

RING-FENCING GUIDELINE

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RING-FENCING GUIDELINE

1. INTRODUCTION

The ring-fencing guideline (RFG) contained in this document was prepared by the Electricity Control Board (ECB) of Namibia.

In terms of the Electricity Act, 2000, the ECB is to exercise control over the electricity supply industry and regulate the generation, transmission, distribution, use, import and export of electricity in accordance with prevailing Government policy. In order to achieve the objective the ECB must make recommendations to the minister with regard to the issue, transfer, amendment, renewal and cancellation of licences, together with the approval of conditions on which a licensee may supply electricity.

In terms of section 5 of the Distribution License Conditions issued by the ECB the licensee shall ring fence the electricity distribution operations and maintain separate accounts of the electricity distribution undertakings as if it were carried on by a separate commercial entity. The licensee shall prepare financial statements in a constantly uniform manner from the accounting records for each financial year, comprising:

- A balance sheet;
- An income statement; and
- A cash flow statement.

2. PURPOSE OF THE GUIDE

The purpose of the RFG is to provide a guideline to local authorities to identify all the issues that are relevant to a stand-alone business. The RFG further describes the process to follow when ring-fencing the electricity business, which will in turn ensure a uniform outcome from all local authorities.

Ring-fencing provides the basis for good governance in that it allows for transparency of the cost of each functional unit and also enables local authorities to prioritise effectively and efficiently. Many local authorities tend to allocate the budget across different sectors thereby often skewing the determination of priorities. This is often the case when revenue generating activities are used to subsidise non-revenue generating activities without due regard to the exact cost to perform such activity or whether such activity is needed at all.

Thus in order to “get the basics” right, ring-fencing is considered a critical starting point towards effective and efficient management of financial and other resources and meeting service delivery needs in a cost effective manner.

3. WHAT IS RING-FENCING

Ring-fencing is a commercial term, which is widely utilised, in the private sector in order to ensure that exact costs are determined in relation to the revenue generated. Its rationale is based on knowing exactly what the bottom line is in any business activity. In so doing companies are in a position to determine their cost effectiveness in operating such a business. Ring-fencing allows one to answer the question: **Are you getting value for what you have put in?**

The term ring-fencing is often seen as being synonymous with that of corporatisation, yet it is significantly different. Corporatisation refers to the institutional mechanism required for a functional unit and therefore impacts on the contractual or legislative mechanism for establishment. Ring-fencing is one of the processes required for corporatisation. Ring-fencing is defined as a process undertaken to determine the total asset and resources base and liabilities and obligations of a particular functional unit and the revenue and operational costs associated with the unit as if it were to operate independently.

In the local government context, Ring-fencing is the identification and isolation of:

Operational items:

- activities and operations;
- community service obligations i.e. future electrification and addressing of the indigent related to the distribution of electricity within a local authority.

Balance Sheet items:

- assets and resources;
- liabilities.

Income Statement items:

- revenues;
- costs i.e. direct, indirect and stranded.

Business separation concepts normally associated with ring-fencing include:

- **Accounting separation:** which requires separate accounting records to be kept by the business. The separation should isolate the value of assets, liabilities, revenues and costs of the business to be included in separate financial statements. This separation reports on the historic financial information, but in turn does not bring about the isolation of the activities that give rise to the financial information.
- **Physical/operational separation:** which requires certain operational activities to be carried out separately from the rest of the business activities. The separation should split the day to day operations and functions of the ring-fenced business from its parent business.

