ISLAND WASTE MANAGEMENT CORPORATION

TO: Cheryl Mosher, Senior Financial Advisor, Island Regulatory and Appeals Commission

FROM: Karen MacDonald, Chief Executive Officer

DATE: February 11, 2022

RE: Response to Interrogatories on Application WM01306

1. Section 2 – Figure 2 – Cost allocation plus NAB Contribution

a. IWMC is proposing to increase the annual fee for Seasonal customers by $15. This represents a 13% increase in rates for these customers. Is this a reasonable increase for Seasonal customers or could it be deemed a significant rate increase also known as rate shock? Please explain.

IWMC used a cost allocation analysis to properly allocate related service costs to each customer category. The increase to the annual fee for Residential Seasonal customers is necessary to recover the cost of delivering the service, plus a 1% contribution to NAB.

We acknowledge that a 13% increase is substantial but cannot justify deviating from proper application of the cost allocation analysis in order to arbitrarily propose a lower cost that would not allow for sufficient cost recovery, or that would transfer costs to another category to subsidize this one.

Without an established threshold, rate shock is a subjective construct. In some circumstances rate mitigation on a 13% increase might be warranted. In this context, the impact is $15 more annually for customers who maintain a second residence.

b. Please provide an explanation and justification why Seasonal customer's costs per collection are significantly more than Extended Seasonal customers.

The explanation for this variance is found in the collection contracts. When collection contracts are tendered, bidders are required to submit separate pricing to collect each of the three residential categories. The costs associated with collection for the residential customer categories vary therefore separate pricing is required in order to be able to assign the actual costs to the appropriate customer category.

Collection contractors analyze and bid each residential segment based on their estimated cost to provide the service. For example, year-round residences are easier to access than most seasonal residences, which are often characterized by narrow lanes, unpaved surfaces, low hanging trees, etc. requiring contractors to use different vehicles to complete collection, and year round residences tend to be located in closer proximity to each other, which means the time and cost to collect 1000 year-round residences is less than that for the same number of seasonal residences.

The annual projected allocated expenditures per unit for Seasonal and Ext-Seasonal residences are $127.95 and $147.86. Seasonal residences are collected for 18 weeks and Ext-Seasonal for 24 weeks, which amounts to $7.11 per collection for Seasonal and $6.16 for Ext-Seasonal, a difference of $0.95 per collection.

A detailed analysis of the residential collection contract costs is included in the IWMC application under tab "Residential Collection Contracts". The total collection costs carry forward to the front page (March 31, 2022) of the Cost Allocation Analysis, allocated by residential type. See attached *Collection Contract Costs* table which calculates the "cost per collection" that comes from the collection contract costs, by type of residence as follows:

Seasonal	$4.74
Ext-Seasonal	$3.82

The variance between Seasonal and Ext-Seasonal is $0.92 indicating that virtually all of the difference stems from the contracted cost of collection.

2. Please provide additional details regarding the East Prince Landfill.

a. The application indicated this is an underfunded liability. Please provide more details regarding the obligations to fund this liability?

Landfill capping forms a barrier between the waste and the surrounding environment. It is necessary to contain the harmful effects of contaminated and decomposing items.

The Waste Resource Management Regulations under the *Environmental Protection Act* https://www.princeedwardisland.ca/sites/default/files/legislation/e09-15-environmental_protection_act_waste_resource_management_regulations.pdf require a landfill final cover system:

Article 15 Landfill final cover system
The purpose of the landfill final cover system is to
(a) control the amount of surface water infiltration into the buried waste material;
(b) limit erosion and sedimentation;
(c) control the release of methane gas from the landfill; and
(d) protect the underlying waste from exposure. (EC691/00)

Article 33 Landfill closure plan
(1) The corporation shall include, in the application for approval, a preliminary closure plan for
the landfill.
(2) The closure plan shall include the following:
(a) the anticipated date of closure;
(b) a description of waste that will remain as part of the closed landfill;
(c) a description of all post-closure control and monitoring programs which will be carried out at the landfill and the length of time they will be carried out;
(d) a description of any decommissioning of components of the landfill;
(e) a closure schedule; and
(f) any other information required by the Minister. (EC691/00)

As well, IWMC is obliged under Generally Accepted Accounting Principles (GAAP) to account for this future cost and the liability to pay it.

b. Please provide details and calculations to determine the value of the East Prince Landfill liability.

