

# Final Submissions of the GSS/GSM Customer Class Representatives

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MANITOBA HYDRO 2023/24-2024/25 GRA

JUNE 22, 2023

# GSS / GSM Customer Class Representatives Coalition Members

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- Building Owners and Managers Association
- Canadian Manufacturers & Exporters
- Automotive Trades Association of Manitoba

# PUB Mandate

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“Under Manitoba law, the Public Utilities Board (“Board”) must set electricity rates for Manitoba Hydro’s customers that are just and reasonable. In so doing, as confirmed by the Manitoba Court of Appeal, the Board balances two concerns: the interests of Manitoba Hydro’s ratepayers and the financial health of Manitoba Hydro. Together and in the broadest interpretation these interests represent the general public interest.”

PUB Order 59-18 – 1.0 Overview (p.4/316)

# Has Manitoba Hydro Satisfied Its Onus That The Requested Rate Increases Will Result In Just And Reasonable Rates?

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- 3.6% interim rate increase
  - It would not be practical to unwind the interim rate increase.
  - However, the interim rate increase and the record net income from 2022/23 should be considerations in setting rates for the test period.
- 2.0% rate increases for 2023/24 & 2024/25
  - Reliable service is vitally important to the members of GSS/GSM. Reliability should not be reduced, even if increased rates are needed.
  - The 2.0% rate increases for each of the test years are likely not necessary if Manitoba Hydro engages in appropriate cost-constraint measures.
  - If the 2.0% rate increases are approved, they should be accompanied by firm direction that Manitoba Hydro exercise cost constraint so that debt can be repaid more quickly.

# Roadmap for Submissions

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1. Depreciation
2. Operation & Administration Costs
3. SAP S/4 HANA
4. Cost of Service & Rate Design

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# Operation & Administration Expenses

# The PUB is a Surrogate for the Market

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The PUB does not manage Manitoba Hydro's expenses. However, it must be satisfied, based on the evidence, that electricity rates it approves are just and reasonable.

# Prudence Standard

Under this principle, customers should be charged only for prudently incurred costs. This recognizes the fact that regulated entities have a responsibility to manage themselves in a prudent manner. This principle is central to the PUB hearing process and the wealth of evidence collected and examined by the Board in its proceedings.

**prudence** [ˈpruːdɪns]  

[See synonyms for prudence on Thesaurus.com](#)

*noun*

1. the quality or fact of being prudent, or wise in practical affairs, as by providing for the future.
2. caution with regard to practical matters; discretion.

**prudence** *noun*

 /'pruːdɪns/

 /'pruːdɪns/

[uncountable] (*formal*)

★ a sensible and careful attitude when you make judgements and decisions; behaviour that avoids unnecessary risks

- *Maybe you'll exercise a little more financial prudence next time.*

# Three Questions on O&A Expense:

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- a. Is Manitoba Hydro tracking and managing its O&A costs in sufficient detail to provide the Board with confidence that costs are being prudently controlled?
- b. Is Manitoba Hydro reporting its O&A costs in sufficient detail to allow the Board to make apples-to-apples comparisons between year-over-year spending levels in various areas of Manitoba Hydro's budget?
- c. Where O&A costs have increased materially, has Manitoba Hydro presented sufficient evidence to satisfy the Board that the increases are prudent and reasonable?

# What is Not Tracked is Not Managed

- Manitoba Hydro does not track or cannot provide information about:
- FTEs by project (PUB/MH I-70c)
- Headcount information (PUB/MH I-71b)
- Final pre-construction budgets (PUB/MH I-95a)
- FTE reductions by Business Unit (PUB/MH II-24a-b)
- First Nations on-reserve customers that have their bills paid 100% by social assistance (PUB/MH II-62Ciii.)
- Net present value of each continuous improvement initiative (MIPUG/MH I-18 & 29c)
- Quantification of annualized cost reductions for each continuous improvement initiative (COALITION/MH I-3d)
- Results of improvement initiatives to line items in budgets (COALITION/MH II-3aii.)
- Incremental costs and numbers of FTEs associated with business model changes (COALITION/MH I-4e)
- Actual and forecast positions along with vacancies (GSS-GSM/MH I-5c)
- The use of contract work or overtime specifically to compensate for vacancies (GSS-GSM/MH II5e-f)

