

**[CDA MEMORANDUM CIRCULAR NO. 2011-09,
March 15, 2011]**

**GUIDELINES FOR THE ADOPTION OF RING-FENCING TOOL FOR
MULTI-PURPOSE 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 (PWRP-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-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 sytem.

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 of 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 Multi-Purpose 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