



LESOTHO ELECTRICITY AUTHORITY

**TARIFF FILING AND REVIEW
PROCEDURE FOR ELECTRICITY AND
WATER TARIFF APPLICATIONS**

Tariff Filing and Review Procedure, February 2012

Tariff Filing and Review Procedure

This Tariff Filing and Review Procedure (the Procedure) version number [1] were approved by the LEA Board at *Meeting No.48 of the 24 February 2012*.

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Definitions and abbreviations

Definitions provided in the LEA Act, its amendments, any Rules and Regulations issued in accordance with this legislation apply equally to this Procedure. Additional definitions used in the Procedures include:

Authority	The Lesotho Electricity Authority or Lesotho Electricity and Water Authority
Board	The Authority's Board
CAM	Cost Allocation Manual for the respective licensee approved by the Authority
Control Period	The period over which multi-year tariff formulae is adopted (for example, 2012/13 to 2016/17)
LEA	Lesotho Electricity Authority
LEC	Lesotho Electricity Company
LEWA	Lesotho Electricity and Water Authority
M	Maloti
RAB	Regulatory Asset Base
RAGs	Regulatory Accounting Guidelines approved by the Authority
RAV	Regulatory Asset Valuation
WACC	Weighted Average Cost of Capital
WASCO	Water and Sewerage Company

1. Introduction and purpose

The purpose of this Procedure is to provide a clear, consistent set of steps that will be followed by staff of the Authority in reviewing tariff submissions and making recommendations to the Board regarding the approval or modification of tariffs proposed by the regulated entities.

The primary legislation allows the Authority only [*three*] months to review and respond to tariff submissions by licensees. *{The LEWA amendment act extends the previous one month to three months.}*

The Procedure also informs the regulated entities in the electricity and water & sewerage sectors on the steps that will be taken by the staff of the Authority and thereby encourage them to prepare their submissions in such a way that avoids delays.

The Procedure will be used for:

- o Review and approval of single-year tariffs,
- o Review and approval of the formulae for multi-year tariffs before the start of a Control Period, or
- o Review and approval of multi-year tariffs within a Control Period.

This Procedure assumes that other procedures adopted by the Authority relating, for example, to the registration and acknowledgement of documents received from licensees or the public or to public hearings, are adhered to; it does not repeat those administrative procedures.

2. Legal basis for tariff reviews

This Procedure is consistent with the primary and secondary legislation listed below. Additional rules and regulations may be issued from time to time and, if necessary, the Procedure will be amended for consistency with the new regulations or rules.

1. Primary legislation:

- a. LEA Act 2002, Section 24, as amended.

2. Secondary legislation:

- a. LEA (Electricity Price Review and Structure) Regulations 2009

3. Licences:

- a. Licences for regulated entities.

This procedure also refers to the Authority's Electricity Charging Principles and Tariff Design (the Charging Principles) and any other related guidelines that may be developed (Regulatory Accounting Guidelines (RAGs) and licensees' Cost Allocation Manual (CAM) and Auditing Procedures, etc).

3. Confidential Information

It is the duty of the licensee to bring to the attention of the Authority all the information that must be treated as confidential in the application. Though the onus of proving confidentiality lies with the licensee, the decision to grant such confidential treatment remains the prerogative of the Authority.

4. General Requirements

Any tariff application submitted to the Authority for consideration and/or approval must include, or make reference to, the following:

- A brief and precise executive summary of the application;
- A statement (or status of the application) detailing the basis for the application;
- All costs and revenues to be disaggregated into regulated business, non-regulated business and corporate entity;
- Regulated business for electricity must further be disaggregated into transmission, distribution and supply;
- A statement on assumptions (economic, financial, social, volumes, etc) taken into account in preparing the application;
- An explanation to all the data (amounts, statistics and volumes) supporting the application;
- Statement on the treatment of affiliate businesses and related parties (if any);
- All data (amounts and volumes) must be submitted in MS Excel format;
- All other documentation submitted must be in an agreed format between the Authority and the licensee, with a PDF submission being the official application submission; and
- Duly filled data templates attached to this procedure.

5. Single-year tariff Review Procedures

This section of the Procedure deals with a review of tariff submissions that do not form part of a multi-year tariff arrangement and that are submitted on an annual basis. Normally they will be submitted to the Authority annually but the tariffs could cover periods of more or less than 12 months and may or may not include a formula allowing automatic indexation to some major cost items. The distinction between a multi-year tariff and a single-year tariff is therefore more related to the complexity and length of the arrangement than just to the time period.

