted Market Price" of the Company's shares on the grant date. Options have a maximum expiry period of up to five years from the grant date and vest at such time as may be determined by the Board of Directors at the date of the grant. Options granted to consultants performing investor relations activities shall vest in stages over a 12-month period with a maximum of one-quarter of the options vesting in any three-month period. The number of options that may be issued under the Plan is limited to no more than 10% of the Company's issued and outstanding shares on the grant date.

The current balance of outstanding options is as follows:

	Weighted Average Exercise Price (C\$)	Options
Balance December 31, 2011	\$ 0.16	2,265,000
Granted	–	–
Expired	–	–
Balance June 30, 2011	\$ 0.16	2,265,000

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## 7. SHARE CAPITAL (continued)

The weighted average remaining contractual lives of the outstanding options are:

Expiration Date	Vested	Outstanding	Weighted Average Exercise Price (C\$)	Weighted Average Remaining Contractual Life
September 3, 2013	140,000	140,000	\$ 0.10	2.2 years
December 1, 2015	2,058,334	2,125,000	0.16	4.4 years
Balance June 30, 2011	2,198,334	2,265,000	\$ 0.16	4.3 years

On December 1, 2010, 2,125,000 options with an exercise price of \$0.16 and a term of five years were granted to directors, officers, employees and consultants of the Company. The stock-based compensation related to these grants had a fair value of \$0.10 per option and was estimated using the Black-Scholes option pricing model, using the following weighted average assumptions and results:

Expected life	5 years
Volatility	130.8%
Risk free interest rate	2.44%
Dividends	0%

## 8. TAXES

Significant components of the Company's deferred tax assets are shown below:

	June 30, 2011	Dec 31, 2010
Non-capital loss carry forwards	\$ 629,000	\$ 547,060
Share issuance costs	59,000	69,616
	\$ 688,000	\$ 616,676
Valuation allowance	(688,000)	(616,676)
Balance, end of year	\$ -	\$ -

As at June 30, 2011, the Company has approximately CAD\$709,000 of non-capital loss carry forwards available to reduce taxable income for future years in Canada. The Canadian loss carry forwards begin to expire in 2028 if unused.

As at June 30, 2011, the Company has approximately \$1,690,000 of non-capital loss carry forwards available to reduce taxable income for future years in the United States. The US loss carry forwards begin to expire in 2030 if unused.

In assessing deferred tax assets, management considers whether it is more likely than not that some portion of all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of deferred tax asset considered realizable could change materially in the near term based on future taxable income during the carry forward period.

# **Alaska Hydro Corporation** (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

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(In US Dollars)

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## **9. MANAGEMENT OF CAPITAL**

The Company's objectives when managing capital is to safeguard the Company's ability to continue as a going concern. The Company does not have any externally imposed capital requirements to which it is subject. The Company seeks to manage capital to provide adequate funding for its projects while minimizing dilution for its existing shareholders. As the Company, is a development stage venture issuer, has limited ability presently to raise money by long term or any other kind of debt, for practical purposes all of its capital management is directed towards management of its issues of equity including warrants. There is thus very limited flexibility in its capital management.

## **10. FINANCIAL INSTRUMENTS AND RISK**

### Financial Instruments

As at June 30, 2011, the Company's financial instruments consist of cash and cash equivalents, accounts payable and amounts due to related parties. The fair values of these financial instruments approximate their carrying values because of their current nature.

The Company classifies its cash and cash equivalents as held-for-trading and its accounts payable and amounts due to related parties as other financial liabilities.

### Liquidity Risk

All of the Company's financial liabilities have contractual maturities of 30 days or less or are due on demand and are subject to normal trade terms. The Company does not have investments in any asset backed commercial paper or similar instruments.

The Company does not generate cash flows from operations and accordingly the Company will need to raise additional funds through future issuance of securities or debt financing. Although the Company has been successful in raising funds in the past, there can be no assurance the Company will be able to raise sufficient funds in the future, in which case the Company may be unable to meet its obligations as they come due in the normal course of business. It is not possible to predict whether financing efforts will be successful or if the Company will attain a profitable level of operations.

