Extracts of Minutes of Audit Committee and Board re Accounting Principles

February 28, 2017 **AC – regular meeting, agenda included discussion of 2016 Audited Financial Statements and Review of Accounting Principles**

2016 Audited Financial Statements

Mr. Matt Betik and Mr. Michel Picard of KPMG joined the meeting.

Ms. Natalie Schaus joined the meeting.

Accounting Principles

Ms. Kimberly Marshall described the review of accounting principles used by the Corporation for rate regulated assets/liabilities and Market Accounts. Messrs. Betik and Picard of the auditing firm KPMG described the evolution of accounting principles and summarized the accounting principles under a wide range of accounting standards, including the Public Sector Accounting Standards used by the Corporation. The Committee questioned Mr. Picard regarding the impact of adopting revised accounting principles on prior financial statements; the accounting principles used by local distribution companies and other North American independent system operators; and the rationale for adopting revised accounting principles.

Management described the treatment of corporate and market accounting on market opening. The Committee discussed the increased transparency that would result from the adoption of revised accounting principles consistent with the approach taken by other independent system operators. The Committee questioned management and the auditors regarding implementation steps, and consultations with the Provincial Controller, the Auditor General and the Ministry of Energy. The Committee instructed management and the auditors to undertake further work and to report back to the Committee with a recommendation.

Mr. Michel Picard left the meeting.

2016 Audited Financial Statements

An Agenda Item Summary titled "Review of 2016 Audited Financial Statements" dated February 28, 2017; the "IESO Management Report" dated March 1, 2017; the draft "Independent Auditor's Report" from KPMG dated March 1, 2017; the 2016 Financial Statements titled "Independent Electricity System Operator Statements of Financial Positions Unaudited" with accompanying "Notes to Financial Statements"; the "Independent Electricity System Operator Audit Findings Report for the year ended December 31, 2016"; and the 2016 Management Representation Letter to KPMG LLP dated March 1, 2017, had been provided to the Committee for review prior to the meeting.

Mr. Betik reviewed highlights of the auditor's report titled "Independent Electricity System Operator Audit Findings Report for the year ended December 31, 2016". Mr. Betik summarized the remaining work to finalize the audit, including any work to incorporate any change in accounting policy; and reviewed highlights of the report. Mr. Betik said that the audit results were clean with no adjustments or issues to report. The Committee questioned Mr. Betik on the materiality threshold and the independence of KPMG.

The Committee then met privately with Mr. Betik in the absence of Management and, upon their return, the Chair advised that there was nothing to be minuted. Management and the external auditor KPMG will finalize the 2016 Financial Statements and return to the Committee.

March 1, 2017 **Board – regular meeting, agenda included discussion of financial statements and accounting principles**

<u>Report of the CEO</u>

In addition to Mr. Bruce Campbell's written report, which had been provided to each Director for review prior to the meeting, Mr. Campbell updated the Board regarding media coverage of the rate mitigation proposals of the government and NDP; the observations contained in the HQ interties report to the Deputy Minister, including commentary regarding the risk to market renewal associated with further supply arrangements with HQ; the exercise of management discretion in responding to a cyber-incident; the status of the conservation greenbank discussions; and discussions with Bert Clark regarding work being done by IMCO to facilitate the pooling of provincial assets for pension investments. Mr. Campbell noted that background materials on Accounting Policies and Regulatory Assets had been posted for the Board's review on Boardbooks. Mr. Campbell also reported on a recent Australian report on the electricity grid and markets, as well as a survey being undertaken by the Australian energy market operator regarding best practices in risk management.

<u>Report of the Audit Committee</u>

Ms. Carole Workman, on behalf of the Audit Committee, reported on the agenda items considered by the Audit Committee:

<u>Accounting Policy and Financial Statements</u>

Ms. Workman summarized the background to the review of accounting principles undertaken by management and KPMG, describing the proposal to amend the accounting policies of the company to record market accounts assets and liabilities on the IESO balance sheet and adopt regulated accounting principles. Ms. Workman advised that the Audit Committee had requested management undertake further analysis of the implications of the proposed change and consult with the government, including the provincial controller, and report back at a special meeting of the Audit Committee. This further report will be supplemental to the materials posted by Mr. Campbell. Ms. Workman also reported on the discussions with the auditors regarding the draft 2016 financial statements, including the potential impact of amending the accounting policies. She advised that the Audit Committee deferred approval of the financial statements pending the Board's consideration of the proposal to amend the accounting policies.

