TransAlta renewables inc.

TransAlta Renewables Inc.

Consolidated Financial Statements

December 31, 2017

Consolidated Financial Statements

Management's Report

To the Shareholders of TransAlta Renewables Inc.

The consolidated financial statements and other financial information included in this annual report have been prepared by management. It is management's responsibility to ensure that sound judgment, appropriate accounting principles and methods, and reasonable estimates have been used to prepare this information. They also ensure that all information presented is consistent.

Management is also responsible for establishing and maintaining internal controls and procedures over the financial reporting process. The internal control system includes an internal audit function and an established business conduct policy. TransAlta Corporation provides general administrative services to TransAlta Renewables Inc. under a Management, Administrative and Operational Services Agreement. Employees of TransAlta Corporation providing such services are required to adhere to TransAlta Corporation's business conduct policy. In addition, TransAlta Renewables Inc. has a code of conduct that can be viewed on TransAlta Renewables Inc.'s website (www.transaltarenewables.com). Management believes the system of internal controls, review procedures and established policies provide reasonable assurance as to the reliability and relevance of financial reports. Management also believes that TransAlta Renewables Inc.'s operations are conducted in conformity with the law and with a high standard of business conduct.

The Board of Directors (the "Board") is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control. The Board carries out its responsibilities principally through its Audit Committee (the "Committee"). The Committee, which consists solely of independent directors, reviews the financial statements and annual report and recommends them to the Board for approval. The Committee meets with management, internal auditors and external auditors to discuss internal controls, auditing matters and financial reporting issues. Internal and external auditors have full and unrestricted access to the Committee. The Committee also recommends the firm of external auditors to be appointed by the shareholders.

John Kousinioris
President

Donald Tremblay
Chief Financial Officer

February 22, 2018

Management's Annual Report on Internal Control over Financial Reporting

To the Shareholders of TransAlta Renewables Inc.

The following report is provided by management in respect of TransAlta Renewables Inc.'s internal control over financial reporting as defined in the Canadian Securities Administrators' National Instrument 52-109.

TransAlta Renewables Inc.'s management is responsible for establishing and maintaining adequate internal control over financial reporting for TransAlta Renewables Inc.

Management has used the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") 2013 framework to evaluate the effectiveness of TransAlta Renewables Inc.'s internal control over financial reporting. Management believes that the COSO 2013 framework is a suitable framework for its evaluation of TransAlta Renewables Inc.'s internal control over financial reporting because it is free from bias, permits reasonably consistent qualitative and quantitative measurements of TransAlta Renewables Inc.'s internal controls, is sufficiently complete so that those relevant factors that would alter a conclusion about the effectiveness of TransAlta Renewables Inc.'s internal controls are not omitted, and is relevant to an evaluation of internal control over financial reporting.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper overrides. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process, and it is possible to design safeguards into the process to reduce, though not eliminate, this risk.

Management has assessed the effectiveness of TransAlta Renewables Inc.'s internal control over financial reporting, as at December 31, 2017, and has concluded that such internal control over financial reporting is effective.

John Kousinioris
President

Donald Tremblay
Chief Financial Officer

February 22, 2018

Independent Auditors' Report of Registered Public Accounting Firm

To the Shareholders of TransAlta Renewables Inc.

We have audited the accompanying consolidated financial statements of TransAlta Renewables Inc., which comprise the consolidated statements of financial position as at December 31, 2017 and 2016, and the consolidated statements of earnings, comprehensive income, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of TransAlta Renewables Inc. as at December 31, 2017 and 2016, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Ernst + Young LLP

Chartered Professional Accountants
Calgary, Canada

February 22, 2018

Consolidated Statements of Earnings

Year ended Dec. 31 ***(in millions of Canadian dollars, except as otherwise noted)***	**2017**	2016
Revenues	**410**	213
Government incentives *(Note 5)*	**18**	19
Lease revenue *(Note 6)*	**31**	27
Total revenue	**459**	259
Fuel, royalties, and other costs *(Note 7)*	**97**	23
Gross margin	**362**	236
Operations, maintenance and administration *(Note 7)*	**83**	53
Depreciation and amortization	**115**	79
Taxes, other than income taxes	**8**	7
Operating income	**156**	97
Finance income related to subsidiaries of TransAlta *(Note 8)*	**86**	151
Net interest expense *(Note 9)*	**(58)**	(49)
Change in fair value of Class B shares	**(2)**	(142)
Foreign exchange gain (loss)	**6**	(35)
Impairment of investment *(Note 8)*	**(137)**	—
Earnings before income taxes	**51**	22
Income tax expense *(Note 10)*	**38**	21
Net earnings	**13**	1
Net earnings (loss) attributable to:		
Common shareholders	**9**	(2)
Non-controlling interest *(Note 11)*	**4**	3
	13	1
Weighted average number of common shares outstanding in the year ***(millions) (Note 21)***	**235**	223
Net earnings (loss) per share attributable to common shareholders, basic and diluted	**0.04**	(0.01)

See accompanying notes.

Consolidated Statements of Comprehensive Income

Year ended Dec. 31 ***(in millions of Canadian dollars)***	**2017**	2016
Net earnings	**13**	1
Other comprehensive income (loss)		
Gains (losses) on derivatives designated as cash flow hedges, net of tax	**(1)**	(1)
Reclassification of (gains) losses on derivatives designated as cash flow hedges to net earnings, net of tax	**1**	1
Available-for-sale financial assets - net change in fair value *(Note 8)*	**(171)**	39
Reclassification of redemption on available-for-sale financial assets to net earnings *(Note 8)*	**(3)**	—
Reclassification of impairment on available-for-sale financial assets to net earnings *(Note 8)*	**137**	—
Total items that will be reclassified subsequently to net earnings	**(37)**	39
Other comprehensive income	**(37)**	39
Total comprehensive income	**(24)**	40
Total comprehensive income attributable to:		
Common shareholders	**(28)**	37
Non-controlling interest *(Note 11)*	**4**	3
	(24)	40

See accompanying notes.

Consolidated Statements of Financial Position

As at Dec. 31 *(in millions of Canadian dollars)*	**2017**	2016
Cash and cash equivalents *(Note 12)*	**20**	15
Accounts receivable *(Note 12)*	**116**	87
Prepaid expenses	**2**	2
Risk management assets *(Note 12)*	**1**	—
Income taxes receivable	**—**	1
Inventory	**6**	4
	145	109
Property, plant, and equipment *(Note 13)*		
Cost[1]	**2,805**	2,766
Accumulated depreciation	**(936)**	(842)
	1,869	1,924
Intangible assets *(Note 14)*	**103**	113
Restricted cash *(Note 16)*	**30**	—
Other assets *(Note 15)*	**35**	3
Investments in subsidiaries of TransAlta *(Note 8)*	**1,437**	1,645
Deferred income tax assets *(Note 10)*	**9**	41
Total assets	**3,628**	3,835
Accounts payable and accrued liabilities *(Note 12)*	**41**	31
Dividends payable *(Note 21)*	**59**	49
Current portion of decommissioning and other provisions *(Note 17)*	**2**	3
Risk management liabilities *(Note 12)*	**4**	—
Current portion of Class B shares liability *(Note 20)*	**—**	384
Current portion of long-term debt *(Notes 12 and 16)*	**250**	70
	356	537
Long-term debt *(Notes 12, 16, and 26)*	**793**	757
Convertible debenture *(Note 19)*	**—**	215
Decommissioning provisions and other provisions *(Note 17)*	**42**	26
Deferred revenues *(Note 18)*	**8**	7
Risk management liabilities *(Note 12)*	**—**	—
Deferred income tax liabilities *(Note 10)*	**232**	232
Total liabilities	**1,431**	1,774
Equity		
Common shares *(Note 21)*	**2,854**	2,469
Deficit[1]	**(701)**	(488)
Accumulated other comprehensive income	**8**	45
Equity attributable to shareholders	**2,161**	2,026
Non-controlling interest *(Note 11)*	**36**	35
Total equity	**2,197**	2,061
Total liabilities and equity	**3,628**	3,835

(1) Prior period adjustment - refer to Consolidated Statements of Changes in Equity

Commitments and contingencies *(Note 25)*

Subsequent event *(Note 29)*

A. R. Hagerman

Kathryn A.B. McQuade

On behalf of the Board:

Allen R. Hagerman
Director

Kathryn A.B. McQuade
Director

Consolidated Statements of Changes in Equity

(in millions of Canadian dollars)

	Common shares	Deficit[1]	Accumulated other comprehensive income	Attributable to shareholders	Attributable to non-controlling interest	Total
Balance, Dec. 31, 2016	2,469	(488)	45	2,026	35	**2,061**
Net earnings	—	9	—	9	4	**13**
Other comprehensive income:						
Net change in fair value of available-for-sale financial assets	—	—	(37)	(37)	—	**(37)**
Total comprehensive income (loss)	—	9	(37)	(28)	4	**(24)**
Common shares issued to TransAlta *(Note 4)*	385	—	—	385	—	**385**
Common share dividends *(Note 22)*	—	(222)	—	(222)	—	**(222)**
Distributions to non-controlling interest	—	—	—	—	(3)	**(3)**
Balance, Dec. 31, 2017	**2,854**	**(701)**	**8**	**2,161**	**36**	**2,197**

(1) Prior period adjustment to the original net book value of certain property, plant, and equipment related to the acquisition of TransAlta's Sarnia cogeneration plant.

See accompanying notes.

(in millions of Canadian dollars)

	Common shares	Deficit	Accumulated other comprehensive income	Attributable to shareholders	Attributable to non-controlling interest	Total
Balance, Dec. 31, 2015	2,152	(169)	6	1,989	37	2,026
Net earnings (loss)	—	(2)	—	(2)	3	1
Other comprehensive income:						
Net change in fair value of available-for-sale financial assets	—	—	39	39	—	39
Total comprehensive income	—	(2)	39	37	3	40
Common shares issued to TransAlta	152	—	—	152	—	152
Public offering	165	—	—	165	—	165
Acquisition of Canadian Assets *(Note 4)*[1]	—	(100)	—	(100)	—	(100)
Common share dividends	—	(217)	—	(217)	—	(217)
Distributions to non-controlling interest	—	—	—	—	(5)	(5)
Balance, Dec. 31, 2016	2,469	(488)	45	2,026	35	2,061

(1) Adjustment to the original net book value of certain property, plant, and equipment related to the acquisition of TransAlta's Sarnia cogeneration plant

See accompanying notes.

Consolidated Statements of Cash Flows

Year ended Dec. 31 *(in millions of Canadian dollars)*	2017	2016
Operating activities		
Net earnings	**13**	1
Depreciation and amortization	**115**	79
Decommissioning provision costs settled	**(1)**	—
Accretion of provisions *(Notes 9 and 17)*	**2**	1
Deferred income tax expense *(Note 10)*	**32**	16
Change in fair value of Class B shares *(Note 20)*	**2**	142
Unrealized foreign exchange (gain) loss	**(5)**	35
Unrealized (gain) loss from risk management activities	**1**	(1)
Provisions *(Note 17)*	**(1)**	1
Impairment of investment *(Note 8)*	**137**	—
Other non-cash items	**12**	1
Cash flow from operations before changes in working capital	**307**	275
Change in non-cash operating working capital balances *(Note 22)*	**(17)**	7
Cash flow from operating activities	**290**	282
Investing activities		
Additions to property, plant and equipment *(Note 13)*	**(38)**	(14)
Additions to intangibles *(Note 14)*	**—**	(1)
Loan receivable *(Note 15)*	**(38)**	—
Proceeds on redemptions of investments in subsidiaries	**217**	—
Investments in subsidiaries of TransAlta *(Note 8)*	**(233)**	(240)
Realized gain on financial instruments	**12**	—
Return of capital on investments in subsidiaries of TransAlta *(Note 8)*	**43**	20
Restricted cash *(Note 16)*	**(30)**	—
Change in non-cash investing working capital balances	**2**	(6)
Cash flow used in investing activities	**(65)**	(241)
Financing activities		
Net increase (decrease) in borrowings under credit facilities *(Note 16)*	**12**	(72)
Repayments of Canadian Assets working capital loan *(Note 16)*	**(13)**	—
Debt issuance costs	**(1)**	(2)
Issuance of long-term debt *(Note 16)*	**260**	159
Long-term debt repayments *(Note 16)*	**(236)**	(76)
Repayment of convertible debenture *(Note 19)*	**(215)**	—
Net proceeds on issuance of common shares *(Note 21)*	**—**	162
Dividends paid on common shares *(Note 21)*	**(212)**	(194)
Proceeds of TEA loan *(Note 16)*	**194**	—
Distributions to non-controlling interest *(Note 11)*	**(3)**	(5)
Other	**(6)**	—
Cash flow from (used in) financing activities	**(220)**	(28)
Increase (decrease) in cash and cash equivalents	**5**	13
Cash and cash equivalents, beginning of year	**15**	2
Cash and cash equivalents, end of year	**20**	15
Cash interest received from investment in MRPS	**47**	42
Cash dividends received from investments in subsidiaries of TransAlta	**29**	90
Cash income taxes paid	**5**	5
Cash interest paid	**50**	46

See accompanying notes.

A. Formation of the Corporation

TransAlta Renewables Inc. ("TransAlta Renewables" or the "Corporation") was incorporated on May 28, 2013, under the *Canada Business Corporations Act* and has been formed to own a portfolio of renewable and natural gas power generation facilities and other infrastructure assets. The Corporation is a majority-owned subsidiary of TransAlta Corporation ("TransAlta"). The Corporation's head office is located in Calgary, Alberta.

B. Basis of Preparation

These consolidated financial statements have been prepared by management in compliance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements include the accounts of the Corporation and the subsidiaries that it controls. Control exists when the Corporation is exposed, or has rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary.

The consolidated financial statements have been prepared on a historical cost basis, except for certain financial instruments, which are stated at fair value.

The consolidated financial statements reflect all adjustments that consist of normal recurring adjustments and accruals that are, in the opinion of management, necessary for a fair presentation of results. The Corporation's results are partly seasonal due to the nature of electricity, which is generally consumed as it is generated; and the nature of wind and run-of-river hydro resources, which fluctuate based on both seasonal patterns and annual weather variation. Typically, run-of-river hydro facilities generate most of their electricity and revenues during the spring and summer months when melting snow starts feeding watersheds and rivers. Inversely, wind speeds are historically greater during the cold winter months and lower in the warm summer months.

The consolidated financial statements are presented in Canadian dollars, which is the Corporation's functional and presentation currency. All financial information presented in the tables is in Canadian dollars and has been rounded to the nearest million dollars unless otherwise noted.

These consolidated financial statements were authorized for issue by the Board of Directors (the "Board") on February 22, 2018.