# O&A Costs by Cost Element

**Table 3 – Manitoba Hydro breakdown of O&A costs by cost element for 2023/24 compared to 2022/23**

**Figure 2. O&A by Cost Element**

MANITOBA HYDRO  
OPERATING AND ADMINISTRATIVE COSTS BY COST ELEMENT  
2022/23 vs 2023/24

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(In thousands of \$)

	2022/23	2023/24		%	Ref
	Forecast	Preliminary	Budget		
Employee Related Expenditures					
Wages & Salaries	\$ 458 803	\$ 482 838	\$ 24 035	5%	1
Overtime	62 639	64 480	1 841	3%	
Employee Benefits	152 528	158 807	6 279	4%	
Other	72 699	82 588	9 889	14%	2
Total Employee Related Expenditures	746 668	788 713	42 045	6%	
Less: Capitalized Labor & Overhead	(247 909)	(256 238)	(8 329)	3%	
Operational Employee Related Expenditures	498 759	532 475	33 716	7%	
Materials & Tools	31 665	33 696	2 031	6%	3
Consulting & Professional Fees	25 050	47 809	22 759	91%	4
Construction & Maintenance Services	29 926	33 642	3 715	12%	5
Building & Property Costs	34 233	37 615	3 382	10%	6
Equipment Maintenance & Rentals	20 771	23 446	2 675	13%	7
Consumer Services	7 945	7 973	28	0%	
Customer & Public Relations	1 651	2 018	368	22%	
Sponsored Memberships	1 770	1 920	150	8%	
Computer Services	8 298	12 362	4 065	49%	8
Communication Systems	1 771	1 830	59	3%	
Research & Development Costs	2 333	2 333	-	0%	
Administrative Services	6 557	6 519	(38)	-1%	
Donations, Sponsorships & Grants	1 756	1 712	(44)	-2%	
Collections Costs	9 170	9 170	-	0%	
Other	(713)	(1 192)	(479)	67%	
Cost recoveries	(21 939)	(19 026)	2 913	-13%	9
O&A charged to gas operations	(70 000)	(77 100)	(7 100)		
Operating & Administrative Expenses	\$ 589 000	\$ 657 200	\$ 68 200	12%	

Reference: GSS-GSM-5, Table 3, p 64

# Higher increases should be supported by more detailed evidence

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**Recommendation:** Changes that cross a threshold should attract higher requirements for filing (e.g. \$1 million to \$ million and/or 10% variance)

# Zero-Based Budgeting

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**Recommendation:** Manitoba Hydro should conduct a trial in one or more of its business units using the zero-based budgeting methodology described Mr. Madsen's written report.

# Adjusted Recommendation for FTE Increases

(\$ 000s)	2022/23 MH Forecast	2023/24 MH Applied	2023/24 Madsen Proposed	2024/25 MH Applied	2024/25 Madsen Proposed
<b>Prior year balance</b>	448,464	458,803	461,700	482,838	478,073
Merit/Progression (@ applied for rate)	6,121	5,958	5,996	6,764	6,697
GWI and provisions for GWI (@ applied for rate)	2,897	5,724	5,760	7,593	7,518
Change in Vacancy Allowance	(49,679)	(21,972)		7,495	
FTE Normal Operating Changes & Other	53,897	34,326		319	
Net increase in FTEs (FTE additions - vacancy)			4,617		4,781
<b>Recommended wages &amp; salaries</b>	<b>461,700</b>	<b>482,838</b>	<b>478,073</b>	<b>505,009</b>	<b>497,069</b>
<b>Applied for wages &amp; salaries</b>	<b>458,803</b>	<b>482,838</b>	<b>482,838</b>	<b>505,009</b>	<b>505,009</b>
<b>Difference</b>	<b>2,897</b>	<b>0</b>	<b>(4,765)</b>	<b>0</b>	<b>(7,940)</b>

FTE increases are presented as *fait accompli* despite unprecedented vacancy rates.

