Approved by ERE's Board of Commissioners Decision No 76, date 26.06.2008

REGULATORY ACCOUNTING MANUAL FOR THE ELECTRICITY LICENSED COMPANIES

Qershor, 2008

Prepared by: Electricity Regulatory Authority of Albania

I. Authority

Uniform System of Accounts (USOA) for the Electricity Distribution Company, according is established as per to the requirements of the Law nr. 9072, dated on May 23, 2003 "On Power Sector", as amended, as well as requests of the National and International Accounting Standards.

The purposes of Law nr. 9072, dated on May 23, 2003 "On Power Sector", as amended, and the Uniform System of Accounts for Regulatory.

(1) Article 23 of Law nr. 9072, dated on May 23, 2003 "On Power Sector", as amended, provides as follows:
"Any licensed power sector company, conducting more then one of the activities related to generation, transmission and distribution, will keep separate accounts for each of the activities in its inside bookkeeping unit and shall also prepare consolidated accounting statement and balance in conformity with require accounting practices. In addition, such integrated company will keep separated accounts for activities unrelated to generation, transmission and distribution activities".

(2) According to article 21 of the above mentioned Power Sector Law, ERE, within one year from the date this law enters into force, shall establish and adopt a uniform and standardised system of accounts for all the licensees in the electric power sector based on Albanian legislation and internationally accepted accounting standards. The annual financial and economic reporting to the ERE by all licensees shall be done according to this system.

The Uniform System of Accounts (USOA) developed by ERE for the licensed companies in power sector offers the framework of the rules for keeping separate accounts by the companies, including assets, equity, liability, revenues and expenses for the purposes of establishing prices under the appropriate tariff methodologies and monitoring the performance of the licensed companies .

Applicability of USOA

The system of accounts specified in the USOA for licensed companies in power sector shall be applicable to the licensed companies hereto, as per requests of the above mentioned Law.

II INSTRUCTIONS

A. General Instructions

1. Accounting Period

Licensed Companies will keep their books on a monthly basis so that for each month all transactions applicable thereto shall be entered in the books of the licensees for that same month. Amounts assignable to any of the licensees' functions shall be so segregated monthly. Each

licensee will close its accounts kept for regulatory purposes at the end of each calendar year unless otherwise authorized by the ERE.

2. Accounting Records

a) Licensees shall record in their accounting books, and preserve all other documents, records and memoranda, which support the entries in the accounting registers so as to be able to furnish at any time full information about any item/entry included in the accounting book. Each entry shall be supported by detailed information to permit easy identification, analysis, and verification of each transaction/operation.

b) Licensees shall preserve their accounting books for a period of 10 years.

c) Licensees may keep in addition to the accounting documents prescribed in the USOA clearing and temporary accounts, as well as subdivisions of the accounts prescribed in USOA, provided that the integrity of the information, which is required for regulatory purposes, is not impaired.

d) The arrangement of the accounts in the USOA will be used as data source for the regulatory reporting forms, elaborated by the ERE.

B. Accounting Policies for Regulatory Purposes

1. Funds

Funds received by the licensed companies shall be classified either as Funds Related to Assets or as Finances Related to Income.

Funds related to the assets of the company are resources transferred to the company under the condition that it will use them to purchase, construct or otherwise acquire fixed assets. Additional conditions may also be attached regarding the location of the assets or the periods during which they are to be acquired or used.

Funds, which are not related to assets, shall be considered as funds related to income.

Funds related to assets shall be presented in the balance sheet as deferred income, which is recognised as an income according to a rational and continual system which shall be applied for the period of the useful life of the asset. This way income from funds related to assets is allocated together with depreciation of the acquired asset.

Funds related to income shall be presented as obligations/borrowings in the income accounts, under a general heading "Other financial income".

All funds are described separately in the Appendices to the financial statements of the companies.

Assets constructed for the purposes of connecting a Consumer to the network and paid for in full by the Consumer shall be treated as funds related to assets. They shall be recorded and presented separately.

