

# ATTACHMENT 08.105 SHARED SERVICE COST ALLOCATION REVIEW - KPMG

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**ATCO**

# ATCO Ltd.

## Shared Service Cost Allocation Review

KPMG LLP

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This report contains 25 pages

ATCO Shared Service Cost Allocation Review

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# 1 Introduction

## 1.1 Background

ATCO Ltd. (“ATCO”) has retained KPMG to review the methodologies used to charge the costs of its internal customer services within the ATCO group of companies. In this context, internal customer services refers to a number of shared services that are provided to individual operating entities. These different operating entities are as follows:

- ATCO Electric Distribution
- ATCO Electric Transmission
- ATCO Power
- ATCO Gas
- ATCO Pipelines
- ATCO Energy Solutions
- ATCO Structures and Logistics (Canadian Operations)
- ATCO Energy

This report focuses on cost allocation methodologies for those services that have recently been moved to a shared service group in order to gain benefits from standardization and optimization.

### 1.1.1 Limitations on Distribution

KPMG’s report is for the internal use of ATCO and ATCO management. It is understood that the KPMG report may be distributed by ATCO externally to the Alberta Utilities Commission (“AUC”) as part of the regulatory process. For the avoidance of doubt, our report may not otherwise be disclosed, copied, quoted or referred to in whole or in part without our prior written consent.

KPMG will not assume any responsibility or liability for any costs, damages, losses, liabilities, or expenses incurred by ATCO as a result of circulation, publication, reproduction, use of or reliance upon our report, contrary to the restrictions noted above. Furthermore, we will not assume any responsibility or liability for any costs, damages, losses, liabilities, expenses incurred by anyone else as a result of circulation, publication, reproduction, use of or reliance upon our report.

### 1.1.2 Engagement Limitations

Our engagement is to assess and comment on the shared service cost allocation methodology of ATCO. Our findings are based upon the results of procedures outlined in **Section 1.4**.

This evaluation does not constitute an audit of the shared cost allocation methodology or of ATCO’s cost allocators. Accordingly, we do not express such an opinion on such matters. For avoidance of doubt, KPMG has neither audited nor reviewed the underlying shared service cost pools, including the data that underpins the cost driver allocators that form the basis of the allocations in this report.

## 1.2 Rationale for Shared Service Model

ATCO's adoption of a shared service model is designed to achieve the following objectives:

- Achieve cost savings through centralization and standardization, allowing greater economies of scale and scope. Savings will arise by eliminating duplication and through reductions in the number of different systems, processes, programs and vendors that must be maintained within the overall organization.
- Provide greater consistency across the organization in the provision of services and in the policies applied in individual functional areas.
- Allow greater optimization in the use of technology and leading practices, as a result of having functional departments with greater scale, purchasing power, and depth of expertise.

## 1.3 Context

ATCO has a number of characteristics that influence the cost allocation approach:

- It covers a broad range of sectors. Within the regulated utility sector, it covers both gas and electricity and, for each, the distribution and transmission segments. It also includes non-utility operations, both in energy and generation (ATCO Energy and ATCO Power) and in infrastructure (ATCO Structures and Logistics).
- It centralizes a number of support services across those companies where the benefits of a shared service model can be attained, whereas a number of other diversified utilities use a more decentralized operating model.

These features mean that direct comparisons with other organizations must be done with caution and approaches at other utilities may not be directly relevant for ATCO, even if apparently relevant.

## 1.4 Approach

A key component of our work plan during this engagement was to meet with representatives of each functional area. The objectives of these meetings were to:

- Document the specific activities undertaken by each group and review the internal organizational structure,
- Collect information on the cost drivers for each major activity undertaken by the group.
- Understand the availability of data with respect to transaction volumes and cost drivers.

Management teams within each of the functional groups were then asked to propose a cost allocation approach that would appropriately allocate the costs of the service, taking into account general principles of cost causality and fairness, and the regulatory guidance outlined in **Section 1.5**.

In parallel, KPMG collected information on cost allocation approaches for shared services at seven other Canadian utilities. This provided us with a range of current cost allocation practices from other peer utilities.

