MEETING OF THE AUDIT COMMITTEE
THE INDEPENDENT ELECTRICITY SYSTEM OPERATOR

Wednesday, March 15, 2017

8:30 a.m. – 9:30 a.m. Special Audit Committee meeting
16th Floor Boardroom
120 Adelaide Street West, Toronto, Ontario and by Conference Call (See details below)

CONFERENCE CALL DETAILS

[redacted]

Highly Confidential
Agenda

	Item	Presenter	Time	Target Time	Action
1.	Welcome and Introductions	Carole Workman	5 Minutes	8:30 – 8:35	Information
2.	Approval of the Proposed Agenda	Carole Workman	5 Minutes	8:35 – 8:40	Decision
3.	Conflicts	Carole Workman	5 Minutes	8:40 – 8:45	Information
4.	Accounting Policies	Kim Marshall	45 Minutes	8:45 – 9:30	Decision

Agenda Item - Summary

Date of Meeting: March 15, 2017

Agenda Item: IESO Accounting Policies

Strategic Priority: IESO Core Business

Executive Summary: The IESO is recommending a change in IESO accounting policies to provide a more appropriate presentation of events or transactions in the IESO financial statements.

These changes are

1. Recording Market Accounts assets and liabilities on the IESO balance sheet
2. Adoption of regulated accounting principles

Significant Issues: Potential communication challenges.

Decision being Sought: Approval of the change in accounting policy as presented to the Committee.

Attachments:

IESO Memo;

KPMG Regulatory Assets/Liabilities and Market Accounts memo;

Pro Forma 2016 Statement of Financial Position and 2016 Statement of Operations including Selected Notes to the 2016 Financial Statements (for illustrative purposes); and

Resolution

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Memorandum

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To: THE AUDIT COMMITTEE OF
THE BOARD OF DIRECTORS
of the Independent Electricity System Operator

From: Kim Marshall
Vice President, Corporate Services and Chief Financial Officer

Date: March 13, 2017

Re: Change in Accounting Policies

In partnership with our auditors, KPMG, the IESO has undertaken a review of its accounting policies under Public Sector Accounting Standards with the objective of ensuring that our statements accurately reflect the IESO's activities and best serve user needs. This review included consideration of the accounting policies utilized in other accounting standards; the practices of other entities in Ontario in the electricity sector; the practices of entities in other sectors with the agent accountabilities similar to the IESO and the practices of other system operators in North America.

As a result of the review, Management is recommending changes in the IESO accounting policy which will result in a more appropriate presentation of events or transactions in its financial statements. Specifically, the changes recommended are:

1. Recording Market Accounts assets and liabilities on the IESO balance sheet
2. Adoption of regulated accounting principles

Management believes that these changes result in financial statements that are more transparent and consistent with the general reporting practice in the electricity sector. These changes better reflect the economic activity and oversight of the IESO. There is a risk that there is misinterpretation or misunderstanding of the financial statements as a result of this change. We believe this can be mitigated with an associated communications plan.

Given that the IESO's corporate financial statements are consolidated into the Provincial Government statements, the IESO has been in contact with the Provincial Controllers office, which is in agreement with our approach.

The audited IESO financial statements are usually filed with the Auditor General in May, subsequent to Board approval and filing with the Ministry of Energy. Consideration is being given to a more proactive approach this year given a change in policy. This will be discussed in more detail with the Audit Committee.

K Marshall

KPMG

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To IESO Audit File
IESO Management, Audit Committee, Board of Directors

Date February 23, 2017

From Matthew Betik

Ref

Subject **Regulatory Assets/Liabilities and Market Accounts**

Purpose:

The purpose of this memorandum is to discuss and illustrate the impacts of the proposed changes to accounting policies of the IESO for rate regulated assets/liabilities and Market Accounts.

Background:

Prior to 2016, IESO annual financial statements included the following two accounting policies:

i) Market Accounts – "These financial statements do not include the financial transactions of market participants within the IESO-administered markets" [excerpt from Note 2(b)]

ii) Regulatory assets/liabilities – while not specifically stated, the IESO did not recognize regulatory assets/liabilities, as it, did not follow rate regulated accounting.