C. Categories and Structures of Assets

An asset shall be categorized as current whenever:

1. It is expected to be realized or is being held for the purpose of sale or use in the normal operating cycle of the enterprise;

2. It is being held primarily for commercial purpose or for a short period of time and it is expected to be realized within 12 months as from the date of the balance sheet; or

3. The asset in question is in cash or cash equivalents for which there are no restrictions as regards their use.

All other assets shall be classified **as non-current.**

The current assets include inventory and trade receivables that are being sold, utilized and realized as part of the normal operating cycle of the enterprise, even when it is not expected that the assets in question will be realized within the next 12 months as from the balance sheet date. Tradable securities shall be defined as current assets, if it is expected that the securities in question will be realized within the next 12 months as from the balance sheet date; in the opposite case they shall be categorized as non-current assets.

1 Assets Held for Future Use

Assets held for future use is the amount of assets that is not being used currently by the Licensee in the provision of service. In principle assets that qualifies for this category is limited to land and construction rights acquired by the Licensee. The time aspect of the acquisition plays an important role when deciding whether the property can qualify as asset held for future use. Assets held for future use may be included in the rate base only with the Regulator's approval.

2. Inventories

a. Cost of Inventories

Definitions:

Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of production cycle completion and the costs necessary to make the sale.

The inventories comprise materials and inventory on stock intended for use in the process of production and materials purchased and intended for sale.

Upon provision of services, the inventories comprise expenses for services for which the enterprise has still not recognized the related revenues.

The cost of the inventories represents the sum of all expenses related to purchase and processing, along with other expenses incurred in relation to their delivery to the present point of destination and state.

The costs of purchase of inventories comprise the sum of purchase price, import custom duties and other taxes (other than those which the enterprise may recover later on from the tax authorities), transport costs and other costs that may be attributed directly to the acquisition of the goods, materials and services.

The trade discounts and other similar components shall be deducted when calculating the purchase price.

Formulas:

The cost of inventories of specific items that are not interchangeable and also goods or services produced and segregated for specific projects should be assigned by using specific identification of their own costs. Specific identification of cost means that specific costs are attributed to identified items of inventory. This is an appropriate treatment for items that are segregated for a specific project, regardless of whether they have been bought or produced. However, specific identification of costs is inappropriate when there are large numbers of items of inventory, which are ordinarily interchangeable. In such circumstances, the method of selecting those items that remain in inventories could be used to obtain predetermined effects on the net profit or loss for the period.

The cost of inventories, other than those dealt with in the previous paragraph should be assigned by using the weighted average cost formulas. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the weighted average of the cost of similar items purchased or produced during the period. The average cost may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the company.

The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of production cycle completion or the estimated costs to be incurred to make the sale have increased. The cost of written down inventories cannot be higher than their net realizable value.

Inventories are usually written off to net realizable value on an item-by-item basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area. It is not appropriate to write inventories off based on a classification of inventory, for example, finished goods, or all the inventories in a particular industry or geographical segment. As a rule service providing companies accumulate costs in respect of each service for which a separate selling price will be charged. That is why each service is treated as a separate item.

3. Expenses Deferred pursuant to Regulatory Order

For pricing purposes the Regulator may ask the Licensees to treat (record and report) some categories of expenses in a way that differs from the way used by the financial accounting practice. In this case such expenses will be entered and reported as deferred regulatory expenses (placed in special accounts) and will be amortized/written down over a period of time. (These specific categories of accounts are usually excluded from the regulatory base.) Examples of such expenses are tariffing expenses, special research/study expenses and casualty related losses from uncontrollable circumstances like storms, floods, etc. In principle deferred regulatory expenses are unusual or one-time expenses.

4. Used and Useful Asset Test and Prudent Investment Test.

The licensees have the obligation to ensure that only assets that are used and useful, and prudently acquired, are included in the regulated asset accounts. The Regulator has the right to determine whether an asset was actually put in service, for what period has it been useful and whether itwas useful in providing the service indicated. If it proves that the asset does not satisfy the requirements the Regulator may decide to exclude the asset (fully or partially) from the regulatory asset base. This requirement is introduced to differentiate the set of assets needed to perform operations from excess capacity and consequently to satisfy prudent investment standards.

The Used and Useful Asset Test and Prudent Investment Test are used to determine whether the Licensee has exercised responsibility and strictness in the acquisition or construction of a particular asset based on the information it had and in light of the specific circumstances at the time of making the investment decision. If the asset fails to pass the test requirements the Regulator may decide to exclude it (fully or partially) from the regulatory base.