KPMG then reviewed the methodologies proposed by each shared service group, in light of the general cost allocation principles and the practices observed at other Canadian utilities. This provided for an independent and objective check on the methodologies proposed. Additional dialogue took

place as necessary to arrive at a cost allocation approach for each function that is consistent with cost allocation principles.

The results for each shared service group were then documented. This documentation appears throughout **Sections 2 and 4** of this report.

## 1.5 Regulatory Guidance

The National Association of Regulatory Utility Commissioners (NARUC) in the US has published guidelines for cost allocation and affiliate transactions.<sup>1</sup> Introductory material to these guidelines notes that the “prevailing premise” of the guidelines is that allocation methods should not result in subsidization of non-regulated services or products by regulated entities, other than in cases authorized by the jurisdictional regulatory authority. A preamble further notes that guidelines are not intended to be prescriptive rules or regulations but, rather, that they are intended to provide a framework within which utilities can develop their own policies and procedures.

NARUC does not have direct jurisdiction over Canadian utilities but nevertheless can provide useful guidance for utilities and regulators that are implementing cost allocation mechanisms.

The principles identified by NARUC that we believe are most relevant for ATCO include the following:

- To the maximum extent practicable, costs should be collected and classified on a direct basis for each asset, service or product provided.
- The general method for charging indirect costs should be on a fully allocated cost basis.
- The allocation methods should apply to the regulated entity's affiliates in order to prevent subsidization from, and ensure equitable cost sharing among the regulated entity and its affiliates, and vice versa.
- The primary cost driver of common costs, or a relevant proxy in the absence of a primary cost driver, should be identified and used to allocate the cost between regulated and non-regulated services or products.

<sup>1</sup> NARUC Staff Subcommittee on Accounts, “Guidelines for Cost Allocations and Affiliate Transactions, March 3, 1998.



## 2 ATCO's Cost Allocation Overall Approach

In this Section we summarize ATCO's overall cost allocation approach for shared services.

### 2.1 Overview

ATCO uses one of three approaches to allocating costs. These approaches are listed in order of preference below:

- Direct Charge.
- Based on Causal Allocator.
- Based on General Corporate Allocator.

These approaches are discussed in more detail below.

#### 2.1.1 Direct Charge

Where costs can be identified as being incurred on behalf of a specific entity, these costs are directly assigned to that entity and are not included in as a shared service. This cost allocation approach is the most defensible: it links costs directly with the entity that benefits from a given activity and that causes the associated costs to be incurred. The direct charge approach may require more administrative effort than other methods. This reflects the fact that it requires that costs be tracked in sufficient detail to isolate those costs applicable to, or caused by, just a single entity.

By its nature, the direct charge methodology is not applicable to joint or common costs, which are shared among different entities. These more general costs must be allocated through one of the two remaining methods.

In general, activities or functions that are dedicated solely to one entity and that therefore would be direct charged if part of the shared service group have instead remained embedded in the entity. Accordingly, direct charges are generally not an important component of the cost allocation methodology outlined herein. This report summarizes allocation methodologies for the shared service costs that cross multiple entities and that thus require that an allocation methodology be employed.

#### 2.1.2 Based on Causal Allocator

Under this approach, costs are allocated based on an indicator intended to represent, or to be a good proxy for, the causal factors that drive the overall level of costs. Allocators are typically based on some form of volumetric measure. Relevant measures, and applicable areas of application, include the following:

- Employee headcount or Full-Time Equivalents ("FTEs"). These are good measures for services, such as Human Resources, that are clearly related to the employee base.
- Number of invoices or invoice lines. This may be appropriate for certain accounting costs.

The specific allocators used are discussed in more detail in sections dealing with individual functions, as presented later in Chapter 4.

### 2.1.3 Based on General Corporate Allocator

Under this approach, costs are allocated based on the General Corporate Allocator (“GCA”). The GCA is a composite metric that takes into account the size and complexity of different entities within the ATCO group. Hence, the GCA is a good general indicator of the degree to which different entities are likely to both cause, and benefit from, shared service functions.

The GCA (as previously approved by the Commission) is based on an equal weighting of three components:

- Net Revenue
- Total Assets, and
- Labour expense.

