Energy Regulatory Development in Bulgaria

Contract No. EEU-I-00-00-00029-00
Task Order No. 804

FINAL REGULATORY ACCOUNTING MANUAL FOR THE ELECTRICITY DISTRIBUTION COMPANIES

June 2004

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FINAL REGULATORY ACCOUNTING MANUAL FOR THE ELECTRICITY DISTRIBUTION COMPANIES

I. Uniform System of Accounts (USOA) for the Electricity Distribution Companies, according to the requirements of the Energy Act

A. The Energy Act and the Uniform System of Accounts for Regulatory purposes.

The Energy Act of the Republic of Bulgaria provides as follows:
(1) Energy companies shall keep separate accounts for:
a) each activity, which is subject to licensing under this act;
b) activities, which are subject to licensing under this act, and other activities;
c) each industrial branch or company;
d) activities, performed at regulated or freely negotiated prices; and

(2) The rules for keeping separate accounts by the energy companies, including assets for the purposes of pricing by groups of consumers, as well as the form and content of the financial statement for regulatory purposes are set with a decision of the Commission under the terms of the ordinances under Article 36, paragraph 3.

The Uniform System of Accounts (USOA) developed by SERC for the EDC offers the framework of the rules for keeping separate accounts by the EDC, including assets, equity, liability, revenues and expenses for the purposes of pricing by groups of consumers.

B. Applicability of USOA

The system of accounts specified in the USOA shall be applicable to all licensed EDCs, which are obliged to adhere to the State Energy Regulation Commission's regulatory accounting requirements in accordance with the Energy Act.

II. INSTRUCTIONS

A. General Instructions

1. Accounting Period

Each EDC shall keep its books on a monthly basis so that for each month all transactions applicable thereto shall be entered in the books of the EDC for that same month. Amounts assignable to any of the EDC functions shall be so segregated monthly. Each EDC shall close its accounts kept for regulatory purposes at the end of each calendar year unless otherwise authorized by the Commission.

2. Accounting Records

a) Each EDC shall record in its 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) Each EDC shall preserve its accounting books for a period of 7 years.

c) Each EDC 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 the integrity of the information, which is required for regulatory purposes is not impaired.

d) The arrangement of the accounts in the USOA shall not be governing the arrangement of accounts in the regulatory reporting forms, elaborated by the SERC.

B. Accounting Policies for Regulatory Purposes

2. Finances

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

Finances 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.

Finances, which are not related to assets, shall be considered as finances related to income.

Finances 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 finances related to assets is allocated together with depreciation of the acquired asset.

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

All finances 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 finances related to assets. They shall be recorded and presented separately.

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.

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. Deferred Regulatory Expenses

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 customary or one-time expenses.

Used and Useful Asset Test and Prudent Investment Test.

This test is used by the Regulator 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.

4. 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. It is usually limited to 10 years.

C 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 energy company is given the opportunity to earn a specified rate of return (established by the regulatory commission) on the price base.

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. The commission establishes the standard to be used for pricing purposes.

a. Asset valuation methodologies

The Historic or Depreciated Cost of Acquisition (DCA) methodology values assets at their original cost of acquisition. The advantages of this methodology are that it is administratively efficient and can be easily audited because the data should be available from financial statements. It is relatively inexpensive since it does not require expert assessments and it is objective because it is based on actual data rather than judgment. It is being used by an extensive number of Regulators.

The disadvantages of this method are: it may understate asset prices in periods of high inflation or it may overstate asset prices in periods of rapid branch reconstruction. Secondly, it may lead to unstable prices (e.g. prices may rise when expensive assets replace existing assets). Thirdly, data may not be available or may be inadequate.

The Replacement Cost methodology is based on calculation of the cost of replacing an asset with another asset (not necessarily the same) that will provide the same services and capacity as the existing asset. Advantages of this method are that assets are valued in current prices and it provides an incentive for efficient investments as it allows the Regulator to reduce the recognized asset cost once it becomes aware that an alternative asset is available at a lower price.