D Accounting Assessments for Regulatory Purposes

5. Asset Valuation for Pricing Purposes

The rate base in principle represents the value of assets used by the energy company in providing the related service. The licensees are given the opportunity to earn a specified rate of return (established by the regulatory commission) on the price base.

The fixed tangible assets shall be reported at cost of acquisition less accumulated depreciation and impairment, and the land and buildings at fair value.

The price base may be calculated under any one or a combination of the following accounting standards: historical cost, fair value, reproduction cost, or prudent investment. In the USOA, the licensed companies shall follow the method established for their assets by the ERE. The licensees will propose to the Regulator the valuation method to be used for each asset. Asset valuations based on historical cost shall ordinarily be presumed to be appropriate. Where asset valuations are based on reproduction cost or fair value, the portion of the value above historical cost may, if ordered by the Regulator, be subject to amortization on a schedule different than the depreciation schedule for the historical cost of the asset.

6. Depreciation and Useful Life of Tangible Fixed Assets

Depreciation and useful life of Tangible Fixed Assets are regulated by the International Accounting Standards (IAS) and specifically addressed in IAS 16, where the following definitions are provided:

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Depreciable Amount is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.

Useful life is either:

(a) The period of time over which an asset is expected to be used by the company; or

(b) The number of production or similar units expected to be obtained from the asset by the company.

Historical Cost (acquisition price) is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.

Residual Value is the net amount, which the enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

Fair Value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

Impairment Loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Carrying Amount is the amount at which an asset is recognized in the balance sheet after deducting the accumulated depreciation and accumulated impairment losses thereon.

IAS 16 also provides some recommendations on determining (defining) of "position of property" and assessing the useful life of assets.

Assessing the useful life of an asset:

a) Some items of property, plant and equipment require replacement at certain intervals. Such items (components) shall be accounted for as separate assets because they have useful lives different from those of the items of property, plant and equipment to which they relate. Therefore, provided the recognition criteria are satisfied, the expenditure incurred in replacing or renewing the item is accounted for as the replacement or acquisition of a new asset and the replaced asset is written off;
b) The depreciable amount of an item of property, plant and equipment shall be allocated on a systematic basis over its useful life. The depreciation method used shall reflect the pattern in which the asset's economic benefits are consumed by the enterprise. The depreciation charge for each period shall be recognized as an expense unless it is included in the carrying amount of another asset;
c) The useful life of an asset is defined in terms of the asset's expected utility to the enterprise. The following factors should be taken into account to determine the useful life of an asset:

- The extent to which the asset's capacity is used;
- The expected physical wear and tear, which depends on operational factors such as the number of cycles for which the asset is used and the repair and maintenance program of the enterprise and the care and maintenance of the asset while idle;
- Technical obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset;
- Legal or other factors preventing the use of the asset, such as the expiry dates of related leases, licenses, etc.

d) The useful life of an asset is defined in terms of the asset's expected utility to the enterprise. The estimation of the useful life of an item of property, plant and equipment is based on the experience of the enterprise with similar assets.

e) The useful life of an item of property, plant and equipment shall be reviewed periodically (at least once every three years) and, if expectations for the useful life of the asset are significantly different from previous estimates, the estimate and the depreciation charge for the current and future periods shall be adjusted.

f) In addition to the requirements set in the previous section, adjustments shall be made in any moment of the life of an asset if it becomes apparent that the estimate of the useful life is inappropriate. For example, the useful life may be extended by subsequent expenditure on the asset, or following the company policy for maintenance and repair, which improves the condition of the asset beyond its originally assessed standard of performance. And vice versa, technological changes or changes in the market for the products may reduce the useful life of the asset. In such cases, the useful life and, therefore, the depreciation rate shall be adjusted for the current and future periods.

g) The repair and maintenance policy of the enterprise may also affect the useful life of an asset. It may result in an extension of the useful life of the asset or in its faster wear and tear. Such policies may be encouraged by ERE through the method of revenue cap or price cap regulation. The adoption of such a policy does not negate the need to charge appropriate depreciation.

The Depreciation methods, to be used by licensees as per in the USOA, shall be consistent with the IAS. The licensees shall demonstrate to the ERE that it has complied with IAS principles. The ERE may require detailed justification of the assessment of the useful life, including statistical analysis supporting assessment, benchmarking, failure modes analysis, etc.

