



## **Corporate Cost Allocation Manual**

**Last Update: September 2023**



## **I. INTRODUCTION**

The corporate entity (“Corporate”) of Otter Tail Corporation provides services to the operating companies that comprise the Corporation. One of three things can occur with costs from Corporate services: 1) allocated to Otter Tail Power Company; 2) allocated to Varistar Corporation, or 3) not allocated and remain at Corporate. The purpose of this manual is to detail how costs are being allocated to Otter Tail Power Company.

Otter Tail Power Company (the largest operating company of Otter Tail Corporation) serves retail electric customers in three jurisdictions including Minnesota, North Dakota and South Dakota and is governed by the rules and regulations in each jurisdiction. As a regulated utility, Otter Tail Power is allowed to recover prudent and reasonable costs for services it receives from Corporate and reflects the cost of these services in its revenue requirements for setting rates. Costs allocated from Corporate are based on allocation factors that are calculated annually. In Minnesota, a different allocation method for the general allocator has been ordered for regulated reporting; however, this change in percentage is adjusted by Otter Tail Power Company so all costs billed from Corporate are at the same rate, regardless of jurisdiction.

The services provided by Corporate include financial reporting, tax planning and reporting, treasury and cash management, financial planning, internal audit, human resource and labor expertise, benefit plans, corporate communications, safety and risk management, shareholder services and investor relations, aviation and executive management services (CEO, CFO and General Counsel). These services are distinct from and do not duplicate similar services in Otter Tail Power Company. See Section V below for additional information of Corporate services. To support these services, there are specific corporate costs associated with administration and information technology (IT) that also need to be allocated.

The remainder of this document is devoted to explaining the services being provided and the methodology and allocation factors used to allocate Corporate service costs to Otter Tail Power Company.

## **II. METHODOLOGY**

Corporate identifies costs in three categories: 1) directly assignable costs, 2) indirect costs that are allocated on a department or functional allocation factor, and 3) general costs that are allocated using a general allocation factor.

Directly assignable costs are those costs where the purpose behind the costs can be attributed to a specific operating company. For example, consulting fees to help with a project related to an individual operating company would be directly assigned to that operating company.



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Indirect costs have an identifiable cost causation related to another activity or factor. For example, costs for an employee in the Risk Management department of Corporate to attend a seminar on safety would be allocated using a functional allocation factor such as number of employees.

General costs are those costs that cannot be directly assigned or where cost-causation cannot be identified. Examples would include postage, local telephone and communication service costs, time spent preparing the annual report and other SEC filings, preparing to meet with rating agencies, working with and tracking shareholder matters. These types of costs will be allocated on a general allocation factor discussed below.

Allocation factors are updated annually in February with the most recent calendar year's data. The updated allocation factors are then implemented and utilized for all Corporate Costs in February and remain unchanged for 12 months.

### **Methodology Changes:**

Should any adjustments be made to the allocation methodology prescribed herein, notice must be provided to the following employees:

Otter Tail Corporation VP of Accounting  
Otter Tail Power Company VP, Regulatory Affairs  
Otter Tail Power Company, VP, Finance and CFO

All parties must approve of the methodology change prior to its implementation. "Methodology changes" should be broadly interpreted to ensure appropriate communication and approval of changes by the parties listed above.

## **III. ALLOCATION FACTORS**

### **Indirect Allocation Factors:**

- A. **IT Factor:** This factor is based on the previous year ending December 31 ratio of corporate labor assigned to Otter Tail Power where the numerator is the total Corporate labor (not including bonuses) assigned to Otter Tail Power and the denominator is the total of all Corporate labor (not including bonuses). See Appendix A.
- B. **HR Factor:** This factor is based on the average of the previous year ending December 31 ratio of employees, and the previous year ending December 31 ratio of benefit expenses. For the employee ratio the numerator is full-time employees in electric operations and the denominator is the total number of full-time employees for all of Otter Tail Corporation. For the benefit ratio, the numerator is total benefit costs (including benefit costs cleared through the payroll loading rate) from electric operations, and the denominator is consolidated benefit costs for all of Otter Tail Corporation (including benefit costs



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cleared through the payroll loading rate). The specific consolidated corporate accounts that will be used to calculate this ratio (including Otter Tail Power benefit costs cleared through payroll loading) are accounts C5030, C5230, C6030, C6530, C7030. See Appendix A.