2. Significant Accounting Policies

A. Revenue Recognition

The majority of the Corporation's revenues are derived from the sale of physical power. Electrical energy sales are recognized: (i) at the time of generation and delivery to the purchasing party as metered at the point of interconnection with the transmission system; (ii) when the amount of the revenue can be reliably measured; (iii) when it is probable that the economic benefits will flow to the Corporation; and (iv) when the costs incurred or to be incurred in respect of the transaction can be reliably measured. Green Attributes sales are recognized at the time of delivery to the purchasing party. Green Attributes are renewable energy certificates and carbon offsets, or other tradable or salable instruments that represent the property rights to the environmental, social and other non-power qualities of renewable electricity generation that can be sold separately from the underlying physical electricity. Revenues are measured at the fair value of the consideration received or receivable.

In certain situations, a power purchase agreement ("PPA") may contain, or be considered, a lease. Revenues associated with non-lease elements are recognized as goods or services revenues as outlined above. Revenues associated with leases are recognized as outlined in Note 2(O).

Dividend income from investments is recognized when the right to receive payment has been established, usually on declaration of dividends by the paying entity's Board of Directors. Dividends characterized as a return of capital are recognized as a reduction in the cost of the related investment.

Interest income on financial assets classified as loans and receivables is accrued on a passage-of-time basis based on the principal outstanding and the applicable stated interest rates. Guarantee fee income is also accrued on the basis of the period and amounts over which the guarantee is provided.

B. Foreign Currency Translation

The Corporation's functional currency is the Canadian dollar. Foreign-currency-denominated monetary assets and liabilities are translated at exchange rates in effect at the end of the reporting period. Transactions denominated in a currency other than the functional currency are translated at the exchange rate in effect on the transaction date. The resulting exchange gains or losses are included in net earnings in the period in which they arise.

C. Financial Instruments and Hedges

I. Financial Instruments

Financial assets and financial liabilities, including derivatives and certain non-financial derivatives, are recognized on the Consolidated Statements of Financial Position when the Corporation becomes a party to the contract. All financial instruments, except for certain non-financial derivative contracts that meet the Corporation's own use requirements, are measured at fair value upon initial recognition. Measurement in subsequent periods depends on whether the financial instrument has been classified as: at fair value through profit or loss, available-for-sale, held-to-maturity, loans and receivables, or other financial liabilities. Classification of the financial instrument is determined at inception depending on the nature and purpose of the financial instrument.

Financial assets and financial liabilities classified or designated as at fair value through profit or loss are measured at fair value with changes in fair values recognized in net earnings. Financial assets classified as either held-to-maturity or as loans and receivables, and other financial liabilities, are measured at amortized cost using the effective interest method of amortization. Available-for-sale financial assets are those non-derivative financial assets that are designated as such or that have not been classified as another type of financial asset, and are measured at fair value through Other Comprehensive Income ("OCI"). Available-for-sale financial assets are measured at cost if fair value is not reliably measurable.

Financial assets are assessed for impairment on an ongoing basis and at reporting dates. An impairment may exist if an incurred loss event has arisen that has an impact on the recoverability of the financial asset. Factors that may indicate an incurred loss event and related impairment may exist include, for example: a debtor is experiencing significant financial difficulty, or a debtor has entered (or it is probable that they will) enter bankruptcy or other financial reorganization. Additionally, a significant or prolonged decline in the fair value, as compared to the cost, of a financial asset classified as available-for-sale may be an indicator of impairment. The carrying amount of financial assets is reduced for impairment losses through the use of an allowance account, and the loss is recognized in net earnings.

Financial assets are derecognized when the contractual rights to receive cash flows expire. Financial liabilities are derecognized when the obligation is discharged, cancelled or expired.

Derivative instruments that are embedded in financial or non-financial contracts that are not already required to be recognized at fair value are treated and recognized as separate derivatives if their risks and characteristics are not closely related to their host contracts and the contract is not measured at fair value. Changes in the fair values of these and other derivative instruments are recognized in net earnings with the exception of the effective portion of derivatives designated as cash flow hedges, which is recognized in OCI.

Transaction costs are expensed as incurred for financial instruments classified or designated as at fair value through profit or loss. For other financial instruments, such as debt instruments, transaction costs are recognized as part of the carrying amount of the financial instrument. The Corporation uses the effective interest method of amortization for any transaction costs or fees, premiums, or discounts earned or incurred for financial instruments measured at amortized cost.

II. Hedges
Where hedge accounting can be applied and the Corporation chooses to seek hedge accounting treatment, a hedge relationship is designated as a fair value hedge or a cash flow hedge. A hedging relationship qualifies for hedge accounting if, at inception, it is formally designated and documented as a hedge, and the hedge is expected to be highly effective at inception and on an ongoing basis. The documentation includes identification of the hedging instrument and hedged item or transaction, the nature of the risk being hedged, the Corporation's risk management objectives and strategy for undertaking the hedge, and how hedge effectiveness will be assessed. The process of hedge accounting includes linking derivatives to specific recognized assets and liabilities or to specific firm commitments or highly probable anticipated transactions.

The Corporation formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives used are highly effective in offsetting changes in fair values or cash flows of hedged items. If hedge criteria are not met or the Corporation does not apply hedge accounting, the derivative is accounted for on the Consolidated Statements of Financial Position at fair value, with subsequent changes in fair value recorded in net earnings in the period of change.

In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is recognized in OCI and any ineffective portion is recognized in net earnings. Hedge effectiveness is achieved if the derivative's cash flows are highly effective at offsetting the cash flows of the hedged item and the timing of the cash flows is similar. All components of each derivative's change in fair value are included in the assessment of cash flow hedge effectiveness. If hedging criteria are met, the fair values of the hedges are recorded in risk management assets or liabilities with changes in fair value being reported in OCI. On settlement, gains or losses on these derivatives are recognized in net earnings in the same period and financial statement caption as the hedged exposure or in the cost of the asset acquired if the hedge relates to a non-financial asset. If hedge accounting is discontinued, the amounts previously recognized in Accumulated Other Comprehensive Income ("AOCI") are reclassified to net earnings during the periods when the variability in the cash flows of the hedged item affects net earnings. Gains or losses on derivatives are reclassified to net earnings from AOCI immediately when the forecasted transaction is no longer expected to occur within the time period specified in the hedge documentation.

D. Cash and Cash Equivalents
Cash and cash equivalents are comprised of cash and highly liquid investments with original maturities of three months or less.

E. Inventory
I. Emission Credits
Purchased emission credits and allowances are recorded as inventory at cost and are carried at the lower of weighted average cost and net realizable value. Credits granted to, or internally generated by, the Corporation are recorded at nil.

II. Parts, Materials and Supplies
Parts, materials and supplies are recorded at the lower of cost, measured at moving average cost and net realizable value.

F. Property, Plant and Equipment
The Corporation's investment in property, plant and equipment ("PP&E") is initially measured at the original cost of each component at the time of construction, purchase or acquisition. A component is a tangible portion of an asset that can be separately identified and depreciated over its own expected useful life, and is expected to provide a benefit for a period in excess of one year. Original cost includes items such as materials, labour, borrowing costs and other directly attributable costs, including the initial estimate of the cost of decommissioning and restoration. Costs are recognized as PP&E assets if it is probable that future economic benefits will be realized and the cost of the item can be measured reliably.

The cost of capital spares is capitalized and classified as PP&E, as these items can only be used in connection with an item of PP&E.

Planned life-cycle maintenance for hydro facilities is performed at regular intervals and includes inspection, repair and maintenance of existing components. Costs incurred are capitalized in the period in which maintenance activities occur and are amortized on a straight-line basis over the term until the next life-cycle maintenance event. Expenditures incurred for the replacement of components are capitalized and amortized over the estimated useful life of such components.

The cost of routine repairs and maintenance and the replacement of minor parts is charged to net earnings as incurred.

Subsequent to initial recognition and measurement at cost, all classes of PP&E continue to be measured using the cost model and are reported at cost less accumulated depreciation and impairment losses, if any.

An item of PP&E or a component is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition is included in net earnings when the asset is derecognized.

The estimate of the useful lives of each component of PP&E is based on current facts and past experience, and takes into consideration existing long-term sales agreements and contracts, current and forecasted demand, and the potential for technological obsolescence. The useful life is used to estimate the rate at which the component of PP&E is depreciated. PP&E assets are subject to depreciation when the asset is considered to be available for use, which is typically upon commencement of commercial operations. Each significant component of an item of PP&E is depreciated to its residual value over its estimated useful life, using the straight-line method. Estimated useful lives, residual values and depreciation methods are reviewed at least annually and are subject to revision based on new or additional information. The effect of a change in useful life, residual value or depreciation method is accounted for prospectively.

Estimated useful lives of the components of depreciable assets, categorized by asset class, are as follows:

Hydro generation	30-50 years
Wind generation	3-30 years
Gas generation	2-30 years
Capital spares and other	2-30 years

The Corporation capitalizes borrowing costs on capital invested in projects under construction (see Note 2(K)). Upon commencement of commercial operations, capitalized borrowing costs, as a portion of the total cost of the asset, are depreciated over the estimated useful life of the related asset.

G. Intangible Assets

Intangible assets acquired in a business combination are recognized at their fair value at the date of acquisition. Intangible assets acquired separately are recognized at cost. Internally generated intangible assets arising from development projects are recognized when certain criteria related to the feasibility of internal use or sale, and probable future economic benefits, of the intangible asset are demonstrated. Intangible assets are initially recognized at cost, which is comprised of all directly attributable costs necessary to create, produce and prepare the intangible asset to be capable of operating in the manner intended by management.

Subsequent to initial recognition, intangible assets continue to be measured using the cost model, and are reported at cost less accumulated amortization and impairment losses, if any. Amortization is included in depreciation and amortization in the Consolidated Statements of Earnings.

Amortization commences when the intangible asset is available for use, and is computed on a straight-line basis over the intangible asset's estimated useful life. Estimated useful lives of intangible assets may be determined, for example, with reference to the term of the related contract or licence agreement. The estimated useful lives and amortization methods are reviewed annually with the effect of any changes being accounted for prospectively.

Intangible assets include power sale contracts with fixed prices higher than market prices at the date of acquisition, software and intangibles under development. Estimated useful lives of intangible assets are as follows:

Software	2-7 years
Power sale contracts	5-20 years

H. Impairment of Tangible and Intangible Assets

At the end of each reporting period, the Corporation assesses whether there is any indication that PP&E and finite life intangible assets are impaired.

Factors that could indicate that an impairment exists include: significant underperformance relative to historical or projected operating results; significant changes in the manner in which an asset is used, or in the Corporation's overall business strategy; or significant negative industry or economic trends. In some cases, these events are clear. However, in many cases, a clearly identifiable event indicating possible impairment does not occur. Instead, a series of individually insignificant events occurs over a period of time leading to an indication that an asset may be impaired.

The Corporation's operations, the market and business environment are routinely monitored, and judgments and assessments are made to determine whether an event has occurred that indicates a possible impairment. If such an event has occurred, an estimate is made of the recoverable amount of the asset. Recoverable amount is the higher of an asset's fair value less costs of disposal and its value in use. Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. In determining fair value, recent market transactions are taken into account. If no such transactions can be identified, an appropriate valuation model, such as discounted cash flows, is used. Value in use is the present value of the estimated future cash flows expected to be derived from the asset from its continued use and ultimate disposal by the Corporation. If the recoverable amount is less than the carrying amount of the asset, an asset impairment loss is recognized in net earnings, and the asset's carrying amount is reduced to its recoverable amount.

At each reporting date, an assessment is made to determine if there is any indication that an impairment loss previously recognized no longer exists or has decreased. If such indication exists, the recoverable amount of the asset is estimated and the impairment loss previously recognized is reversed if there has been an increase in the asset's recoverable amount. Where an impairment loss is subsequently reversed, the carrying amount of the asset is increased to the lesser of the revised estimate of its recoverable amount or the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognized previously. A reversal of an impairment loss is recognized in net earnings.

I. Income Taxes

Income tax expense comprises current and deferred income tax. Current income tax is the expected income tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to income taxes in respect of previous years.

Deferred income tax is recognized in respect of differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes (temporary differences). Deferred income tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the tax laws that have been enacted or substantively enacted at the reporting date.

A deferred income tax asset is recognized for unused tax losses and tax credits to the extent that it is probable that future taxable profits will be available against which such losses can be utilized. Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related income tax benefit will be realized.

J. Provisions

Provisions are recognized when the Corporation has a present obligation (legal or constructive) as a result of a past event, it is probable that the Corporation will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. A legal obligation can arise through a contract, legislation or other operation of law. A constructive obligation arises from an entity's actions, whereby through an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated it will accept certain responsibilities and has thus created a valid expectation that it will discharge those responsibilities. The amount recognized as a provision is the best estimate, remeasured at each period-end, of the expenditures required to settle the present obligation considering the risks and uncertainties associated with the obligation. Where expenditures are expected to be incurred in the future, the obligation is measured at its present value using a current market-based, risk-adjusted interest rate.

The Corporation records a decommissioning and restoration provision for all generating facilities for which it is legally or constructively required to remove the facilities at the end of their useful lives and restore the site. For some hydro facilities, the Corporation is required to remove the generating equipment, but is not required to remove the structures. Initial decommissioning provisions are recognized at their present value when incurred. Each reporting date, the Corporation determines the present value of the provision using the current discount rates that reflect the time value of money and associated risks. The Corporation recognizes the initial decommissioning and restoration provisions, as well as changes resulting from revisions to cost estimates and period-end revisions to the market-based, risk-adjusted discount rate, as a cost of the related PP&E (see Note 2(F)). The accretion of the net present value discount is charged to net earnings each period and is included in net interest expense.

Changes in other provisions resulting from revisions to estimates of expenditures required to settle the obligation or period-end revisions to the market-based, risk-adjusted discount rate are recognized in net earnings. The accretion of the net present value discount is charged to net earnings each period and is included in net interest expense.

K. Borrowing Costs

The Corporation capitalizes borrowing costs that are directly attributable to, or relate to general borrowings used for, the construction of qualifying assets. Qualifying assets are assets that take a substantial period of time to prepare for their intended use and typically include generating facilities or other assets that are constructed over periods of time exceeding 12 months. Borrowing costs are considered to be directly attributable if they could have been avoided if the expenditure on the qualifying asset had not been made. Borrowing costs that are capitalized are included in the cost of the related PP&E component. Capitalization of borrowing costs ceases when substantially all the activities necessary to prepare the asset for its intended use are complete.

All other borrowing costs are expensed in the period in which they are incurred.

L. Non-Controlling Interest

A non-controlling interest arises from contractual arrangements between the Corporation and other parties, whereby the other party has acquired an interest in a specified asset or operation, and the Corporation retains control.