In estimating assets useful lives the licensees can use (a) general guidelines obtained from manufacturers, vendors, procurers and professional or industry organizations, (b) information for comparable assets of other electricity distribution companies, or (c) internal information. In determining estimated useful life, the licensed companies also should consider an asset's present condition and how long it is expected to meet service demands. It is important, that such general information be adapted to the licensees' specific circumstances. The following factors should be taken into account:

- **Quality and technical specification:** Similar assets may differ substantially in quality, and hence in their useful lives, because of differences in materials, design and workmanship. For example, a type SF6 110 kV breaker will not have the same useful life as a regular air-filled 110 kV breaker. Likewise, the materials used for paving purposes, the underlying base and coating, will affect the useful life of a highway.

- **Application** (expected level of use): The useful life of a given type of asset may vary significantly depending upon its intended use. For instance, the life of a motor vehicle used in customer service may differ from the life of the same type of vehicle used for general and administrative purposes.

- **Environment:** Environmental differences among licensees' service territories can have an important impact on the useful lives of their assets. For instance, the useful life of assets in the mountains is different from that of similar assets located in a temperate climate region.

The potential effect of each of these factors could be mitigated or exacerbated as a consequence of licensees' maintenance, repair and replacement policy. For example, the potential for transformer damage is increased if the transformer oil is not replaced regularly.

Estimating the useful life of an asset is not a one-time exercise. The licensees need to monitor their actual experience with capital asset lives and make appropriate changes to estimated useful lives based upon that experience.

In practical terms Licensees shall submit to the ERE special reports titled "Depreciation Study" containing the estimates on projected parameters of the useful life and depreciation rates of the assets together with their annual reports. The ERE shall review and approve the estimates using as a reference the probable and residual useful life used by other participants in the industry. The approved parameters shall be used by the Licensees during the useful life of each asset.

The probable and residual useful life of each asset submitted by the applicants shall be considered untrue by the Commission if:

1. Estimates do not correspond to industry standards;

2. Estimates differ from international guidelines, or

3. Estimates are contrary to previous decisions of the ERE in similar cases.

The ERE may consider appropriate the proposals submitted by the applicants, even if one or more of the above-referred circumstances are present, as long as the parameters proposed are properly justified and defended.

In the context of tariff proceedings, the ERE may revise the probable and residual life of some assets, and, if applicable, adjust the depreciation rates.

7. Categories and structure of Fixed Intangible Assets

The categories and structure of the fixed intangible assets have been designed in line with IFRS 38 – Intangible assets and further detailed for the regulatory accounting purposes.

The expenses for acquisition of licenses shall be capitalized and depreciated according to the linear method over the license term, and the other intangible fixed assets primarily for five years. The carrying amount of each intangible fixed asset shall be reviewed each year and, if necessary, a provision shall be recorded into the accounting books for impairment of the assets.

The assets reported in the above-mentioned accounts shall meet the following criteria:

1. Non-cash nature.

2. Verifiable.

3. May be distinguished from the goodwill.

4. May be sold, exchanged, leased out, etc. for the purpose of obtaining economic benefits from holding them in possession.

5. Are used for manufacture, services, administrative or other purposes.

The costs related to an intangible asset following its purchase or completion shall be reported as expense at the moment of their occurrence, except in the following cases:

1. Where it is likely that the expenses will help the asset to generate more future economic benefits compared to the initially planned ones.

2. Where these costs may be reliably estimated and attributed to the asset.

After the initial recognition, the intangible asset shall be reported at prime cost less the accumulated depreciation and possible accumulated impairment losses.

The depreciable amount of the intangible asset shall be distributed systematically on the basis of the optimum judgment about its useful life.

The depreciation shall start upon providing the asset for use.

Having in mind that the future economic benefits embodied in the intangible asset are consumed over time, the net book value of the asset shall be discounted to reflect such consuming. This shall be achieved through systematic allocation of the asset's prime cost or revaluated amount from which is deducted the residual amount, as an expense over the asset's useful life.

The depreciation shall be recognized regardless of whether there is or isn't increase of, for example, the asset's fair value or recoverable amount. A number of factors need to be considered when determining the useful life of an intangible asset:

1. The estimated benefit from the asset for the enterprise and whether the asset may be effectively managed by another management team.

2. The life cycles of a product typical for the asset and publicly available information with estimations for the useful life of similar assets used for similar purposes.