No evidence that reduction in executive, HR, or finance FTEs (e.g.) will affect safety, reliability, customer timelines (c/f MH-57, Final Written Argument, p 133/244)

# Consulting costs are skyrocketing



Reference: MH-42 Revenue Requirement Direct Evidence, Slide 30

# Updated Recommendation on Consulting Costs

Item description	Source	(\$000s)			
		2021/22 Actual	2022/23 Forecast	2023/24 Prelim Budget	2024/25 Prelim Budget
Consulting fees	GSS-GSM/MH II-3a-c	15,409	25,050	47,809	50,564
Computer services	GSS-GSM/MH II-3a-c	6,675	8,298	12,362	15,230
Remove SAP costs	PUB/MH I-29b, Figure 2	0	0	(10,986)	(20,067)
Remove other Cloud Computing Costs	PUB/MH I-29b, Figure 2	0	0	(11,300)	(6,750)
<b>Net costs excl. SAP and CCA</b>		<b>22,084</b>	<b>33,348</b>	<b>37,885</b>	<b>38,977</b>
<b>Scenario 1 - Costs at 2021/22A + 4%</b>		<b>22,084</b>	<b>22,967</b>	<b>23,886</b>	<b>24,841</b>
<b>Scenario 2 - Avg of 2021/22A and 2022/23A + 4%</b>				<b>28,825</b>	<b>29,978</b>
<b>Scenario 1 - Difference from net costs</b>				<b>13,999</b>	<b>14,136</b>
<b>Scenario 2 - Difference from net costs</b>				<b>9,060</b>	<b>8,999</b>

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# SAP S/4 HANA

# SAP S/4 HANA

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- The makings of an IT boondoggle.
- Appears to be Manitoba Hydro's preferred option.
- Little evidence & no business case presented.
- Very little idea of cost.
- Unnecessary sense of urgency.
- Major IT transitions present major challenges.

**Recommendation: Apart from Phase 0 investigation costs, no other costs related to SAP S/4 HANA should be included in revenue requirement or permitted in deferral account until the Board can review and approve Manitoba Hydro's decision.**

# Challenges of IT Transition & the Need for Caution

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- Potential for significant cost overruns.
- The presence of and need to assess other viable alternatives including maintaining the status quo.
- Concerns expressed by other Canadian regulators with similar proposed transitions.
- Complex customizations that require modification and transition to the new system.
- The inherent issues of attempting to train employees that are resisting the change and are required to adopt new approaches to performing the same work they have grown accustomed to.

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# DEPRECIATION

# Depreciation - General Principles

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- Depreciation is an estimate.
- Professional judgment is needed.
- Level of componentization is not prescribed by IFRS.
- “Significance” as driving factor for componentization.
- Componentization is an ongoing process under ELG or ALG.

# ALG is Preferable

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- ALG procedure provides improved continuity and consistency for depreciation expense.
- ALG is simpler to implement than ELG.
- ALG is more transparent and understandable than ELG.
- ALG has less risk of overstated depreciation expense than ELG.

# Manitoba Hydro's IFRS-compliant ASL Depreciation Study Did Not Minimize Components

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Order 73/15 (p. 46 / 108):

Accepting Gannett Fleming's testimony that additional componentization tends to reduce the difference between ASL and ELG, the Board requests that the IFRS-compliant ASL depreciation study, if and when filed by Manitoba Hydro, be based on the minimum level of additional componentization required by IFRS, but avoid optional additional componentization.

However, Manitoba Hydro and Alliance acknowledge that less componentization than used in the Alliance study would be appropriate.