Subsequent to acquisition, the carrying amount of the non-controlling interest is increased or decreased by the non-controlling interest's share of subsequent changes in equity and payments to the non-controlling interest. Total comprehensive income is attributed to the non-controlling interest even if this results in the non-controlling interest having a negative balance.

M. Joint Arrangements

A joint arrangement is a contractual arrangement that establishes the terms by which two or more parties agree to undertake and jointly control an economic activity. The Corporation's joint arrangements are generally classified as joint operations.

A joint operation arises when two or more parties that have joint control have rights to the assets, and obligations for the liabilities, relating to the arrangement. Generally, each party takes a share of the output from the asset and each bears an agreed-upon share of the costs incurred in respect of the joint operation. The Corporation reports its interests in joint operations in its consolidated financial statements using the proportionate consolidation method by recognizing the assets, liabilities, revenues and expenses in respect of its interest in the joint operation that it has a right to.

N. Government Incentives

Government incentives are recognized when the Corporation has reasonable assurance that it will comply with the conditions associated with the incentive and that the incentive will be received. When the incentive relates to an expense or revenue item, it is recognized in net earnings over the same period in which the related costs or revenues are recognized. When the incentive relates to an asset, it is recognized as a reduction of the carrying amount of PP&E and released to earnings as a reduction in depreciation expense over the expected useful life of the related asset.

O. Leases

A lease is an arrangement whereby the lessor conveys to the lessee, in return for a payment or series of payments, the right to use an asset for an agreed period of time.

PPAs may contain, or may be considered, leases where the fulfilment of the arrangement is dependent on the use of a specific asset (i.e., a generating facility) and the arrangement conveys to the customer the right to use that asset.

Where the Corporation determines that the contractual provisions of a PPA contain, or are, a lease and result in the Corporation retaining the principal risks and rewards of ownership of the asset, the arrangement is an operating lease. For operating leases, the asset is, or continues to be, capitalized as PP&E and depreciated over its useful life. Rental income, including contingent rent, from operating leases is recognized over the term of the arrangement and is reflected in revenue on the Consolidated Statements of Earnings. Contingent rent may arise when payments due under the PPA are not fixed in amount but vary based on a future factor such as the amount of use or production.

P. Earnings per Share

Basic earnings per share is calculated by dividing earnings attributable to common shareholders by the weighted average number of common shares outstanding in the year.

The Corporation has no dilutive or potentially dilutive instruments.

Q. Significant Accounting Judgments and Key Sources of Estimation Uncertainty

The preparation of financial statements requires management to make judgments, estimates and assumptions that could affect the reported amounts of assets, liabilities, revenues, expenses, and disclosures of contingent assets and liabilities during the period. These estimates are subject to uncertainty. Actual results could differ from those estimates due to factors such as fluctuations in interest rates, foreign exchange rates, inflation and commodity prices, and changes in economic conditions, legislation and regulations, and such differences could be material.

In the process of applying the Corporation's accounting policies, management has to make judgments and estimates about matters that are highly uncertain at the time the estimate is made and that could significantly affect the amounts recognized in the consolidated financial statements. Different estimates with respect to key variables used in the calculations, or changes to estimates, could potentially have a material impact on the Corporation's financial position or performance.

The key judgments and sources of estimation uncertainty are described below:

I. Significant Influence through Tracking Preferred Shares

The Corporation has invested in preferred shares of subsidiaries of TransAlta that pay dividends based on tracking certain financial results of other subsidiaries of TransAlta. Under IFRS, a 20 per cent voting interest is presumed to provide the holder with significant influence over the investee. Significant influence is the power to participate in the financial and operating policy decisions of an investee.
The rights associated with the Corporation's investment in the preferred shares of a subsidiary of TransAlta tracking the financial results of TransAlta Wyoming Wind LLC provide the Corporation with a 25 per cent voting interest in that subsidiary. In the event that any dividends have not been paid within six months of the date at which the payout formula would have them paid, and while such amounts remain unpaid, the Corporation will have the right to appoint 75 per cent of the directors.

The investment in the preferred shares of a subsidiary of TransAlta tracking the financial results of TransAlta Energy (Australia) Pty Ltd. ("TEA") does not provide the Corporation with any voting rights, unless and until the subsidiary fails to pay four quarterly dividends on the dates when due in accordance with the payout formula, whether or not consecutive, and whether or not such dividends have been declared. Thereafter, but only for so long as any such dividend remains in arrears, the Corporation is entitled to elect 30 per cent of the directors of the subsidiary. The investment agreement provides the Corporation with rights to financial information and further protections against adverse changes in the operation and financial structure of TEA through post-closing covenants.

The Corporation determined that it does not have significant influence over the TransAlta subsidiaries, in consideration of TransAlta's block ownership of the voting shares, and accordingly, the investments were determined to constitute financial assets.

II. Dividends as Income or Return of Capital

The Corporation receives dividends from its investment in the preferred shares tracking adjusted TEA amounts, TEA preferred shares, preferred shares tracking earnings, distributions of TransAlta Wyoming Wind LLC, and in 2016 from preferred shares tracking adjusted Canadian Assets amounts. Determining whether a dividend represents in substance a return of capital requires significant judgment. The Corporation determines the amount of dividends that represents a return of capital based on the lower of: (i) the difference, if positive, between the cost base of the shares and their fair value, at the end of the reporting period; and (ii) the actual dividend declared on the shares during the reporting period. When it is determined that a dividend represents a return of capital, the carrying amount of the related investment is reduced. During the second, third and fourth quarters of 2016, the Corporation determined that a portion of the dividend earned on the preferred shares tracking adjusted Canadian Assets amounts constituted a return of capital. During the third and fourth quarters of 2017, the Corporation determined that the dividend earned on the preferred shares tracking adjusted TEA amounts constituted a return of capital.

III. Financial Instrument Fair Values

The Corporation has entered into financial instruments and derivatives that are accounted for at fair value, with the initial and subsequent changes in fair value affecting earnings and other comprehensive income in the period the change occurs. The fair values of financial instruments and derivatives are classified within three levels.

Level III fair values are determined using inputs for the asset or liability that are not readily observable. These fair value levels are outlined and discussed in more detail in Note 12. Some of the Corporation's fair values are included in Level III because they require the use of significant unobservable assumptions in the internal valuation techniques or models to determine fair value. The determination of the fair value of these contracts can be complex and relies on judgments and estimates concerning operating revenue, costs, discount rates and business alternatives, among other factors. These fair value estimates may not necessarily be indicative of the amounts that could be realized or settled, and changes in these assumptions could affect the reported fair value of the financial instruments. Fair values can fluctuate significantly and can be favourable or unfavourable depending on current market conditions.

IV. Consolidation of Kent Hills 1, and 2 and 3 (“Kent Hills”) Wind Farms

Under IFRS, the Corporation is required to consolidate all entities that it controls. The Corporation consolidates Kent Hills as a subsidiary. As at Dec. 31, 2016, Kent Hills was subject to a joint venture agreement but was not an incorporated entity. As at Dec. 31, 2016, the Corporation had determined that Kent Hills was considered an entity as it was sufficiently ring-fenced to be considered a deemed separate entity. Kent Hills was considered ring-fenced because the assets, liabilities and results of operations of Kent Hills were separate from the Corporation and the joint venture agreement specified how Kent Hills was to be managed. In September 2017, the Corporation and the Kent Hills non-controlling interest partner formed a limited partnership ("LP") that owns the Kent Hills 1 and 2 Wind Farms and the Kent Hills 3 expansion project. Ownership of the LP is 83 per cent and 17 per cent, respectively. The Corporation controls the Kent Hills Wind LP through its 83 per cent ownership, and accordingly, consolidation is required.

V. Impairment of PP&E

Impairment exists when the carrying amount of an asset exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use. An assessment is made at each reporting date as to whether there is any indication that an impairment loss may exist or that a previously recognized impairment loss may no longer exist or may have decreased. In determining fair value less costs of disposal, information about third-party transactions for similar assets is used and if none is available, other valuation techniques, such as discounted cash flows, are used. Value in use is computed using the present value of management’s best estimates of future cash flows based on the current use and present condition of the asset. In estimating either fair value less costs of disposal or value in use using discounted cash flow methods, estimates and assumptions must be made about sales prices, production, capital expenditures, asset retirement costs, and other related cash inflows and outflows over the life of the facilities, which can range from 25 to 50 years. In developing these assumptions, management uses estimates of contracted prices, anticipated production levels, planned and unplanned outages, changes to regulations, and transmission capacity or constraints for the remaining life of the facilities. Appropriate discount rates reflecting the risks specific to the asset under review are used in the assessments. These estimates and assumptions are susceptible to change from period to period and actual results can, and often do, differ from the estimates, and can have either a positive or negative impact on the estimate of the impairment charge, and may be material. All of the Corporation’s generating assets are contracted under the TransAlta PPAs or other PPAs with various third parties.

VI. Income Taxes

Preparation of the consolidated financial statements involves determining an estimate of, or provision for, income taxes in each of the jurisdictions in which the Corporation operates. The process also involves making an estimate of income taxes currently payable and income taxes expected to be payable or recoverable in future periods, referred to as deferred income taxes. Deferred income taxes result from the effects of temporary differences due to items that are treated differently for tax and accounting purposes. The tax effects of these differences are reflected in the Consolidated Statements of Financial Position as deferred income tax assets and liabilities. An assessment must also be made to determine the likelihood that the Company’s future taxable income will be sufficient to permit the recovery of deferred income tax assets. To the extent that such recovery is not probable, deferred income tax assets must be reduced. Management must exercise judgment in its assessment of continually changing tax interpretations, regulations and legislation to ensure deferred income tax assets and liabilities are complete and fairly presented. Differing assessments and applications than the Corporation’s estimates could materially impact the amounts recognized for deferred income tax assets and liabilities.

VII. Provisions for Decommissioning and Restoration Activities

The Corporation recognizes provisions for decommissioning and restoration obligations as outlined in Note 2(J) and Note 17. Initial decommissioning provisions, and subsequent changes thereto, are determined using the Corporation’s best estimate of the required cash expenditures, adjusted to reflect the risks and uncertainties inherent in the timing and amount of settlement. The estimated cash expenditures are present valued using a current, risk-adjusted, market-based, pre-tax discount rate. A change in estimated cash flows, market interest rates or timing could have a material impact on the carrying amount of the provision.

VIII. Useful Life of PP&E

Each significant component of an item of PP&E is depreciated over its estimated useful life. Estimated useful lives are determined based on current facts and past experience, and take into consideration the anticipated physical life of the asset, existing long-term sales agreements and contracts, current and forecasted demand, the potential for technological obsolescence and regulations. The useful lives of PP&E are reviewed at least annually to ensure they continue to be appropriate.

IX. Impairment of Investments
For investments in subsidiaries carried at fair value or cost, the Corporation assesses at the end of each reporting period whether there is any indication that the investment may be impaired. If an indication exists, the Corporation estimates the recoverable amount of the investment.

An indicator of impairment may exist if there is a measurable decrease in the estimated future cash flows from a financial asset since its initial recognition or a significant or prolonged decline in the fair value arises. Judgement is required in assessing whether an indicator of impairment exists.

When changes in fair values of an available-for-sale financial asset have been recognized in other comprehensive income, and there is objective evidence that the asset is impaired, the impairment loss that had been recognized in other comprehensive income is reclassified to net earnings as a reclassification adjustment, even though the financial asset has not been derecognized.

3. Accounting Changes

A. Future Accounting Changes
Accounting standards that have been previously issued by the IASB but that were not yet effective as at Dec. 31, 2017, and have not been applied by the Corporation, include IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*.

As part of each implementation plan, a centralized project team has been created to manage project activities. A stakeholder committee has been formed to oversee the implementation process and it includes individuals from the relevant functions and business units.

I. IFRS 9 *Financial Instruments*
In July 2014, on completion of the impairment phase of the project to reform accounting for financial instruments and replace International Accounting Standard ("IAS") 39 *Financial Instruments: Recognition and Measurement*, the IASB issued the final version of IFRS 9 *Financial Instruments*. IFRS 9 includes guidance on the classification and measurement of financial assets and financial liabilities, impairment of financial assets (i.e., recognition of credit losses) and a new hedge accounting model. IFRS 9 is effective for annual periods beginning on or after Jan. 1, 2018, with early application permitted. IFRS 9 will be applied by the Corporation on January 1, 2018.

Under the classification and measurement requirements, financial assets must be classified and measured at either amortized cost, at fair value through profit or loss, or through OCI, depending on the basis of the entity's business model for managing the financial asset and the contractual cash flow characteristics of the financial asset.

The classification requirements for financial liabilities are unchanged from IAS 39. IFRS 9 requirements address the problem of volatility in net earnings arising from an issuer choosing to measure certain liabilities at fair value and require that the portion of the change in fair value due to changes in the entity's own credit risk be presented in OCI, rather than within net earnings.

The new general hedge accounting model is intended to be simpler and more closely focus on how an entity manages its risks, replaces the IAS 39 effectiveness testing requirements with the principle of an economic relationship, and eliminates the requirement for retrospective assessment of hedge effectiveness.

The new requirements for impairment of financial assets introduce an expected loss impairment model that requires more timely recognition of expected credit losses. IAS 39 impairment requirements are based on an incurred loss model where credit losses are not recognized until there is evidence of a trigger event.

With respect to IFRS 9, the Corporation has completed its assessment of the impacts of IFRS 9, with the following results:
- Classification and measurement:
    - A classification change has been identified that will lead to a material opening balance sheet adjustment related to the Corporation's investment in the preferred shares of a subsidiary of TransAlta related to TEA. The transition adjustment will result in the reclassification of $137 million from retained earnings to accumulated other comprehensive income ("AOCI"), arising from the 2017 impairments on the preferred shares tracking adjusted TEA amounts. Under IFRS 9, gains or losses recognized in OCI for investments in equity instruments designated at fair value through OCI are not reclassified subsequently to net earnings.

The Corporation intends to use the IFRS 9 election to continue to recognize changes in fair value on this equity investment through OCI, as opposed to through net earnings.

- A measurement change has been identified that is expected to result in a $4 million opening balance sheet adjustment. The Corporation's investment in the preferred shares of a subsidiary of TransAlta related to Wyoming Wind LLC is required to be measured at fair value through profit and loss under IFRS 9, as opposed to cost as permitted under IAS 39. The Corporation intends to use the IFRS 9 election to recognize changes in fair value on this equity through OCI, as opposed to through net earnings.

- Impairment: IFRS 9 introduces a new impairment model based on expected credit losses, rather than incurred losses as required under IAS 39. Expected credit losses are required to be measured through a loss allowance at an amount equal to 12-month expected credit losses or lifetime expected credit losses. The Corporation has determined that no material expected credit losses are required to be recognized on transition to IFRS 9.
- Hedge accounting: The Corporation has elected not to apply the hedge accounting requirements of IAS 39 to hedging relationships on transition to IFRS 9, and thus is applying the requirements of IFRS 9 prospectively, and has reviewed its hedge documents to confirm all qualifying hedge criteria under IFRS 9 have been met.
- The Corporation, as permitted under IFRS 9, will not restate prior periods for any of the above-noted impacts.