At a high level, the reason for i) is that IESO did not view itself as a counterparty to market participant transactions (rather as an administrator or facilitator) and the market rules and legislation clearly set out that it was not to be liable for market participant transactions. The reason for ii) is that Public Sector Accounting Standards (PSAS), which is the accounting framework applied to IESO's financial statements did not have specific standards or guidance relating to regulatory accounting. Additionally, IESO did not follow regulatory accounting in its pre-PSAS accounting framework prior to 2011, and the existing accounting policies met the user needs.

Through a review of accounting policies in 2016, it was determined that a re-examination of these two policies should be made to ensure that periodic and annual financial reporting was relevant to IESO financial statement users.

Market Accounts:

IESO is contemplating including year-end asset and liability balances of the Market Accounts in its annual audited financial statements. These balances include assets such as cash, market accounts receivable, conservation contracts receivable, generation contracts receivable, regulated price plan variance, etc., and liabilities such as line of credit facility, market accounts payable, prepayments, generation contracts settlements payable, and provisions for future transmission rights, OESP, RRRP and enforcement activity. Revenue and expense activity throughout the year would not be recorded in the financial statements because IESO is not a principal to those transactions.

Working with KPMG, IESO determined that there were reporting options for market accounts and that a choice is required as to whether or not to record Market Accounts assets and liabilities in the IESO financial statements. By analyzing the nature of the accounts, IESO's economic relationship to them, legislative requirements and market rules it was concluded that an appropriate position for either treatment was acceptable.

Should IESO include these balances in its annual financial statements, it would be done via a change in accounting policy, with retroactive application. This means that there would be full disclosure of the change and that the 2015 balances in the financial statements would be restated for the effect of the change.

Impact to the proposed change to include Market Accounts in the IESO financial statements:

Pros:	Cons:
- More transparent as it includes assets and liabilities that IESO is holding on behalf of the market - Presents the net position of the market of $0 at the end of the reporting period - Provides auditing reporting on activities that IESO governance is ultimately accountable for	- Adds some additional complexity to the financial statements, including line items and notes (including additional time and cost to prepare/audit) - Potential for some users to misinterpret the nature of assets/liabilities or not fully understand the impact - Financial statement users, including market participants may incorrectly conclude that they have recoveries from/payments to IESO as opposed to the IESO administered market.

<u>Regulatory assets/liabilities:</u>

A regulatory asset/liability (also referred to collectively as a regulatory deferral account balance) is "The balance of any expense (or income) account that would not be recognised as an asset or a liability in accordance with other Standards, but that qualifies for deferral because it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers." (IFRS 14, Appendix A). In other words, an entity that applies this type of accounting has been granted a right (normally by an independent regulator) to charge different rates in the future based on costs that have previously been incurred, and as such, can record an asset for that right. This accounting is most common with utilities (public or private) where the utility has a monopoly over a service territory and a regulator is required to ensure fair treatment of both the customer and supplier of the utility. In Ontario, almost all Local Electricity Distribution Companies (LDCs) and Natural Gas Distribution Companies use rate regulated accounting. Furthermore, many ISOs in the United States also follow rate regulated accounting, in accordance with FASB 980.

As noted above, IESO has not historically used rate regulated accounting, despite having transactions that may have "fit" into the type of transactions that qualify. Most notably, the Smart Metering Entity incurred millions of dollars in costs between 2007 and 2012 with a commitment from the Minister of Energy to provide for a rate for recovery in the future. This rate was granted in 2013. Rate regulated accounting is not specifically addressed in PSAS, so the decision was made not to use it. However, entities are permitted under PSAS, under certain conditions, to consult other sources of accounting standards (Canadian Private Company Standards ("ASPE"), IFRS, US GAAP, US Government Standards) for guidance when PSAS does not address a specific issue. KPMG and IESO have performed a technical analysis of this and concluded it would be acceptable to consult these other sources. It is important to note that ASPE, US GAAP, and US Government standards all recognize rate regulated accounting. IFRS does not specifically recognize it at this time, but a standards working group is examining the issue and has approved standards permitting entities using IFRS for the first time to continue to use rate regulated accounting until a final determination has been made.

IESO, in collaboration with KPMG, performed a detailed analysis as to whether or not rate regulated accounting could be applied to IESO and it was concluded that this treatment is an appropriate accounting policy.

Similar to Market Accounts, should IESO include rate regulated accounting in its annual financial statements, it would be done via a change in accounting policy, with retroactive application. This means that there would be full disclosure of the change and that the prior year balances in the financial statements would be restated for the effect of the change. Adopting this change will bring IESO's accounting policies more closely in line with LDCs and other ISOs in North America.