- C. RM Factor: This risk-management factor is the average of the previous year ending December 31 ratio of employees, and the current year ratio of insurance premiums paid. For the employee ratio the numerator is full-time employees in electric operations and the denominator is the total number of full-time employees for all of Otter Tail Corporation. For the insurance premium ratio, the numerator is the total premiums paid by Otter Tail Power and the denominator is the sum of insurance premiums paid by all operating companies. See Appendix A.
- D. Internal Audit Factor: This factor is based on the previous year ending December 31 ratio where the numerator is the total hours spent auditing electric operations and the denominator is the sum of hours auditing electric and non-electric operations. Non-electric operations do not include hours spent auditing Corporate-related matters. See Appendix A.

### **General Allocation Factor:**

This factor is based on a three-factor formula that is comprised of the average ratio of Total Assets, Total Revenues and Total Labor Dollars for the most recent calendar year. The specific consolidated corporate accounts that will be used to calculate the Total Labor Dollars ratio are C5010, C5020, C5030, C5210, C5220, C5230, C6010, C6015, C6020, C6030, C6510, C6520, C6530, C7010, C7020 and C7030. Appendix A shows the computation of this factor based on prior-year audited numbers and shows the source for the information to calculate each ratio.<sup>1</sup>

In computing the General Allocation Factor for 2022, due to extreme material cost inflation impacting our Manufacturing and Plastics segments in 2021, we calculated an Adjusted Total Revenue amount for these two segments to exclude the inflation effects from the reported amounts of revenue of these segments. We then used the ratio of Otter Tail Power revenues to Adjusted Total Revenues as one of the factors in determining the General Allocation Factor.

## **IV. CLARIFICATION ON CERTAIN COSTS**

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<sup>1</sup> The Minnesota Public Utilities Commission (PUC) ordered in Otter Tail Power Company's rate case (Docket No. E017/GR-07-1178), that the General Allocator calculation method must comply with the PUC's orders in Docket E,G999/CI-90-1008. That docket established a general allocator based on the ratio of regulated to unregulated expenses, excluding fuel, purchased power, and purchased cost of goods sold.



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There are certain costs that need to be discussed in further detail to gain an understanding of exactly how they are being allocated, or in some instances, not being allocated. This section will list each of these costs individually and provide background and instruction on how each is handled for allocation purposes.

- A. Labor: Employees at Corporate track their time on a daily basis. Percentages are used to track time between Corporate, Otter Tail Power Company, and Varistar activities. The time designated Otter Tail Power is directly assigned to the power company. The percentage of time being recorded in the Corporate column is allocated based on the employee's position and will use one of the allocation factors discussed above in Section III.
- B. Bonuses and Benefits: Cash bonuses are allocated based on each employee's labor ratio from the previous year. An employee's labor ratio reflects both directly assigned and allocated labor. Bonuses are accrued and allocated during the current year, and a true-up is made in the following year after the exact bonus amount is determined and the employee's actual labor ratio from the previous year is available. Benefit costs are allocated on each employee's labor ratio from the most recent 30-day pay period.
- C. Charitable Contributions: The contributions made by Otter Tail Corporation are not allocated to Otter Tail Power. Each operating company makes its own contributions and those contributions made from a corporation perspective are typically not allocated.
- D. Employee Stock Purchase Plan and Deferred Compensation Expense: The costs associated with the Employee Stock Purchase Plan are allocated based on the ratio of Otter Tail Power employee stock purchases to the total of the most recent stock purchase and Deferred Director Compensation expense is allocated to Otter Tail Power based on the general allocator.
- E. Stock Option Expense: Under Accounting Standard Codification (ASC) Topic 718 companies are required to record the value of stock options over the period in which the options vest. These expenses are allocated to Otter Tail Power based on the number of options granted to employees in this company. No stock options were granted in 2021 and none are expected to be granted to employees in 2022.
- F. Restricted Stock and Restricted Stock Units: Under ASC Topic 718 companies are required to record the value of restricted stock and restricted stock units over the grantee's requisite service period. Restricted stock and restricted stock unit expense on shares granted to Otter Tail Power employees are directly assigned to Otter Tail Power. The portion of restricted stock or restricted stock units granted to Corporate employees and the Board of Directors is allocated to Otter Tail Power Company based on the general allocator.