II. IFRS 15 *Revenue from Contracts with Customers*

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*, which replaces existing revenue recognition guidance with a single comprehensive accounting model. The model specifies that an entity recognizes revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which it expects to be entitled in exchange for those goods or services. In April 2016, the IASB issued an amendment to IFRS 15 to clarify the identification of performance obligations, principal versus agent considerations, licences of intellectual property, and transition practical expedients. IFRS 15, including the amendment, is required to be adopted either retrospectively or using a modified retrospective approach for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 15 will be applied by the Corporation on January 1, 2018.

With respect to IFRS 15, the Corporation has completed the review and accounting assessment of its revenue streams and underlying contracts with customers. The majority of the Corporation's revenues within the scope of IFRS 15 are earned through the sale of energy and Green Attributes under long-term contracts. IFRS 15 requires the application of a five-step model to determine when to recognize revenue, and at what amount. The model specifies that revenue should be recognized when (or as) an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognized either over time, in a manner that depicts the entity's performance, or at a point in time, when control is transferred to the customer.

The Corporation has chosen to apply the modified retrospective method of transition. Under this method, the comparative periods presented in the consolidated financial statements as at and for the year ended Dec. 31, 2018, will not be restated. Instead, the Corporation will recognize the cumulative impact of the initial application of the standard in retained earnings as at Jan. 1, 2018.

The Corporation has concluded that no material changes to its current revenue recognition practices from contracts with customers is required.

III. IFRS 16 *Leases*

In January 2016, the IASB issued IFRS 16 *Leases*, which replaces the current IFRS guidance on leases. Under current guidance, lessees are required to determine if the lease is a finance or operating lease, based on specified criteria. Finance leases are recognized on the Consolidated Statements of Financial Position, while operating leases are not. Under IFRS 16, lessees must recognize a lease liability and a right-of-use asset for virtually all lease contracts. An optional exemption to not recognize certain short-term leases and leases of low value can be applied by lessees. For lessors, the accounting remains essentially unchanged. IFRS 16 is effective for annual periods beginning on or after Jan. 1, 2019, with early application permitted if IFRS 15 is also applied at the same time. The standard is required to be adopted either retrospectively or using a modified retrospective approach. IFRS 16 will be applied by the Corporation on January 1, 2019.

The Corporation is in the process of completing its initial scoping assessment for IFRS 16 and has prepared a detailed project plan. The Corporation anticipates that most of the effort under the implementation plan will occur in mid-to-late 2018. It is not yet possible to make a reliable estimate of the potential impact of IFRS 16 on the Corporation's financial statements and disclosures.

4. Significant Events

A. 2017

South Hedland Power Station and Conversion of Class B Shares

On July 28, 2017, commissioning of the South Hedland Power Station was achieved and on Aug. 1, 2017, the Corporation converted the 26.1 million Class B Shares held by TransAlta into 26.4 million common shares. The Class B shares were converted at a ratio greater than 1:1 because the construction and commissioning costs for the project were below the referenced costs agreed upon in the amended contribution agreement, dated July 26, 2017, between the Corporation and TransAlta. On the conversion date, the carrying amount of the Class B shares liability of $385 million was derecognized and the common shares issued on conversion were recognized at that same amount.

On Aug. 1, 2017, Fortescue Metals Group Ltd. ("FMG") notified TransAlta that in its view the South Hedland Power Station had not yet satisfied the requisite performance criteria under the South Hedland PPA between FMG and TransAlta. In TransAlta's view, all conditions to establish commercial operations have been fully satisfied under the terms of the South Hedland PPA. Horizon Power, the local utility and offtaker of the majority of the generation of the facility, has confirmed and not disputed commercial operation. On Nov. 13, 2017, FMG issued a notice purporting to terminate the PPA. TransAlta's view is that the contract termination is invalid. TransAlta continues to invoice FMG for monthly capacity in accordance with the terms of the contract.

Kent Hills Wind Project

During the second quarter of 2017, the Corporation entered into a long-term contract with the New Brunswick Power Corporation ("NB Power") for the sale of all power generated by an additional 17.25 MW of capacity from the Kent Hills wind project. At the same time, the term of the Kent Hills 1 contract with NB Power was extended from 2033 to 2035, matching the life of the Kent Hills 2 and Kent Hills 3 wind projects.

This is an expansion project of the Corporation's existing Kent Hills wind farm, increasing the total operating capacity of the facility to approximately 167 MW. As part of the regulatory process, the Corporation submitted an Environmental Impact Assessment to the Province of New Brunswick in September 2017. The Corporation expects to begin the construction phase during the spring of 2018.

Closing of $260 Million Project Financing

On Oct. 2, 2017, the Corporation closed an approximate $260 million bond offering, which is secured by, among other things, a first ranking charge over all assets of Kent Hills Wind LP, a subsidiary of the Corporation. The bonds are amortizing and bear interest at an annual rate of 4.454 per cent, payable quarterly and maturing Nov. 30, 2033. Proceeds from the financing will partly fund the expansion at Kent Hills, with the remaining proceeds, net of $30 million held in a construction reserve account, being distributed to each partner in the Kent Hills wind project.

Syndicated Credit Facility

On July 24, 2017, the Corporation entered into a syndicated credit agreement giving the Corporation access to $500 million in direct borrowings or letters of credit. The agreement is fully committed for four years, expiring in 2021. The facility is subject to a number of customary covenants and restrictions in order to maintain access to the funding commitments. In conjunction with entering into the new credit agreement, the $350 million credit facility provided by TransAlta was cancelled.

Repurchase of Solomon Power Station

On Aug. 1, 2017, TransAlta received notice of FMG's intention to repurchase the Solomon Power Station from TEC Pipe Pty Ltd., a wholly-owned subsidiary of TransAlta, for approximately US$335 million. The Corporation has an economic interest in the cash flows from the Solomon Power Station (see Note 8 for additional information). FMG completed its acquisition of the Solomon Power Station on Nov. 1, 2017, and TEC Pipe Pty Ltd received approximately US$325 million from FMG for the repurchase. FMG has held back the balance from the purchase price. It is TransAlta's view that this should not be held back and TransAlta is taking action to recover all, or a significant portion, of this amount from FMG.

TEA used part of the proceeds received from the termination of the Solomon PPA to redeem $179 million of the Mandatory Redeemable Preferred Shares ("MRPS") and $39 million of the preferred shares of TEA (see Note 8 for additional information). In addition, the Corporation received a loan in the amount of AUD199 million from TEA. The loan is due on the earlier of receipt of a demand notice and Dec. 31, 2018 (see Note 16 for additional information).

The Corporation utilized the proceeds to repay the credit facility used to fund the development of the South Hedland Power Station and to repay the $215 million convertible debenture issued to TransAlta.

Early Redemption of Debentures

On Sept. 27, 2017, the Corporation provided notice of the early redemption of the unsecured debentures issued by its subsidiary, Canadian Hydro Developers, Inc., on Oct. 12, 2017, with a weighted average interest rate of 6.3 per cent. The debentures were scheduled to mature in June 2018. On Oct. 12, 2017, the Corporation redeemed the unsecured debentures for $201 million, comprised of the principal of $191 million, an early redemption premium of $6 million, and accrued interest of $4 million. A $6 million early redemption premium was recognized and is included in net interest expense.

B. 2016

Closing of $159 Million Project Financing

On June 3, 2016, the Corporation's indirect wholly owned subsidiary, New Richmond Wind L.P. (the "Issuer"), closed a bond offering of approximately $159 million, which is secured by a first ranking charge over all assets of the Issuer. The bonds are amortizing and bear interest from their date of issue at a rate of 3.963 per cent, payable semi-annually, and mature on June 30, 2032. Net proceeds of the financing were used to repay debt maturing in a subsidiary and intercompany debt with TransAlta as well as to fund the construction of the South Hedland facility in Australia.

Akolkolex Contract Renewal

In the second quarter of 2016, the Corporation finalized the recontracting of its 10 MW Akolkolex hydro facility and executed a 30-year contract with BC Hydro, which received regulatory approval in January 2017.

Investment in TransAlta's Sarnia Cogeneration Plant, Le Nordais Wind Farm and Ragged Chute Hydro Facility

On Jan. 6, 2016, the Corporation invested in an economic interest based on the cash flows of TransAlta's Sarnia cogeneration plant, Le Nordais wind farm and Ragged Chute hydro facility (the "Canadian Assets") for a combined value of approximately $540 million. The Canadian Assets consist of approximately 611 MW of highly contracted power generation assets located in Ontario and Quebec. The Corporation's investment consisted of the acquisition of tracking preferred shares of a subsidiary of TransAlta that provided the Corporation with an economic interest based on cash flows broadly equal to the underlying net distributable profits of the entities that own the Canadian Assets. The transaction was originally announced on Nov. 23, 2015.

As consideration, the Corporation provided to TransAlta $173 million in cash, issued 15,640,583 common shares with a value of $152 million, and issued a $215 million convertible unsecured subordinated debenture as discussed in Note 19.

The Corporation funded the cash consideration of the purchase price primarily through the issuance of 17,692,750 subscription receipts at a price of $9.75 per subscription receipt. Upon the closing of the transaction, each holder of subscription receipts received one common share of the Corporation and a cash dividend equivalent payment of $0.07 for each subscription receipt held. As a result, the Corporation issued 17,692,750 common shares and paid a total dividend equivalent of $1 million. Share issuance costs amounted to $8 million, net of a $2 million income tax recovery.

On Nov. 30, 2016, the Corporation acquired direct ownership of the Canadian Assets from a subsidiary of TransAlta for a purchase price of $520 million and the preferred shares tracking adjusted Canadian Assets amounts were redeemed by the issuing subsidiary of TransAlta at their fair value of $520 million. The redemption of the preferred shares and the acquisition of the direct ownership in the Canadian Assets were subject to a set-off arrangement and resulted in no cash payments. The Corporation also acquired working capital and certain capital spares totalling $19 million through the issuance of a non-interest-bearing loan (see Note 16).

The acquisition of the Canadian Assets was accounted for as a business combination under common control, as TransAlta controlled the Canadian Assets both prior to, and after, the acquisition by the Corporation. IFRS 3 *Business Combinations* requires fair value accounting for acquisitions and does not provide guidance for common control transactions. Under established IFRS practice, common control transactions are generally accounted for using either the fair value or the pooling of interest (book value) methods of accounting. The Corporation applied the pooling of interest method to account for the acquisition of the Canadian Assets, consistent with its previously chosen accounting policies. The Canadian Assets' assets and liabilities acquired have been recognized at the book values previously recognized by TransAlta at Nov. 30, 2016, and not at their fair values. As a result, the Corporation recognized a charge to retained earnings of $94 million for the difference between the proceeds and book value of the Canadian Assets.

The results of operations of the Canadian Assets have been included in the Corporation's Consolidated Statements of Earnings prospectively from the Nov. 30, 2016, acquisition date and prior period comparative financial statements have not been restated.

5. Government Incentives

Certain of the Corporation's wind and hydro facilities are eligible to receive incentives under the Wind Power Production Incentive or the ecoENERGY for Renewable Power incentive programs sponsored by the Canadian federal government to encourage the development of clean power generation projects in Canada. Qualifying facilities receive specified incentive payments for every kilowatt hour of energy production for a period of up to 10 years from the date of commissioning.

6. Lease Revenue

Several of the Corporation's wind and hydro PPAs for the sale of electrical energy meet the criteria of operating leases, whereby the Corporation is the lessor and the customer is the lessee. Revenues earned under these contracts are reported as lease revenue.

7. Expenses by Nature

Expenses classified by nature are as follows:

Year ended Dec. 31	**2017**		2016	
	Fuel, royalties and other costs	**Operations, maintenance, and administration**	Fuel, royalties and other costs	Operations, maintenance, and administration
Fuel	**81**	**—**	11	—
Royalties and land lease costs	**14**	**—**	11	—
Transmission tariffs	**2**	**—**	1	—
Contracted operating expenses	**—**	**43**	—	24
Other operating expenses	**—**	**40**	—	29
Total	**97**	**83**	23	53

8. Finance Income Related to Subsidiaries of TransAlta

Finance income related to subsidiaries of TransAlta is comprised of income from various interests that in aggregate and over time indirectly provide the Corporation with cash flows based on those of TEA and TransAlta Wyoming Wind LLC, and, in 2016, the Canadian Assets.

Year ended Dec. 31	**2017**	2016
Interest income from investment in mandatory redeemable preferred shares of TEA	**47**	42
Dividend income from investment in preferred shares of TEA	**5**	3
Fee income from indirect guarantee of TEA obligations	**22**	23
Dividend income from investment in preferred shares tracking adjusted TEA amounts	**6**	28
Total finance income related to TEA	**80**	96
Dividend income from investment in preferred shares tracking adjusted Canadian Assets amounts (1)	**—**	44
Dividend income from investment in preferred shares tracking earnings and distributions of TransAlta Wyoming Wind LLC	**6**	11
Total	**86**	151

(1) The Canadian Assets were acquired on Nov. 30, 2016 (see Note 4 (B)).

Finance income is recognized in cash flows from operating activities in the Consolidated Statements of Cash Flows. Foreign exchange gains and losses related to monetary investments in subsidiaries of TransAlta are recognized within foreign exchange gain (loss) in the Consolidated Statements of Earnings.