The use of the GCA is particularly suitable for those activities that are not closely linked to, or driven by, the level of activity in various group entities. For these types of common costs, there is inherently no measure that is a good indicator of cost causality (since costs are largely unaffected by underlying affiliate attributes). In this case, the GCA can be considered as a measure of the relative benefit received by various entities from these shared service functions, assuming that benefits are distributed in proportion to the entities’ scale.

The GCA can also be used as an allocator when causal mechanisms are unclear or incorporate many different factors. In this case, the GCA can be considered as a reasonable composite allocator.

The GCA approach was first approved by the AUC (which was the Alberta Energy and Utilities Board at the time) in the 2002-069 decision, which focused on ATCO Group’s Affiliate Relationship Code of Conduct. At the time, the GCA was used for ‘Corporate Services – Administration’. This decision acknowledged the benefit of shared services with respect to economies of scale.

In the 2013-111 decision, the AUC directed ATCO to remove capital expenditures from the GCA and replace it with labour expense. This resulted in the approval of the GCA in its current form as an equally weighted average of labour expense, total assets, and net revenue proportions.

## 2.2 The Use of a One-Step Methodology

ATCO’s goal is to have a simple Cost Allocation methodology. As such, ATCO aims, where possible, to have all allocations “one-step, one-way”. In other words, if services from a subsidiary flow through shared services to another subsidiary, the cost will be direct from subsidiary to subsidiary. Additionally, allocations will not be stacked on other allocations. The costs are accrued into their respective functions and are typically allocated in one allocation step.

### 3 Comparator Utility Summaries

In this Section, we profile the utilities that formed the peer group for our collection of benchmark information on cost allocation approaches. The utilities were selected because they each allocate certain shared service costs to individual operating utilities from a central entity. In addition, information on their cost allocation approaches was available from publicly-filed materials submitted to the relevant utility regulator.

#### 3.1 Direct Energy

Direct Energy Marketing Ltd. is a subsidiary of Centrica PLC, a British multinational utility company. Direct Energy Marketing Ltd. is itself split into a variety of subsidiaries, with Direct Energy Regulated Services, which is one of these subsidiaries, being the primary focus of this cost allocation review.

Information regarding Direct Energy's cost allocation methodology was found within the *2012-2016 Default Rate Tariff and Regulated Rate Tariff*. More specifically, allocation information was found within attachment *CCA-DERS-018*, which was Direct Energy's response to the Consumers Coalition of Alberta.

The AUC accepted Direct Energy's allocators but instructed Direct Energy to review the selection of allocation drivers for future filings.

#### 3.2 EPCOR

EPCOR is a municipally owned utility, with the City of Edmonton being the sole shareholder. EPCOR has three subsidiaries, EPCOR Energy Alberta, Distribution and Transmission, and Water. The primary focus of this cost allocation review is on EPCOR's Distribution and Transmission subsidiary.

Information regarding EPCOR's cost allocation methodology was found within the *2015-2017 TFO Tariff Application*. Specifically, allocation information was found within *Appendix K-1 Corporate Service Overview*.

The AUC accepted EPCOR's cost allocation approach with little commentary.

#### 3.3 Fortis BC

Fortis Inc. ("Fortis") is a publicly traded utility headquartered in St. John's, NL. Fortis has a number of subsidiaries, but for the purposes of this cost allocation review the focus is on Fortis's subsidiary FortisBC Holdings Inc., which is a holding company for three regulated entities: Fortis BC Energy Inc., Fortis BC Energy (Vancouver Island) Inc. and FortisBC Energy (Whistler) Inc.

Information regarding Fortis Inc. and FortisBC Holding Inc. cost allocation methodology was found within the *2014-2018 Multi-Year Performance Based Ratemaking Plan*. Specifically, the allocation information was summarized within *Appendix F2a – FortisBC Holdings Inc. Cost Allocation Report*.

The BCUC accepted the cost allocation approach with little commentary.

### 3.4 ENMAX

ENMAX is a municipally owned utility, with the City of Calgary being the sole shareholder. ENMAX has a variety of subsidiaries but, for the purposes of this cost allocation review, the focus is on ENMAX Power Corporation, which manages the regulated side of ENMAX's business.

Information regarding ENMAX's cost allocation methodology was found within the *2014 Phase I Distribution Tariff Application DTA and 2014-2015 Transmission General Tariff Application GTA*. Specifically, allocation information was found within *Appendix I and J*.