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Independent Electricity System Operator
Regulatory assets/liabilities and Market Accounts
February 23, 2017

Impact to Financial Statements:

The most significant impact of the above noted matters is for rate regulated accounting. An initial analysis indicates the following areas will be impacted:

- Smart Metering Entity Charges
- PSAS transition amounts for Pension and Other Post Employment Benefits

Smart Metering Entity

As noted above, the SME incurred costs before it was granted a rate order to recover those costs. Assuming these costs qualify as regulatory assets, the initial costs would have been recorded as assets and not expenses (and accumulate deficit).

A simplified example, in 2012, SME costs incurred were $23,734 thousand. The two accounting treatments are as follows:

As previously reported		Pro-form using rate-regulated accounting	
Dr. SME Expenses	23,734	Dr. SME Regulatory Asset	23,734
Cr. Cash	(23,734)	Cr. Cash	(23,734)

In other words, instead of recording net expenses, IESO would have recorded an asset. Similarly, for years subsequent to 2012, where an SME rate was ordered and charged, rather than record the entire amount as revenue, only revenue sufficient to recover current year's costs would be presented, with the remainder reducing the regulatory asset.

A simplified example, in 2013, SME costs incurred were $26,531 thousand and SME collections were $30,144 thousand. The two accounting treatments are as follows:

As previously reported		Pro-form using rate-regulated accounting	
Dr. SME Expenses	26,531	Dr. SME Expenses	26,531
Cr. Cash	(26,531)	Cr. Cash	(26,531)
Dr. Cash received	30,144	Dr. Cash received	30,144
Cr. SME Revenues	(30,144)	Cr. SME Revenues	(26,531)
		Cr. SME Regulatory Asset	(3,613)

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Under the rate-regulated accounting option, the process would continue until such time as the regulatory asset is reduced to zero. Should it be reduced below zero, a regulatory liability would be recorded.

PSAS Transition Items for Pensions and Other Post-Employment Benefits

In 2011, as the IESO transitioned to PSAS, it moved approximately $80M of unamortized net actuarial losses and past service costs from its asset/liability accounts to its accumulated deficit. This treatment was permitted by the first time adoption rules of PSAS. As these unamortized losses would no longer flow through the statement of operations of IESO, and if left unadjusted the rate setting process would no longer recover the costs. As such, the IESO has included in its annual rate submissions to the OEB to recover a portion of the unamortized losses. Since 2012, this has ranged from $4 million to $6 million annually.

Assuming PSAS transition items qualified as regulatory assets, the initial transaction would have been recorded as assets and not accumulate deficit.

A simplified example of the two accounting treatments are as follows at the date of transition is as follows:

As previously reported		Pro-form using rate-regulated accounting	
Dr. Acc. deficit – PSAS Transition	80,967	Dr. Acc. deficit – PSAS Transition	80,967
Cr. Pension + OPEB Liab.	(80,967)	Cr. Pension + OPEB Liab.	(80,967)
		Dr. Regulatory asset – PSAS Trans.	80,967
		Cr. Acc. deficit – PSAS Transition	(80,967)

A simplified example of the two accounting treatments are as follows at dates following the date of transition to PSAS is as follows:

As previously reported		Pro-form using rate-regulated accounting	
Dr. Cash received	3,912	Dr. Cash received	3,912
Cr. System fees	(3,912)	Cr. Regulatory asset – PSAS Trans.	(3,912)

See attached pro-forma statement of financial position and statement of operations to illustrate the impacts. Furthermore, several of the notes to the financial statements would have to be amended.

Impact to the proposed change to adopt regulatory accounting in the IESO financial statements:

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Regulatory assets/liabilities and Market Accounts
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Pros:	Cons:
- Provides a clearer picture of the IESO's financial position with respect to items that have been charged to income or directly to accumulated surplus for which a recovery from market participants will be made - Makes IESO accounting more similar to other market participants, especially LDCs - Future initiatives, for which IESO may be incurring costs but may not have a rate order yet, will not necessarily be recorded as a net loss until such time as the order is received	- Need to ensure OEB understands and appropriately sets rates - Subject to the changing nature of accounting policies by standard setters (i.e., what if IFRS eventually rejects rate regulated accounting and other market participants are required to abandon that accounting)

<u>Conclusion:</u>

IESO has concluded, and KPMG concurred that these contemplated changes are appropriate accounting treatments and as such, would be recorded as a change in accounting policy if adopted in the year of effective adoption.

