

MEMORANDUM CIRCULAR No. 2011-009
Series of 2011

TO : ALL CONCERNED

SUBJECT : GUIDELINES FOR THE ADOPTION OF RING-FENCING TOOL FOR MULTIPURPOSE COOPERATIVES (MPCs) WITH WATER SERVICE OPERATIONS

Section 1. Legal Basis. This Memorandum Circular is being issued pursuant to RA 9520, otherwise known as the Philippine Cooperative Code of 2008, which professionalizes the management and operation of cooperatives, and requires a monitoring and evaluation tool for the cooperatives to conduct self-assessments of its managerial, financial, and social objectives; Rule III of its Implementing Rules and Regulations (IRR) which specifically provides that “the new and existing cooperatives transformed into a multi-purpose cooperative (MPC) are required to maintain separate books of accounts for each business activity”; and Item V of Memorandum Circular (MC) No. 2009-04 prescribing the Standard Chart of Accounts (SCA) for all cooperatives and specifying that “for cooperatives with multi- business activities, separate financial reports shall be prepared for each type of activity”.

Consistent with these rulings, ring- fencing was developed as a tool to segregate the operations of a particular business activity, like the Water Service Unit, from the general accounts of the MPC. Ring- fencing is deemed as an essential step in improving the performance of water service operations and pursuing utility reform. The Cooperative Development Authority (CDA), with technical assistance from the USAID-Philippine Water Revolving Fund Support Program (PWRF-SP), conducted an orientation and training of trainers on ring- fencing to promote the approach in 2008. Ring- fencing of water service unit operations was also pilot- tested in three MPCs¹ in 2008-2009. The pilot MPCs successfully ring-

¹ The pilot MPCs included the Lamac Multipurpose Cooperative (LMPC) in Brgy. Lamac, Pinamungajan, Cebu, Matanao Waterworks and Sanitation Multipurpose Cooperative (MAWASAMCO) in Brgy. Poblacion, Matanao, Davao del Sur, and O’Donnell Resettlement Waterworks Multipurpose Cooperative (ORWAMCO) in Brgy. Cristo Rey, Capas, Tarlac.

fenced their 2008 accounts and were able to generate financial reports showing the actual performance of their water service units; and to identify operational gaps. The pilot MPCs have institutionalized the ring-fencing system in their operations to enable them to fully implement it and pursue reforms in their water utility operations more effectively. The pilot-testing also led to the development of the “Ring- fencing guide for Multipurpose Cooperatives with Water Service Operations” which takes into account the peculiar features of cooperative operations and accounting system. It is envisioned therefore, that this guidelines shall be promoted and adopted as a tool to ring- fence the water service operations of all MPCs with water service operations.

Section 2. Title. This Circular shall be known as the “**Guidelines for the Adoption of Ring- fencing Tool for Multi- purpose Cooperatives (MPCs) with Water Service Operations**”.

Section 3. Scope. These Guidelines shall be applied in the segregation (ring- fencing), accounting and financial reporting of water service operations of multi-purpose cooperatives duly registered with the CDA.

Section 4. Objectives. These Guidelines provides information on ring-fencing and guidelines for its adoption in separating water utility operations of MPCs from their general system of accounts. It introduces new accounts for MPCs with water supply operations to ensure uniformity and common understanding of water utility accounts, facilitate the analysis and evaluation of financial management performance and provide the basis for monitoring and supervision of water service operations.

Section 5. Definition. *Ring- fencing* is the segregation of the activities, assets and liabilities and revenues and costs generated by a specific economic undertaking from the general business of the MPC. It involves the isolation or segregation of a certain business endeavor, in this case, its water supply operations, as an autonomous enterprise from its other business activities. It denotes that funds set aside for this certain enterprise are not spent on anything else, and that revenues generated from it are invested back for its operations. Ring- fencing entails the separation of financial accounts through the use of a subsidiary accounting system.

The ultimate goal of ring- fencing is the formation of a self-sustaining unit within the MPC operating without any change in its legal personality; or as a subsidiary cooperative with separate legal entity or charter.

Section 6. Benefits of Adopting the Ring- fencing Tool. Ring-fencing of water utility operations from the general operations of the cooperative results in the generation of more accurate financial information that can be used for making decisions about resources allocation, management and operational changes and improvements, and setting tariffs. Better decision-making is expected to lead to sustainable water supply services for the coop members and the community being served.