3. Technical, technological or other types of obsolescence.

4. The stability of the sphere within which the asset is functioning and the changes in the market demand of products or services generated by the asset in question.

5. Expected actions of competitors or potential competitors.

6. The level of expenses for maintenance needed to obtain future economic benefits from the asset and the capability and intention of the enterprise to reach this level;

7. The period of control over the asset and the legal or other limits to the asset's use, such as expiry dates of lease contracts.

8. The dependency or non-dependency of the asset's useful life on the useful life of other assets of the enterprise.

The assets' useful life shall be set in the enterprise's depreciation plan elaborated for all intangible assets and approved by the management.

The organization of synthetic accounting of the intangible assets is in direct relation to the content of each object. For regulatory accounting purposes the fixed intangible assets shall be reported in the usual accounts from Group 21 Fixed Intangible Assets, indicated with a three-digit code.

8. Categories and structure of Receivables

The receivables from clients shall be reported at their billing value, from which is deducted a provision for impairment. Provision for impairment shall be made if there is certain likelihood that the company will not be in a position to collect all amounts due pursuant to the initial conditions in relation to the respective estimations The impairment loss is the amount by which the carrying amount exceeds the recoverable amount which represents the present value of the cash flows, discounted with a market interest rate applicable for similar clients.

For regulatory accounting purposes the receivables shall be reported in the accounts from Group 41 Clients, indicated with a three-digit code.

8.1 Un-collectible Receivables (Bad debt)

Definition of un-collectible receivables

Un-collectible receivables shall be viewed as expense of selling on credit. The reason for that is that granting credit is considered an event that increases sales and revenues. The companies are often willing to incur bad debt losses that will prove un-collectible if the net effect to the business is increasing sales and profits. On the other hand the Licensees are generally "forced" to sell on credit because of technical character of the operation, therefore the licensees consider un-collectable receivables a needed sales cost.

Recording and reporting bad debt expenses under accruals accounting requires that the expense from bad debt be reported in the same accounting period as the revenue they are associated with.

The method used to record bad debt expense shall be referred to as "the allowance method of accounting for bad debt". Besides satisfying the requirements of the accruals principle the allowance method, which involves an estimate of the bad debt also ensures that the accounts receivable are reported on the balance sheet at their net realizable value. Thus recording and reporting bad debt may be viewed as a normal end-period receivables adjustment entry.

8.2 Recording the bad debt expense

Receivables provision by the allowance method involves a contra asset account called Allowance for Sales Receivable. The book entry is recorded with a debit to the Bad Debt

Expenses account and with a credit to the Allowance for Sales Receivable account. It should be noted that a contra asset account Allowance for Sales Receivable is used not only because it is always better to disclose the original amount of receivables but also because at the time of the adjusting entry the specific customer accounts and amounts in default are not known. Subsequently, customer accounts and amounts cannot be removed from the Accounts Receivable Ledger and therefore the controlling account for Accounts Receivable in the General Ledger (whose balance equals the total of all receivables recorded in the Accounts Receivable Ledger) cannot be credited with the bad debt total. Instead the Allowance for Sales Receivable account is credited. The credit balance of this account has the effect of reducing the Sales Receivable account to their estimated net realizable value.

On the balance sheet receivables appear as	
Sales Receivable	xxxx,xx
Less Allowance for Sales Receivable	xxx.xx
Sales Receivable at Net realizable value	xxxx,xx

The different ways to produce an estimate of the bad debt are prescribed in section D. below.

8.3 Identification and writing off of a specific Sales Receivable account

When specific customer Sales Receivable accounts are identifiable as un-collectible they are credited against debiting with the Allowance for Sales Receivable account. Posting the credit entry to the customer's specific Sales Receivable Account removes the amount of bad debt (writes the account off) from the Sales Receivable Ledger and therefore removes it from the General Ledger controlling account. Notice the following important moments: First, though a certain customer's account writing off is treated as an expense, it is the Allowance for Sales Receivable that is debited. This is because the estimated total bad debt expense was previously recorded as an expense by receivables adjustment at the end of the period in which it occurred. Second, although the write-off removes the amount of account receivable from the ledgers it does not change the amount of net realizable value of accounts receivable (because the balance of the Allowance for Sales Receivable account is reduced by the same amount).

In the instances where the licensed company collects an amount that was previously written-off it shall make two accounting entries. The first shall reverse the original write-off and reinstate the customer's account. The second shall record the collection of the reinstated account.