Throughout the tariff review and approval process the Authority shall, when reviewing the data and forecasts submitted by the licensee, ensure that cost allocation methodologies that have been approved by the Authority (in the licensee's Cost Allocation Manual) have been followed.

5.1. Validation of the content of submissions

The Authority shall check the content of submissions to ensure that all important information has been submitted. Some of the information may have been provided by the licensee with routine data provided to the Authority and if this is the case then there is an obligation on the licensee to indicate in the tariff submission when and how that information had been provided.

Some of the information may be provided to the Authority in the model templates of the *Economic and Financial Regulatory model*.

The data to be provided should include:

Table 1 Initial submission review - checklist

Item	Received	Not Received
1. Past accounts		
Regulatory accounts for the year before (i.e., if the submission is made in March 2012, regulatory accounts should be provided for 2010/11)		
Reconciliation of outturn regulatory accounts against forecasts used in the tariff submission relating to the year before (i.e., if the submission is made in March 2012, regulatory accounts should be reconciled for 2010/11)		
Management accounts for the year up to the date of the submission (i.e., if the submission is made in		

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Item	Received	Not Received
March 2012, management accounts should be provided for the year 2011/12 up to February 2012)		
Budget approved by the Board for the tariff year (i.e., if the submission is made in March 2012, the budget should be provided for the year 2012/13)		
Reconciliation of the outturn management accounts against budget and against forecasts used in the tariff submission relating to the year-to-date (i.e., if the submission is made in March 2012, the reconciliation should be provided for the year-to-date 2011/12)		
2. Sales data		
Statistics on volumes for the year before including MWh or m ³ sales by customer category and in total, MWh received by the transmission system (electricity), losses, system maximum demand (MW for electricity or m ³ /day for water) (i.e., if the tariff submission is made in March 2012, the statistics should be provided for the year 2010/11)		
Reconciliation of outturn volume sales against forecasts used in the tariff submission relating to the year before (i.e., if the submission is made in March 2012, sales should be reconciled for 2010/11)		
Volume statistics (as above) for the year up to the date of the tariff submission		
Reconciliation of the outturn volume sales against budget and against forecasts used in the tariff submission relating to the year-to-date		
3. Cost of sales (these data only relate to LEC)		
Electricity purchased (MWh and cost of purchases) from LHDA, ESKOM (at each bulk supply point), EDM and others for the year before (i.e., if the tariff submission is made in March 2012, the data should be provided for the year 2010/11)		

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Item	Received	Not Received
Reconciliation of above against forecasts used in the tariff submission relating to the year before (i.e., if the submission is made in March 2012, the cost of sales should be reconciled for 2010/11)		
Electricity purchased (MWh and cost of purchases) from LHDA, ESKOM (at each bulk supply point), EDM and others for the year-to-date (i.e., if the tariff submission is made in March 2012, the data should be provided for the year 2011/12 up to February 2012)		
Reconciliation of the above against budget and against forecasts used in the tariff submission relating to the year-to-date		
4. Cost of production (these data only relate to WASCO)		
Cost of bulk water production (if any)		
5. Other parameters used in previous forecasts		
Outturn inflation in the year before and in the year-to-date. Reconciliation of outturn inflation against inflation expected at the time of tariff submissions in the year before and in the current year.		
6. Forecasts of cost of sales and operating costs		
Forecasts of each major cost item (cost of sales and operating costs) for the tariff year. Major cost items of the revenue requirements		
Information on the cost-drivers in the forecasts above including staff numbers, wage cost pressures, expected changes to specific contracts for purchased equipment or services, trends in the costs of chemicals, equipment or services, etc. The information should be sufficient to allow the Authority and stakeholders to judge whether the expected changes in costs are reasonable. Where possible licensees should provide information that benchmarks the expected costs against costs in other utilities or other sectors.		

Item	Received	Not Received
Forecasts of depreciation charges including detailed breakdown of depreciation charges by major asset group. Charges for depreciation of assets financed by third parties should be shown separately and divided into customer financed assets, Government financed assets and assets financed by other third parties.		
7. Weighted-average cost of capital		
WACC model (in Excel) duly completed and annotated		
8. Regulatory Asset Base (RAB)		
Forecasts of RAB for the year ahead including detailed breakdown of RAB by major asset group. Assets financed by third parties should be shown separately and divided into customer financed assets, Government financed assets and assets financed by other third parties. Licensees should separately identify assets that, according to the Charging Principles, are treated differently from other assets. {In the case of electricity, transmission assets developed before 2007 are not included in RAB but data on these assets should still be provided}.		