(MIPUG/MH I-91i. p. 6/14 & PUB-20, p.29)

# Manitoba Hydro Did Not File Independent Expert Evidence

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- Dustin Madsen was the only independent IFRS expert.
- Dane Watson is not a certified professional accountant (GSS-GSM/MH I-b-c).
- Mr. Watson's CV contains limited IFRS training or experience.
- Mr. Watson was not engaged to opine on the relative merits of ALG vs ELG.
- Mr. Watson was not expected to testify, so he was not cross-examined.
- Alliance's clients predominantly use ALG.
- ALG is frequently used by US regulated utilities.
- Most Canadian utilities that use ELG are investor-owned – ELG benefits cash flow.

# EXPERIENCE OF DUSTIN MADSEN

Senior Auditor – Deloitte

IFRS Project Manager/Sponsor – FortisAlberta

Manager Forecasting & Budgets/Regulatory – FortisAlberta

Experienced Online Facilitator – CA School of Business

IFRS online and in-person course teaching – IASeminars

Vice Chair – Canadian Electrical Association Accounting and Finance Subcommittee

Senior Consultant – Finance and Regulatory – AltaLink

President Emrydia Consulting Corporation (including previous entities)

# DEPRECIATION EXPERIENCE OF DUSTIN MADSEN

More than 15 years of depreciation experience, excluding accounting experience at Deloitte.

Preparation of depreciation testimony on virtually every area of depreciation expense.

In-house and external experience managing depreciation calculations.

Active in the Society of Depreciation Professionals (instructor at Sept 2023 conference/Nominating Committee).

Created own depreciation model and have prepared depreciation studies utilizing the model.

Detailed understanding of calculations. In discussions with SDP to revise certain texts.

Have taught extensively on depreciation from the perspective of IFRS, CGAAP, and US GAAP.

# ALG Transition Would Not Be Onerous

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- Mr. Madsen testified that the transition costs should not be significant.
- Aligning financial reporting and regulatory reporting will lead to efficiencies.
- Manitoba Hydro acknowledges that the costs of transitioning to ALG would not be material. (PUB-20, p. 29)

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# Part 2: Cost of Service and Rate Design

# COSS Methodology and the Zone of Reasonableness

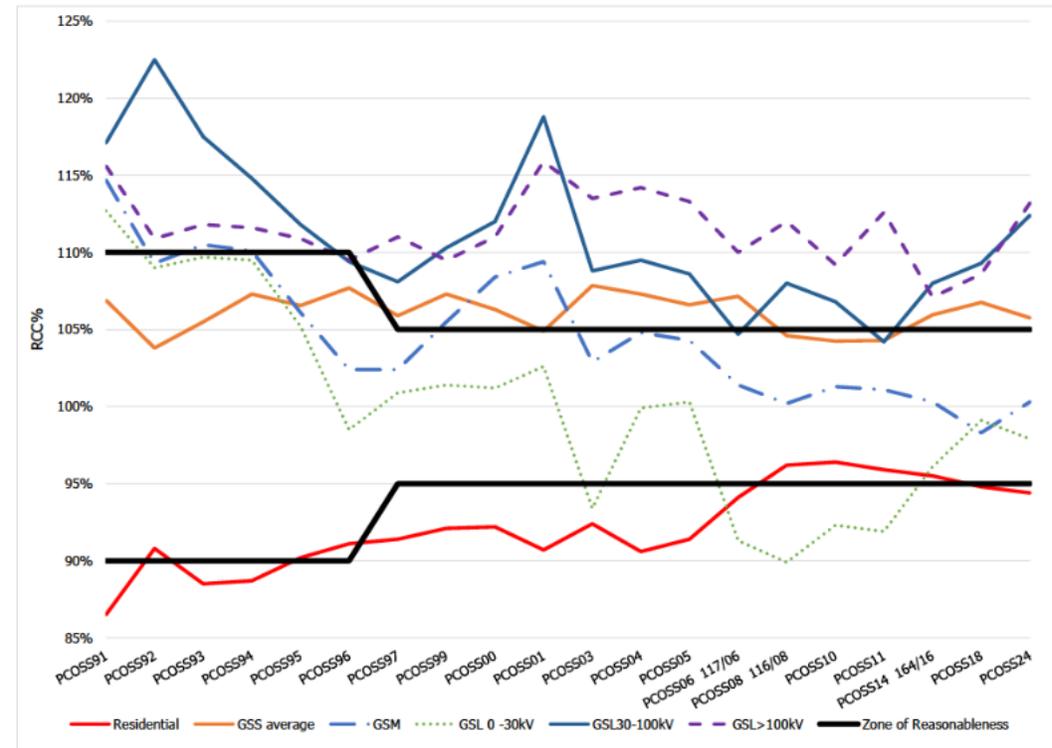
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- The COSS methodology used in this proceeding is “sophisticated”, the result of a dedicated process before this Board less than a decade ago.
- Cost causation should be “paramount” in COSS, and it is in PCOSS24.
- Half-way through the period this Board set to move all classes into ZOR.
- No need or reason to expand the Zone of Reasonableness.
- $3.5\% - 2.4\% = 1.1\%$  and Ms. Derksen’s evidence should be disregarded.