Please see attached Asset Retirement Obligation 2021 calculation. The auditors review this complicated calculation each year.

c. Is there a plan to setup a fund for this liability and, if so, is it included in the proposed rates?

The recognition of future landfill closure costs is an accounting requirement, based on the environmental regulation that the landfill must be properly closed when its useful life has ended. The costs must be estimated and the auditor reviews them each year to determine they are a fair representation of the present value of what the future costs will be, as set out in Note 8 to the 2021 audited financial statements (page 39 of the application).

This present value future cost has been added to the carrying cost of the landfill, as shown in Note 4 (page 12) of the audited financial statements. Note that the addition for the current year and the prior year are $276,640 and $605,505 respectively, which mirror the increases to the asset retirement obligation for those years (see Note 8, bottom of page 15).

Having been added to the cost of the cell in annual increments, the total liability of $3,579,830 at March 31, 2021 is therefore included as part of the total cell cost of $14,559,878. Each year, the amortization of the cell includes, as a component, amortization of the $3,579,830. Since amortization is an eligible expense in the cost allocation model, the total amount of the amortization of the closing cost to March 31, 2021, which is $2,446,180 has been theoretically recovered from ratepayers over the years, and therefore represents the amount that should have been set aside to fund the future retirement obligation to that date.

There is nothing included in the proposed rates to set up a fund in respect of this amortized amount to date which should have already been set aside over the years.

There is a current expense of $50,000 which represents the annual amortization expense of the capitalized cost of $3,579,830, so this is included in the proposed rates. It is found at tab "Dep'n" on line 13.

IWMC intends to commence setting this annual amount aside going forward, but has not settled on a plan to fund the past amount of $2,446,180 recognizing that those funds had previously been used to fund other things.

3. Projected Statement of Operations 2021-2022

a. Please confirm whether the 2021-2022 budget revenue figures were based on the current approved rates or the rates approved prior to February 2021.

The 2021-2022 Budget revenue figures were based on rates prior to February 2021. When the budget was prepared, IRAC had not yet issued a decision regarding the 2021 rate application.

b. If the budgeted revenue figures are based on the current approved rates, please explain the significant increase in revenues between the 2022 budget and the 2022 projected statements.

N/A

4. Section 9 – Net Asset Balance

a. The application indicates a 1% increase in rates is to be used to rebuild IWMC's Net Asset Balance. Please provide details and calculations of when IWMC expects the net asset balance to be rebuilt.

In proposing a 1% rate increase to rebuild the NAB it will take many years for IWMC to reach the target of $5.5M. This measured approach is being used to mitigate the financial impact on customers while working towards more financial stability for the corporation.

In future years, where a rate increase is either minimal or not required to recover operational costs, IWMC may apply to increase the NAB contribution; therefore, it is not possible to estimate, with any certainty, when the target might be achieved.

b. Please explain IWMC's next steps once the net asset balance is rebuilt.

Once the NAB is rebuilt, IWMC will maintain it at that level in order to support effective and efficient operations.

c. Please explain why an external line of credit is not a reasonable option, rather than maintaining 3 months of operating expenditures as a net asset balance.

An external line of credit is not a reasonable or cost effective way to address the timing differences regarding the economic life of certain capital assets, such as carts, which must be amortized versus the length of time over which they could be financed particularly when carts are an annual purchase both to supply new residences and replace aging carts that have failed. As well, in a period of rising interest costs it will be less expensive in the long run to "self-finance" certain items such as low dollar capital assets like vehicles and carts, than to borrow commercially, and it will also help level out cash flow pressures arising from timing of payments and receipts.