Independent Electricity System Operator
Statements of Financial Position
Unaudited

As at (in thousands of Canadian dollars)	Previous Policies December 31, 2016	Adjustments	Pro-forma rate regulated December 31, 2016
	$		$
FINANCIAL ASSETS			
Cash and cash equivalents	33,005		33,005
Accounts receivable	31,103		31,103
Long-term investments (Note 3)	40,355		40,355
Regulatory assets		65,064	65,064
Market accounts - assets (Note XX)		1,646,565	1,646,565
TOTAL FINANCIAL ASSETS	**104,463**		**1,816,092**
LIABILITIES			
Accounts payable and accrued liabilities (Note 4)	38,964		38,964
Accrued interest on debt	315		315
Rebates due to market participants (Note 5)	12,551		12,551
Debt (Note 6)	90,000		90,000
Accrued pension liability (Note 7)	34,620		34,620
Accrued liability for employee future benefits other than pension (Note 7)	90,251		90,251
Market accounts - liabilities (Note XX)		1,646,565	1,646,565
TOTAL LIABILITIES	**266,701**		**1,913,266**
NET DEBT	**(162,238)**		**(97,174)**
NON-FINANCIAL ASSETS			
Net tangible capital assets (Note 8)	105,047		105,047
Prepaid expenses	6,614		6,614
TOTAL NON-FINANCIAL ASSETS	**111,661**		**111,661**
ACCUMULATED DEFICIT			
Accumulated deficit from operations (Note 5)	(58,483)	65,064	6,581
Accumulated remeasurement gains	7,906		7,906
ACCUMULATED DEFICIT	**(50,577)**		**14,487**

On behalf of the Board:

Tim O'Neill
Chair
Toronto, Canada

Carole Workman
Director
Toronto, Canada

Independent Electricity System Operator
Statement of Operations and Accumulated Deficit

For the year ended December 31 (in thousands of Canadian dollars)	Previous Policies 2016 Actual	Adjustments	Pro-forma rate regulated 2016 Actual
IESO CORE OPERATIONS	**$**		**$**
System fees	189,443	(3,912)	185,531
Other revenue (Note 9)	2,531		2,531
Interest and investment income	2,157		2,157
Core operation revenues	**194,131**		**190,219**
Compensation and benefits	(105,570)		(105,570)
Professional and consulting	(16,844)		(16,844)
Operating and administration	(34,336)		(34,336)
Core operating expenses	**(156,750)**		**(156,750)**
Amortization	(19,577)		(19,577)
Interest	(1,341)		(1,341)
Core expenses	**(177,668)**		**(177,668)**
Core operations annual surplus before rebates	**16,463**		**12,551**
Rebates due to market participants	(12,551)		(12,551)
Core operations annual surplus	**3,912**		**0**
MARKET SANCTIONS AND PAYMENT ADJUSTMENTS			
Market sanctions and payment adjustments	**3,889**		3,889
Compensation and benefits	(2,180)		(2,180)
Professional and consulting	(770)		(770)
Operating and administration	(705)		(705)
Customer education and market enforcement expenses	(3,655)		(3,655)
Market sanctions and payment adjustments annual surplus/(deficit)	**234**		**234**
SMART METERING ENTITY			
Smart metering charge	**46,651**	**(19,225)**	**27,426**
Compensation and benefits	(2,661)		(2,661)
Professional and consulting	(14,659)		(14,659)
Operating and administration	(5,705)		(5,705)
Smart metering operating expenses	**(23,025)**		**(23,025)**
Amortization	(3,861)		(3,861)
Interest	(540)		(540)
Smart metering expenses	(27,426)		(27,426)
Smart metering entity annual surplus	**19,225**		**-**
ANNUAL SURPLUS	**23,371**	**(23,137)**	**234**
ACCUMULATED DEFICIT FROM OPERATIONS, BEGINNING OF PERIOD	(81,854)	88,202	6,348
ACCUMULATED DEFICIT FROM OPERATIONS, END OF PERIOD	**(58,483)**		**6,582**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Basis of financial statement preparation

The accompanying financial statements have been prepared on a going concern basis and in accordance with Canadian public sector accounting standards and the financial statements reflect the following significant accounting policies.

a) Revenue recognition

System fees earned by the IESO are based on approved rates for each megawatt of electricity withdrawn from the IESO-controlled grid (including scheduled exports) and embedded generation. System fees are recognized as revenue at the time the electricity is withdrawn. Rebates are recognized in the year in which the regulatory deferral account, before such rebates, exceeds regulated limits.