The Board considered the proposed revisions to the accounting policies and the approval of the Corporation's financial statements. The Board indicated its support for the proposed revisions, subject to the Audit Committee being satisfied that management's further analysis, consultation and report to the Audit Committee did not identify significant issues. Following discussion, the Board indicated that it was satisfied with the recommendations to delegate to the Audit Committee, the authority to approve amendments to the accounting policies and approval of the financial statements, subject to the Audit Committee being satisfied that no significant issues were identified and, on motion duly made and seconded, the following resolution was unanimously carried,

BE IT RESOLVED THAT the Board of the Independent Electricity System Operator ("IESO") delegate 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; and
- the financial statements of the corporation.

Rate Mitigation

Mr. Campbell reported to the Board on the anticipated elements of a government rate mitigation initiative and the resultant implications for the IESO. The Board questioned management as to the impact on the Conservation First Framework, and the role of LDC's and governance concerns regarding the role of government.

March 15, 2017 **AC- Special meeting to consider amendments to the accounting policies of the Independent Electricity System Operator (IESO) to record Market Accounts assets and liabilities on the IESO's balance sheet, and to adopt regulated accounting principles.**

Accounting Principles

An Agenda Item Summary titled "IESO Accounting Policies" dated March 15, 2017; a memorandum titled "Change in Accounting Policies" dated March 13, 2017; a memorandum from KPMG titled "Regulatory Assets/Liabilities and Market Accounts" dated February 23, 2017; the Pro-forma 2016 Financial Statements titled "Independent Electricity System Operator Statements of Financial Positions Unaudited" with accompanying "Notes 2, 3, and 5 to Financial Statements" and the draft resolution, had been provided to the Committee for review prior to the meeting.

The Chair summarized the background to the review of accounting principles undertaken by management and KPMG and the consideration by both the Committee and the Board. Management had been requested to undertake further research and consultation regarding the proposed change in accounting principles. The Chair described the Board's decision to delegate to the Committee, the authority to 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 and, following the decision on whether to amend the accounting policies, the 2016 financial statements of the IESO.

Ms. Kim Marshall reviewed the rationale for the proposed change in accounting principles to record market accounts assets and liabilities, and adopt regulated accounting principles. The Committee questioned management and the auditor, Mr. Matthew Betik, regarding the benefit of improved transparency in relation to the risk of potential misinterpretation; the rationale for, and elements of, the proposed communications plan to respond to enquiries; and confirmed that that no order was required from the Ontario Energy Board to adopt regulated accounting principles, and that the proposed change was fee neutral. The Committee discussed the improved line of sight and clarity afforded to the Board through the proposed change in accounting for markets. The Committee further questioned management regarding consultations with government officials and agencies; the revisions to the notes to the financial statements; and the appropriate manner in which to report overall market activity. The Committee will further consider the reporting of overall market activity at a later date.

Following discussion, the Committee indicated that it was satisfied with the recommendations before it and, on motion duly made and seconded, the following resolution was unanimously carried,

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.

March 22, 2017 **AC- Special meeting to approve the financial statements of the Independent Electricity System Operator for the fiscal year ended December 31, 2016, together with the auditor's report**

Approval of 2016 Audited Financial Statements

An Agenda Item Summary titled "Approval of 2016 Audited Financial Statements" dated March 22; a Management Report titled "Management's Responsibility for Financial Reporting", dated March 22, 2017; a KPMG Independent Auditors' Report dated March 22, 2017; a document titled "Independent Electricity System Operator Statements of Financial Position" and accompanying notes for 2016; a KPMG document titled "Independent Electricity System Operator: Addendum to the Audit Findings Report Presented on February 28, 2017; a KPMG document titled "Independent Electricity System Operator Audit Findings Report For the year ended December 31, 2016"; and letter from Bruce Campbell and Kim Marshall to KPMG LLP, dated March 22, 2017 regarding IESO'S Financial Statements for the period ended December 31, 2016, had been provided to the Committee for review prior to the meeting.

