

EPCOR WATER SERVICES INC. PROPOSED IMPROVEMENTS TO FINANCIAL AND REGULATORY REPORTING

RECOMMENDATION

That the November 4, 2022, Financial and Corporate Services report FCS01533, be received for information.

Requested Council Action	Information only		
ConnectEdmonton's Guiding Principle	ConnectEdmonton Strategic Goals		
CONNECTED This unifies our work to achieve our strategic goals.	n/a		
City Plan Values	LIVE		
City Plan Big City Move(s)	n/a	Relationship to Council's Strategic Priorities	Conditions for service success
Corporate Business Plan	Managing the corporation		
Council Policy, Program or Project Relationships	<ul style="list-style-type: none"> Bylaw 19626 - EPCOR Water Services Bylaw Bylaw 19627 - EPCOR Drainage Services and Wastewater Treatment Bylaw 		
Related Council Discussions	<ul style="list-style-type: none"> FCS00624, Utility Committee, June 25, 2021 		

Previous Council/Committee Action

At the June 25/July 9, 2021, Utility Committee meeting, the following motion was passed:

That Administration work with EPCOR to bring forward reports prior to the next Performance Based Rates term for Drainage Services and Wastewater Treatment effective April 1, 2025, providing further background and the appropriate regulatory treatment for the following items:

7.1
ROUTING - Utility Committee | DELEGATION - S. Padbury / H. Rai / J. Olsen / EPCOR Water Services Inc.
November 4, 2022 - Financial and Corporate Services FCS01533

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1. Improved disclosure of changes in accounting and capitalization policies and treatment;
2. Reporting the size of the workforce including actual and forecast full-time equivalents;
3. A review of how long-term debt interest rates are set for EPCOR Water Services Inc.;
4. A review of the performance measures to ensure they are increasingly stringent and challenging over time; and
5. A review of the deferral account and other adjustment mechanisms to deal with variations in usage.

Executive Summary

- The EPCOR Water Services Inc. (EWSI) report, included in Attachment 1, addresses item (1), (2), and (3) in the July 9, 2021 Utility Committee motion.
- EWSI intends to provide its review of items (4) and (5) of the motion (performance measures and a deferral account to deal with variations in usage) to Utility Committee in the fall of 2023.
- Administration considers that EWSI's proposed approaches are reasonable and that they satisfy items (1), (2) and (3) of the July 9, 2021 motion.

REPORT

During the June 25/July 9 2021 Public Hearing in respect of EWSI's 2022-2026 Water Services and 2022-2024 Wastewater/Drainage Services Performance Based Rates (PBR) Applications, Administration submitted its review of EWSI's applications in Financial and Corporate Services report FCS00624 Reasonableness Review. The Reasonableness Review highlighted certain aspects of EWSI's applications that Administration felt required further study and consideration. Those aspects were captured in the motion above.

EPCOR's response provides recommendations with respect to the first three items in the motion. Recommendations for the fourth and fifth item "A review of the performance measures to ensure they are increasingly stringent and challenging over time" and "A review of the deferral account and other adjustment mechanisms to deal with variations in usage " will be provided to Utility Committee in the Fall of 2023.

Administration has reviewed EPCOR's recommendations in response to the first three items in the motion and are in agreement with the conclusions and recommendations reached by EPCOR which are summarized below.

1. Improved Disclosure of Accounting Changes

In its Reasonableness Review, Administration noted an expenditure type that was approved as an operating cost in the 2017-2021 Water Services PBR Application, and then subsequently capitalized in 2020 due to a change in accounting treatment. Administration recommended a regulatory adjustment to reimburse utility customers for the amounts included as operating costs in the 2020 and 2021 Water Services revenue requirements but capitalized for both financial statement and rate regulation purposes, which was reversed by EWSI in its Compliance

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Application with \$5.2 million reimbursed to customers, as well as improved disclosure of changes in accounting and capitalization policies and treatment.