The AUC approved the cost allocation methodology, and this methodology was subsequently reaffirmed in Decision 22238, *2016-2017 Transmission General Tariff Application* paragraphs 439-441.

### 3.5 Enbridge (Ontario)

Enbridge Inc. is a publicly-traded utility headquartered in Calgary, Alberta. Enbridge's regulated subsidiary is Enbridge Gas Distribution, which operates in Ontario. Enbridge Gas Distribution also operates in Quebec, New York State, and New Brunswick through partnerships and wholly owned subsidiaries.

Information regarding Enbridge Inc.'s cost allocation methodology was found within the *2014 – 2018 Enbridge Gas Distribution Inc. Rate Application*. Specifically, the *Regulatory Cost Allocation Methodology ("RCAM")* was found in Exhibit D1 – Tab 4 – Schedule 3.

Enbridge's RCAM was originally approved in 2006 but has undergone revisions since its acceptance. The Ontario Energy Board accepted the 2012 version with no changes.

### 3.6 NB Power

NB Power is a Crown Corporation, wholly owned by the Government of New Brunswick. NB Power allocates costs across six divisions: Generation, Nuclear, Transmission, Distribution, System Operator, and NB Energy Marketing.

Information regarding NB Power's cost allocation methodology was found within *NB Power 2015-2016 General Rate Application*. Specifically, the report *Review and Update of Overhead Capitalization Rate and Corporate Services Cost Allocation* was found in Attachment NBP5.15.

The New Brunswick Energy Utility Board's discussion around the cost allocation focused on variations in corporate costs. There was little discussion about the specific allocation methodologies.

### 3.7 Hydro One

Hydro One is publicly traded utility, with the Government of Ontario owning a significant minority share. Hydro One has four subsidiaries: Hydro One Networks Inc., Hydro One Remote Communities Inc., Hydro One Telecom Inc., and Hydro One Brampton Inc.

Information regarding Hydro One's allocation methodology was found within *Hydro One Networks Inc. For Electricity Distribution Rates 2006 (EB-2005-0378)*. Specifically, the cost allocation methodology was outlined in Exhibit C1-Tab 6- Schedule 1.

Hydro One's cost allocation methodology has followed the same general allocation approach since the 2006 rate application, but the methodology is reviewed in each application by a third party.

The methodology was approved in the 2006 rate decision with no changes. However, there was some discussion around the lack of transparency with certain cost allocators and how that must be balanced with the level of effort expended to allocate costs.

### **3.8 National Grid**

National Grid plc is a publicly-traded British multinational utility with operations in both the UK and the USA. For this cost allocation review, the focus is on the USA subsidiaries that operate in Massachusetts, New York, and Rhode Island.

Information regarding National Grid's allocation methodology was found within *Docket No. 4770 - The Narragansett Electric Co. d/b/a National Grid - Application for Approval of a Change in Electric and Gas Base Distribution Rates* (The Narragansett Electric Co. is the subsidiary operating in Rhode Island). The *Cost Allocation Manual (Revised, December 2014)* was found in Attachment PUC 1-76-1.

*Docket No. 4770* is still undergoing proceedings with the State of Rhode Island Public Utility Commission and Division of Public Utilities and Carriers.

## 4 Cost Allocation by Function

In this section we review the cost allocation methodologies proposed for each individual functional area. We then assess the reasonableness of methodologies proposed and assess their consistency with methodologies used at a number of peer utilities.

### 4.1 Financial Services

Overall, ATCO's approaches to cost allocation for its Finance and Accounting function are aligned with the guidance and considerations provided in **Section 1.5**. In general, ATCO's approaches for the Finance and Accounting function are also aligned with other utilities' allocation methodologies, where comparable functions and streams exist.

The Finance and Accounting function includes the following streams:

- General Accounting
- Accounts Payable
- Project Accounting
- Fixed Asset Accounting.

Each of these streams is discussed in more detail in the sections below.

#### 4.1.1 General Accounting

General Accounting is a business process group, containing processes for the management of the organization's ongoing financial records. It thus includes operational activities performed to close the books on a monthly, quarterly and yearly basis. It is also responsible for:

- Accounts receivable, collections, revenue accounting,
- Accounting standards and practices,
- Contract billing and revenue recognition for third party and intercompany projects.