For 2015, the system fee for the then newly amalgamated IESO was comprised of the combined rate calculations of the respective pre-amalgamation entities. Specifically, the former IESO rate base was calculated on electricity withdrawn from the IESO-controlled grid (including scheduled exports and embedded generation), whereas the former OPA rate base only considered Ontario electricity consumers. The OEB approved the continued use of this combined rate calculation for 2016 in an interim order issued on December 22, 2015.

These financial statements do not include the revenue and expenses of the financial transactions of market participants within the IESO-administered markets (IAM).

Other revenue represents amounts that accrue to the IESO relating to investment income on funds passing through market settlement accounts, as well as application fees. Such revenue is recognized as it is earned.

Interest and investment income represents realized interest income and investment gains or losses on cash, cash equivalents, short-term investments and long-term investments.

Market sanctions represent funds received to offset payments disbursed related to penalties, damages, fines and payment adjustments arising from resolved settlement disputes.

b) Financial instruments

The IESO records cash and cash equivalents, investment portfolio and foreign currency exchange forward contracts at fair value. The cumulative change in fair value of these financial instruments is recorded in accumulated surplus as remeasurement gains and losses and is included in the value of the respective financial instrument shown in the statement of financial position and the statement of remeasurement gains and losses. Upon disposition of the financial instruments, the cumulative remeasurement gains and losses are reclassified to the statement of operations and all other gains and losses associated with the disposition of the financial instrument are recorded in the statement of operations. Transaction costs are charged to operations as incurred.

Cash and cash equivalents comprise cash, term deposits and other short-term, highly rated investments with original maturity dates of less than 90 days.

The IESO records accounts receivable, accounts payable and debt at amortized cost.

d) Regulated assets and liabilities

As a rate-regulated entity, the IESO, in appropriate circumstances establishes regulated assets or liabilities, and thereby defers the impact on the statement of operations of certain expenses or revenues because it is probable to be collected or refunded to market participants through future billings. The IESO has applied guidance from United States (US) Generally Accepted Accounting Principles (GAAP) Topic 980, *Regulated Operations* in this policy.

e) Market accounts – assets and liabilities

The IESO records the market accounts assets, liabilities and amounts due to and from market participants held on behalf of the IESO-administered markets in its statements of financial position. The IESO-administered markets is a balancing system, and as such, the net position of market accounts will settle to a $nil balance in accordance with market rules.

f) Tangible capital assets

Tangible capital assets are recorded at cost, which includes all amounts directly attributable to the acquisition, construction, development or betterment of the asset. The IESO capitalizes applicable interest as part of the cost of tangible capital assets.

g) Assets under construction

Assets under construction generally relates to the costs of physical facilities, hardware and software, and includes costs paid to vendors, internal and external labour, consultants and interest related to funds borrowed to finance the project. Costs relating to assets under construction are transferred to tangible capital assets when the asset under construction is deemed to be ready for use.

h) Amortization

The capital cost of tangible capital assets in service is amortized on a straight-line basis over their estimated service lives.

The estimated service lives in years, from the date the assets were acquired, are:

Class	Estimated Average Service Life 2016	Estimated Average Service Life 2015
Facilities	37	37
Market systems and applications	4 to 12	4 to 12
Infrastructure and other assets	4 to 10	4 to 7
Meter data management/repository	10	10

Gains and losses on sales or premature retirements of tangible capital assets are charged to operations.

The estimated service lives of tangible capital assets are subject to periodic review. The effects of changes in the estimated lives are amortized on a prospective basis. The most recent review was completed in fiscal 2016.

i) Pension, other post-employment benefits and compensated absences

The IESO's post-employment benefit programs include pension, group life insurance, health care, long-term disability and workers' compensation benefits.

The IESO accrues obligations under pension and other post-employment benefit (OPEB) plans and the related costs, net of plan assets. Pension and OPEB expenses and obligations are determined annually by independent actuaries using the projected benefit method and management's best estimate of expected return on plan assets, salary escalation, retirement ages of employees, mortality and expected health-care costs. The discount rate used to value liabilities is based on the expected rate of return on plan assets as at the measurement date of September 30.