- a. Generation of reliable financial reports showing the true performance of the water utility

The financial operations of the water service unit are centralized within the MPC, and financial performance results are consolidated and reported along with those of its other business activities. Ring- fencing will enable the MPC not only to get more reliable financial reports specific to its water operations but also to overcome barriers to increase their revenue generating potentials.

The accounting system for cooperatives uses the modified accrual method of recording revenues. This modified accrual basis is applied by the MPC to all of its business activities, including water service. Revenues are recognized when they are collected and not when they are realized. Apart from having an inaccurate income reported by the water service unit, the practice does not provide for the automatic monitoring of collection performance, as collections are not usually compared against the receivables, which are normally established under the accrual system. With the ring- fencing tool, the accrual method is used and collection efficiency is easily monitored.

There are other operating units within the MPC that support activities related to water service provision. At the same time, there are also personnel within the water service unit who perform activities related to the other business operations of the MPC. These expenses are not currently included or considered in the financial report of the water service operations. Ring- fencing Tool provides a mechanism to capture all expenses related to the provision of water supply.

With the ring- fencing tool, the MPC can also engage in private sector participation and/ or public private partnerships to operate and manage part or all the water utility operations. It can even convert the water utility to form a subsidiary cooperative.

- b. Generation of relevant information as a transparent basis for tariff-setting

The financial statements to be generated by the ring- fenced accounting provides accurate information about the property, Plant and Equipment Entitled to Return (PEER), revenues and expenses that will provide useful inputs in reviewing the adequacy of tariff that can be charged by the MPC.

- c. Better monitoring/ tracking of the financial performance of water service operations

Ring- fencing tool facilitates monitoring and evaluation of the performance of water supply operations. Through ring- fencing, the MPC can have more efficient control of the water service unit's expenses. Staff performance can be gauged and monitored and accountability can be improved. Collection efficiency can be increased because operations are more transparent. Investment needs can also be determined with more precision with better and more accurate information from the ring-fenced system.

Section 7. Framework and Process for the adoption of Ring- Fencing Tool of LGU- Run Water Utilities. The ring- fencing framework and process is elaborated in the "Ring-fencing Manual Guide for Multipurpose Cooperatives with Water Services Operations".

- a. Framework

The ring- fencing of water service accounts in the MPC follows the accounting policies and practices that conform with RA 9520, CDA rules and regulations, Philippine Financial Reporting Standards (PFRS), and other government policies and guidelines. The process will consider and adopt all basic and peculiar features of cooperative accounting.

- b. Phases of Ring- fencing

The development of the financial system to ring- fence water utility operations is divided into two phases. Phase 1 involves the preparatory activities and reconstruction of water utility accounts, which still form part of the MPC's general accounting records. When the water utility has its own budget and separate books of accounts, it no longer needs to ring-fence and has crossed over to Phase 2. Phase 2 is when the water utility is already operating viably and is sustainable. It has its own budget, keeps a separate financial accounting and reporting system, and even maintains its own separate bank account. Because financial reporting is already autonomous, it is now automatically ring-fenced.

c. Steps in Ring- fencing²

1. *Affirmation of commitment.* This circular is issued in consonance with the MC 2009-04 requiring MPCs to prepare separate financial reports for each type of business activity, like water service. The separation can be assisted by implementing ring- fencing system. Its implementation starts with the issuance by the Board of Directors (BOD) of a Board Resolution to that effect.

2. *Account reconstruction.* This involves the establishment of the beginning balances for the financial statements of the water service unit using the full cost method.

3. *Interim accounting procedures.* Revenues based on the total amount of bills issued (accrual method). All costs and expenses incurred by other operating units of the MPC related to water service provision are captured through the interim accounting procedures. A system of obtaining the cost of services done by other operating units in the MPC, which are related to water service provision, is implemented. A separate set of books of accounts is maintained. Then, the ring-fenced financial statements of the water utility are prepared.

4. *Bank Account and Other Activities.* A separate bank account is established for the water utility where collections can be deposited and disbursements can be paid from. A full budget for the following year for the ring-fenced operations is prepared adopting full cost accounting.

When financial reporting of the utility's operations is already autonomous, it is now automatically ring-fenced.