Interest income from the investment in MRPS and TEA preferred shares represents income realized from the average coupon rates. The Corporation also receives a fee for providing an indemnity in respect of those guarantees of TransAlta disclosed in Note 25. Ultimately, these cash flows are deducted from the TEA amounts that form the basis for dividends payable to the Corporation from TEA. That basis is broadly comprised of earnings before interest, income taxes, depreciation and amortization, plus net cash interest, less cash taxes, sustaining capital expenditures, and other adjustments. Income from all Australian sources is fixed in Canadian dollars at the following exchange rates:

	2016	**2017**	**2018**	**2019**	**Thereafter until June 30, 2020**
Income denominated in AUD	0.96	0.96	0.94	0.94	0.94
Income denominated in USD	1.24	1.24	1.24	1.24	1.20

A summary of investments in subsidiaries of TransAlta is as follows:

As at	**Dec. 31, 2017**	Dec. 31, 2016
Investment in MRPS	**601**	613
Investment in preferred shares tracking adjusted TEA amounts	**616**	841
Investment in preferred shares of TEA	**94**	52
Total investments in subsidiaries related to TEA	**1,311**	1,506
Investment in preferred shares tracking earnings and distributions of TransAlta Wyoming Wind LLC	**126**	139
Total investments in subsidiaries of TransAlta	**1,437**	1,645

Investment in Subsidiaries of TransAlta Related to TEA

Changes in the investments in subsidiaries of TransAlta that relate to TEA are detailed as follows:

Year ended Dec. 31, 2017	**MRPS(1)**	**Preferred shares tracking adjusted TEA amounts**	**Preferred shares of TEA(2)**	**Total**
Investment balance at Dec. 31, 2016	613	841	52	1,506
Additional investments	161	—	72	233
Redemption(3)	(179)	—	(39)	(218)
Unrealized foreign exchange gains recognized in earnings	6	—	—	6
Return of capital(4)	—	(42)	—	(42)
Impairment of investment	—	(137)	—	(137)
Net change in fair value recognized in OCI	—	(46)	9	(37)
Investment balance at Dec. 31, 2017	**601**	**616**	**94**	**1,311**

(1) Principal amount as at Dec. 31, 2017, and Dec. 31, 2016, was AUD620 million and AUD641 million, respectively.
(2) Principal amount as at Dec. 31, 2017, and Dec. 31, 2016, was AUD86 million and AUD54 million, respectively.
(3) See Note 4.
(4) See Note 2 (Q).

As a result of FMG's determination to repurchase the Solomon Power Station, the Corporation recognized an impairment during the third quarter on the preferred shares tracking adjusted TEA amounts in the amount of $114 million. While the Corporation's economic interest in the Australian business is based on the net underlying cash flows of the Australian Assets, the fair value of the investment in the preferred shares tracking adjusted TEA amounts does not depreciate in line with the assets. The fair value is based on the underlying cash flows of the Australian business and is impacted by foreign currency and discount rate assumptions. Over time, the accounting value of the preferred shares tracking adjusted TEA amounts was also increased to reflect lower discount rates. Since acquiring the investment in 2015, the Solomon Power Station has generated over $100 million of free cash flow.

As disclosed in Note 4, on Nov. 13, 2017, FMG issued a notice purporting to terminate the South Hedland PPA. Due to the purported termination, which, in TransAlta's view is invalid, the Corporation revised the expected underlying cash flows of the preferred shares tracking adjusted TEA amounts based upon the best estimates of recovery through legal recourse and other means. As a result, in the fourth quarter of 2017, the Corporation recognized an impairment on the preferred shares tracking adjusted TEA amounts of $23 million.

The third and fourth quarter dividend of approximately $28 million and $14 million, respectively, on the preferred shares tracking adjusted TEA amounts were considered a return of capital and not dividend income. Refer to Note 2(Q).

Year ended Dec. 31, 2016	MRPS[(1)]	Preferred shares tracking adjusted TEA amounts	Preferred shares of TEA[(2)]	Total
Investment balance at Dec. 31, 2015	589	804	29	1,422
Additional investments	46	—	21	67
Unrealized foreign exchange gains recognized in earnings	(22)	—	—	(22)
Net change in fair value recognized in OCI	—	37	2	39
Investment balance at Dec. 31, 2016	613	841	52	1,506

(1) Principal amount as at Dec. 31, 2016, and Dec. 31, 2015, was AUD641 million and AUD593 million, respectively.
(2) Principal amount as at Dec. 31, 2016, and Dec. 31, 2015, was AUD54 million and AUD32 million, respectively.

The MRPS are non-voting and rank subordinate to all present and future secured and unsecured indebtedness of TEA, but senior to all other classes of issued and outstanding shares in the capital of TEA. The Corporation is entitled to receive cash dividends on the MRPS. The MRPS are subject to mandatory redemption in whole, on their maturity date or earlier at TEA's option. The MRPS are denominated in Australian dollars. The MRPS are classified as a loans and receivables financial asset and are carried at amortized cost.

The Canadian-dollar-denominated preferred shares tracking adjusted TEA amounts are issued by another subsidiary of TransAlta, which provide cumulative variable cash dividends, when declared, that are broadly equal to the underlying net distributable profits of TEA. The Corporation has designated the tracking preferred shares as an available-for-sale financial asset.

The preferred shares of TEA are non-voting and rank subordinate to all present and future secured and unsecured indebtedness of TEA, subordinate to the MRPS, but senior to all other classes of issued and outstanding shares in the capital of TEA. The dividends are non-cumulative and payable quarterly at a rate of 7.4 per cent per annum. The preferred shares have been designated as an available-for-sale financial asset.

The Corporation estimated the fair value of the preferred shares tracking adjusted TEA amounts utilizing significant unobservable inputs such as TEA's long-range forecast as part of a discounted cash flow model, as outlined in Note 12(B)(I)(c). Key assumptions in respect of significant unobservable inputs used in the fair value measurement include the discount rate and the quarterly cash flows from the instrument and guarantee fees. The forecast extends over 30 years, which is consistent with the expected cash flow periods. The table below summarizes quantitative data regarding these unobservable inputs:

Unobservable input	**Dec. 31, 2017**	Dec. 31, 2016
Discount rate	**6.7%**	7.2%
Quarterly cash flows	**Average of $10.50**	Average of $15.60

The following table summarizes the impact on the fair value measurement of a change in the above unobservable inputs to reflect reasonably possible alternative assumptions:

Unobservable input	**Alternative assumption**	**Change in fair value as at Dec. 31, 2017**	Change in fair value as at Dec. 31, 2016
Basis point change in discount rates	**-10 basis points decrease**	**4.6**	7.3
	+10 basis points increase	**(4.5)**	(7.1)
Quarterly cash flows	**+1% increase**	**6.2**	8.4
	- 1% decrease	**(6.2)**	(8.4)

Investment in a Subsidiary of TransAlta Related to TransAlta Wyoming Wind LLC

The investment in preferred shares of a subsidiary of TransAlta related to TransAlta Wyoming Wind LLC provides cumulative variable cash dividends, when declared, that are broadly equal to the pre-tax earnings and distributable profits of TransAlta's Wyoming Wind farm. The preferred shares have been designated as available-for-sale; however, they are accounted for at cost (see Note 12(B)(III)).

Changes in the investment balance are detailed as follows:

Year ended Dec. 31, 2017	**Preferred shares tracking earnings and distributions of TransAlta Wyoming Wind**
Investment balance at Dec. 31, 2016	139
Redemption	(3)
Unrealized foreign exchange loss recognized in earnings	(10)
Investment balance at Dec. 31, 2017	**126**

On Nov. 30, 2017, the TransAlta subsidiary that issued the preferred shares tracking earnings and distributions of TransAlta Wyoming Wind redeemed 22,888 shares for total proceeds of $3 million.

9. Net Interest Expense

The components of net interest expense are as follows:

Year ended Dec. 31	**2017**	2016
Interest on long-term debt	**38**	36
Interest on convertible debenture	**9**	10
Loss on redemption of unsecured debentures	**6**	1
Other net interest[1]	**3**	1
Accretion of provisions *(Note 17)*	**2**	1
Net interest expense	**58**	49

(1) Consists of letters of credit and guarantees, credit facility commitments, other interest and banking fees. For the year ended Dec. 31, 2017, interest on letters of credit and guarantees pledged by TransAlta was $2 million (2016 - $1 million).

10. Income Taxes

A. Consolidated Statements of Earnings

I. Rate Reconciliation

Year ended Dec. 31	2017	2016
Earnings before income taxes	**51**	22
Net earnings attributable to non-controlling interests	**(4)**	(3)
Adjusted earnings before income taxes	**47**	19
Statutory Canadian federal and provincial income tax rate (%)	**26.0**	26.0
Expected income tax expense	**12**	5
Increase (decrease) in income taxes resulting from:		
Non-taxable capital (gains) losses	**1**	5
Writedown (recovery) of deferred income tax assets	**—**	(1)
Adjustments in respect of deferred income tax of previous years	**2**	—
Statutory and other rate differences	**—**	1
Change in fair value of Class B shares	**(1)**	38
Investment in subsidiary	**36**	4
Transaction fair value differences at initial recognition	**—**	—
Dividend income not subject to tax	**(17)**	(35)
Other	**5**	4
Income tax expense	**38**	21

II. Components of Income Tax Expense

The components of income tax expense (recovery) are as follows:

Year ended Dec. 31	2017	2016
Current income tax expense	**6**	5
Adjustments in respect of deferred income tax of previous years	**2**	—
Deferred income tax expense (recovery) arising from the writedown of deferred income tax assets	**—**	(1)
Deferred income tax expense resulting from changes in tax rates or laws	**—**	1
Deferred income tax expense related to temporary difference on investment in subsidiary	**—**	4
Deferred income tax expense related to the origination and reversal of temporary differences	**30**	12
Income tax expense	**38**	21

Year ended Dec. 31	2017	2016
Current income tax expense	**6**	5
Deferred income tax expense	**32**	16
Income tax expense	**38**	21

B. Consolidated Statements of Changes in Equity

The aggregate current and deferred income tax related to items charged or credited to equity is as follows:

Year ended Dec. 31	2017	2016
Income tax recovery related to:		
Common share issue costs	**—**	(2)
Income tax recovery reported in equity	**—**	(2)

C. Components of Net Deferred Income Tax Liability

Significant components of the Corporation's net deferred income tax (asset) liability are as follows:

As at Dec. 31	2017	2016
Net operating and capital loss carryforwards (1)	(128)	(172)
Property, plant and equipment	352	363
Foreign exchange differences on US-denominated debt	1	—
Risk management assets and liabilities, net	(2)	—
Net deferred income tax liability	**223**	**191**

1) Net operating losses expire between 2026 and 2037.

As at Dec. 31	2017	2016
Deferred income tax assets (1)	(9)	(41)
Deferred income tax liabilities	232	232
Net deferred income tax liability	**223**	**191**

(1) The deferred income tax assets presented on the Consolidated Statements of Financial Position are recoverable based on estimated future earnings and tax planning strategies. The assumptions used in the estimate of future earnings are based on the Corporation's long-range forecasts.

11. Non-Controlling Interest

The Corporation's non-controlling interest is comprised of Natural Forces Technologies Inc.'s 17 per cent interest in the Kent Hills (1, 2 and 3) wind facilities. Summarized financial information relating to Kent Hills is as follows:

Year ended Dec. 31	2017	2016
Results of operations		
Revenues	42	37
Net earnings and total comprehensive income	26	20

As at Dec. 31	2017	2016
Financial position		
Current assets	43	4
Long-term assets	425	202
Current liabilities	8	1
Long-term liabilities	251	—
Total equity	(209)	(205)

12. Financial Instruments and Risk Management

A. Financial Assets and Liabilities – Classification and Measurement

The following table outlines the carrying amounts and classifications of financial assets and liabilities:

Carrying value as at Dec. 31, 2017

	Derivatives classified as held for trading	Loans and receivables	Available-for-sale[1]	Other financial liabilities	Total
Financial assets					
Cash and cash equivalents	—	20	—	—	**20**
Accounts receivable	—	116	—	—	**116**
Risk management assets (current)	1	—	—	—	**1**
Restricted cash	—	30	—	—	**30**
Investments in subsidiaries of TransAlta	—	601	836	—	**1,437**
Other assets	—	33	—	—	**33**
Financial liabilities					
Accounts payable and accrued liabilities	—	—	—	41	**41**
Dividends payable	—	—	—	59	**59**
Risk management liabilities (current)	4	—	—	—	**4**
Long-term debt[2]	—	—	—	1,043	**1,043**

(1) Includes investment in TransAlta Wyoming Wind LLC, which is measured at cost of $126 million (US$100 million) (see section B(III) of Note 12).
(2) Includes current portion.

Carrying value as at Dec. 31, 2016

	Loans and receivables	Available-for-sale[1]	Liabilities measured at fair value	Other financial liabilities	Total
Financial assets					
Cash and cash equivalents	15	—	—	—	15
Accounts receivable	87	—	—	—	87
Investments in subsidiaries of TransAlta	613	1,032	—	—	1,645
Financial liabilities					
Accounts payable and accrued liabilities	—	—	—	31	31
Dividends payable	—	—	—	49	49
Class B shares liability	—	—	384	—	384
Convertible debenture	—	—	—	215	215
Long-term debt[2]	—	—	—	827	827

(1) Includes investment in TransAlta Wyoming Wind LLC, which is measured at cost of $139 million (US$103 million) (see section B(III) of Note 12).
(2) Includes current portion.

B. Fair Value of Financial Instruments

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair values can be determined by reference to prices for that instrument in active markets to which the Corporation has access. In the absence of an active market, the Corporation determines fair values based on valuation models or by reference to other similar products in active markets.

Fair values determined using valuation models require the use of assumptions. In determining those assumptions, the Corporation looks primarily to external readily observable market inputs. In limited circumstances, the Corporation uses inputs that are not based on observable market data.

The Corporation's financial instruments measured at fair value are as follows:

As at	**Dec. 31, 2017**		Dec. 31, 2016	
	Fair value Level II	**Fair value Level III**	Fair value Level II	Fair value Level III
Preferred shares tracking adjusted TEA amounts[1]	**—**	**616**	—	841
Preferred shares of TEA	**94**	**—**	52	—
Net risk management liabilities	**(3)**	**—**	—	—
Class B shares liability	**—**	**—**	—	(384)

(1) Excludes TransAlta Wyoming Wind LLC as the investment is measured at cost.

I. Level Determinations and Classifications

The Level I, II and III classifications in the fair value hierarchy utilized by the Corporation are defined below. The fair value measurement of a financial instrument is included in only one of the three levels, the determination of which is based on the lowest level input that is significant to the derivation of the fair value.

a. Level I

Fair values are determined using inputs that are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.

b. Level II

Fair values are determined, directly or indirectly, using inputs that are observable for the asset or liability, either directly or indirectly.

Fair values within the Level II category are determined through the use of quoted prices in active markets, which in some cases are adjusted for factors specific to the asset or liability, such as basis, credit valuation and location differentials.

The Corporation's commodity risk management Level II financial instruments include over-the-counter derivatives with values based on observable commodity futures curves and derivatives with inputs validated by broker quotes or other publicly available market data providers. Level II fair values are also determined using valuation techniques, such as option pricing models and regression or extrapolation formulas, where the inputs are readily observable, including commodity prices for similar assets or liabilities in active markets, and implied volatilities for options.

In determining Level II fair values of other risk management assets and liabilities and the TEA preferred shares measured and carried at fair value, the Corporation uses observable inputs other than unadjusted quoted prices that are observable for the asset or liability, such as interest rate yield curves and currency rates. For certain financial instruments where insufficient trading volume or lack of recent trades exists, the Corporation relies on similar interest or currency rate inputs and other third-party information such as credit spreads. The fair value of the TEA preferred shares is determined by calculating an implied price based on a current assessment of the yield to maturity.

c. Level III
Fair values are determined using inputs for the asset or liability that are not readily observable.