More generally, the General Accounting function supports operational improvement of the Finance and Accounting functions. The majority of the costs in the General Accounting function relate to labour and employee benefits.

The broad scope of General Accounting lends itself to the GCA methodology, which has been selected by ATCO as the basis of allocation.

**Table 1 - General Accounting Comparators**

Utility	Methodology
ATCO Proposed	GCA
<b>Comparators</b>	
Enbridge	FCER
ENMAX	Level of Effort Estimation
EPCOR	ECPOR-approved GCA (Revenue, Assets, and Headcount)
Hydro One	Controller Department Labour Cost
National Grid (USA)	Direct Charge # of GL Transactions Capital Expenditures Dollar Value of Property Owned General Allocator

As outlined in **Table 1**, EPCOR, Enbridge, and National Grid all use some form of financial-based indicator or composite metric. Enbridge utilizes FCER (Financing Capital Employed Ratio), which is each individual affiliate’s capital employed without purchase premium, divided by total consolidated capital employed (including all purchase premiums) plus a gross up to reflect full ownership of other subsidiaries and minor investments. National Grid uses a variety of different allocators for different functions within General Accounting. These include various financial allocators, including Capital Expenditures, Dollar Value of Property Owned and a General Allocator. Overall, ATCO’s use of the GCA appears appropriate, as this method considers a number of financial metrics in parallel.

#### **4.1.2 Accounts Payable**

This stream is responsible for the processing of invoices and issuing of payments. Activities include the verifying of accounts payable with vendor records and auditing and approving payments. Reimbursement of employee expenses is part of this function. Included in this function is the development of processes and procedures for the activities undertaken within the group.

Accounts Payable uses the number of invoices second year prior as a cost allocator. Use of the number of invoices is appropriate as there is a strong link between the volume of invoices and resulting departmental costs.

**Table 2 – Accounts Payable Comparators**

Utility	Methodology
ATCO Proposed	# of invoices of second prior year (e.g. 2017 for 2019)
<b>Comparators</b>	
Direct Energy	# of transactions processed
EPCOR	# of invoice lines
Hydro One	# of invoices to vendors

All comparator utilities, Direct Energy, EPCOR, and Hydro One, use some form of transactional based allocator. This validates ATCO’s allocation methodology of using number of invoices.

### 4.1.3 Project Accounting

The Project Accounting stream encompasses the financial planning and supervision of capital projects. Activities include the development of business cases for capital projects, and managing and accounting for ongoing activities related to capital projects. Once the project has been completed and assets capitalized, the tracking of these assets going forward is done by the Fixed Asset Accounting group.

Project Accounting allocates costs using the GCA method.

**Table 3 – Project Accounting Comparators**

Utility	Methodology
ATCO Proposed	GCA
<b>Comparators</b>	
ENMAX	Level of Effort Estimation

The only comparator, ENMAX, uses estimates of the level of effort. Conceivably, it would be possible to use a metric such as the value of capital spending as an indicator of effort, although this may not be stable from year to year and would require additional effort to define and compute. GCA appears reasonable since it is likely to be well correlated with the scale of capital projects and the benefits received by individual entities. Further, the costs of this function are relatively small.

### 4.1.4 Fixed Asset Accounting

The Fixed Asset Accounting stream is responsible for the tracking and reporting of fixed assets transactions, including additions, retires, transfers, adjustments and depreciation expenses.



Fixed Asset Accounting allocates costs using the GCA method.

**Table 4 – Fixed Asset Accounting Comparators**

Utility	Methodology
ATCO Proposed	GCA
<b>Comparators</b>	
ENMAX	Level of Effort Estimation
Hydro One	Gross Utility Plant

One other direct comparator, Hydro One, uses Gross Utility Plant as an allocator to estimate the level of underlying effort for fixed asset accounting. This methodology appears appropriate given that the value of fixed assets is likely a good indicator of plant accounting effort. ENMAX allocates costs based on direct estimates of time effort. For ATCO, use of the GCA method is appropriate as the GCA is correlated with general company size. ATCO considered using annual capital expenditures as a metric, since this would correlate to the number of new asset entries in any year. However, this metric would be more volatile. Measures, such as the GCA, that take into account the outstanding stock of assets provide more stability.