8.4 Estimating bad debt

Income Statement method (Percentage of Sales)

The method assumes that there is a fairly regular relationship between previous period's sales and bad debt amount. This relationship is converted to a percentage and used to determine the year's bad debt expense.

Balance Sheet method (Percentage of Outstanding Receivables)

The method assumes that there is a fairly stable relationship between the age of outstanding receivables and bad debt. This relationship is converted in a series of percentages for the different age groups (30, 60, 90 and 180-day receivables) and used to determine the bad debt expense for the period as the sum of the un-collectible amounts calculated using these

percentages. The percentage for each age group shall be based on statistical information. In general the percentage of un-collectable amounts increases with the age of the receivables.

This method is widely used and is considered more accurate. It must be noted, however, that it violates the accruals principle; therefore it is not recommended for monthly and quarterly statements.

The Licensed Company should clearly indicate what method it has used to record bad debt in its accounts. The Regulator may require the company to use a different method.

9. Working Capital

In general the working capital represents the capital investment provided by the owner during the interval between incurring expenses of providing service and receipt of revenues from customers.

The regulatory base shall include working capital in the form of a Working Capital Allowance (WCA) covering such elements as cash and minimum bank balances, materials, prepayments, and tax payments. The working capital allowance shall be enough to bridge the gap between the time when costs in providing the service are paid for and the time the utility is paid for that service.

The Licensee shall submit a study justifying his working capital requirements. The working capital allowance shall be determined based on the average amount of investor-financed capital (equity, borrowings or earnings retained in the business) necessary to finance the utility's working capital requirements. The licensed company shall propose to ERE its preferred method for calculating the WCA. The ERE may require a different method if the ERE concludes that the method proposed by the licensee does not fairly represent the its working capital requirements.

The most accurate, and therefore the most complex method of determining working capital requirements is the so called performance of a "lead-lag" study. This is a comprehensive task conducted to compare the difference in the timing lead or the timing lag between cash inflows and outflows. The study requires detailed analysis of company expenditures to determine the time at which the enterprise actually must pay for its expenses and compares this with the time at which it receives payment for those expenses. The time difference under the lead and lag method is then multiplied by the average daily operating expenses to arrive at the required level of working capital for inclusion in the regulatory base.

An alternative to this method is to estimate the appropriate level of working capital using income statement and balance sheet information on the average level of inventory, the average daily level of expenses incurred by the Licensee (including operating, maintenance, administrative and general, taxes, etc.) and the interval between cash outflow and inflow.

The working capital allowance (WCA) is the sum of two components: Cash WCA and Materials and Supplies WCA. Cash WCA shall include Petty Cash WCA and Minimum Bank Balances.

Cash WCA is an estimate of the investor-supplied cash to finance the pre-defined Allowance for Utility Operating Costs (AUOC) in the period in which operating income is collected. The best way to determine Cash WCA is through a lead-lag study. The lead-lag study usually ignores the lag in recovery of non-cash expenses (depreciation, etc.) deferred taxes etc.

A lead-lag study will be performed in accordance with the following criteria:

i The lead-lag study will use the cash method; all non-cash items, including but not limited to depreciation, amortization, deferred taxes, prepaid items, and return (including interest on long-term debt and dividends), will not be considered.

ii Any unbiased method may be used in performing the lead-lag study.

iii The payment order date or the invoice due date will be used for the lead-lag study purposes. In those cases where multiple due dates are offered by vendors/suppliers, the invoice due date is the date corresponding to the terms accepted by the licensee.

iv All funds received by the electric utility except electronic transfers shall be considered available for use no later than the business day following the receipt of the funds in any repository of the licensee (post offices, branch offices, etc). All funds received by electronic transfer will be considered available the day of receipt.

v For the licensee the balance of cash and working funds included in the working cash allowance calculation shall consist of the average daily bank balance of all non-interest bearing demand deposits and working cash funds.

vi The lead on income tax expense shall be calculated by measurement of the interval between the mid-point of the tax period and the actual tax payment date of the licensee.

vii If the cash working capital calculation results in a negative amount, the negative amount shall be included in the regulatory base.

Petty cash WCA and Minimum Bank balance shall be added to the amount determined by the lead-lag study.