In its response, EWSI proposes to include a brief paper detailing material changes in accounting and capitalization policies along with appropriate regulatory treatment as part of its annual rate filings. In the event there are material impacts to financial statements and customer rates, EWSI proposes to utilize the Non-routine Adjustment (NRA) financial criteria as a measure to determine whether to apply for an update to rates during the PBR period. Thus, any accounting and capitalization policies and treatment changes that result in a revenue requirement impact less than \$500,000 annually would not be eligible for approval as an update to rates. Changes resulting in either an annual adjustment to the revenue requirement less than \$3 million but either greater than \$500,000 or greater than \$1 million cumulatively would be eligible for consideration and approval by City Manager. Changes resulting in an annual adjustment to the revenue requirement equal to or greater than \$3 million would be eligible for consideration and approval by City Council.

Administration considers this to be a reasonable approach.

2. Reporting the Size of the Workforce

In its Reasonableness review, Administration also identified a need to report the size of EWSI's workforce in future PBR applications, resulting in the second item in the July 9, 2021 motion; reporting the size of the workforce including actual and forecast full-time equivalents (FTEs). FTE is a calculated measure generally determined based on paid regular hours divided by standard hours of work for a position. EWSI states that they do not actively track FTE information for determining resource requirements or for internal decision-making. Instead, EPCOR uses headcount data, generally defined as the total number of full time, part time and temporary workers employed at any given point in time. To comply with the July 9, 2021 motion, EWSI undertook a process to compile FTE information for its Edmonton regulated utilities and compare that to readily available headcount information. In its response, EWSI provides a comparison of annual average FTE and headcount information for the years 2017-2021 for Water Services, Wastewater Treatment and Drainage Services. EWSI notes that there are minimal differences between the annual average FTE and headcount numbers and proposes to provide readily available headcount data in future PBR applications.

Administration considers this to be a reasonable approach.

3. Setting of Long-term Debt Interest Rates

Administration also noted in its Reasonableness Review that EPCOR's debt issuances and rates are not subject to ongoing regulatory review and recommended a further review of how EPCOR's debt costs are calculated. EWSI's response explains how it obtains both short term and long term funding from its parent, EPCOR Utilities, and provides some background on the regulatory treatment of the cost of debt for electric and natural gas utilities in Alberta. EWSI states that it follows the stand-alone principle for calculating the cost of long term debt, where the cost of debt for regulatory purposes reflects the credit rating for EWSI's regulated operations rather than the

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credit rating of the larger legal entity, that includes both regulated and riskier non-regulated operations. EWSI recommends the following:

- (1) the standalone principle for calculating the cost of debt be maintained;
- (2) interest rate risk continue to be borne by EWSI and not passed on to customers;
- (3) that supplemental information to further enhance the understanding of EWSI's cost methodology and calculation of long-term debt rates be provided in future PBR applications; and
- (4) a process to review new debt issuances during the PBR term not be introduced.

A process to review new debt issuance during the PBR term further complicates the rate-making process, increases overhead associated with the review, impacts efficient delivery of utility services, and could delay the implementation of key capital renewal and growth programs requiring debt financing.

Administration considers these recommendations to be reasonable.

Further details on EWSI's analysis and recommendations related to the three motions are included in Attachment 1, EWSI's response to the July 9, Utility Committee motions.

COMMUNITY INSIGHT

The general public was engaged during the review and approval of the most recent EWSI PBR applications to set new utility rates for Water, Wastewater Treatment and Drainage Services effective April 1, 2022, including providing feedback at the June 25, 2021, Utility Committee meeting. The PBR applications form the foundation upon which all regulatory reporting will be developed.

GBA+

GBA+ specific to this report was not conducted, as the information is regarding internal reporting standards.

The cost of providing water, wastewater and drainage services is equitably allocated to customers. Customer rates are guided by industry best practice and well established cost of service and utility rate design principles. Utility fees and charges are based on a cost of service methodology whereby customer rates are designed to recover the fairly apportioned cost of providing utility service to individual customer classes.

ATTACHMENT

1. EPCOR Water Services Inc. - Response to July 9, 2021 Utility Committee Motions