## 4.2 Regulatory

The Regulatory function serves all regulated entities. This function includes all work related to maintaining and ensuring regulatory compliance (i.e. general rate/tariff and performance-based applications, deferral account applications, asset dispositions, etc.). This stream is specific to regulated utility entities and does not provide support to non-regulated affiliates.

The Regulatory function is allocated using the GCA method using data just for the utilities (ATCO Electric (T&D), ATCO Gas, ATCO Pipelines). This allocator is considered appropriate as it considers each entity's size and complexity. Further, since the scope of services is limited to regulated entities, limiting the data for this allocator to these entities is appropriate.

**Table 5 – Regulatory Comparators**

Utility	Methodology
ATCO Proposed	GCA
<b>Comparators</b>	
ENMAX	Level of Effort Estimation
Hydro One	Direct Charge
National Grid (USA)	Direct Charge General Allocator

The comparator utilities in **Table 5** rely more extensively than ATCO on time estimates or direct allocation (a portion of National Grid costs is nevertheless allocated using a General Allocator). If considering a change, ATCO would need to review the costs of implementing more direct allocation approaches and weigh them against the possible increased accuracy.

### 4.3 Human Resources

Human Resource (“HR”) shared services includes the functions Employee Resource Centre, Disability, and Labour Relations. HR shared service functions are allocated based on headcount across ATCO (Canada). ATCO’s approach to HR cost allocation is logical given that the level of effort for this function is driven by the underlying number of employees in the entities being supported.

General HR costs can reasonably be allocated using headcount as a causation driver. This approach, or variations of it, are used at the majority of peer utilities analyzed. The number of employees is the most logical proxy for the cost drivers associated with these services.

**Table 6 – Human Resources Comparators**

Utility	Methodology
ATCO Proposed	Allocate based on Canadian headcount
<b>Comparators</b>	
Direct Energy	FTE count in each business
Enbridge	Affiliate Headcount
ENMAX	Employee headcount (excluding contracted manpower)
EPCOR	Canadian headcount
Fortis BC	Variation of Massachusetts formula (Fortis Holdings to Fortis BC)
Hydro One	FTEs (except for Director, costs are allocated by proportional HR Dept. Labour Costs)
National Grid (USA)	Direct Charge # of Employees General Allocator
NB Power	Employee count

Nearly all comparator utilities (**Table 6**) use headcount as an allocator; only Fortis BC and National Grid approach human resource cost allocation differently. Given this, ATCO’s approach is considered consistent with its peers and is a reasonable approach.

#### 4.4 Information Technology

The Information Technology (“IT”) Function’s scope is the management, governance, and strategic planning function for IT. ATCO contracts out many IT services. These contracted services are generally more operationally focused than those that remain in-house; for example, an IT service provider provides work stations to employees. The costs of such contract services are directly billed to each entity and hence are excluded from this cost allocation. The scope of the IT Function in ATCO is therefore less focused on day-to-day support and operations than at many companies. This influences the allocators used.

The IT Function is allocated using a composite allocator calculated as follows:

- 50% based on the Net Book Value (NBV) of IT Assets, and
- 50% based on IT annual operating costs.

For any entity, the NBV of IT assets reflects investments made by that entity in computer software and hardware specific to its needs. Thus, entities such as natural gas and electricity distribution will invest in sector-specific IT programs; for example, they invest in Geographic Information Systems (GIS), which track the location of network assets, and asset management and work management

software (to help track and manage asset condition). The costs of these investments in software will be directly charged to the entity.

The use of the composite allocator noted above ensures that the allocation of IT Function costs takes into account both:

- The work-load associated with managing divisions' investments in their own specific IT assets.
- The work-load associated with managing other, more general, IT services. (This work load is captured through the inclusion of IT annual operating costs as the second component of the composite allocator.)

Overall, the composite allocator takes into account the fact that entities with high IT assets tend to require more management and strategic oversight. This allocator is therefore appropriate given that it aims to represent the underlying level of effort, or cost causality, for IT Function costs.