The Chair summarized the Committee's prior consideration and approval, on behalf of the Board, of proposed revisions to the IESO's accounting policies. The Chair advised that following the approval of the revisions to the IESO's accounting policies, management and the auditors, KPMG, revised the draft 2016 Audited Financial Statements as previously presented to the Committee on March 15, 2017 to incorporate the revisions to the IESO's accounting policies.

Ms. Susan Nicholson, and the Auditor, Mr. Matthew Betik of KPMG, reviewed the revisions to the draft 2016 Audited Financial Statements and highlights of the Addendum to the Audit Findings Report Presented on February 28, 2017. Mr. Betik described the additional field work undertaken and advised that the test items and samples were clean with no differences being identified. He noted in particular the cooperation and assistance of IESO staff in completing the additional field work. Mr. Betik summarized the changes to the financial notes to fully disclose the changes to accounting policies in a clear and transparent manner. The Committee questioned Mr. Betik regarding the use of a conservative materiality threshold and details of the financial notes.

The Chair enquired whether Committee would like to meet in-camera with the Auditor. Following discussion it was agreed that it was not necessary to meet in-camera given the Committee's prior in-camera discussion with the Auditor regarding the draft 2016 Audited Financial Statements and the full discussion of the nature of the changes to them to reflect the changes to accounting policies.

Following discussion, the Committee indicated that it was satisfied with the recommendations before it and, on motion duly made and seconded, the following resolution was unanimously carried,

BE IT RESOLVED THAT the financial statements of the Independent Electricity System Operator for the fiscal year ended December 31, 2016, together with the auditor's report, be approved and that the Chair of the Board of Directors and the Chair of the Audit Committee be authorized to sign the balance sheet.

April 11, 2017 **AC – regular meeting, agenda included Rate Mitigation Update**

Energy Pricing & Programs

Rate Mitigation Update

Ms. Jeanette Briggs and Mr. Michael Boll joined the meeting.

An Agenda Item Summary and Presentation titled "Rate Mitigation Update" dated April 11, 2017 were provided to the Committee for review prior to the meeting. Mr. Michael Boll described the process and parties involved in the development of the legislative and regulatory framework to implement the Ontario Fair Hydro Plan and risks for the corporation. The Committee questioned management regarding reputational and financial risks, the potential impact of cost reductions on consumer behaviour, risks associated with representations and warranties associated with the debt financing, and the tracking of risks associated with the rate mitigation initiative in the corporate risk tolerance.

April 12, 2017	**Board – regular meeting, agenda included Fair Hydro Plan Update**

Report of the CEO

In addition to Mr. Campbell's written report, which had been provided to each Director for review prior to the meeting, Mr. Campbell updated the Board regarding a high reliability risk factor event by market participants in the fall of 2016, market price spike events, and the participation of certain Ontario based generators in a New York capacity auction. Mr. Campbell discussed the Fair Hydro Plan implementation, the Green Bank arrangements with the Ministry of the Environment and Climate Change, the status of and possible policy implications of the Quebec Interties report, and the on-going support being provided to the Ministry in relation to the development of the LTEP. Mr. Campbell summarized the risks associated with the recently announced Agreement on Internal Trade, and described the nature of updates to the Memorandum of Understanding between the corporation and the government.

Fair Hydro Plan

Ms. Jeannette Briggs, Mr. Michael Boll, and Mr. Anthony Martinello joined the meeting.

Mr. Steen Hume, ADM Energy Supply Policy Division, Ministry of Energy joined the meeting.

An Agenda Item Summary titled "Rate Mitigation-Fair Hydro Plan" dated April 12, 2017, a Technical Briefing titled "Ontario's Fair Hydro Plan: Providing Relief for Consumers" dated April 2017, and a document titled "Ontario's Fair Hydro Plan Impact Summary" dated April 2017 were provided to the Board for review prior to the meeting. Mr. Steen Hume reviewed highlights of the Technical Briefing with the Board. In response to questioning Mr. Hume confirmed that in the event that OPG Trust was unable to finance the debt, the province would step in to take over the debt. The Board discussed with Mr. Hume the implementation timeline, the impact of the price reduction on LDC Conservation targets, cost recovery, financing issues, accounting treatment, indemnification, and risks faced by the IESO. The Board expressed concern regarding the reputational and commercial risks to the IESO and the need for indemnification and a financial backstop. In response to questions from the Board, Mr. Hume advised that the government has responsibility for and will direct the communications plan for the Fair Hydro Plan.