Building up a NAB over a number of years should come at an overall lower cost than incurring interest on a line of credit.

d. IWMC indicated there would be a new policy developed in relation to the unrestricted and restricted net asset balance. Please explain what this policy will include.

IWMC will develop a policy to present a clearer picture of how corporation resources may be employed. The policy could include definitions, policy statements, approval procedures, outline how assets may be used, define a policy review period, establish internally restricted surpluses for future requirements, etc.

e. Please prepare a projected cash flow statement for the years 2022, 2023, 2024 assuming: i. the proposed rates are approved; and ii. rates are approved to cover the cost of service but the 1% to rebuild the net asset balance is not approved.

See attached.

5. Section 10 – Projected Statements of Operations 2022-23, & 2024

a. Please explain why IWMC expects disposal revenue will increase by approximately 4% per year.

In reviewing the Projected Statements of Operations 2022-2023 and 2023-2024 to respond to this query, it became evident that the disposal revenue projection should have been calculated based on static disposal tonnage of 42,004 without anticipating any increases. The costs in the model are based on this tonnage. Accordingly, disposal fee revenues on the Projected Statement of Operations for 2022-2023 and 2023-2024 have been revised.

b. Under the Admin expenditure tab, it was noted that insurance expense has increased significantly over the past three years. IWMC anticipates insurance expense to increase a further 20% per year for the projections. This assumption means insurance expense will double in a five year time period. Please explain the rationale for this increase.

The responsibility for insurance for IWMC rests with the Risk Management & Insurance (RMI) Section of the Treasury Board Secretariat. This includes “making necessary arrangements for risk financing, including negotiating commercial insurance coverages…” On November 26, 2021 RMI advised IWMC to budget a 20% increase for 2022-23 based on market trends and information available at that time.

We are advised that the insurance market is experiencing what is referred to as a 'hard market', meaning that insurers are reducing the number of risks they accept while also increasing their rates drastically to make up for low yields in previous years. Predictions from two of the largest broker firms (Marsh and Aon) note that the market may begin to soften in fall 2022- winter 2023, but some IWMC facilities will always be considered 'hard-to-place'.

c. Below is a table that summarizes wages from the three year projection and compares it to the March 31, 2021 audited financial statements. According to the Application, IWMC forecasts future wage increases at 1.75% for 2022/2023, 1.37% for 2023/2024 and 2% per year thereafter. However, the analysis below indicates significantly larger increases over the 2021 audited financial statements. Please explain.

IWMC uses wage rates established in the Pay Plan in the UPSE Civil Collective Agreement. The current Collective Agreement expires March 31, 2022. [redacted]

[redacted]

Despite a reference in the notes to a 2% increase beyond 2023-24, we have not submitted projections for 2024-25 in this application.

The projections do indicate a significant increase from the 2021 audited financial statements. Notwithstanding the COL increase, IWMC has increased the staffing complement in the Admin and Residential departments, and a number of unexpected staffing transitions and extended leave have increased costs. IWMC has a combination of salaried and hourly wage employees. The nature of the work at IWMC means the operational demand for staffing fluctuates, which can also result in some variance between projections and actuals on wage costs.

d. Does IWMC anticipate any significant capital asset purchases or debt acquisitions during the projection period? If so, have they been included in the projections for depreciation and interest on long term debt?

IWMC does anticipate significant capital asset purchases and/or debt acquisitions during the projection period, but they have not been included in the projections. IWMC is awaiting the final report and recommendations from a condition assessment at the Central Compost Facility, completed by external consultants. The report will inform a plan for the future of the CCF. Given the age of the facility, it is known that considerable replacement or upgrade to existing equipment and systems will be required. At this time, no decisions or approvals have been made.

e. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Attachments:

Asset Retirement Obligation 2021
Collection Contract Costs
Projected Cash Flow
Revised 3 Yr Projections – No Increase
Updated for COS + 1% - 3 yr Projections
Update for COS Rate – 3 yr Projections