The disadvantages of this method are that it involves estimation and judgment. Besides, the information is more difficult and expensive to collect because it requires expert involvement (e.g. from engineers). Also assets may be overvalued. Finally, this method may lead to price instability if product prices are unpredictable.

Optimized (Depreciated) Replacement Cost (ODRC) is a variant of the previous methodology. It reflects the cost of the most efficient method of providing the services of the current asset.

Optimized replacement cost has the advantage that asset value can be adjusted/updated where, for example, the service capacity of assets is in excess to requirements as a result of changes in demand or over investment in past periods. A disadvantage of this method is that it involves an undue degree of judgment and expert consultation.

Deprival Value (DV) is a method where the minimum loss that would result if the business were deprived of the asset is assesses. For example, where the asset can and should be replaced, the deprival value is the replacement cost. If the asset would not be replaced, then the deprival value is the greater of the net present value of expected cash flows from continued use of the asset or the net realizable value of retiring/selling the asset. In other words, it is the minimum of an asset's replacement cost or its real market value.

$DV_t = \min\{RC_t , EV_t\}$

where RC_t= replacement cost of the asset;

$EV_t = \max\{PV_t , NRV_t\}$;

PV_t= present value of future income streams; and

NRV_t= net realisable value, e.g. the amount the asset could be sold for.

Optimized Deprival Value (ODV) is a variant of the deprival value(DV) approach. It takes into account the most efficient method of providing the asset's services if the asset is to be replaced. The formula for ODV is the same as for DV except it uses the optimized replacement cost.

$ODV_t = \min\{O(D)RC_t , EV_t\}$

where $O(D)RC_t$= optimized (depreciated) replacement cost of the asset.

An advantage of this method is it prevents to a certain extent inefficient investment because regulators will be in a position to revalue inefficient assets down to their optimized (depreciated) replacement cost.

A disadvantage of any method based on optimization is that it requires expert engineering assessment, which increases the complexity and cost of the valuation. The valuations may also be subject to legal challenge.

Both deprival value and ODV methods are criticized as introducing a circularity problem. This is because if the asset would not be replaced, DV and ODV require an estimation of the future returns on the asset, which is made by a special mechanism set by the Regulator.

The Scrap Value method evaluates an asset on the basis of the value of the asset in its next best alternative use. The scrap value of unusable assets with no alternative use, will be close to zero. If an asset is valued below scrap value, it will be better (economically expedient) to transfer the asset to a possible alternative use.

Scrap value method is good for valuation of the lower limit of an asset. However, it is considered unfair as the return on the investment may be below the cost of capital. Another disadvantage is it may not provide incentives for future investment.

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 SERC through the method of revenue cap regulation. The adoption of such a policy does not negate the need to charge appropriate depreciation.

Depreciation methods based on assets useful life, determined by SERC, will 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 SERC 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, EDC 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 EDC specific circumstances. We specifically emphasize the need to take into account each of the following factors:

- 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 EDC 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 EDC 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. EDC's 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 Commission 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 Commission 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 notoriously differ from international guidelines, or

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

The Commission 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 five-year period referenced in the Tariff Ordinance, the Commission may revise the

probable and residual life of some assets, and, if applicable, adjust the depreciation rates.

Estimating the useful life of assets is closely connected with determining the "items of property." As a result of the diversity among utilities, there is considerable, and completely justifiable, diversity in the "items of property" determined. We do believe it would be appropriate for the SERC to impose a "standard list of property items" to be used for regulatory accounting purposes. Of course SERC may allow certain degree of flexibility in relation to the list, so long as the approach is reasonable and consistently applied.

5) Un-collectible Receivables (Bad debt)

A. 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 EDC's are generally "forced" to sell on credit because of technical character of the operation, therefore EDCs 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.

B. 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.

C. 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 EDC 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.

D. 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.

6. 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 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 EDC.

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 EDC (post offices, branch offices, etc). All funds received by electronic transfer will be considered available the day of receipt.

v For EDCs 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 EDC.

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 EDC 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).

6. Un-Audited Items

Whenever a financial statement is required by SERC, 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.

7. 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 electricity distribution 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) EDC shall propose certain type of allocation of labor costs and shall be prepared to justify it to SERC.