The expected return on plan assets is based on management's long-term best estimate using a market-related value of plan assets. The market-related value of plan assets is determined using the average value of assets over three years as at the measurement date of September 30.

Pension and OPEB expenses are recorded during the year in which employees render services. Pension and OPEB expenses consist of current service costs, interest expense on liabilities, expected return on plan assets and the cost of plan amendments in the period. Actuarial gains/(losses) arise from, among other things, the difference between the actual rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligations. Actuarial gains/(losses) are amortized over the expected average remaining service life of the employees covered by the plan.

The expected average remaining service life of employees covered by the pension plans is 15 years (2015 – 15 years) and OPEB plan is 16.2 years (2015 – 14.7 years).

The IESO sick pay benefits accumulate but do not vest. The IESO accrues sick pay benefits based on the expectation of future utilization and records the accrual within accounts payable and accrued liabilities.

j) Foreign currency exchange

Transactions denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing on the date of the transaction. Items on the statement of financial position denominated in foreign currency are translated to Canadian dollars at the rate of exchange as of the financial statements date. The cumulative unrealized foreign currency exchange gains and losses of items continuing to be recognized on the statement of financial position are recorded in accumulated deficit as remeasurement gains and losses and shown in the statement of financial position and the statement of remeasurement gains and losses. Upon settlement of the item denominated in a foreign currency, the cumulative remeasurement gains and losses are reclassified to the statement of operations, and all other gains and losses associated with the disposition of the financial instrument are recorded in the statement of operations.

k) Use of estimates

The preparation of the financial statements in conformity with Canadian public sector accounting standards requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the financial statements. The IESO's accounts that involve a greater degree of uncertainty include the carrying values of tangible capital assets, accrued pension liability and accrual for employee future benefits other than pensions. Actual results could differ from those estimates.

3. NEW ACCOUNTING POLICIES

As of January 1, 2016, the IESO changed its accounting policy regarding the recognition of assets and liabilities subject to rate regulation. The change was made to better reflect the economic substance of certain types of expenses which may not be directly recovered through the normal revenue requirement model. This change has been applied retroactively and has increased amounts previously unrecorded for regulatory assets and decreased amounts previously reported for accumulated deficit.

The IESO recognizes two regulated assets; 1) unrecovered smart metering expenses and 2) unrecovered PSAB transition items.

The smart metering expenses result from the IESO's role as the Smart Metering Entity. As such, the IESO funds its SME operating costs and capital investment in the meter data management/repository through fees from users of smart meters in Ontario. The OEB approves the Smart Metering Entity charge and the charge is intended to cover the costs of developing and operating the MDM/R.

The unrecovered PSAB transition items result from the IESO's adoption of Canadian public sector accounting standards effective January 1, 2011. The adoption of PSAB was accounted for by retroactive application with restatement of prior periods subject to the requirements in Section PS 2125, *First-time Adoption by Government Organizations*. The corresponding change to pension and other post-employment benefits resulted in previously unrecognized actuarial losses and past service costs of $80,617 thousand at the date of transition.

Regulated assets consist of the following:

As of December 31 (in thousands of Canadian dollars)	**2016**	**2015**
	$	**$**
Unrecovered smart metering expenses	21,623	40,849
Unrecovered PSAB transition items	43,441	47,353
Closing balance	**65,064**	**88,202**

In addition, as of January 1, 2016 the IESO changed its accounting policy regarding the recognition of market accounts assets and liabilities on the statement of financial position. The change was made to better reflect the assets and liabilities and amounts due to and from market participants held by the IESO on behalf of the IAM at year end. This change has been applied retroactively and has increased amounts previously unrecorded for market accounts assets and liabilities. There is no impact to the accumulated deficit or revenues and expenses as the IESO is not party to these transactions as per the market rules.