In estimating the fair value of the preferred shares tracking adjusted TEA amounts the Corporation uses a discounted cash flow method and makes estimates and assumptions about sales prices, production, capital expenditures, asset retirement costs and other related cash inflows and outflows over the life of the facilities, as well as the remaining life of the facilities. In developing these assumptions, management uses estimates of contracted and merchant prices, anticipated production levels, planned and unplanned outages, changes to regulations, and transmission capacity or constraints for the estimated remaining life of the facilities. Appropriate discount rates reflecting the risks specific to TEA are used in the valuations. Management also develops assumptions in respect of ongoing financing and tax positions of TEA. These estimates and assumptions are susceptible to change from period to period and actual results can, and often do, differ from the estimates, and can have either a positive or negative impact on the estimate of the fair value of the instrument, and such differences may be material. Additional disclosures on these measurements are presented in Note 8.

TransAlta enters into commodity risk management contracts on behalf of the Corporation. These contracts may include commodity transactions for which market-observable data is not available or contracts with terms that extend beyond a liquid trading period where forward price forecasts are not available for the full period of the contract. In these cases, Level III fair values are determined by TransAlta personnel using valuation techniques such as the mark-to-forecast model with inputs that are based on historical data such as unit availability, transmission congestion, demand profiles for individual non-standard deals and structured products, volatilities and correlations between products derived from historical prices, and/or a combination of external and internal fundamental modelling, including discounting.

TransAlta has a Commodity Exposure Management Policy that governs both proprietary and hedging commodity transactions undertaken by TransAlta on behalf of the Corporation, and defines and specifies the controls and management responsibilities associated with commodity trading activities, as well as the nature and frequency of required reporting of such activities.

Methodologies and procedures regarding commodity-based Level III fair value measurements are determined by TransAlta's risk management department, on behalf of the Corporation. Level III fair values are calculated within TransAlta's energy trading risk management system based on underlying contractual data and observable and non-observable inputs. Development of non-observable inputs requires the use of judgment. To ensure reasonability, system-generated Level III fair value measurements are reviewed and validated by TransAlta's risk management and finance departments. Review occurs formally on a quarterly basis or more frequently if daily review and monitoring procedures identify unexpected changes to fair value or changes to key parameters.

II. Commodity and Other Risk Management Assets and Liabilities
The Corporation's commodity-based risk management assets and liabilities relate to trading activities and certain contracting activities. Other risk management assets and liabilities include risk management assets and liabilities that are used in managing foreign-denominated receipts and expenditures, capital project expenditures, debt, and those related to funding the construction costs of the South Hedland Power Station (the Contribution Agreement).

To the extent applicable, changes in net risk management assets and liabilities for non-hedge positions are reflected within net earnings.

The net risk management liabilities as at Dec. 31, 2017, was $3 million (2016 - nil), which was comprised of $2 million of Other and $1 million of Commodity.

III. Financial Instruments – Not Measured at Fair Value
The carrying value of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities, and dividends payable approximates their fair value at the Consolidated Statement of Financial Position date due to their short-term nature.

The fair value of financial instruments not measured at fair value is as follows:

As at	Dec. 31, 2017		Dec. 31, 2016	
	Fair value Level II	**Carrying value**	Fair value Level II	Carrying value
MRPS	**605**	**601**	613	613
Loan receivable[(1)]	**38**	**38**	—	—
Convertible debenture (liability component)	**—**	**—**	216	215
Long-term debt[(1)]	**1,019**	**1,043**	831	827

(1) Includes current portion.

The fair value of the MRPS is determined using a discounted cash flow methodology based on inputs including interest and currency rates and a discount rate reflecting the risks specific to TEA. The fair value of the convertible debenture is determined using prices observed in secondary markets. The fair values of long-term debt and the loan receivable are determined by calculating an implied price based on a current assessment of the yield to maturity.

The Corporation's investment in the preferred shares of a subsidiary of TransAlta tracking financial results, earnings and distributions of TransAlta Wyoming Wind LLC (see Note 8) has been designated as available-for-sale. The investment can fluctuate in value based on fluctuations in fair value of the member units of TransAlta Wyoming Wind LLC. There are no quoted prices for an identical instrument in an active market for either instrument. The Corporation has determined that the fair value of the investment in preferred shares is not reliably measurable as the probabilities of the various estimates cannot be reasonably assessed, notably because of the related-party nature of the investment. Accordingly, the investment in preferred shares is measured at cost. The Corporation intends to realize the value of the investment over time and through mutual agreement with TransAlta.

IV. Cash Flow Hedges

a. Foreign Currency Rate Risk Management

The Corporation uses foreign exchange forward contracts to hedge a portion of its future foreign-denominated receipts and expenditures and its foreign-denominated capital project expenditures, and to manage foreign exchange exposure on foreign-denominated debt.

Outstanding notional amounts and fair values associated with forward contracts on foreign-denominated debt and capital project expenditures, are as follows:

As at Dec. 31	2017		2016		
Notional amount sold	**Notional amount purchased**	**Maturity**	Notional amount sold	Notional amount purchased	Maturity
CAD 4	**USD 3**	**2018**	—	—	—
CAD 14	**EUR 9**	**2018**	—	—	—
—	—	**—**	CAD 26	USD 20	2018

During the first quarter of 2017, the Corporation discontinued hedge accounting for its cash flow hedge of its US$20 million debt. The cumulative gain on the cash flow hedge has been reclassified to net earnings from AOCI as the debt was repaid in October 2017.

b. Effect of Cash Flow Hedges

The pre-tax amounts recognized in and out of OCI in 2017 related to the effective portion of cash flow hedges was a $1 million foreign exchange loss relating to foreign exchange forward contracts on US debt. No significant ineffectiveness has been recognized.

V. Non-Hedges

a. Foreign Exchange Forward Contracts

The Corporation periodically enters into foreign exchange forward contracts to economically hedge future foreign-denominated cash flows for which hedge accounting is not pursued. These items are classified as held for trading, and changes in the fair values associated with these transactions are recognized in net earnings.

Outstanding notional amounts and fair values associated with these forward contracts are as follows:

As at Dec. 31	2017				2016			
	Notional amount sold	**Notional amount purchased**	**Fair value liability**	**Maturity**	Notional amount sold	Notional amount purchased	Fair value liability	Maturity
	CAD 26	**USD 20**	**(1)**	**2018**	CAD 10	USD 8	—	2017
	USD 27	**CAD 34**	**—**	**2018**	USD 14	CAD 18	—	2017-2018
	AUD 44	**CAD 42**	**(1)**	**2018**	—	—	—	—
	CAD 43	**AUD 44**	**—**	**2018**	—	—	—	—

b. Contribution Agreement
In 2015, the Corporation entered into an economic hedge agreement with TransAlta related to its commitment to fund the Australian-dollar-denominated construction costs of the South Hedland Power Station. The cost of the Australian dollar was fixed at 0.9684 Canadian per Australian dollar. On July 28, 2017, commissioning of the South Hedland Facility was achieved, and, during the third and fourth quarters of 2017, the Corporation funded the final construction costs. Accordingly, the economic hedge program was concluded.

The outstanding notional amounts and fair values are as follows:

As at Dec. 31	2017				2016			
Notional amount sold	**Notional amount purchased**	**Fair value asset**	**Maturity**		Notional amount sold	Notional amount purchased	Fair value asset	Maturity
—	—	—	—		CAD 231	AUD 239	—	2017

c. Commodity
The Corporation enters into various derivative transactions as well as other contracting activities that do not qualify for hedge accounting. As a result, the related assets and liabilities are classified as held for trading. Changes in the fair value of these derivatives are reported in earnings in the period the change occurs.

The fair value liability associated with commodity activities as at Dec. 31, 2017, is $1 million (2016 - nil). The outstanding commodity derivative instruments are as follows:

As at Dec. 31	2017		2016	
Type (thousands)	**Notional amount sold**	**Notional amount purchased**	Notional amount sold	Notional amount purchased
Electricity *(MWh)*	**365**	**—**	305	—
Natural gas *(GJ)*	**—**	**899**	385	2,553
Emissions *(tonnes)*	**4**	**—**	3	—

C. Nature and Extent of Risks Arising from Financial Instruments and Derivatives

I. Credit Risk
Credit risk is the risk that customers or counterparties will cause a financial loss for the Corporation by failing to discharge their obligations, and the risk to the Corporation associated with changes in creditworthiness of entities with which commercial exposures exist. The Corporation actively manages its exposure to credit risk by assessing the ability of counterparties to fulfil their obligations under the related contracts before entering into such contracts. The Corporation makes detailed assessments of the credit quality of all counterparties and, where appropriate, obtains corporate guarantees, cash collateral, letters of credit or third-party insurance to support the ultimate collection of these receivables. For commodity trading, the Corporation sets strict credit limits for each counterparty and monitors exposures on a daily basis. If credit limits are exceeded, the Corporation will request collateral from the counterparty or halt trading activities with the counterparty.

The Corporation has limited direct exposure to credit risk, as the majority of its power sales contracts are with TransAlta, governments and large utility customers with extensive operations. Historically, the Corporation has not had collection issues associated with its receivables and the aging of receivables is reviewed on a regular basis to ensure the timely collection of amounts owing to the Corporation.

As at Dec. 31, 2017 and 2016, none of the Corporation's billed receivables were outstanding for more than 60 days.

The Corporation's maximum exposure to credit risk at Dec. 31, 2017, without taking into account collateral held or right of set-off, and including indirect exposures arising from the Corporation's investment in preferred shares tracking adjusted TEA amounts, is detailed as follows:

Component	Amount	Key risk assessment factors
Direct exposure		
Trade accounts receivable	**96**	Approximately 76 per cent of the Corporation's receivables are due from investment-grade counterparties. As at Dec. 31, 2017, $22 million of receivables are owing from TransAlta. TransAlta maintains investment-grade ratings from three credit rating agencies. At Dec. 31, 2017, the Corporation had three unrelated customers whose outstanding balances each accounted for greater than 10 per cent of the total third-party trade accounts receivable outstanding. The Corporation has evaluated the risk of default related to these customers to be minimal.
Distributions receivable from subsidiaries of TransAlta	**15**	As the distribution declarations were made by paying entities and having regard to the sufficiency of funds available, the risk of default has been assessed as minimal.
Loan receivable	**38**	The Corporation has evaluated the risk of default related to this loan to be minimal due to its long-term relationship with the counterparty. See Note 15 for additional information on this loan.
MRPS	**601**	The MRPS form TEA's least subordinate significant form of long-term financing, which benefits from TEA's contract and counterparty profile.
Total - Direct exposure	**750**	
Indirect exposure		
Accounts receivable of TEA	**102**	TEA had one unrelated below investment grade customer whose outstanding balances accounted for 64 per cent of total trade accounts receivable.
Total	**852**	

II. Other Market Risks

The Corporation is exposed to market risks based on changes in the fair value of the preferred shares of TEA and the preferred shares tracking adjusted TEA amounts. A one per cent increase (decrease) in the value of these securities would result in a $7 million increase (decrease) in other comprehensive income.

III. Liquidity Risk

Liquidity risk relates to the Corporation's ability to access capital to be used in commodity hedging, capital projects, debt refinancing and general corporate purposes. The Corporation is focused on maintaining a strong financial position.

The Corporation manages its liquidity risk associated with its financial liabilities by utilizing cash flow generated from operations, capital markets and its third-party credit facility. The Corporation manages liquidity risk associated with its long-term debt through preparing and revising long-term external financing plans reflecting business plans and market availability of capital. The Corporation is in compliance with all financial covenants relating to its debt obligations as at Dec. 31, 2017.

The following table presents the contractual maturities of the Corporation's financial liabilities:

	2018	2019	2020	2021	2022	2023 and thereafter	Total
Accounts payable and accrued liabilities	41	—	—	—	—	—	**41**
Long-term debt	250	49	51	78	54	570	**1,052**
Net risk management liabilities	3	—	—	—	—	—	**3**
Interest on long-term debt(1)	39	31	29	27	25	108	**259**
Dividends payable	59	—	—	—	—	—	**59**
Total	**392**	**80**	**80**	**105**	**79**	**678**	**1,414**

(1) Not recognized as a financial liability on the Consolidated Statements of Financial Position.

IV. Foreign Currency Rate Risk
The Corporation has exposure to various currencies, such as the US and Australian dollars, as a result of investments in subsidiaries of TransAlta, and the euro, due to capital expenditures. Following the closing of the investment in Australian Assets the Corporation has mitigated the anticipated incremental exposure to the Australian- and US-dollar-denominated cash flows arising for the period through June 30, 2020, through the use of contractual agreements with TransAlta (see Notes 4 and 8).

The possible effect on net earnings and OCI for the years ended Dec. 31, 2017 and 2016, due to changes in foreign exchange rates associated with financial instruments denominated in currencies other than the Corporation's functional currency is outlined below. The sensitivity analysis has been prepared using management's assessment that an average four cent (2016 – four cent) increase or decrease in these currencies relative to the Canadian dollar is a reasonable potential change over the next quarter.

As at Dec. 31	**2017**		2016	
Currency	**Net earnings increase(1)**	**OCI gain(1)**	Net earnings increase(1)	OCI gain(1)
USD	**3**	**6**	3	18
AUD	**15**	**23**	22	31
Total	**18**	**29**	25	49

(1) These calculations assume an increase in the value of this currency relative to the Canadian dollar. A decrease would have the opposite effect.

V. Interest Rate Risk
Interest rate risk arises if the future cash flows of a financial instrument fluctuate due to changes in market interest rates, which can impact the Corporation's borrowing costs.

All of the Corporation's long-term debt, except its credit facility, as described in Note 16, is comprised of fixed interest rate debt.

The Corporation's interest rate risk management strategy is to minimize cash flow volatility due to interest rate risk by ensuring its long-term debt has fixed interest rates, where possible.

VI. Commodity Price Risk
The Corporation's contractual profile minimizes commodity price risk by selling substantially all power under long-term contracts.