**Table 7 – IT Function Comparators**

Utility	Methodology
ATCO Proposed	50/50 NBV IT Assets and IT Spend 2 years prior
<b>Comparators</b>	
Direct Energy	Information Systems (IS) and IS Depreciation both use Headcount and Server Usage
ENMAX	Workstation Count
EPCOR	Headcount (Application Services and Major Capital Projects) Direct Charge (Infrastructure Operations)
Fortis BC	Variation of Massachusetts formula (Fortis Holdings to Fortis BC)
National Grid (USA)	<b>Solution Delivery</b> Direct Charge Mainframe Profile Server Profile # of Employees General Allocator <b>Relationship Management</b> Direct Charge Mainframe Profile Server Profile General Allocator
NB Power	Allocations base on previous Financial Plans.

There is no consensus across the comparators on how IT Function costs should be allocated, as seen in **Table 7**. This is likely a result of the differing scopes of each IT group, with some relying more on in-house operations and thus using more physical allocators (i.e. servers server usage, workstation count, etc.).

## 4.5 Supply Chain

The Supply Chain function encompasses two areas:

- Inventory Management
- Enterprise Sourcing

These functions (or sub-functions) are discussed in more detail in the sections below.

### 4.5.1 Inventory Management

This function covers the operation of warehouses and associated logistics support (such as the delivery of parts and supplies to ATCO operating locations). This function also:

- Provides governance over processes used within the overall Supply Chain group.
- Manages supplier records.

Goods in inventory are owned by the entity for which they have been purchased, and associated costs of goods (for purchasing and financing) do not flow through the Inventory Management function. Hence, this function covers just the operating costs of warehouse space and associated logistics teams.

Costs for Inventory Management, which operates across Business Units, are allocated based on the GCA formula.

**Table 8 – Inventory Management Comparators**

Utility	Methodology
ATCO Proposed	GCA
<b>Comparators</b>	
Enbridge	ACER (Adjusted Capital Employed Ratio)
Hydro One	Operations and maintenance capital
NB Power	46% Operational Cost allocated using Net PP&E
	54% of cost considered as capitalized overhead and allocated based on spending on material by division

A number of the comparator utilities allocate materials management costs based on dollar spending on materials or on capital. Such metrics are used by NB Power (which uses materials costs as an allocator for the capitalized overhead portion of management costs) and by Hydro One (which uses capital spending). For costs charged to operations, NB Power uses Net PP&E, a reflection of the fact that warehouse and material management costs are likely to be correlated to each divisions' installed plant. While these various approaches are reasonable, ATCO's use of GCA for the costs of the shared management and logistics team is also reasonable.

## 4.5.2 Enterprise Sourcing

The Enterprise Sourcing function develops overall strategies for procurement and helps negotiate new supply agreements with vendors. Centralization of this function helps ATCO better to manage relationships with suppliers and to implement best practices with respect to supply chain functions.

A significant portion of ATCO’s spending on supplies flows through Master Agreements with vendors. These Agreements typically specify pricing and delivery terms and may be in place for a number of years. The Sourcing group helps develop these Master Agreements. In some cases, Master Agreements may cross a number of different entities.

Costs for the Sourcing function are also allocated based on the GCA.

An alternative approach to using the GCA for would be to allocate costs based on some measure of purchase value or purchase order lines. ATCO considered this approach but rejected it on the following grounds:

- Different business units have different spending profiles. Distribution business units generate a very large number of transactions, with a low average dollar value per transaction. In contrast, generation and transmission often purchase very large dollar-value items (e.g. transformer units or turbines) on a much less frequent basis. Hence, neither dollar amounts purchased nor purchase order lines provide good indications of the level of support effort and would not be consistent with actual cost drivers of the function.
- Relative dollar amounts may be influenced from period to period by significant one-time expenditures. A measure of expenditure may not be consistent with the desire for stability.

**Table 9 – Enterprise Sourcing Comparators**

Utility	Methodology
ATCO Proposed	GCA
<b>Comparators</b>	
Enbridge	ACER (Adjusted Capital Employed Ratio)
NB Power	Spending on materials by division
Hydro One	Operations and maintenance capital
National Grid (USA)	Direct Charge # of PO Lines General Allocator

Comparator utilities (NB Power and Enbridge) do use measures of spending value as allocators. For the reasons noted above, however, ATCO has opted to use GCA instead, and this is reasonable and appropriate.