5. *Preparation, adoption and implementation of the ring- fencing financial management guidelines.* The adoption of the ring-fencing guidelines will institutionalize the implementation of the ring- fencing system. This will enforce the maintenance of separate books of accounts and the periodic preparation of ring- fenced financial reports. The utility's business plan can then be prepared based on ring-fenced financial statements.

6. *Shift to a fully self- sustaining entity.* The MPC, with approval of its General Assembly and subject to the pertinent laws of incorporation, can

² From the "Ring-Fencing Guide for Multipurpose Cooperatives with Water Services", Philippine Water Revolving Fund – Support Program (PWRF-SP) implemented by Development Alternatives, Inc. and United States Agency for International Development (USAID), August 2010, Manila.

spin-off its water operations into a separate legal entity when it has the following characteristics:

- has dedicated staff members or assigned shared staff;
- has a separate financial and accounting system;
- has a full cost budget that considers all the costs of operating and running the water utility; and
- has the fiscal autonomy to utilize its funds as appropriate for system expansion and improvement.

Section 8. Ring- fencing Chart of Accounts. The ring- fenced financial management system of Water Service Cooperatives generally follows the CDA Standard Chart of Accounts (SCA) for all cooperatives. For accounts peculiar and exclusive for Water Service Cooperatives, some account titles and descriptions are customized to fit in the type of business activity, that is, the water supply services. These accounts are as follows:

<i>Account Code</i>	<i>Account Title</i>	<i>Account Description</i>
Non-Current Assets – Property, Plant and Equipment:		
14150	Water Utility Plant	This account refers to cost of property and equipment used in the generation of water utilities for operation and/or for distribution to consumers.
14151	Accumulated Depreciation – Water Utility Plant	This account refers to total amount of depreciation cost on Utility Plant that are set up periodically and charged against the current operations
Other Non-Current Asset:		
17600	Due from Branch / Subsidiary	This account refers to receivables from Head Office/ Branches/ Subsidiary
Other Non-Current Liabilities:		
24830	Due to Head Office	The account is used to record inter-office transactions in the books of Head Office (HO)/Branch/ Subsidiary and should be closed at the end of the accounting period.
24850	Depreciation Reserve Fund	This account refers to fund provided by Public Service Law, Section 16, for all utilities to set aside its depreciation expense into a depreciation reserve fund to be used only for improvements, new constructions, extensions or

<i>Account Code</i>	<i>Account Title</i>	<i>Account Description</i>
		additions to the property of the water utility.
24860	Water Maintenance Fund	This account refers to advance collections from customers to cover maintenance of water facilities from the distribution lines up to the water meters.
Revenue Items – Income from Service Operations:		
40210	Water Service Income	This account refers to the amount collected for various services rendered.
40211	Other Service Income	This account refers to revenues arising from water service provision other than regular water consumption. A subsidiary ledger shall be maintained for each sub-account.

Section 9. Capacity Building Assistance. Interested Multi- Purpose Cooperatives are hereby requested to signify their commitment to adopt the approach with the CDA. Trainers/ facilitators from the CDA and the Polytechnic University of the Philippines College of Cooperatives and the ring- fencing teams of the pilot Cooperatives can be mobilized as a resource group to provide assistance to MPC interested in adopting ring- fencing tool for their water service operations unit.

The use of the “Guide to Ring- Fencing (Manual) for Multipurpose Cooperatives with Water Services” developed by the Philippine Water Revolving Fund- Support Program (PWRP-SP) is also encouraged to guide interested MPCs in the adoption of the approach. Templates of the Board of Directors resolution on ring- fencing developed under the Program are also available to facilitate the institutionalization of this process at the ground level.

Section 10. Advocacy on and Monitoring of Adoption of Ring- fencing. The CDA through its Extension Offices shall lead the advocacy activities on ring- fencing, including its promotion to MPCs. They shall also monitor the adoption of this approach at the cooperative level.

All CDA Regional Directors are hereby directed to cause the dissemination of this Memorandum Circular to all their field personnel and our partners the Local Cooperative Development Officers (LCDOs) from LGUs within their areas of jurisdiction, and to provide administrative and technical guidance, as appropriate and as may be necessary.

Section 11. Effectivity. These Guidelines shall take effect upon fifteen (15) days from approval of the Board of Administrators and submission of copy hereof to the Office of the National Administrative Registry (ONAR).

Approved in Quezon City, Philippines, this 15th day of March 2011.

For the Board of Administrators:

EMMANUEL M. SANTIAGUEL
Chairman