13. Property, Plant, and Equipment

The changes in the cost of major classes of property, plant, and equipment and related accumulated depreciation are as follows:

	Hydro generation	Wind generation	Gas generation	Capital spares and other	Total
Cost					
As at Dec. 31, 2015	245	1,762	–	5	2,012
Additions	4	10	–	–	14
Acquisitions *(Note 4)*(1)	23	72	633	13	741
Disposals and retirements	(1)	(2)	–	–	(3)
Revisions and additions to decommissioning costs	1	1	2	–	4
Transfers	–	–	(8)	6	(2)
As at Dec. 31, 2016(1)	272	1,843	627	24	2,766
Additions(2)	**2**	**18**	**16**	**2**	**38**
Disposals and retirements	**(1)**	**(2)**	**–**	**–**	**(3)**
Revisions and additions to decommissioning costs	**3**	**4**	**8**	**–**	**15**
Transfers	**–**	**–**	**(3)**	**(8)**	**(11)**
As at Dec. 31, 2017	**276**	**1,863**	**648**	**18**	**2,805**
Accumulated depreciation					
As at Dec. 31, 2015	65	378	–	–	443
Depreciation	6	60	2	–	68
Disposals and retirements	–	(1)	–	–	(1)
Acquisitions *(Note 4)*	8	22	302	–	332
As at Dec. 31, 2016	79	459	304	–	842
Depreciation	**8**	**64**	**31**	**–**	**103**
Disposals and retirements	**–**	**(1)**	**–**	**–**	**(1)**
Transfers	**–**	**–**	**(8)**	**–**	**(8)**
As at Dec. 31, 2017	**87**	**522**	**327**	**–**	**936**
Carrying amount					
As at Dec. 31, 2016(1)	193	1,384	323	24	1,924
As at Dec. 31, 2017	**189**	**1,341**	**321**	**18**	**1,869**

(1) Prior period adjustment to the original net book value of certain property, plant, and equipment related to the acquisition of TransAlta's Sarnia cogeneration plant.
(2) Wind generation additions include $9 million related to assets under construction.

The Corporation has transmission connection facilities for Kent Hills that are leased under a finance lease. The net carrying amount included in wind generation as at Dec. 31, 2017, was $4 million (2016 – $4 million).

14. Intangible Assets

A reconciliation of the changes in the carrying amount of intangible assets is as follows:

	Power sale contracts(1)	Software	Total
Cost			
As at Dec. 31, 2015	134	2	136
Additions	—	1	1
Acquisition *(Note 4)*	36	6	42
Transfers	—	1	1
As at Dec. 31, 2016, and Dec. 31, 2017	**170**	**10**	**180**
Accumulated amortization			
As at Dec. 31, 2015	43	1	44
Acquisition *(Note 4)*	11	4	15
Amortization	7	1	8
As at Dec. 31, 2016	61	6	67
Amortization	**8**	**2**	**10**
As at Dec. 31, 2017	**69**	**8**	**77**
Carrying amount			
As at Dec. 31, 2016	109	4	113
As at Dec. 31, 2017	**101**	**2**	**103**

(1) Comprised of values associated with certain power sale contracts that arose on TransAlta's acquisition of Canadian Hydro Developers, whereby the price of electricity to be delivered under the contracts exceeded the market price.

15. Other Assets

On Nov. 2, 2017, the Corporation's subsidiary, Kent Hills Wind LP, advanced $39 million of the Kent Hills Wind bond financing proceeds to its 17 per cent partner. The loan bears interest at 4.55 per cent, with interest payable quarterly, commencing on Dec. 31, 2017, is unsecured and matures on Oct. 2, 2022. The Corporation may, at any time, demand repayment of any advances outstanding for the purpose of funding any capital required for the construction of the Kent Hills 3 expansion project. The balance of the loan receivable is $38 million at Dec. 31, 2017. The current portion of $5 million is included in accounts receivable and the long-term portion of $33 million is included in Other Assets.

16. Long-Term Debt

A. Amounts Outstanding

As at	Dec. 31, 2017			Dec. 31, 2016		
	Carrying value	**Face value**	**Interest(1)**	Carrying value	Face value	Interest(1)
Credit facility	**27**	**27**	**2.75%**	—	—	—
Credit facility with TransAlta	**—**	**—**	**—**	15	15	2.88%
Unsecured debentures(2)	**—**	**—**	**—**	193	193	6.31%
Pingston bond	**45**	**45**	**2.95%**	45	45	2.95%
Melancthon Wolfe Wind bond	**367**	**372**	**3.83%**	402	407	3.83%
New Richmond bond	**146**	**148**	**3.96%**	153	155	3.96%
Kent Hills Wind bond	**256**	**258**	**4.45%**	—	—	—
TEA loan(3)	**196**	**196**	**2.80%**	—	—	—
Canadian Assets working capital loan	**6**	**6**	**—**	19	19	—
	1,043	**1,052**		827	834	
Less: current portion	**(250)**	**(250)**		(70)	(70)	
Total long-term debt	**793**	**802**		757	764	

(1) Interest rate reflects the stipulated rate or the average rate weighted by principal amounts outstanding.
(2) Includes US$20 million as at Dec. 31, 2016.
(3) AUD199 million as at Dec. 31, 2017.

Unsecured debentures On Oct. 12, 2017, the Corporation early redeemed the 6.3 per cent unsecured debentures of its subsidiary, Canadian Hydro Developers, for $201 million in total, comprised of the principal of $191 million, an early redemption premium of $6 million and accrued interest of $4 million. A $6 million loss on redemption was recognized and is included in net interest expense. The debentures were scheduled to mature in June 2018.

Pingston bond bears interest at 2.95 per cent, with interest payable semi-annually and no principal repayments until maturity in May 2023, and is secured by the Pingston hydro facility, which at Dec. 31, 2017, had a carrying value of $46 million (2016 - $47 million).

Melancthon Wolfe Wind bond bears interest at 3.834 per cent, with principal and interest payable semi-annually in blended payments until maturity on Dec. 31, 2028, and is secured by a first ranking charge over all assets of the issuer, which primarily include the Melancthon and Wolfe Island wind farms, which at Dec. 31, 2017, had a combined carrying value of $598 million (2016 - $623 million).

New Richmond bond issued in June 2016, bears interest at 3.963 per cent, with principal and interest payable semi-annually in blended payments until maturity on June 30, 2032. The New Richmond bond is secured by a first ranking charge over all the assets of the issuer, New Richmond Wind L.P., which primarily includes the New Richmond wind farm, which at Dec. 31, 2017, had a carrying value of $193 million (2016 - $200 million).

Kent Hills Wind bond issued in October 2017, bears interest at 4.454 per cent, with principal and interest payable quarterly in blended payments until maturity on Nov. 30, 2033. The Kent Hills Wind bond is secured by a first ranking charge over all of the assets of the issuer, Kent Hills Wind LP, which primarily includes the Kent Hills 1, 2 and 3 wind farms, which at Dec. 31, 2017, had a combined carrying value of $201 million.

TEA loan On Nov. 9, 2017, the Corporation borrowed AUD199 million from TEA, which is a subsidiary of TransAlta. The loan bears interest at the Australian Bank Bill Swap Rate ("BBSW") rate (the rate displayed by the Australian Financial Markets Association) plus 110 basis points for the applicable quarterly BBSW period. The balance is due on the earlier of receipt of a demand notice and Dec. 31, 2018.

Credit Facility The Corporation has a $500 million committed syndicated credit facility, of which $473 million was available as at Dec. 31, 2017. The $500 million credit facility is the primary source for short-term liquidity after the cash flow generated from the Corporation's business. Interest rates on the credit facility vary depending on the type of borrowing selected: Canadian prime, bankers' acceptances, LIBOR, or US base rate in accordance with a pricing grid that is standard for such a facility. The agreement is fully committed for four years, expiring in 2021.

In conjunction with the new credit agreement, the $350 million credit facility provided by TransAlta was cancelled. The facility was made available for general corporate purposes, including financing ongoing working capital requirements.

Canadian Assets Working Capital Loan On Nov. 30, 2016, the Corporation acquired the working capital and certain other capital spares and supplies of the Canadian Assets from a subsidiary of TransAlta, through the issuance of the Canadian Assets working capital loan. The loan is non-interest bearing with the balance due in 2018. The Corporation may, at its election, repay all or any portion of the loan.

B. Restrictions

The Melancthon Wolfe Wind, Pingston, New Richmond and Kent Hills Wind bonds are subject to customary financing conditions and covenants that restrict the Corporation's ability to access funds generated by the facilities' operations. Upon meeting certain distribution tests, typically performed once per quarter, the funds can be distributed by the subsidiary entities to their respective parent entity. These restrictions include the ability to meet a debt service coverage ratio prior to distribution. Funds in these entities that have accumulated since the fourth quarter test will remain there until the next debt service coverage ratio can be calculated in the first quarter of 2018. As at Dec. 31, 2017, $14 million of cash was subject to these financial restrictions (2016 - $13 million).

C. Restricted Cash

The Corporation has $30 million of cash received from the Kent Hills Wind bond financing, which is held in a construction reserve account. The restricted cash will be released from the construction reserve account upon satisfaction of certain conditions, including the Kent Hills 3 wind expansion project achieving commercial operations.

Additionally, the Melancthon Wolfe Wind, Pingston, New Richmond, and Kent Hills Wind bonds require that certain reserve accounts be established and funded through cash held on deposit and/or by providing letters of credit. The Corporation has elected to use letters of credit as at Dec. 31, 2017. Accordingly, no cash was subject to these restrictions.

D. Principal Repayments

	2018	2019	2020	2021	2022	2023 and thereafter	Total
Principal repayments	250	49	51	78	54	570	**1,052**

E. Letters of Credit

The Corporation has an uncommitted $100 million demand letter of credit facility, under which $69 million of letters of credit have been issued as at Dec. 31, 2017 (2016 - nil). Letters of credit are issued to counterparties under various contractual arrangements with the Corporation and certain subsidiaries of the Corporation. If the Corporation or its subsidiary does not perform under such contracts, the counterparty may present its claim for payment to the financial institution through which the letter of credit was issued. Any amounts owed by the Corporation or its subsidiaries under these contracts are reflected in the Consolidated Statements of Financial Position. All letters of credit expire within one year and are expected to be renewed, as needed, in the normal course of business.

17. Decommissioning and Other Provisions

The change in the decommissioning and restoration provision balance is outlined below:

	Decommissioning and restoration
Balance, Dec. 31, 2015	7
Acquisition *(Note 4)*	16
Accretion	1
Revisions in discount rates	4
Balance, Dec. 31, 2016	28
Liabilities settled	**(1)**
Accretion	**2**
Revisions in discount rates	**15**
Balance, Dec. 31, 2017	**44**

	Other	**Decommissioning and restoration**	**Total**
Balance, Dec. 31, 2016	1	28	29
Current portion	1	2	3
Non-current portion	—	26	26
Balance, Dec. 31, 2017	**—**	**44**	**44**
Current portion	**—**	**2**	**2**
Non-current portion	**—**	**42**	**42**

A decommissioning and restoration provision has been recognized for all generating facilities for which the Corporation is legally, or constructively, required to remove the facilities at the end of their useful lives and restore the sites to their original condition. The Corporation estimates that the undiscounted amount of cash flows required to settle the decommissioning and restoration obligations is approximately $189 million, which will be incurred between 2029 and 2060.

18. Deferred Revenues

Deferred revenues consist primarily of a payment received under a PPA for the option, by the purchaser, to extend the term of the contract. This amount is amortized on a straight-line basis into revenue over the term of the contract.

19. Convertible Debenture

As part of the Canadian Assets investment, the Corporation issued a $215 million convertible unsecured subordinated debenture to TransAlta. The debenture was on an interest-only basis at a coupon rate of 4.5 per cent per annum, payable semi-annually in arrears on June 30 and Dec. 31. On Nov 9, 2017, the Corporation repaid the debentures early, for $218 million in total, comprised of the principal of $215 million and accrued interest of $3 million. The convertible debenture was scheduled to mature on Dec. 31, 2020.

20. Class B Shares Liability

As at Dec. 31, 2017, nil Class B shares were outstanding (2016 – 26.1 million). On July 28, 2017, commissioning of the South Hedland Power Station was achieved and on Aug. 1, 2017, the Corporation converted the 26.1 million Class B shares into 26.4 million common shares. The Class B shares were converted at a ratio greater than 1:1 because the construction and commissioning costs for the project were below the referenced costs agreed upon in the amended contribution agreement between the Corporation and TransAlta. On the conversion date, the $385 million carrying amount of the Class B shares liability was derecognized and the common shares issued on conversion were recognized at that same amount.

21. Common Shares

A. Authorized and Outstanding

The Corporation is authorized to issue an unlimited number of common shares without nominal or par value and an unlimited number of preferred shares. The common shares entitle the holders thereof to one vote per share at meetings of shareholders. The preferred shares are issuable in series and have such rights, restrictions, conditions and limitations as the Board may from time to time determine. No preferred shares have been issued.

The change in issued and outstanding common shares during the years ended Dec. 31, 2017 and 2016 is as follows:

As at Dec. 31	**2017**		2016	
	Common shares *(millions)*	**Amount *(millions)***	Common shares *(millions)*	Amount *(millions)*
Issued and outstanding, beginning of year	**224**	**2,469**	191	2,152
Issued to TransAlta	**26**	**385**	15	152
Public offering[1]	**—**	**—**	18	165
Issued and outstanding, end of year	**250**	**2,854**	224	2,469

(1) Net of after-tax issuance costs of $8 million for 2016 ($10 million issuance costs, less tax-effects of $2 million).

B. Dividends

The declaration of dividends on the Corporation's common shares is at the discretion of the Board.

The following table summarizes the common share dividends declared in 2017 and 2016:

Dividends declared	**Total dividends per share**	**Total dividends**	**TransAlta**	**Other shareholders**
Year ended Dec. 31, 2017	**0.91496**	**222**	**140**	**82**
Year ended Dec. 31, 2016	0.95662	217	129	88

On Nov. 2, 2017, the Corporation declared a monthly dividend of $0.07833 per common share payable on Jan. 31, 2018, Feb. 28, 2018, and March 29, 2018.

22. Cash Flow Information

A. Change in Non-Cash Operating Working Capital

Year ended Dec. 31	**2017**	2016
Source (use):		
Accounts receivable	**(25)**	1
Accounts payable and accrued liabilities	**8**	6
Change in non-cash operating working capital	**(17)**	7

B. Changes in Liabilities from Financing Activities

	As at Jan. 1, 2017	Cash inflows	Cash outflows	Other	**As at Dec. 31, 2017**
Convertible debenture	215	—	(215)	—	**—**
Dividends payable	49	—	(212)	222	**59**
Long-term debt[1]	827	466	(249)	(1)	**1,043**
Total liabilities from financing activities	1,091	466	(676)	221	**1,102**

(1) Includes current portion. Credit facility cash inflows and outflows included on a net basis.

23. Capital

The Corporation's objectives in managing its capital are to ensure it is able to support day-to-day operations and meet required financial obligations, as well as to provide for growth opportunities and ensure stable and predictable distributions to shareholders.