# GSSND Remains an Outlier

- GSS (orange) historically has overpaid for its electrical service since the late 1990s.
- GSSND was well above upper threshold of ZOR in PCOSS18 (115.7%) and PCOSS21 (113.8%).
- Differential rates appropriate and necessary.
- Breaking rate harmonization for GSSND is appropriate and recommended.
- If proposed rates accepted, GSSND would remain above the ZOR, but progress is being made in the right direction.

Figure 4-1: Manitoba Hydro PCOSS RCC results since 1991



Reference: MIPUG-6, p 56.

# Conclusion & Recommendations

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**Recommendation 1:**

MH should be directed to provide more detailed and transparent supporting evidence when it seeks large expense increases for use in the revenue requirement. For example, consulting fees and FTEs should be tracked and forecast at a program or activity level of detail.

**Recommendation 2:**

MH should be directed to consider a trial of zero-based budgeting into one or more departments for further consideration at the next GRA. Ideal areas where a zero-based budget process would be effective in the short-term include finance, regulatory, human resources, and information technology, all of which are seeing cost increases.

**Recommendation 3:**

For the purposes of the revenue requirement, the PUB should reduce FTE expense by \$4.8 million in 2023/24 and by \$7.9 million in 2024/25.

**Recommendation 4:**

For the purpose of the revenue requirement, the PUB should permit no more than a 4% escalation per year during the test period, after adjusting to remove SAP S/4 HANA costs and CCA costs.

**Recommendation 5:**

The PUB should approve a deferral account for the Phase 0 costs related to investigating ERP solutions and for the costs associated with small-scale software applications that are subject to CCA accounting rules.

**Recommendation 6:**

Manitoba Hydro should be directed to provide a detailed report to the PUB once it has completed Phase 0 of its ERP investigation and its Board has selected an option. Until that has happened, no SAP S/4 HANA expenses other than those incurred for the Phase 0 investigation should be permitted to be included in the deferral account or the revenue requirement.

**Recommendation 7:**

The PUB should direct that the ALG depreciation procedure be used for regulatory reporting.

# Conclusion & Recommendations

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**Recommendation 8:**

The PUB should reiterate its previous direction that componentization be limited to the minimum level required by IFRS and confirm the guidance of Mr. Madsen regarding the definition of “significant” in the context of the IFRS requirements.

**Recommendation 9:**

To the extent necessary, the issues of treatment of gains and losses and level of componentization should be dealt with at the next GRA once a decision on the appropriate depreciation procedure has been made.

**Recommendation 10:**

Recoverable periods should be determined for all deferral accounts according to IFRS 14, and for all capital related deferral accounts the recoverable period should be equal to the average expected remaining life of the assets.

**Recommendation 11:**

Account 3200M – Substations – HVDC Synchronous Condenser and Unit Transformers should keep its previous life curve of 65-R4, in the absence of evidence supporting the life shortening to 60-R3.

**Recommendation 12:**

PCOSS 24 should be approved for rate-setting purposes.

**Recommendation 13:**

Manitoba Hydro’s proposal to break class harmonization for GSS-ND should be approved.

**Recommendation 14:**

Manitoba Hydro’s proposed differential rates should be approved.