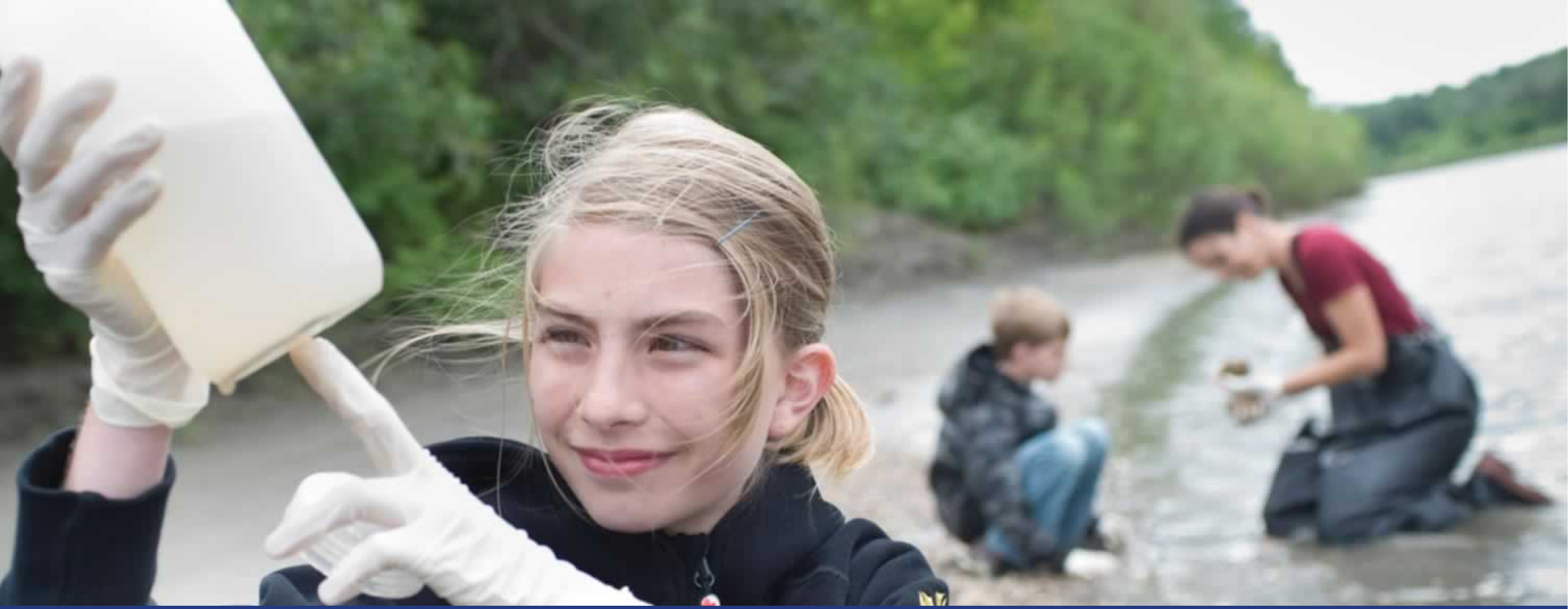

Response to July 9, 2021 Utility Committee Motions

EPCOR Water Services
November 2022

PROVIDING MORE EPCOR

2021 Utility Committee Motions

Following motion was issued at the July 9, 2021 Utility Committee meeting:

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:

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.

1. Improved Disclosure of Changes in Accounting and Capitalization Policies

Background

- EWSI reports financial information in accordance with International Financial Reporting Standards (IFRS)
- Certain IFRS requirements not consistent with rate-making or regulatory accounting practices
- EWSI utilizes existing regulatory accounting practices, EUI policies, as well as guidance from AUC Rule 026[1] to assess application of IFRS requirements
- For EWSI, significant differences between IFRS and regulatory accounting relate to property, plant and equipment

For example

Accounting Policy Item	IFRS Accounting Treatment	Regulatory Accounting Treatment
Capitalized Interest – financing charges included in the capital cost for projects during construction	Interest During Construction (IDC) - charged to capital projects lasting longer than 6 months and only includes **debt** component	Allowance for Funds Used During Construction (AFUDC) - charged to projects lasting longer than 12 months and includes both **debt and equity** components
Abandonments – expenses incurred to abandon, demolish, or decommission an asset no longer in use	Expense abandonments as incurred	Charge abandonments to capital as incurred

[1]AUC rule regarding regulatory account procedures pertaining to the implementation of the International Financial Reporting Standards

Why Accounting Policies and Treatments Change?