Mr. Steen Hume, Mr. Michael Boll, and Mr. Anthony Martinello left the meeting.

May 9, 2017 **AC – Special meeting to receive update on IESO Role in Global Adjustment Smoothing**

Update on IESO Role in Global Adjustment Smoothing

An Agenda Item Summary and memorandum titled "Update on IESO Role in Global Adjustment Smoothing", both dated May 5, 2017; and a KPMG document titled "Final Draft, KPMG Letter to the Independent Electricity System Operator, An Accounting Opinion on the Application of PSAS to the Consolidation of a Trust and to the Recognition and Derecognition of a Variance Account in Relation to the Proposed *Ontario Fair Hydro Plan Act, 2017*" dated May 4, 2017, had been provided to the Committee for review prior to the meeting.

The Chair summarized the prior consideration and approval by the Committee and Board of proposed revisions to the IESO's accounting policies, and discussions with the provincial controller and the Auditor General. The Chair advised that management and KPMG would provide an update on the timing of the legislation; an update on the risk register and requested indemnities; and the accounting treatment.

Mr. Matthew Betik of KPMG, the accounting partner on the IESO financial audit, summarized a recent meeting with the Auditor General (AG) noting enquiries made by the AG regarding audit planning and documentation; the rationale for the IESO's change in accounting policies; and the application of rate-regulated accounting principles under PSAS. In response to questions from the Committee, Mr. Betik confirmed that KPMG's opinion, which supported the adoption of the revised accounting policies, had not changed. The Committee further discussed the corporation's proposed role in the Fair Hydro Plan; the role of other parties; and the distinction between how the corporation accounts for regulatory assets vs. other parties. Management was instructed to continue to monitor and manage the risks associated with the Fair Hydro Plan.

Mr. Matthew Betik, KPMG, left the meeting.

Management updated the Committee regarding the current status of the legislative drafting; the preparation of a corporate risk register; and the Ministry's response to the corporation's request for indemnification. The Committee questioned management regarding draft regulations; operational risks; the flow of monies; the nature of the transfer to OPG Trust; the draft KPMG opinion; and potential impacts on IESO revenue and staff requirements. Management was requested to prepare a schematic to show the flow of monies under the proposed Fair Hydro Plan.

The Committee determined that it was not necessary to meet in-camera with the Auditor.

May 17, 2017	**AC- Special meeting to receive update on IESO Role in Global Adjustment Smoothing**

Update on IESO Role in Global Adjustment Smoothing

An Agenda Item Summary and memorandum titled "IESO Risks – Ontario Fair Hydro Act", both dated May 17, 2017; and a letter to Mr. Bruce Campbell from the Deputy Minister of Energy, Serge Imbrogno, dated May 15, 2017, had been provided to the Committee for review prior to the meeting.

Mr. Bruce Campbell summarized the status of the Fair Hydro Plan legislation; the request for indemnification from the Ministry; and KPMG's accounting opinion. The Committee questioned Mr. Campbell regarding media reports of the costs associated with the Fair Hydro Plan; the Auditor General's enquiries of the IESO; and perspective on the accounting treatment.

Ms. Kimberly Marshall provided an overview of key risks identified, including a subsequent change in government policy and the OPG financing entity not purchasing the regulatory asset in whole or in part. Committee questioned management regarding the communications strategy; media coverage; rating agency comments; and whether there had been any change in the draft accounting opinion. Management responded to further questions regarding the risks associated with non-standard representations, warranties and opinions; a fundamental change in the nature of the program; IESO insolvency; and the IESO being a named party of the U.S. prospectus. Management was requested to consider how to quantify the risks faced and whether there were activities where the IESO could create risks.

Following further discussion, the Committee indicated that it was satisfied that management was carefully monitoring the status of the Fair Hydro Plan, including the role of the IESO; public reaction; and the response of rating agencies to the proposed financing. Management will report further at the June meetings of the Committee and Board, and if there are developments prior to the June meetings which heighten the risks for the IESO, management was instructed to convene a special meeting of the Committee and/or Board.