Materials and Supplies WCA shall include reasonable inventories of materials, supplies, and fuel held specifically for guaranteeing efficient operation of the licensed company in providing normal electric utility service. The Licensee shall bear in mind that any amounts of inventories, found by the commission to be unreasonable, excessive, or not in the public interest shall be excluded from the Materials and Supplies WCA.

When justifying the amount of inventories the Licensee shall take into account all inventory costs: carrying costs (storage and handling costs, insurance, property taxes, depreciation, and obsolescence); ordering costs (cost of placing orders, shipping and handling costs); costs of running short (disruption of production schedules and customer dissatisfaction).

D Liabilities categories and structure

A liability shall be categorized as current whenever:

1. It is expected that the liability in question will be settled within the normal operating cycle of the enterprise.

2. It should be settled within 12 months as from the date of the balance sheet.

All other liabilities shall be classified as non-current liabilities.

The current liabilities shall be classified similarly to the current assets. Current liabilities such as trade payables and accrued payables to staff and payables for other operating expenses represent part of the working capital utilized in the normal operating cycle. Such operating article shall be classified as current liabilities, even if they should be settled within a period longer than 12 months as from the date of the balance sheet.

Current liabilities are also those payables that are not settled within the usual operating cycle but should be settled within 12 months as from the date of the balance sheet.

The enterprise shall categorize its long-term interest payables as non-current, even if they should be settled within 12 months as from the date of the balance, if:

1. The initial term for the settlement has been longer than 12 months.

2. The enterprise intends to refund the payable in question on long-term basis.

3. The intention is backed up by a refunding agreement or an agreement for change in the payment arrangements concluded prior to the date of approval for issue of financial statements.

The loans shall be recognized initially up to the amount of the revenue, without including the expenses on the loan. Subsequently, the loans shall be reported at depreciated historical value using the effective profitability method; the differences, if any, between the revenue (without the expenses on the loan) and the pay-off amount shall be recognized in the Income Statement according to the payback plan.

The long – term loans should be used to finance capital expenditures for repair and renovation of existing asets, but should not be used to cover operating expenses.

For regulatory accounting purposes the payables shall be reported in the accounts from Group 40 Suppliers, indicated with a three-digit code.

10 Categories and structure of Operating Expenses

The Chart of Accounts structure has been further detailed for regulatory accounting purposes and permits, where necessary, to extract additional information, beyond the classification for reporting included in the Income Statement of the power generation companies for the purposes of the regulatory mechanism.

The companies shall prepare their financial statements, except the statements related to the cash flows, on the basis of the accruals principle.

Upon accounting on the basis of accruals principle, the operations and events are recognized at the moment of their occurrence and not when cash or cash equivalents are received or paid, and are entered into the accounting books and are reported in the financial statements for the relevant period.

The expenses and recognized in the Income Statement on the basis of the direct link between the incurred expenses and the revenues of particular income carriers (comparison). The application of the principle of compatibility, however, does not permit to recognize those items in the balance sheet which do not match the definition for asset or liability; the expenses are not recognized as assets in those cases where they can not be compared with specific revenues in follow-up reporting periods. Revenues shall not be recognized as liabilities in the instances where in a follow-up reporting period will not be generated expenses against them.

The expenses by economic elements shall be reported in the accounts from Group 60 Expenses by economic elements, and the Operating expenses shall be reported in the calculative accounts from Group 61 Operating expenses.

11. Un-Audited Items

Whenever a financial statement is required by ERE, if it is known that a transaction has occurred which affects the accounts but the amount involved in the transaction and its effect upon the accounts cannot be determined with absolute accuracy, the amount shall be estimated and such estimated amount included in the related accounts. The utility is not required to anticipate minor items, which would not appreciably affect the accounts.

12 Cost Allocation

The methodology for classification of costs is in accordance with USOA. A major requirement is clear differentiation and financial separation of regulated from non-regulated activities of every energy company. USOA comprises the following costs classification:

- By functions
- By nature
- By groups of consumers
- By voltage levels

The methodology for classification of costs by functions in accordance with the functional expense accounts prescribed in the USOA shall be based on engineering, economical and statistical analysis. The licensed company shall assign costs to certain services or certain rate classes, so as to secure that the total expense or a share of an expense is assigned to the related class. In the absence of detailed timesheets (tracking job costs) the licensee shall propose certain type of allocation of labor costs and shall be prepared to justify it to ERE.