



Prishtina, 15/08/2016

Comments on DH Termokos Tariff Application for season 2016/2017

Introduction

Energy Regulatory Office (ERO), within its duties and activities, has started District Heating tariffs review for DH Termokos for season 2016/2017; regarding this, on 1 July 2016, a notice-letter was sent to DH Termokos on commencement of tariff review for season 2016/2017 and “Implementation Plan and Schedule”. Following this, on 4 July, a request was sent to DH Termokos, containing data and information on tariff review, specifying the data, information and documents that DH Termokos shall submit for tariff review. On 25 July 2016, DH Termokos submitted, via email, the tariff application containing the required data and information. In this document, comments were given on the tariff application content in general, as well as the content of each document submitted within the application. Comments are related to completion/non-completion of application, stating which documents have been submitted and which should have been submitted. Further, the comments elaborate the application in general and provide instructions on correctness of documents contained in tariff application, and also, following the evaluation of each submitted document, necessary corrections, information and additional explanations are required.

Tariff Application Content

The tariff application, submitted electronically on 25 July 2016 by DH Termokos, contains the following documents:

- 1) Regulatory Statements with forecasted data and information for heating season 2016-2017:
 - a) Statement A of Operative Assets – forecasted data on fixed assets;
 - b) Statement B of Revenues and Expenses- forecasted data on revenues and costs (expenses);
 - c) Statement C of Billing and Collection –data and information on heating area, customer billing and collection;
 - d) Statement D of Investments –data and information on planned capital investments;
 - e) Statement E- Technical – forecasted data on thermal energy balance, as well as technical and customer data (assumptions on calculation of real heating demand, heating production and supply, and estimated heating area).
- 2) Audit Report and Statutory Financial Statements for 2015- submitted on regular annual/seasonal reporting:
 - a) Profit/Loss Statement (Success Balance);
 - b) Balance Sheet;
 - c) Cash Flow Statement; and
 - d) Equity Changes Statement.
- 3) Other data and information and additional documents:



- a) List of substations - data on heating area and respective capacities, as well as other technical data;
- b) List of assets –detailed data on fixed assets where the initial value (of purchase), cumulative depreciation and current asset value (submitted on regular annual/season reporting) are given;
- c) Planning for new connections for season 2016/2017;
- d) Planning on customer billing based on metered supply/consumption;
- e) Registered metering for thermal energy produced by cogeneration (submitted on regular annual/seasonal reporting);
- f) Data on customer billing based on metered consumption in the last season 2015/2016;

Comments on Tariff Application Content

Tariff Application submitted by DH Termokos is completed to some extent and is in compliance with ERO's requirements. However, some deficiencies were noticed regarding the details and extra explanations on main data and additional documents, which can be summarized as follows:

- Details on forecasts of thermal energy production, such as: engaged capacities, thermal energy amounts, and respective network losses;
- Detailed technical data and main descriptions of investment/development projects;
- Data on registration of supply measurement reading at thermal substations (in all substations where functional meters exist);
- Detailed disclosure and respective explanations for main components of forecasted Regulatory Statements;

Comments on each document submitted at ERO

- 1) Regulatory Statements with estimated data and information for heating season 2016-2017:

Initially, it should be emphasized that in all regulatory statements you have written the reporting period 15 October- 15 April. As stated in our requirements, the forecasts shall include the one year period which includes full heating season- therefore 15 October 2016- 14 October 2017. We understand the fact that due to the nature of the service, the majority of costs are incurred during heating season, however, given that DH Termokos operates during the entire year, the forecasts shall include the whole one year period.

- a) Statement 'A' of Operative Assets – forecasted data for fixed assets;

In statement A are presented assets in their initial value (cost of purchase), and cumulative depreciation and current value (Net Book Value) are given as well. The assets are presented according to licensing activities: generation, distribution and supply, and common assets. The forecasted Net Book Value is €40,827,339 which represents an increase of € 6,607,934 compared to the value of assets in the period June 2016 (€34,219,405). This increase approximately complies with the value of planned investments for the period in question (€ 6,743,640). Therefore, it can be concluded that Statement A was completed in the right manner and data forecast is real.



However, this statement was not accompanied with details on calculation of main factors, where details on calculation of depreciation are especially necessary.

b) Statement B of revenues and expenses- forecasted data on costs and revenues.

- Cost of thermal energy production, namely fuel cost- heavy fuel oil, in DH Termokos is not provided. Regardless that heating plants are forecasted to be used only in the event of outages/defects in TPP Kosova B, you shall forecast the fuel amount- heavy fuel oil for a reasonable period, as well as the price per ton which would result the cost of heavy fuel oil for thermal energy generation in Heating. Given that in Statement 'E' you have forecasted the amount of heavy fuel oil of 1,000 ton and the amount of 10,170 MWh of thermal energy generation in Heating, you have not presented the respective cost.
- For cost of thermal energy from cogeneration is presented the amount of € 1,134,263, which represents an increase of around € 46,000 compared to last season, which is considered a justifiable increase due to the increase of planned heating area. However, you shall provide details on calculation of this cost; these details shall be provided separately for capacity component based on capacity reservation according to Energy Balance and thermal energy quantity component based on forecasted consumption. Normally, applicable electricity tariffs shall be taken as a basis for this calculation, as described in Annex 4 of Heat Supply Agreement between KEK and DH Termokos.
- For electricity cost was presented the cost of € 550,000, which represents a significant increase of around € 125,000 compared to the cost realized in the last season (€ 425,000). Given that this represents a considerable increase, it is necessary to provide a justification and an explanation for it.
- Staff cost, in the total amount of € 788,193 also represents an increase of around €108,000 compared to staff cost realized in the last season. Regarding this, we shall firstly express our reserves regarding the reporting period, since there is a considerable discrepancy between the value of this cost in Regulatory Statements and Statutory Financial Statements for calendar year 2015 (€ 1,241,140). However, you need to provide details on calculation of this cost by giving the number of employees, average salary and other elements of staff cost, such as contributions/taxes etc. You should also provide respective justifications for the forecasted increase.
- With respect to "Sales and other administrative costs" was presented quite a high amount of € 700,000, and no further details about sub-components under this heading are provided. In the last season this cost was € 529,771, where the main part belonged to sub-component "cost related to the provision of accounts receivable" in an amount of €458,263. Regarding this, we want to inform you that pursuant to provisions of Thermal Energy Pricing Rule, ERO determines/ allows a reasonable share of bad debts level.

c) Statement 'C' of Billing and Collection- forecasted data on heating area, billing and collection.