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- G. Executive Stock Performance Award Plan: Under ASC Topic 718 the Company is required to record the value of the total shareholder return (TSR) portion of incentive stock award, based on the grant date fair value of the targeted TSR awards and to record the return on equity (ROE) portion of the award based on the grant date fair value of the ROE portion of the award over the grantee's requisite service period. However, the ROE portion of the award must be adjusted for the actual number of shares earned through the end of performance measurement period. Otter Tail Corporation provides incentive stock to the corporate officers as part of their overall compensation package. The costs associated with this plan are allocated based on the prior year time allocations for each executive. In addition, when performance shares are awarded to Otter Tail Power's president the cost related to his award is directly assigned to Otter Tail Power.
- H. Bank Charges: Corporate serves as the "Bank" for operating companies and therefore incurs the various fees associated with the accounts maintained by the operating companies. Otter Tail Power is directly charged for its respective fees and the fees associated with Corporate's accounts are allocated using the General Allocation Factor.
- I. External Audit Fees: Otter Tail Corporation currently retains an independent registered public accounting firm to audit its financial reports and records. Each year this firm provides to Otter Tail Corporation the number of hours it has assigned to audit electric, non-electric and corporate operations which are used in determining their Client Service Plan and fees for the year. Fees from the firm are allocated based on the ratio of assigned hours for electric versus total audit hours on consolidated operations. The hours assigned to corporate are allocated using the general allocator.
- J. Meetings: Costs associated with periodic meetings that involve personnel from across the operating companies such as leadership meetings, quarterly accounting and HR meetings are not allocated.
- K. Training and Development: Costs associated with training and development are direct charged where possible but otherwise allocated using the appropriate indirect allocator or the general allocator.
- L. Travel and meals: With the exception of travel-related expense related to operations of Otter Tail Power's jointly owned generation plants or if corporate employees are working specifically for Otter Tail Power, corporate travel expense is not allocated.
- M. Aviation Services: Corporate provides air service for the operating companies of Otter Tail Corporation. There is one aircraft available for use which is the King Air. The King Air is owned by Otter Tail Power Company. To help recover the variable costs associated



with flying this aircraft, corporate charges hourly rates which are reviewed periodically.<sup>2</sup> (See Appendix B for hourly rates)

Because the King Air is owned by Otter Tail Power, at the end of each quarter the costs associated with the King Air that have not been recovered through the hourly rate are charged to Otter Tail Power. For example, the costs not cleared for the quarter total \$9,000. Otter Tail Power has recorded depreciation expense for the quarter of \$1,000 which is added to the \$9,000 of un-cleared costs for a total of \$10,000. The \$10,000 is multiplied by the non-utility usage factor (the percentage of hours flown for operating companies other than Otter Tail Power) and for our example we'll say it's 52%. Otter Tail Power will then be charged \$3,800 (\$9,000 less \$5,200 (\$10,000 x 52%)) to reflect the utility-portion of costs not cleared on the King Air.

## **V. DESCRIPTION AND ALLOCATION OF SERVICES PROVIDED**

Further detail is discussed below on the services provided by Corporate. Each service shown below is directly related to an individual cost center at Corporate. For each service, a description is provided along with the primary allocation factor that is used to allocate associated costs. Again, costs that can be directly assigned to the various operating companies are directly assigned. Indirect costs are allocated using one of the factors discussed in Section III.

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<sup>2</sup> The aviation charge rates may be changed during the year to reflect changes in variable costs (i.e., aviation fuel).



## **Corporate Overheads**

Description: Represents charges for bank charges, building lease and depreciation expense.

Allocation Factor: All costs not directly assigned are allocated on the General Allocation Factor.

### **A. Executive Management Services**

Description: Represents charges for Otter Tail Corporation's executive management team and Contributions.

Allocation Factor: Contributions are not allocated and all other costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

### **B. Board of Directors**

Description: Represents charges for board of director fees, restricted stock, travel and other expenses associated with attending Board meetings or related to being a board member.

Allocation Factor: Fees and restricted stock expense are allocated on the General Allocation Factor. Otter Tail Power is not allocated any costs associated with travel related expenses.

### **C. Platform Leadership**

Description: Represents charges for the Platform Leaders and their staff that have oversight responsibilities with the non-electric operating companies.