The current cash resources are not adequate to pay our accounts payable and to meet our minimum commitments at the date of this MD&A, including planned corporate and administrative expenses, the Hydro Project programme, and other Project implementation costs. To complete the development of the Cascade Creek Hydro Project beyond the date of these Consolidated Financial Statements, we will need to raise additional funds. The availability of funds to develop the Cascade Creek Hydro Project is not guaranteed and will be contingent upon a number of factors including the condition of the equity and debt markets at the time they are required. If the Company is unable to raise additional funds it may have to joint venture, sell or abandon its interest in the Cascade Creek project and/or cease operations.

### Foreign Exchange Risk

The Company does monitor its foreign exchange risk. A significant portion of the Company's transactions are in US funds whereas the equity based sources of capital are in Canadian dollars.

# Alaska Hydro Corporation (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

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## 10. FINANCIAL INSTRUMENTS AND RISK (continued)

### Interest Rate Risk

The Company manages its interest rate risk by obtaining commercial deposit interest rates available in the market from major Canadian financial institutions. The Company has guaranteed investment certificates. The following table summarizes the impact of reasonable possible changes in interest rates for the Company at June 30, 2011 and December 31, 2010. The sensitivity analysis is based on the assumption that the interest rate changes by 1% with all other variables remaining constant. The 1% sensitivity is based on reasonably possible changes over a financial year, using the observed range of historical rates for the preceding year.

	Jun 30, 2011	Dec 31, 2010
Impact on net loss:		
1% increase	\$ 300	\$ 1,900
1% decrease	\$ (300)	\$ (1,900)

### Fair Value

The Corporation classifies its fair value measurements in accordance with an established hierarchy that prioritizes the inputs in valuation techniques used to measure fair value as follows:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities

Level 2 - Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly, and

Level 3 - Inputs that are not based on observable market data

The following table sets forth the Corporation's financial assets measured at fair value on a recurring basis by level within the fair value hierarchy:

	Level 1	Level 2	Level 3	Total June 30, 2011
Cash and cash equivalents	\$ 29,881	\$ -	\$ -	\$ 29,881
	\$ 29,881	\$ -	\$ -	\$ 29,881

## 11. RELATED PARTY TRANSACTIONS AND BALANCES

### a) Due to Related Parties

As at June 30, 2011, the Company has accrued \$157,949 (2010 - \$122,587) due to directors and companies controlled by directors or officers of the Company for legal, accounting and consulting services described in Note 11(b). The amounts are non-interest bearing, unsecured and due on demand.

# **Alaska Hydro Corporation** (formerly Project Finance Corp)

Notes to the Consolidated Financial Statements

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(In US Dollars)

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## **11. RELATED PARTY TRANSACTIONS AND BALANCES (continued)**

### **b) Transactions with Related Parties**

During the six months ended June 30, 2011 and 2010, the Company had the following related party transactions:

- i) For the six months ended June 30, 2011, the Company paid or incurred a total of \$68,828 (2010 - \$Nil) to a director for legal services and to a company controlled by an officer for CFO services.
- ii) For the six months ended June 30, 2011, the Company paid or incurred a total of \$89,220 (2010 - \$81,502) to a company controlled by a director, and in which another director is an officer, for consulting and engineering services relating to the Cascade Creek hydro electric project.
- iii) For the six months ended June 30, 2011 the Company paid or incurred a total of \$39,748 (2010-\$Nil) to two directors for management services.
- iv) For the six months ended June 30, 2011 the Company advanced its 100% owned subsidiary Cascade Creek LLC \$259,500 (2010-\$Nil)

These transactions are in the normal course of operations and are recorded at their exchange amounts, which is the consideration agreed upon by the related parties.