## 4.6 Fleet Services

Within ATCO shared services, the Fleet Services function provides services to manage the fleets of the various business units and its costs are allocated based on the number of vehicles at client

entities. (The direct costs of vehicle ownership and operation are not included within the Fleet Services stream, although Fleet Services provides oversight and management of these costs.)

Relative to other services, there are fewer comparators with respect to the allocation factors used for Fleet Services; this reflects the fact that fewer companies centralize this service. ATCO uses the number of vehicles as the cost allocator.

The number of vehicles is a logical cost allocator because it is based on the most likely driver of fleet costs. This allocator is also easy to implement and update, as it is based on readily observable data on vehicle counts.

**Table 10 – Fleet Services Comparators**

Utility	Methodology
ATCO Proposed	# of vehicles
<b>Comparators</b>	
NB Power	# of vehicles

The only comparator in our sample group, NB Power, also uses the number of vehicles as an allocator for the costs of its fleet management function.

## 4.7 Facilities Management

The Facilities Management group manages the property portfolio of ATCO. This portfolio includes approximately 180 buildings across the various entities, some of which are leased and some of which are owned. The services provided by Facilities may differ between leased and owned buildings: for leased building, certain property management services, such as maintenance oversight, may be provided by the lessor. For owned buildings, the Facilities group is likely to play a larger role.

For buildings owned by ATCO, costs associated with building ownership (depreciation and return on capital) are incurred directly by the entity that owns the building. Accordingly, these costs are not included in the Property and Facilities Management group and are not subject to allocation. To the extent that there is sharing of owned facilities amongst ATCO entities, separate affiliate agreements are in place.

For many buildings owned by ATCO, the company has entered into a facilities maintenance contract with a third-party service provider. The costs of this contract flow through to each property and thus to the entity that owns the property. The third party provides operations and maintenance support and construction management services. Under the contract, routine operating and maintenance services are priced on a per square foot basis while non-routine capital oversight is charged through an hourly fee or through a markup on incurred costs.

ATCO facility costs that are directly attributable to individual businesses (i.e. rent and lease costs) do not flow through the Facilities Management group. Rather, the Facilities Management group provides management services for the overall property portfolio. The costs that are incurred by this shared services group are allocated based on square footage occupied. This is a reasonable approach given that area of occupancy is clearly the primary cost driver of management and oversight costs. It is also an easily measurable and objective metric.

**Table 11 – Facilities Comparators**

Utility	Methodology
ATCO Proposed	Area occupied (square feet)
<b>Comparators</b>	
ENMAX	Direct allocated by square footage occupied. Common spaces are allocated based on the direct allocation percentage (includes rent but as a separate accounting line item)
EPCOR	Real Estate is assigned by composite of Revenue, Assets, and Headcount Rent is directly assigned by actual area occupied
Fortis BC	Variation of Massachusetts formula (Fortis Holdings to Fortis BC) (includes rent)
National Grid (USA)	Direct Charge Square Footage (periodic study) General Allocator (excludes rent, only Facilities Management)

ATCO’s methodology is generally supported by the comparator methodologies presented in **Table 11**. There is variation among the comparators in whether or not rent costs are included in the budget for the property function or are handled separately.

## 4.8 Project Management Office (PMO)

The PMO currently provides project governance standards and tools. The PMO does not provide direct project management services directly.

ATCO allocates PMO costs using the GCA method. This is considered reasonable given that the PMO does not provide direct project management services, but rather supports project management processes generally. The benefit of the services provided does not necessarily scale with the volume of projects managed by each entity. Also, use of the GCA metric avoids challenges associated with measuring and tracking project management activity in individual entities.



**Table 12 – Project Management Office Comparators**

Utility	Methodology
ATCO Proposed	GCA
<b>Comparators</b>	
National Grid	<b>Emergency Planning PMO</b> Direct Charge Miles of Overhead Lines General Allocator

The only comparator for the PMO function was the Emergency Planning PMO within National Grid. The more specific focus of National Grid’s PMO lends itself to a different allocation approach given that risk mitigation would be a larger driver of effort rather than general company size. Thus, for Nation Grid, measures of physical assets are appropriate. For ATCO’s more general PMO function, the use of the GCA appears appropriate.

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