Components of the market accounts are as follows:

As of December 31 (in thousands of Canadian dollars)	**2016**	**2015**
	$	**$**
Cash, restricted for market activities	323,318	271,574
Amounts due from market participants	1,323,061	1,171,389
Interest receivable	186	157
Revolving line of credit	(150,501)	(12,739)
HST receivable	21,622	20,247
Amounts due to market participants	(1,399,290)	(1,380,086)
Other liabilities	(118,396)	(70,542)
Closing balance	**-**	**-**

Comparative figures

A detailed reconciliation of the IESO's restated statement of financial position as at December 31, 2015 as follows:

As of (in thousands of Canadian dollars)	December 31, 2015 (as reported)	December 31, 2015 adjustments	December 31, 2015 (as restated)
FINANCIAL ASSETS	**$**	**$**	**$**
Cash and cash equivalents	14,715		14,715
Accounts receivable	33,199		33,199
Long-term investments	37,318		37,318
Regulated assets	-	88,202	88,202
Market accounts - assets	-	1,443,121	1,443,121
TOTAL FINANCIAL ASSETS	**85,232**	**1,531,323**	**1,616,555**
LIABILITIES			
Accounts payable and accrued liabilities	48,868		48,868
Accrued interest on debt	315		315
Rebates due to market participants	9,595		9,595
Debt	90,000		90,000
Accrued pension liability	36,062		36,062
Accrued liability for employee future benefits other than pension	84,501		84,501
Market accounts – liabilities	-	1,443,121	1,443,121
TOTAL LIABILITIES	**269,341**	**1,443,121**	**1,712,462**
NET DEBT	**(184,109)**	**88,202**	**(95,907)**
NON-FINANCIAL ASSETS			
Net tangible capital assets	103,716		103,716
Prepaid expenses	6,197		6,197
TOTAL NON-FINANCIAL ASSETS	**109,913**		**109,913**
ACCUMULATED SURPLUS/(DEFICIT)			
Accumulated surplus/(deficit) from operations	(81,854)	88,202	14,006
Accumulated remeasurement gains	7,658		7,658
ACCUMULATED SURPLUS/(DEFICIT)	**(74,196)**	**88,202**	**21,664**

A detailed reconciliation of the IESO's restated statement of operations for the year ended December 31, 2015 is as follows:

For the year ended (in thousands of Canadian dollars)	**December 31, 2015 (as reported)**	**December 31, 2015 adjustments**	**December 31, 2015 (as restated)**
IESO CORE OPERATIONS	**$**	**$**	**$**
System fees	190,099	(3,912)	186,187
Other revenue	5,377		5,377
Interest and investment income	1,430		1,430
Core operations revenues	**196,906**	**(3,912)**	**192,994**
Compensation and benefits	(104,994)		(104.994)
Professional and consulting	(21,461)		(21,461)
Operating and administration	(35,005)		(35,005)
Core operating expenses	**(161,460)**		**(161,460)**
Amortization	(17,933)		(17,933)
Interest	(1,610)		(1,610)
Core expenses	**(181,003)**		**(181,003)**
Core operations annual surplus before rebates	**15,903**	**(3,912)**	**11,991**
Rebates due to market participants	(9,595)		(9,595)
Core operations annual surplus	**6,308**	**(3,912)**	**2,396**
MARKET SANCTIONS AND PAYMENT ADJUSTMENTS			
Market sanctions and payment adjustment	**6,021**		**6,021**
Compensation and benefits	(3,094)		(3,094)
Professional and consulting	(1,351)		(1,351)
Operating and administrative	(114)		(114)
Customer education and market enforcement expenses	**(4,559)**		**(4,559)**
Market sanctions and payment adjustments annual surplus	**1,462**		**1,462**
SMART METERING ENTITY			
Smart metering charge	**46,215**	**(20,030)**	**26,185**
Compensation and benefits	(2,607)		(2,607)
Professional and consulting	(14,902)		(14,902)
Operating and administration	(4,200)		(4,200)
Smart metering operating expenses	**(21,709)**		**(21,709)**
Amortization	(3,524)		(3,524)
Interest	(952)		(952)
Smart metering expenses	**(26,185)**		**(26,185)**
Smart metering entity annual surplus	**20,030**	**(20,030)**	**-**
ANNUAL SURPLUS	**27,800**	**(23,942)**	**3,858**
ACCUMULATED DEFICIT FROM OPERATIONS, BEGINNING OF PERIOD	(109,654)	112,144	2,490
ACCUMULATED DEFICIT FROM OPERATIONS, END OF PERIOD	**(81,854)**	**88,202**	**6,348**

5. REBATES DUE TO MARKET PARTICIPANTS AND ACCUMULATED ~~DEFICIT~~ SURPLUS

In 2016, the IESO recognized $12,551 thousand in rebates due to market participants of system fees (2015 – $9,595). As at December 31, 2016, rebates due to market participants were $22,146 thousand, with the 2015 portion of $9,595 thousand rebated in January 2017.