5.2. Gaps in the data

Any data gaps identified by the Authority will be communicated to the licensees and the submission would have been deemed modified.

The Authority will review the submission with reference to the data template (Annex 1) and to the *Auditing Procedures* to ensure that the tariff submission and data submitted to support the tariff submission have been approved and signed-off by the appropriate officer employed by the licensee. Where the tariff submission or data submitted to support the submission has not been properly approved, the Authority will deem that the data has not been submitted.

5. 3. Timetable for the tariff review

Following the validation of the content of the submission, the Authority shall develop a timetable detailing dates for:

- o receipt of missing data from the licensee;
- o public hearing(s) relating to the tariff submission; and
- o Board approval for the tariff.

5. 4. Review of outturn against previous forecast

When reviewing outturn data for the year before and for the current year-to-date, the Authority will consider the following:

Table 2 Outturn review - checklist

Action	Outcome
Do the outturn figures (year before and the year-to-date in the current year) provided by the licensee (costs, sales, etc) match the forecasts made in the two previous tariff submissions?	State percentage deviation
If not already done by the licensee, enter the outturn parameters into the <i>Economic and Financial Regulatory model</i> and estimate what the allowed revenue would have been if there had been perfect foresight.	Are there substantial deviations between the outturn revenue and the allowed revenue if there had been perfect foresight?
Make a recommendation to the Authority's Board on whether an outturn adjustment should be made.	

5. 5. Review of year-ahead cost forecasts

When reviewing year-ahead forecasts of costs of sales or operating costs, the Authority will consider the following:

Table 3 Review of operating costs - checklist

Action	Outcome
Compare the forecast figures with figures for the previous two or three years (including the current	

Action	Outcome
year). What are the growth rates?	
What are the underlying cost drivers (customer numbers, area supplied, etc) and has the licensee provided information relating to the changes in the cost drivers?	If the cost drivers are not clear or if there is insufficient data provided to review the fundamental drivers of costs, the Authority will request more information from the licensee.
Calculate the costs per customer or per MWh or m ³ delivered or other similar metrics. Are changes in these metrics consistent over time with the underlying cost drivers over time? Are these consistent with benchmarks provided by the licensee or those obtained by the Authority?	If forecast costs are not consistent with the fundamental cost drivers, the Authority will seek clarification from licensees.
Make a recommendation to the Authority's Board on whether the forecast costs and forecast of cost drivers are reasonable and, if not, what alternatives should be used.	

5. 6. Review of depreciation allowances

When reviewing previous years' and year-ahead depreciation allowances, the Authority will compare the submitted figures with figures for the previous two or three years and in cases where there are significant changes, will expect to see justification provided by the licensee.

The Authority will expect to see the depreciation allowances separately identified relating to assets purchased using customer contributions or assets financed using grants from Government. The Authority will ensure that the treatment of depreciation on such assets is in accordance with the Charging Principles and with the RAGs.

Depreciation on assets that are included in the statutory accounts but that have been disallowed from the regulatory asset base should be separately identified. A reconciliation between the depreciation charged in the statutory accounts and in the regulatory accounts should be provided by the licensee. The Authority will ensure that the treatment of depreciation on such assets is in accordance with the Charging Principles and with the RAGs.

5. 7. Review of Regulatory Asset Base (RAB)

Licensees shall provide sufficient information to allow the Authority to verify that the RAB used for tariff calculations is correct. Information must include, as a minimum, gross fixed assets, cumulative depreciation, impairment of assets (if any), revaluation, and net fixed assets.

The RAB shall only include those assets that comply with the Charging Principles and RAGs. If a licensee wishes to include assets in the RAB that have previously been excluded by the Authority then the licensee shall provide a justification for their inclusion.

Licensees shall reconcile the fixed assets included in the statutory accounts and those in the regulatory accounts.

The Authority will ensure that the RAB is in accordance with the Charging Principles and with the RAGs.

5. 8. Review of Weighted-average cost of capital (WACC)

Licensees shall use the Excel-based WACC model provided by the Authority to calculate WACC and WACC should be calculated in accordance with the Regulatory Accounting Guidelines (RAGs).

The Excel spreadsheet shall be sent to the Authority.

Separate WACC calculations and spreadsheet models shall be sent to the Authority for each of the licensed businesses.

The assumptions used in the spreadsheet, and the sources of data should be fully documented in the spreadsheet model.

The Authority will review the reasonableness and accuracy of each of the assumptions used by the licensee based on the checklist below.