- From our analysis is noticed that the overall heating area has increased for 102,467 m² from the last season. But, this amount is twice higher than plannings of new connections regarding which you declared the area of 45,865 m². We assume that reactivation of a



number of so-called passive customers is included as well. Please, provide explanations and details on calculation of forecasted heating area.

- In accordance with the forecasted increase of heating area, you have fairly forecasted the increase of billing and collection level. Forecasts on increase of collection from 45.6% in the last season to 60% for household customers, and increase of collection level from 81.7% to 85% for commercial and institutional customers, are quite real and reachable if you continue with the improvement of heating supply service and increased efforts on efficient collection.

d) Statement 'D' of investment expenses– planned capital investments

The planned investments that you presented were accompanied by relevant explanations for financing manner, where it is noticed that the majority of investments is planned to be financed by international organizations/institutions (KfW and European Commission) and a small share self-financing by the enterprise. The accompanying explanations do not contain other details of presented investment projects. In order to have a real determination of Regulatory Asset Base, a small description of investment/development projects is required, where main components of the projects shall be presented as well as the plan for their execution.

e) Technical Statement 'E'- forecasted data on thermal energy balance, as well as technical and customer data.

In general, the data presented in this statement can be evaluated as real and well-grounded. However, during our analysis, we noticed two errors in calculation. Under heading '11': Thermal Energy Net Production, you have calculated the amount of 255,865 MWh- we think that the correct value is 254,735 MWh; this error is then reflected in the headings '13-16'. ii) Heading '20' Full Load Hours and '21' Heating Demand are wrongly calculated- exceedingly increased values. Please, make respective corrections.

2) Audit Report and Statutory Financial Statements for 2015

Statutory Financial Statements for 2015: " Financial Position Statement", "Comprehensive Revenues Statement" Cash Flow Statement and Statement on Changes in Equity", are included in the independent Audit Report and approved by management of the enterprise and signed by competent officials. There is no additional comment.

3) Other additional documents :

a) List of substations- data on heating area and respective capacities, as well as other technical data;

List of substations contains sufficient detailed data on heating area connected to each substation, respective capacities, status (active respectively passive), technical data and division by districts and customer groups are given as well. During the analysis of this list, a discrepancy was noticed in heating area compared to data presented in Statements 'C' and



'E'. In fact, the total heating area presented in the list of substations is 1,325,829 m² whereas in Statements 'C' and 'E' is 1,221,480 m² –therefore a difference of approximately 100.000 m². By assuming that “passive customers” are also included here, we evaluated the area of passive customers, but under grouping “residential” is only one substation categorized as “passive” with an area of 7,569 m². Also, at the end of the list, under grouping “institutional” are presented a number of “passive” substations with an area of 23,456 m² but their heating area is not presented. Therefore, in total there is an area of around 31 thousand m² of area categorized as ‘passive’. Please provide explanations, namely relevant explanations on this discrepancy and make required corrections.

- b) List of Assets –detailed data on fixed assets where initial value (of purchase), cumulative depreciation and assets current value are given.

List of Assets provides a comprehensive and detailed statement of fixed assets, where all assets are given with short description (labeling), date of purchase, initial value (of purchase), cumulative depreciation and current value (net book value after subtraction of cumulative depreciation). Also, the assets are grouped according to departments of the enterprise.

The major remark is related to assets from cogeneration project which are registered as a total amount of € 28, 198,580- without division in ordinary asset categories- and are divided under the sub group “DH Termokos”. These assets are required to be categorized in ordinary categories such as: plants and equipment, pipelines and network fittings, etc. Approximately, the same remark is given in the independent Audit Report (“ Basis for qualified opinion” item ‘1’).

Also, investment project assets of network and substations rehabilitation are registered as “ongoing investments” in a total amount of € 4,133,033 and are placed under the group “DH Termokos”. Regarding this, it shall initially be emphasized that, according to regulatory practices, the assets are accepted in Regulatory Asset Base when they are realized and set-in-operation. We inform you that these can be included in Regulatory Asset Base as New Investments.

Given that the List of Assets serves as a basis for determination of Regulatory Asset Base, the above mentioned comments shall be addressed by you.

- c) Planning for new connections for season 2016/2017

Sufficient detailed data presented in tabular form- no comments.

- d) Planning for customer billing based on metered supply/consumption

Except the data on heating area and capacity, in this table, for some facilities/customers are presented the figures of thermal energy meters and registration of consumption metering, whereas this data does not exist for others(meter figure and consumption registrations). Please, provide explanations whether these facilities/substations currently are equipped with thermal energy meters.



e) Registered measurements for thermal energy from cogeneration;

No comments

f) Data on customer billing based on consumption metering in the last season 2015/2016

No comments

Note:

These comments were given with the purpose of correction and completion of tariff application in accordance with specific requirements presented therein.

Prepared by:

Thermal Energy and Gas Department (TEGD)