Two Key Reasons for Changes in Accounting Policies and Treatments

Issuance of new and amended IFRS standards

- EWSI is required to change accounting policies and treatments to remain compliant

Changes due to revised interpretation of the IFRS guidelines

- Determine a more appropriate accounting treatment

Accounting treatment reviewed and approved by EPCOR's Corporate Accounting group and external Auditors (KPMG)

EWSI flows the accounting change through the regulatory records

- EWSI recognizes that the process of communicating changes in accounting policies and applicable regulatory treatment with City Council can be more transparent

Recommendation for Improved Disclosure

Disclose material changes in accounting, capitalization policies and regulatory treatment in **EWSI's Annual Rate Filings**

- Rate Filings reviewed and approved annually by City Manager
- Utilize the Non-routine Adjustment (NRA) financial criteria as a measure
- Only material impacts to the Utility or customer rates qualify
- Revenue requirement impact < $0.5 million annually ineligible
- City Manager approval for revenue requirement impact >= $0.5 million and < $3 million
- City Council approval for revenue requirement >= $3 million

2. Reporting the Size of Workforce

Background

- FTE information is not actively tracked. Headcount and costs used for decision making
- Customer rates are driven by total costs, not the type or number of staff
- Greater *emphasis placed on finding cost efficiencies* to maintain net income
- Significant operating cost reductions realized by EWSI and *benefits passed on to customers*
- 2022 – 2026 PBR cost increases are limited to approximately 1% per year
- EWSI *bears the risk* of cost increases resulting from higher workforce requirements during the PBR term

FTE Analysis

- EWSI compiled FTE data and compared it against readily available headcount data
- FTE's determined based on paid regular hours divided by the standard hours of work for each position
- Minimal differences between the two measures
- Significant reductions in the size of workforce

FTE vs Headcount by Utility	2017	2018	2019	2020	2021
Water FTE's	529	521	518	497	479
Water Headcount	529	525	516	499	475
Difference	-	(4)	2	(2)	4
Wastewater FTE's	173	179	178	174	175
Wastewater Headcount	174	179	178	174	175
Difference	(1)	-	-	-	-
Drainage FTE's	702	699	690	653	658
Drainage Headcount	698	697	685	652	657
Difference	4	2	5	1	1

Recommendations for Reporting the Size of Workforce

- EWSI proposes to provide headcount information for its Edmonton regulated utilities in future PBR Applications
- Headcount data readily available
- Minimal differences between headcount and FTE

3. Setting of Long-term Debt Interest Rates

Background

- In EWSI's 2022 – 2024/2026 PBR Applications, interest rates were inadvertently calculated based on an indicative stand-alone credit rating of BBB+ instead of A (low)
- EWSI notified City Administration and corrected this error in its "Compliance Application" by reducing debt costs by $3.7 million
- Annual long-term debt issuances required to fund EWSI's capital program – secured using intercompany debt from EUI
- Interest rates for intercompany long-term debt calculated based on an <u>*indicative*</u> stand-alone credit rating of EWSI – process and methodology consistent with AUC regulated utilities
- EWSI's cost of new long-term debt for the 2022 – 2024/2026 PBR <u>*set once and held throughout*</u> the PBR term at 3.5%
- EWSI <u>*bears the risk*</u> of interest rate fluctuations during the PBR term – <u>**Risk not passed on to ratepayers**</u>

How Long-term Debt Interest Rates are Set?

Information from banks for 30-year Government of Canada bond yields + Current indicative credit spread for 30-year long-term debt + 5 basis point transaction cost = EWSI's interest rate for long-term debt issuances

- EWSI follows the stand-alone principle for calculating the cost of new long-term debt
  - Reflects credit rating for regulated Edmonton operations (Water, Wastewater and Drainage Services)
  - Excludes EWSI's non-regulated operations – considered more risky
- Ratepayers have cost responsibility commensurate with the risks of the utility
- The 30-year term closely matches the average useful asset lives

Recommendations For Long-term Debt Interest Rates

- Continue using the stand-alone principle for calculating the cost of new long-term debt
- Set and hold interest rates for the duration of the PBR term - maintaining stable, predictable rates
- Defer introducing changes to the debt cost methodology or process until the next PBR Application

Questions?

Example – Seasonal Water Use Adjustment

		Scenario #1 Current Approach	Scenario #2	Notes
1	Revenue Requirements	$105,000	$105,000	Costs based on wastewater received at plant
2	In-City Consumption (m^3) - Total	85,000	85,000	Water consumption - proxy for wastewater
3	Less Summer Outdoor Water Use Estimate (m^3)		17,000	Assumed 20 % additional use in summer
4	Net Consumption (Winter)		68,000	
5	Rate per m^3 - based on total consumption	$1.24		
6	Rate per m^3 - based on net consumption		$1.54	
7	Average Residential - monthly bill @ 13.5 m^3	$16.68		
8	Average Residential - monthly bill @13.5m^3 less 20%		$16.68	
	Note: Fixed charges not included			