Table 4 Review of WACC assumptions - checklist

Parameter	Outcome (Is it reasonable?)	Is it Accurate?
Inflation		
Risk free rate		
Market return		
Country risk premium		
Beta		

Parameter	Outcome (Is it reasonable?)	Is it Accurate?
Cost of debt to licensee		
Debt/equity proportions		

5. 9. Required Revenue

Licensees shall provide the Authority with a copy of the *Economic and Financial Regulatory model* used to calculate the Allowed Revenue.

The Authority will review the required revenue calculated by the *Economic and Financial Regulatory model* using the data provided by the licensee and approved by the Authority and the methodology described in the *Charging Principles*.

5. 10. Public hearing(s)

Public hearing(s) shall be held in accordance with the Law and with the Authority's procedures.

5. 11. Recommendations to the Board

Following completion of the tariff review, including conducting of public hearing (s), the staff of the Authority will prepare a written Report to the Board that includes:

- o a brief summary of the proposed tariffs submitted by the licensee including any information on unusual circumstances behind the tariff submission that should be highlighted to the Board;
- o a brief commentary on the financial performance of the business over the previous two years and how the business' costs and revenues compare with the forecasts made in tariff submissions at the start of the two years;
- o a recommendation on whether an outturn adjustment should be applied, and the amount of the outturn adjustment;
- o an assessment of the assumptions used in the year-ahead forecasts that are used to establish the allowed revenue (the Board Report should only mention those cost items where cost

increases are particularly large or items where the staff of the Authority recommend that different assumptions be made);

- o a recommendation on the allowed revenue and the allowed average tariff;
- o details of the tariffs by customer category that are implied by the above allowed revenue.

5. 12. Tariff approval

Following the review of Management's recommendations by the Board, it may approve the recommendations, or may request Management to consider or revise certain assumptions and/or findings and prepare revised recommendations. This may be repeated until the Board is able to approve the recommended tariff.

6. Multi-year tariff formulae

This section of the Procedure deals with a review of submissions by licensees for multi-year tariff *formulae*. This deals with the review and approval of the formulae themselves and not to the tariffs that may subsequently be derived from the approved formulae. In practice, the submission may cover both the formulae and the tariffs for the coming year ahead in the first year of the Control Period but the review of the tariffs for the coming year (the first year of the Control Period) should be reviewed using the Procedures described in 6.2, 6.3 and 6.4 sections below.

6.1. Control period

The submission should identify the proposed Control Period over which the multi-year tariff will apply. The Authority will review the proposed duration of the Control Period with regard to incentives (recognising that a long control period gives the licensee stronger incentives to lower costs) and customer benefit (recognising that a long control period may benefit the customers through stable prices). The Authority may propose a shorter Control Period when the multi-year tariff approach is first trialled.

6.2. Repetition of Steps 5.1 and 5.2 of the Single-year tariff procedure

Steps 5.1 and 5.2 of the *Single-year tariff procedure* will be used to review submissions though references to year-ahead data will, instead, relate to data for the entire Control Period.

6.3. Review of cost forecasts over the Control Period

Step 5.4 of the *Single-year tariff procedure* will be used though references to year-ahead data will, instead, relate to data for the entire Control Period.

6.4. Depreciation and RAB

Steps 5.5 and 5.6 of the *Single-year tariff procedure* will be used except that the licensee will additionally submit projections of investments expected to be required over the Control Period together with justifications for the expected investments. *{These forecasts will not impact on the tariff formulae if depreciation and return on investment are passed through in the allowed revenue, but it is useful to show what the tariffs are likely to be over the Control Period}.*

6.5. Proposed multi-year tariff formulae

Licensees shall provide the Authority with a copy of the *Economic and Financial Regulatory model* used to calculate the Allowed Revenue.

The Authority will review the required revenue calculated by the *Economic and Financial Regulatory model* using the data provided by the licensee and

approved by the Authority and the methodology described in the *Charging Principles*.

6.6. Public hearing(s)

Public hearing(s) shall be held in accordance with the law and with the Authority's procedures.

6.7. Recommendations to the Board

Following completion of the review of the proposed multi-year tariff formulae, the staff of the Authority will prepare a written report to the Board that includes:

- a brief summary of the proposed multi-year tariff formulae submitted by the licensee including any information on unusual circumstances behind the submission that should be highlighted to the Board;
- an assessment of the assumptions used in the forecasts that are used to establish the multi-year tariff formulae paying particular attention to items where the staff of the Authority recommend that different assumptions be made;
- a recommendations on the multi-year tariff formulae;
- details of the indicative tariffs by customer category that are implied by the formulae (NB. At this stage, the review relates only to the formulae and not to the tariffs, but the tariffs can be calculated for information purposes).