## **12. COMMITMENTS**

### **a) Unearned Income**

On January 13, 2009, the Company entered into an agreement with the City and Borough of Wrangell (the "City") for the Company to construct, own, operate, and maintain the Cascade Creek facility for the generation of electric power located in Thomas Bay, Alaska, USA. The Company agreed to sell up to 1% of the net output to the City and the City has the first right to purchase 1% of the net output from the Company for a period of 25 years at the break even production cost.

The City advanced a payment of \$250,000 to the Company in 2009. In the event the Company defaults on any of the conditions of the agreement, the Company must repay any payment made by the City, plus interest at a maximum statutory rate from the date of such payment, with the repayment obligation to be secured by a lien against the Company's assets.

### **b) Consulting and Engineering Services**

The Company has an ongoing non-exclusive agreement with a company controlled by a director of the Company for permitting and technical consulting services as directed by the Company. Fees are to be paid for time and materials in accordance with an agreed fee schedule. Either party may terminate the agreement by giving reasonable notice to the other party.

# Alaska Hydro Corporation (formerly Project Finance Corp)

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## 13. CDN GAAP to IFRS

The major differences between the previous accounting policies of the Company and those the Company now applies in preparing IFRS financial statements are included below. These differences do not represent a complete list of changes under IFRS.

Key areas	Canadian GAAP	IFRS	Analysis
Capital assets	Capital assets are recorded at cost.	Under IFRS 1, capital assets can be recorded at historical cost or at fair value. The carrying value must be assessed annually or when events or circumstances occur which could impair the carrying value.	The Company will continue to record its capital assets at cost due to the minimal values at the current period.
Hydropower projects and deferred costs	Evaluation and development costs can be either capitalized or expensed when incurred.	IFRS provides only limited guidance on this topic and currently allows the Company to continue its current treatment.	The existing policy of expensing evaluation development cost pending viability will be maintained.
Impairment of long lived assets	Hydropower project costs are tested for impairment on an annual basis or when there are indicators of Impairment.	Same as Canadian GAAP.	The use of discounted future cash flows as an indicator of impairment may increase the likelihood of write downs in the future.
Functional currency	The Company has determined that the Canadian dollar is its functional currency of the parent company and USD is the functional currency of the sub. Functional currency is determined by the reference to the following: The currency used in day-to day operations; and the currency used for labour, materials and other costs of the product or service.	IFRS provides more guidance in determining functional currency. Functional currency is defined as the currency of the primary economic environment in which the entity operates. IFRS provides additional factors to consider in determining functional currency.	The Company's functional reporting currency under IFRS is USD as this is the currency of the project which is the primary economic environment with potential development costs and future revenues.
Stock based compensation	Stock based compensation is determined using the Black Scholes option pricing model. Allows use of the straight line method or accelerated method to account for graded vesting features.	Stock based compensation is determined using the Black Scholes option pricing model. For graded vesting features, each instalment or vesting period is treated as a separate share option grant, and hence the fair value of each vesting period will differ.	The recognition of the value of stock based compensation will remain unchanged from the current treatment as the graded vesting method is in use.

# Alaska Hydro Corporation (formerly Project Finance Corp)

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## 13. CDN GAAP to IFRS (continued)

The audit committee of the Company is kept informed of management's decision on accounting policy choices under IFRS.

Reconciliation of Equity:

	June 30 2010
Equity under Canadian GAAP	\$ (620,673)
Equity component of convertible debenture	-
Share capital (note 5)	-
Contributed surplus (note 5)	-
Deficit	-
Total IFRS adjustments to equity	-
Equity under IFRS	\$ (620,673)

Reconciliation of total comprehensive income:

	Three Months Ended June 30, 2010	Six Months Ended June 30, 2010
Comprehensive loss	\$ 181,825	\$ 337,322
Changes	-	-
Total comprehensive loss	\$ 181,825	\$ 337,322

## 14. SUBSEQUENT EVENTS

Subsequent to the quarter end the Company issued an aggregate of 160,000 incentive share options to 2 company directors in recognition of a change in responsibilities and a new appointment as a director.