The IESO's approved regulatory deferral account balance has been historically maintained at a maximum of $10.0 million. The 2016 approved regulatory deferral account balance at $10.0 million was approved by the OEB on December 1, 2016.

Prior to 2014, unrealized gains and losses from portfolio investments and foreign exchange were included in the balance of the regulatory deferral account (life-to-date total $4,144 thousand). As of January 1, 2014, only realized gains and losses are included in this balance.

As at December 31, the components of the accumulated ~~deficit~~ surplus were as follows:

Accumulated ~~Deficit~~Surplus

As at December 31 (in thousands of Canadian dollars)	2016	2015
	$	$
Regulatory deferral account (a)	10,000	10,000
Accumulated market sanctions and payment adjustments (b)	726	492
~~Smart metering entity – accumulated deficit (c)~~	~~(21,624)~~	~~(40,849)~~
~~PSAB transition items (d)~~	~~(43,441)~~	~~(47,353)~~
Remeasurement gains	3,762	3,514
Accumulated ~~deficit~~ surplus – end of year	**~~(50,577)~~14,488**	**~~(74,196)~~14,006**

a) Regulatory Deferral Account

As at December 31 (in thousands of Canadian dollars)	2016	2015
	$	$
Accumulated surplus – beginning of year	10,000	7,604
Revenues (before rebates due to market participants)	~~194,131~~190,219	~~196,906~~192,994
Rebates due to market participants	(12,551)	(9,595)
Core operation expenses	(177,668)	(181,003)
~~Recovery of PSAB transition items~~	~~(3,912)~~	~~(3,912)~~
Accumulated surplus – end of year	**10,000**	**10,000**

b) Accumulated Market Sanctions and Payment Adjustments

As at December 31 (in thousands of Canadian dollars)	2016	2015
	$	$
Accumulated surplus/(deficit) – beginning of year	492	(970)
Market sanctions and payment adjustments	3,889	6,021
Customer education and market enforcement expenses	(3,655)	(4,559)
Accumulated surplus – end of year	**726**	**492**

~~c) Smart Metering Entity - Accumulated Deficit~~

~~As at December 31 (in thousands of Canadian dollars)~~	~~2016~~	~~2015~~
	~~$~~	~~$~~
~~Accumulated deficit – beginning of year~~	~~(40,849)~~	~~(60,879)~~
~~Smart metering charge~~	~~46,651~~	~~46,215~~
~~Smart metering expenses~~	~~(27,426)~~	~~(26,185)~~
~~Accumulated deficit – end of year~~	**~~(21,624)~~**	**~~(40,849)~~**

~~d) PSAB Transition Item - Accumulated Deficit~~

~~As at December 31 (in thousands of Canadian dollars)~~	~~2016~~	~~2015~~
	~~$~~	~~$~~
~~Accumulated deficit – beginning of year~~	~~(47,353)~~	~~(51,265)~~
~~Recovery of PSAB transition items~~	~~3,912~~	~~3,912~~
~~Accumulated deficit – end of year~~	**~~(43,441)~~**	**~~(47,353)~~**

~~Effective January 1, 2011, the IESO adopted Canadian public sector accounting standards with a transition date of January 1, 2010. The adoption of PSAB was accounted for by retroactive application with restatement of prior periods subject to the requirements in Section PS 2125, *First-time Adoption by Government Organizations*. The corresponding change to pension and other-post employment benefits resulted in previously unrecognized actuarial losses and past service costs of $80,617 thousand at the date of transition being charged to the accumulated deficit.~~

~~The IESO includes a portion of the accumulated deficit resulting from the PSAB transition items in the annual proposed expenditures to the OEB for recovery through system fees.~~

IESO-N-0015884

Resolution of the Audit Committee of the Independent Electricity System Operator

March 15, 2017

In Respect of the Approval of Amendments to the Accounting Policies

of the Independent Electricity System Operator

WHEREAS by resolution dated March 1, 2017 the Board of the Independent Electricity System Operator ("IESO") delegated authority to the Audit Committee of the IESO to consider and approve on behalf of the Board, or refer back to the Board for further consideration as appropriate, amendments to the accounting policies of the IESO.

BE IT RESOLVED THAT the accounting policies of the Independent Electricity System Operator (IESO) be amended to record Market Accounts assets and liabilities on the IESO's balance sheet, and to adopt regulated accounting principles.