

Registrar,
National Electric Power Regulatory Authority (NEPRA),
NEPRA Tower, Attaturk Avenue (East), G-5/1,
Islamabad.

Ref No. KE/BPR/NEPRA/2020/255
March 6, 2020

Subject: Mechanism of Claw back within the MYT Determination 2017 – 2023

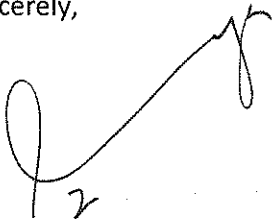
Dear Sir,

This is with reference to the mechanism of Claw back provided in the Multi-Year Tariff Determination (MYT Determination) for the control period FY 2017 to FY 2023, dated July 5, 2018 and notified vide SRO no. 576(I)/2019 dated May 22, 2019 and direction provided in NEPRA's decision dated December 31, 2019, in the matter of quarterly tariff adjustment for the period from July 2016 to March 2019 for submission of working of claw back.

Accordingly working of claw back for FY 2017 and 2018 as per the provided mechanism is being submitted for NEPRA's consideration (*Please refer enclosed Annexure A*). Further, Financial statements for FY-2019 are under audit and working of claw back for FY-19 will be submitted in due course.

We would request the Authority to consider the working and explanation provided in Annexure A and provide us an opportunity of hearing in this regard.

Sincerely,



Ayaz Jaffar Ahmed
Director – Finance & Regulations

Encl: Annexure – A

For information & n/a pt.
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Date: 11-3-20
 Dy. No: 2297
 REGISTRAR
 Dy. No: 4085
 Date: 10-03-20

Annexure A – Claw back calculation for FY 2017 and 2018

Claw back mechanism provided in Annexure VII of the Multi-Year Tariff Determination (MYT Determination) of K-Electric Limited (KE), dated July 5, 2018 includes formula for calculation of Regulatory Asset Base (RAB) and Return on Regulatory Asset Base (RoRB) as follows 'Given Formula':

Extract from Annexure VII of the MYT Determination dated July 5, 2018

4. EBIT shall be worked out according to formula mentioned hereunder:

Earning Before Interest and Tax as per the financial Statement	
Add	Provision for Doubtful debt
Add	Any other provision/expenses charged by the Petitioner that the Authority considers unjustified
Add	Depreciation charged to P&L with revaluation
Less	Write-offs amount allowed by the Authority for respective year
Less	Depreciation for the year on Cost Basis
Less	Late Payment Surcharge (LPS)
Less	Any Cost Allowed as Pass-Through by the Authority (e.g. Corporate Tax Paid, WWF, WPPF, etc.)
EBIT for the Purpose of application of Claw back	

5. Average RAB

Average RAB shall be worked out according to the following formula:

	Fixed Assets Without Revaluation (O/B)
Add	Additions during the Year
Less	Accumulated Depreciation on cost
=	Net Fixed Assets
Add	WIP on Cost (C/B)
Less	Deferred Revenue (Consumer financed Asset)
=	Regulatory Asset Base (RAB)

$$\text{Average RAB} = ((\text{Current RAB} + \text{Last Year RAB}) / 2)$$

Here, we would like to highlight that the above formula includes following inconsistencies:

Formula for calculation of Regulatory Asset Base (RAB)

1. **Disposal of Fixed Assets:**

Formula for calculation of RAB does not capture disposals or write offs of Fixed assets made during the year, resulting in higher RAB.

Formula for calculation of Earning Before Interest and Tax (EBIT)

2. **Cost allowed as Pass-Through:**

Formula for calculation of 'EBIT for the purpose of application of claw back' allows for deduction of costs allowed as pass through including Corporate tax, WWF and WPPF from 'EBIT as per Financial Statements'.

However, amounts of WWF and WPPF are part of 'Other operating expenses' in the Financial Statements, and are already deducted from 'EBIT as per Financial statements', resulting in double deduction of WWF and WPPF as per the 'Given Formula'.

3. **Provision for Doubtful debt and Write-offs:**

Formula for calculation of 'EBIT for the purpose of application of claw back' directs adding back of total Provision for doubtful debt, however, allows for deduction of write offs only to the extent allowed by the Authority to be claimed in Tariff for the respective year, ignoring the actual write offs made by KE as per audited Financial statements.

We would like to submit that the total write offs as per the audited Financial Statements also include those write offs which may not fall under the criteria give in the MYT Determination for claim in Tariff including those of Public Sector consumers, however, these write offs are made as per the Company's policy after following due process including approval by the Board of Directors (BoD).

Therefore, it is important to consider total write offs for deduction in the formula, as the EBIT as per Financial Statements includes revenue / income from all types of consumers and correspondingly the total write offs would represent the complete revenue lost against these consumers. Disallowing deduction of total write offs as per audited Financial Statements would result in unjustified incidence of claw back on the revenue / income which has already been considered as lost and has been written off by KE in the Financial Statements.

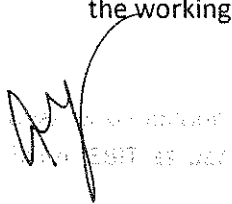
Accordingly, KE considers that total write offs as per audited Financial Statements should be deducted in the EBIT formula.

Note: The above calculations are based on claw back thresholds given in the MYT Determination. However, KE is in the process of filling of mid-term review as part of the Multi Year Tariff, which will also result in revision of Claw back thresholds for the tariff control period including FY-2017 & FY-2018. Accordingly, we would request the Authority to account for respective change in Claw back thresholds in mid-term review proceedings.