The Corporation's capital is comprised of the following:

As at Dec. 31	2017	2016
Current portion of long-term debt	**250**	70
Less: available cash and cash equivalents	**(20)**	(15)
	230	55
Long-term debt	**793**	757
Convertible debenture	**—**	215
Class B shares liability	**—**	384
Equity		
Common shares	**2,854**	2,469
Deficit	**(701)**	(488)
Accumulated other comprehensive income	**8**	45
Non-controlling interest	**36**	35
	2,990	3,417
Total capital	**3,220**	3,472

In 2017, the Corporation's capital structure included a larger percentage of long-term debt than it did in 2016. This was driven by the nature of the transactions in 2017 that were financed utilizing a larger proportion of debt, primarily the Kent Hills Wind bond. The Corporation is focused on matching long-term amortizing debt to assets with long-term contracts, as was done with the Kent Hills Wind bond. This is consistent with the Corporation's objectives in managing capital.

The Melancthon Wolfe Wind bond of $372 million (2016 – $407 million), the Pingston bond of $45 million (2016 – $45 million), the New Richmond bond of $148 million (2016 - $155 million) and the Kent Hills Wind bond of $258 million (2016 - nil) are subject to customary financing restrictions, which restrict the Corporation's ability to access funds generated by the facilities' operations (see Note 16).

At Dec. 31, 2017, TransAlta Renewables was in compliance with all financial covenants relating to its debt obligations.

Dividends on the Corporation's common shares are at the discretion of the Board. In determining the payment and level of future dividends, the Board considers the financial performance, results of operations, cash flow and needs, with respect to financing ongoing operations and growth, balanced against returning capital to shareholders.

24. Joint Operations

The Corporation's joint operations at Dec. 31, 2017 and 2016 include the following:

Joint operation	Ownership *(per cent)*	Description
McBride Lake	50	Wind facility in Alberta operated by the Corporation
Pingston	50	Hydro facility in British Columbia operated by the Corporation
Soderglen	50	Wind facility in Alberta operated by the Corporation

25. Commitments and Contingencies

A. Contracts for Goods and Services

In the ordinary course of operations, the Corporation routinely enters into contracts for the purchase of goods and services and for leases of equipment. The Corporation also has several long-term service agreements in place for repairs and maintenance that may be required on turbines at wind facilities. In addition, the Corporation has an agreement with TransAlta for general and administrative services.

Approximate future payments under these and other contractual obligations are as follows:

	Long-term service agreements(1)	General administrative services(2)	Land access and leases	Purchase contracts(3)	Total
2018	28	20	2	**5**	**55**
2019	24	18	2	**—**	**44**
2020	41	19	2	**—**	**62**
2021	30	19	2	**—**	**51**
2022	14	20	2	**—**	**36**
2023 and thereafter	32	230	37	**—**	**299**
Total	**169**	**326**	**47**	**5**	**547**

(1) Included in long-term service agreements are operating leases of less than $1 million per year.
(2) Excludes portion charged directly to Wyoming Wind.
(3) Includes natural gas purchase and transportation.

B. Guarantees

As part of the acquisition of the Australian Assets, the Corporation entered into a Guarantee and Indemnification Agreement in favour of TransAlta related to certain guarantees TransAlta has provided to third parties in respect of certain obligations of TEA (the "TEA Guarantees"). The Corporation has agreed to indemnify TransAlta from and against all claims, actions, proceedings, liabilities, losses, costs, expenses or damages against or incurred by TransAlta arising out of or in connection with the TEA Guarantees and to reimburse TransAlta in full for the amount of any payment made by TransAlta under and in accordance with the TEA Guarantees, relating to actions, omissions, events and circumstances that occur. As at Dec. 31, 2017, the total amounts guaranteed by the Corporation were $921 million (2016 - $925 million).

As consideration for this indemnity, TransAlta is required to pay the Corporation the Canadian-dollar equivalent of the guarantor fees it receives from TEA in respect of any of the TEA Guarantees, subject to the fixed rate conversion as described in Note 8.

C. Growth

The Corporation has committed future expenditures of $27 million related to its Kent Hills 3 Wind expansion project.

D. Litigation

In the normal course of business, the Corporation may become party to litigation claims. While the Corporation is not directly involved in the ongoing dispute with FMG over the purported termination of the South Hedland PPA, the results of the litigation could impact the finance income received as a result of the Corporation's economic interest in the Australian Assets. In addition, FMG withheld approximately AUD 43 million in tax applicable to the repurchase of the Solomon Power Station. TransAlta has commenced proceedings to recover the tax payable by FMG by filing and serving FMG with a Writ and Statement of Claim on Nov. 17, 2017, and also applied for summary judgment for this amount. The hearing is scheduled for March 23, 2018.

E. Line Loss Rule Proceeding

TransAlta has been participating in a line loss rule proceeding before the Alberta Utilities Commission ("AUC"). The AUC determined that it has the ability to retroactively adjust line loss charges going back to 2006 and directed the Alberta Electric System Operator to, among other things, perform such retroactive calculations. The various decisions by the AUC are, however, subject to appeal and challenge. The AUC recently issued a decision (which is subject to appeal) that determined the methodology to be used retroactively. Based on that methodology, TransAlta concluded that Corporation's maximum exposure for retroactive line loss charges is not material.

26. Related-Party Transactions and Balances

The Corporation has entered into certain agreements and transactions with TransAlta, which are discussed below.

A. Related-Party Transactions

Related-party transactions include the finance income related to subsidiaries of TransAlta (Note 4). Also, all financial instruments and derivatives that relate to the Corporation are entered into on behalf of the Corporation by a subsidiary of TransAlta.

Significant related-party transactions that are not otherwise presented elsewhere consist of the following:

Year ended Dec. 31	**2017**	2016
Revenue from TransAlta PPAs *(I)*	**38**	37
Revenue from Green Attributes(1)	**—**	3
G&A Reimbursement Fee(2)*(II)*	**17**	16
Natural gas purchases*(III)*	**9**	1
Power swap sales (financial)*(III)*	**4**	—
Interest expense on convertible debenture	**9**	10
Asset optimization fee(3)	**2**	—
Realized foreign exchange gain on hedge of contribution agreement	**6**	—
Interest expense on credit facility and letter of credit and guarantee fees *(Note 9)*	**2**	1

(1) The value of the Green Attributes was determined by reference to market information for similar instruments, including historical transactions with third parties, with the transactions ultimately reviewed and approved by the Corporation's independent members of the Board.
(2) Includes portion charged directly to the Wyoming Wind farm and, in 2017, the Kent Hills 3 development fee discussed below.
(3) A subsidiary of TransAlta provides asset management and optimization services for the Corporation's Sarnia cogeneration plant. The Sarnia cogeneration plant is charged a fixed fee of approximately $0.125 million per quarter, plus a variable fee of 1.6 per cent of its gross margin.

All of these transactions are with TransAlta or subsidiaries of TransAlta.

I. TransAlta PPAs
The Corporation has agreements with TransAlta for certain wind and hydro facilities, providing for the purchase by TransAlta, for a fixed price, of all of the power produced by such facilities. The fixed prices are adjusted annually for changes in the Consumer Price Index (“CPI”). TransAlta is only required to purchase power that is actually produced. Each TransAlta PPA has a term of 20 years or end of asset life, where end of asset life is less than 20 years.

II. Management, Administrative and Operational Services Agreement (“Management Agreement”)
Under the Management Agreement, TransAlta provides all the general administrative services, including key management personnel services, as may be required or advisable for the management of the affairs of the Corporation. As reimbursement for the services provided, the Corporation pays TransAlta a fee (the “G&A Reimbursement Fee”), adjusted annually for changes in the CPI. The G&A Reimbursement Fee is increased or decreased by an amount equal to five per cent of the amount of any increase or decrease, respectively, to the Corporation’s total Earnings Before Interest, Taxes, Depreciation and Amortization resulting from the addition or divestiture of assets by the Corporation.

The Corporation has paid TransAlta a development fee of $1 million upon signing the PPA with NB Power for Kent Hills 3, and will pay a further upfront fee of $2 million upon achieving commercial operation of Kent Hills 3, in lieu of the annual five per cent of incremental EBITDA that would otherwise be paid pursuant to the Management Agreement.

TransAlta also provides operational and maintenance services under the Management Agreement, which generally includes all services as may be necessary or requested for the operation and maintenance of the Corporation’s gas, wind and hydro facilities. TransAlta is reimbursed for all out-of-pocket and third-party fees and costs, including salaries, wages and benefits associated with managing and operating the facilities not captured by the G&A Reimbursement Fee.

III. Natural Gas Purchases, Sales and Power Swap Sales
The Corporation's subsidiary, TransAlta (SC) LP (“Sarnia”), and TransAlta Energy Marketing Corp. ("TEMC"), a Canadian subsidiary of TransAlta, are parties to a Gas Management Intercompany Agreement for the Sarnia facility to obtain its natural gas at the Dawn Hub from TEMC in consideration of TEMC being allowed to trade and profit from Sarnia's storage position. The terms of the Gas Management Intercompany Agreement are as follows:

- all gas burned at Sarnia is purchased by Sarnia from TEMC priced at the NGX Union Dawn Daily Spot Price published by the Canadian Gas Price Reporter ("CGPR") on the day the gas is burned;

- TEMC will purchase all customer make-up gas from Sarnia at the Dawn Daily Index at the day of occurrence;
- all gas not consumed and used by Sarnia for hedging purposes is purchased by TEM at the Dawn Daily Index; and
- in exchange for the gas, Sarnia grants TEMC the unlimited right to inject, store and withdraw gas from the Sarnia storage asset for proprietary purposes.

Additionally, Sarnia remains responsible for all storage and transportation costs, which are based on the volumes of gas taken in-kind by Union Gas for each day at the NGX Union Dawn Daily Spot Price of gas published by the CGPR.

B. Related-Party Balances

Related-party balances include the investments in subsidiaries of TransAlta disclosed in Note 8, the risk management assets and liabilities disclosed in Note 12, the Canadian Assets working capital loan and the TEA loan disclosed in Note 16, and the guarantees provided by the Corporation on behalf of TransAlta and TEA disclosed in Note 25. Additional related-party balances outstanding at Dec. 31, 2016, include the credit facility, the Canadian Assets working capital loan, the convertible debenture and the Class B shares.

Significant related-party balances that are not otherwise presented elsewhere consist of the following:

As at Dec. 31	**2017**	2016
Trade and other receivables	**37**	36
Accounts payable and accrued liabilities (including interest payable)	**11**	11
Dividends payable	**37**	29
Letters of credit issued by TransAlta on behalf of the Corporation *(I)*	**1**	60
Guarantees provided by TransAlta on behalf of the Corporation *(II)*	**105**	58

I. Letters of Credit
TransAlta has provided letters of credit on behalf of the Corporation. Any amounts owed by the Corporation for obligations under the contracts to which the letters of credit pertain are reflected in the Consolidated Statements of Financial Position. All letters of credit expire within one year and are expected to be renewed, as needed, in the normal course of business. No amounts have been exercised by third parties under these arrangements.

II. Guarantees
If the Corporation does not perform under the related guarantee agreements, the counterparty may present a claim for payment from TransAlta.

C. Key Management Personnel Services

The Corporation’s key management personnel include the members of its Board and its Corporate Officers. Key management personnel services from Corporate Officers are provided through TransAlta and its subsidiaries and are part of the G&A Reimbursement Fee. Total compensation comprised of short-term employee benefits that pertain exclusively to director compensation, consisting of retainer and meeting fees and an allocation of director compensation towards grants of deferred share units and the purchase of common shares in the market, was $1 million for the year ended Dec. 31, 2017 (2016 - $1 million).

27. Significant Customers

In addition to revenue from TransAlta (see Note 26), which represented nine per cent of total revenues (2016 - 14 per cent), the Corporation had revenues from one other customer (2016 - two customers) that exceeded 10 per cent of the Corporation’s total revenues at 42 per cent (2016 - 37 per cent and 13 per cent).

28. Segment Disclosures

A. Description of Reportable Segments

The Corporation has four reportable segments outlined below.

B. Reported Segment Earnings (Loss) and Other Segment Information

I. Earnings Information

Year ended Dec. 31, 2017	Canadian Wind	Canadian Hydro	Canadian Gas	Corporate	Total
Revenues	201	18	191	—	410
Government incentives	18	—	—	—	18
Lease revenue	22	9	—	—	31
Total revenue	241	27	191	—	459
Fuel, royalties and other costs	11	3	83	—	97
Gross margin	230	24	108	—	362
Operations, maintenance and administration	31	3	30	19	83
Depreciation and amortization	74	9	32	—	115
Taxes, other than income taxes	5	2	1	—	8
Operating income (loss)	120	10	45	(19)	156
Finance income related to subsidiaries of TransAlta					86
Net interest expense					(58)
Change in fair value of Class B shares					(2)
Foreign exchange gain					6
Impairment of investment					(137)
Earnings before income taxes					51

Year ended Dec. 31, 2016	Canadian Wind	Canadian Hydro	Canadian Gas	Corporate	Total
Revenues	172	21	20	–	213
Government incentives	18	1	–	–	19
Lease revenue	22	5	–	–	27
Total revenue	212	27	20	–	259
Fuel, royalties and other costs	10	3	10	–	23
Gross margin	202	24	10	–	236
Operations, maintenance and administration	31	3	2	17	53
Depreciation and amortization	69	7	3	–	79
Taxes, other than income taxes	5	2	–	–	7
Operating income (loss)	97	12	5	(17)	97
Finance income related to subsidiaries of TransAlta					151
Net interest expense					(49)
Foreign exchange loss					(35)
Change in fair value of Class B shares					(142)
Earnings before income taxes					22

II. Selected Consolidated Statements of Financial Position Information

Year ended Dec. 31, 2017	**Canadian Hydro**	**Canadian Wind**	**Canadian Gas**	**Total**
PP&E	191	1,344	334	1,869
Intangible assets	1	100	2	103

Year ended Dec. 31, 2016	Canadian Hydro	Canadian Wind	Canadian Gas	Total
PP&E	193	1,390	341	1,924
Intangible assets	2	107	4	113

III. Selected Consolidated Statements of Cash Flows Information

Year ended Dec. 31, 2017	**Canadian Hydro**	**Canadian Wind**	**Canadian Gas**	**Total**
Additions to non-current assets:				
PP&E	2	20	16	38

Year ended Dec. 31, 2016	Canadian Hydro	Canadian Wind	Canadian Gas	Total
Additions to non-current assets:				
PP&E	4	10	–	14
Intangible assets	–	–	1	1

29. Subsequent Event

On Feb. 20, 2018, the Corporation announced it entered into an arrangement to acquire two construction-ready projects in the Northeast United States. The wind development projects consist of: (i) a 90 Megawatt ("MW") project located in Pennsylvania which has a 15-year PPA and (ii) a 29 MW project located in New Hampshire with two 20-year PPAs. All three counterparties have S&P credit ratings of A+ or better.

Total cost of the two projects is estimated to be US$ 240 million, of which approximately 70 per cent will be funded in 2018 and the remainder in 2019. The commercial operation date for both projects is expected during the second half of 2019.

The Corporation will fund the acquisition and construction costs using existing liquidity and tax equity.