Allocation Factor: All costs are currently being directly assigned to Varistar Corporation with the exception of the Administrative Assistant position assigned to this department. Since that role not only provides services to the Platform Leadership but to other corporate functions, her time is allocated between Varistar and Otter Tail Power by being directly assigned as appropriate or by the Corporate Allocation Factor.

### **D. Administrative Services**

Description: Represents charges for providing administrative support to all the other services, office supplies and office equipment leases.





Allocation Factor: All costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

### **E. Information Technology**

Description: Represents charges for supporting corporate computers, networks, land-based phones and T1 lines, videoconferencing, internet, software and other various pieces of hardware. In addition, consulting services are provided as requested to the various operating companies.

Allocation Factor: License and maintenance fees comprise a large portion of the non-labor costs. As much as possible, these costs are directly assigned based on the number of user licenses utilizing the software by each operating company. All costs not directly assigned are allocated on the IT Factor including labor classified as Corporate. The corporate VP of Information Technology is a shared position with Otter Tail Power Company. The specific costs for this position are directly assigned to Otter Tail Power as appropriate.

### **F. Corporate Accounting**

Description: Represents charges for maintaining financial records, statements and systems, SEC filings, tax accounting and filings, cash management and consulting with various operating companies on an as-needed basis.

Allocation Factor: External audit fees are allocated as discussed in Section IV. Costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

### **G. Internal Audit**

Description: Represents charges for reviewing internal controls and conducting operational audits at the various companies within Otter Tail Corporation.

Allocation Factor: Costs not directly assigned are allocated on the Internal Audit Factor including labor classified as Corporate.

### **H. Financial Planning**

Description: Represents charges for supporting financial analysis and budgeting at the operating company and corporate level.

Allocation Factor: Costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.



## **I. Treasury**

Description: Represents charges for communicating with both debt and equity analysts, maintaining Otter Tail Corporation's capital structure, monitoring and accessing capital markets and other services as identified by the Chief Financial Officer.

Allocation Factor: Costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

## **J. Corporate Communications**

Description: Represents charges for corporate communications including, but not limited to, brand strategy and corporate narrative, advertising, press releases, annual report and related annual meeting production, and enterprise news distribution.

Allocation Factor: Costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

## **K. Shareholder Services**

Description: Represents charges for maintaining shareholder records, communicating with investors at various fairs, coordinating transfer agents and planning the annual shareholder meeting.

Allocation Factor: Costs not directly assigned are allocated on the General Allocation Factor including labor classified as Corporate.

## **L. Human Resources/Leadership Development**

Description: Represents charges for establishing and maintaining policies related to employment and benefits of corporate employees and executive compensation, searches for candidates for upper-level management positions on behalf of operating companies, organizing and facilitating leadership training, organizing and aiding in the administration of company benefit programs.

Allocation Factor: Costs not directly assigned are allocated on the HR Factor including labor classified as Corporate. In case of leadership and employee development training, costs are allocated based on employees in attendance at training sessions, if possible and otherwise allocated using the HR allocator.



## **M. Legal Affairs**

Description: Represents charges for legal services related to employment law, litigation, contracts, rates and regulation, environmental matters, real estate and other various legal matters.

Allocation Factor: Most costs associated with legal services are directly assigned but if costs cannot be directly charged, the general allocator is used. Typically, labor costs for all corporate lawyers other than the General Counsel are generally assigned to the Varistar companies as Otter Tail Power employs their own attorneys, however, there are times when corporate lawyers perform work for Otter Tail Power which would be assigned as such.

## **N. Risk Management**

Description: Represents charges for assisting operating companies with assessment and management of risks, identifying and implementing loss control strategies to minimize the frequency and financial consequences of accidental losses, assisting operating companies in post loss claim management, overseeing Otter Tail Corporation's consolidated insurance program, and identifying and documenting the environmental conditions during the process of acquiring a new company.

Allocation Factor: Costs not directly assigned are allocated on the RM Factor including labor classified as Corporate.

## **VI. CONCLUSION**

As circumstances arise, such as adding a new service that will be provided by Corporate, appropriate changes will be made to the manual. Appendix A will be updated annually in February when the prior-year audited records are available, and Appendix B will be updated as Aviation Rates are changed.