Conclusion

The calculation of claw back for FY 2017 and FY 2018 in both the scenarios i.e. as per the 'Given formula' and as per the formula after considering corrections explained above - 'Corrected formula', is provided in Annexure A1 and A2, respectively. Claw back is not being triggered for FY 2017 and FY 2018 in both the scenarios.

In light of the above, NEPRA is requested to consider the changes required in the Claw-back formula and the workings for FY 2017 and 2018 as per the 'Corrected formula'.



Signature of the representative of KE
Name: _____
Designation: _____
Date: _____

Calculation of Clawback
Given Formula

Annexure A1
KE/BPR/NEPRA/2020/255
Amounts in PKR Million

		FY 2017 ¹	FY 2018		
Regulatory Asset Base (RAB) - Opening					
	Net Fixed Assets w/o revaluation	122,068	142,022		
Add:	Capital work-in-progress (CWIP)	30,029	30,345		
Less:	Deferred Revenue	(18,065)	(20,193)		
	Regulatory Asset Base (RAB)- opening	A	134,031		
Regulatory Asset Base (RAB) - movement					
	Fixed asset w/o revaluation (cost) - opening	209,232	236,401		
Add:	Additions during the year	27,169	17,688		
Less	Accumulated Depreciation on cost	(94,379)	(103,485)		
	Net Fixed Assets w/o revaluation	142,022	150,604		
Add:	Capital work-in-progress (CWIP)	30,345	57,080		
Less:	Deferred revenue	(20,193)	(21,388)		
	Regulatory Asset Base-Closing	B	152,173		
	Average RAB	C = (A + B) / 2	143,102		
Return on RAB - FY 17					
	Earnings before Interest and Tax as per Financial statements	12,321	16,956		
Add:	Depreciation charged to P&L with revaluation	13,433	15,352		
Less:	Depreciation for the year on cost basis	(7,215)	(9,106)		
Less:	Tax and WPPF pass through	(463)	(2,199)		
Add:	Provision for doubtful debts	18,141	16,300		
Less:	Write-offs amount allowed by the authority for respective year ²	(6,195)	(3,371)		
Less:	Late Payment Surcharge (LPS)	(2,479)	(2,318)		
	EBIT for the purpose of application of claw back	D	31,613		
	Annual Return on RAB	E = D / C	19.25%		
	Threshold for applicability of Claw back	23.40%	18.95%		
Returns at given thresholds					
i	23.40% / 18.95% of RAB	23.40%	33,486	18.95%	32,070
ii	26.41% / 21.96% of RAB	26.41%	37,793	21.96%	37,164
iii	29.41% / 24.96% of RAB	29.41%	42,086	24.96%	42,241
Profits to be shared					
	Annual Return from i-ii of Regulatory assets to be shared at 25%	25%	-	25%	-
	Annual Return from ii-iii of Regulatory assets to be shared at 50%	50%	-	50%	-
	Annual Return above iii of Regulatory assets to be shared at 75%	75%	-	75%	-
	Total amount of claw back				

¹ Restated numbers

² Write-offs amount is subject to approval of NEPRA

Calculation of Clawback
Corrected Formula

Annexure A2
KE/BPR/NEPRA/2020/255
Amounts in PKR Million

		FY 2017 ¹	FY 2018
Regulatory Asset Base (RAB) - Opening			
	Net Fixed Assets w/o revaluation	122,068	139,379
Add:	Capital work-in-progress (CWIP)	30,029	30,345
Less:	Deferred Revenue	(18,065)	(20,193)
	Regulatory Asset Base (RAB)-opening	134,031	149,530
	A		
Regulatory Asset Base (RAB) - movement			
	Fixed asset w/o revaluation (cost) - opening	209,232	232,596
Add:	Additions during the year	27,169	17,688
Less:	Accumulated Depreciation on cost	(94,379)	(102,323)
Less:	Disposals, assets written offs & impairment during the year (excluding revaluation surplus)	(2,643)	(400)
	Net Fixed Assets w/o revaluation	139,379	147,561
Add:	Capital work-in-progress (CWIP)	30,345	57,080
Less:	Deferred revenue	(20,193)	(21,388)
	Regulatory Asset Base- closing	149,530	183,253
	B		
	Average RAB	C = (A + B) / 2	141,781
		141,781	166,391
Return on RAB			
	Earnings before Interest and Tax as per Financial Statements	12,321	16,956
Add:	Depreciation charged to P&L with revaluation	13,433	15,352
Less:	Depreciation for the year on cost basis	(7,215)	(9,106)
Less:	Tax pass through	(4)	(1,477)
Add:	Provision for doubtful debts	18,141	16,300
Less:	Write-offs as per Financial Statements	(8,536)	(8,577)
Less:	Late Payment Surcharge (LPS)	(2,479)	(2,318)
	EBIT for the purpose of application of claw back	25,660	27,130
	D		
	Annual Return on RAB	E = D / C	18.10%
		18.10%	16.30%
	Threshold for applicability of Claw back	23.40%	18.95%
Returns at given thresholds			
(i)	23.40% / 18.95% of RAB	23.40%	33,177
(ii)	26.41% / 21.96% of RAB	26.41%	37,444
(iii)	29.41% / 24.96% of RAB	29.41%	41,698
			18.95%
			31,531
			21.96%
			36,540
			24.96%
			41,531
Profits to be shared			
	Annual Return from (i) to (ii) of Regulatory assets to be shared at 25%	25%	-
	Annual Return from (ii) to (iii) of Regulatory assets to be shared at 50%	50%	-
	Annual Return above (iii) of Regulatory assets to be shared at 75%	75%	-
	Total amount of claw back		

¹ Restated numbers