6.8. Approval of the multi-year tariff formulae

Following the review of Management's recommendations by the Board, it may approve the recommendations, or may request Management to consider or revise certain assumptions and/or findings and prepare revised recommendations. This may be repeated until the Board is able to approve the recommended multi-year tariff formulae.

7. Multi-year tariff Review

7.1. First Year of the Control Period

This section of the Procedure deals with a review of submissions by licensees for tariffs in the first year within the Control Period in a multi-year tariff arrangement. This differs from the review in subsequent years of the Control Period because in the first year of the Control Period there are no outturn adjustments or, if there are outturn adjustments then they relate to the years before this multi-year tariff formulae came into effect.

Steps 5.1 to 5.11 of the *Single-year tariff procedure* should be repeated. The only difference is that forecasts or assumptions in Step 5.4 will only be provided for those parameters that are used in the multi-year tariff formulae (e.g., inflation, losses, unaccounted-for-water, etc.) but not those parameters that have been fixed in the formulae.

7.2. Second Year of the Control Period

This section of the Procedure deals with a review of submissions by licensees for tariffs in the second and subsequent year within the Control Period in a multi-year tariff arrangement. This differs from the review in first year of the Control Period because at this stage of the Control Period there are outturn adjustments relating to this multi-year tariff formulae.

Steps 5.1 to 5.11 of the *Single-year tariff procedure* should be repeated. The only two differences are that:

- outturn adjustments in Step 5.3 can be calculated using the *Economic and Financial Regulatory model* and the approved multi-year tariff formulae,
- forecasts or assumptions in Step 5.4 will only be provided for those parameters that are used in the multi-year tariff formulae (e.g., inflation, losses/unaccounted-for-water, etc.) but not those parameters that have been fixed in the formulae.

7.3. Tariff structures

This section of the Procedure deals with a review of submissions by licensees for changes to tariff structures.

A proposal for a revision to a tariff structure may be submitted in combination with a normal annual submission (either a single-year tariff or a submission within the Control Period of a multi-year tariff arrangement). If a proposal for a revision to the tariff structure is combined with another submission, some of the steps described below will need to be undertaken only once.

7.4. Initiation of a review of tariff structures

End user tariff structures should be reviewed periodically and at least every [five] years. Licensees should prepare and submit a review of tariff structures periodically, and at least every five years, even though the submission may request that no change is made to the existing tariff structure.

The Authority may, where appropriate, request a licensee to review a tariff structure and submit the review to the Authority for approval.

7.5. Validation of the content of the submission

The Authority will briefly check the content of submissions to ensure that all important information has been submitted.

Any data gaps identified by the Authority will be communicated to the licensees and the submission would have been deemed modified.

The Authority will review the submission with reference to the data templates (Annex 1) and to the *Auditing Procedures* to ensure that the tariff submission and data submitted to support the tariff submission have been approved and signed-off by the appropriate officer employed by the licensee. Where the tariff submission or data submitted to support the submission have not been properly approved, the Authority will deem that the data has not been submitted.

7.6. Timetable for the tariff review

Following the validation of the content of the submission, the Authority shall develop a timetable detailing dates for:

- o receipt of missing data from the licensee;
- o public hearing(s) relating to the submission;
- o a recommendation by Authority staff to the Board regarding the tariff structure proposed by the licensee; and

- o Board approval for the tariff structure.

7.7. Review of tariff structures against tariff principles

The proposed tariff structures will be reviewed by the Authority against the tariff design principles described in the *Charging Principles* (cost reflectivity, social/industrial policies, etc.) and with any Government policies that licensees are required to comply with. Licensees should submit sufficient information to ensure that the Authority is able to verify that proposed tariff designs comply with the Charging Principles and with Government policies.

7.8. Public hearing(s)

Public hearing(s) shall be held in accordance with the Law and with the Authority's procedures.

7.9. Recommendations to the Board

Following completion of the review, the staff of the Authority will prepare a written Report to the Board that includes:

- o a brief summary of the proposed tariff structures submitted by the licensee including any information on unusual circumstances behind the submission that should be highlighted to the Board;
- o an assessment of the assumptions or forecasts that are used to establish the tariff structure (the Board Report should only mention those cost items where cost increases are particularly significant or items where the staff of the Authority recommend that different assumptions or forecasts be used); and
- o recommendations on the allowed tariff structure.

7.10. Tariff structure approval

Following the review of Management's recommendations by the Board, it may approve the recommendations, or may request Management to consider or revise certain assumptions and/or findings and prepare revised recommendations. This may be repeated until the Board is able to approve the recommended tariff structure.