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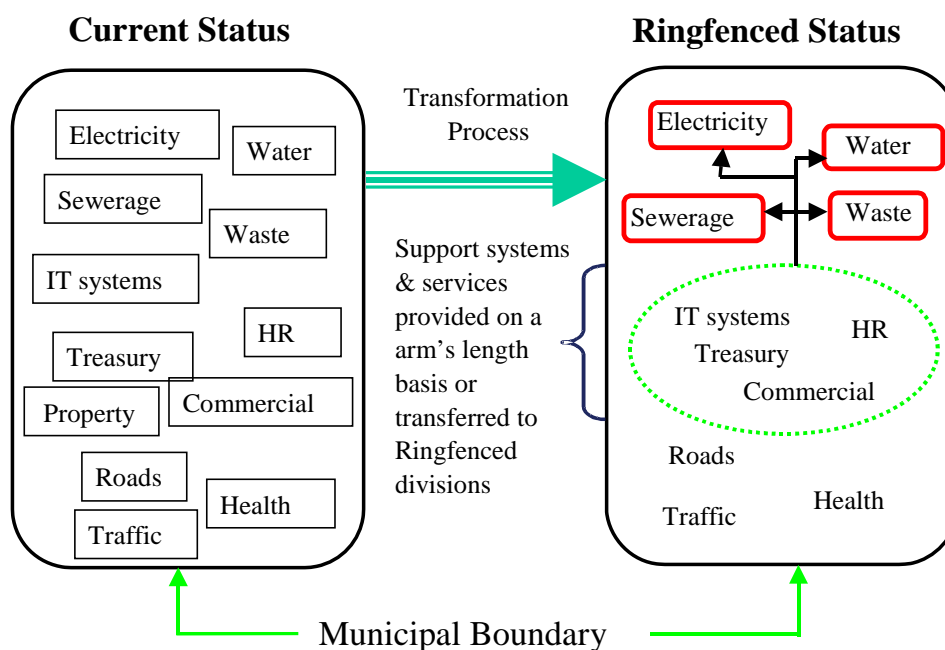
- **Legal separation:** which requires regulated activities to be contained within a separate legal entity, in terms of law. Through the separation the electricity distribution business will be transformed to a separate legal entity with its own rights and obligations.
- **Ownership separation:** which requires the business to separate its ownership from that of the municipality. The business is usually separated through share holding schemes.

This guideline addresses the process of accounting and operational separation, and does not provide guidance in terms of the legal or ownership separations for Regional Electricity Distributors (RED) creation purposes.

The transformation process for a local municipality is depicted below. The illustration shows the transformation process from:

- the current state of the municipality where different functions overlap and the revenue and operational costs of the different functions can not be determined; to
- the ring fenced status of functions where the total asset and resources base and liabilities and obligations of a particular functional unit and the revenue and operational costs associated with the unit can be determined.

It is evident from the illustration that no physical or legal separation has taken place.



4. WHY IS RING-FENCING NECESSARY AT LOCAL AUTHORITIES

Local authorities by nature of their constituents are multifunctional, ranging from grass cutting to planning to health care to provision of water, sanitation, electricity and waste management to facilitating job creation etc. Ring-fencing these entities allows local authorities a glimpse into the actual cost to operate each entity independently and make sound decisions, based on business principles, in this regard. It also allows for priorities to be determined in accordance with each functional entity. Currently, budgeting, expenditure and revenue is the domain of the finance departments in many local authorities. The result is an ambiguous allocation and expenditure pattern with often ad-hoc priorities. Furthermore, in the absence of a proper ring-fencing process there is a tendency by departments to inflate the budget and cause cross subsidisations.

One thing is for certain though, those municipalities that take the brave step and embark on ring-fencing exercises are more likely to provide services expediently and more cost effectively than those that don't. The overall motivation for and benefits of ring-fencing are set out below, as it:

- Establishes a reliable, accurate and “live” data base;
- Allows for transparency, bringing hidden costs to the fore;
- Sets the benchmark for achieving efficiency and effectiveness;
- Enables comparison with best practice;
- Gives insight into credit control and debt collection systems;
- Enables the organisation to get the basics right;
- Streamlines bureaucratic processes to the level of the functional entity;
- Provides the basis for determining an appropriate service delivery mechanism;
- Enables optimal utilisation and budgeting;
- Identifies actual costs associated with a particular service delivery program;
- Facilitates access to the capital market; and
- Adequately meets the requirements of legislative and policy documents.

5. LEGISLATIVE REQUIREMENTS

Section 17 of the Electricity act, 2000, states that no person may establish or carry on any undertaking for the distribution of electricity unless such person holds a license issued under the act. Section 32 (2) of the act states that the Minister may instruct the ECB to gather information in respect of the supply of electricity by a local council, and the ECB, after consultation with the local authority council concerned, may accordingly make arrangements or issue directives to the local authority for the promotion of the efficient utilisation of electricity.

The Electricity Regulations: Economic, issued in terms of Section 39 of the Electricity act, 2000, states under Section 3 that licensed undertakings must be ring-fenced in accordance with the regulation. The regulation stipulates that a licensed undertaking must:

- Keep, or cause to be kept, ring-fenced accounting records; and
- Prepare, in consistently uniform manner, in respect of each financial year of the licensee, financial statements.

In terms of the Distribution License Conditions issued by the ECB the licensee shall ring fence the electricity distribution operations and maintain separate accounts of the electricity distribution undertakings as if it were carried on by a separate commercial entity. The licensee shall prepare financial statements in a constantly uniform manner from the accounting records for each financial year, comprising:

- A balance sheet;
- An income statement; and
- A cash flow statement.

Conclusion

In terms of the above legislation ring-fencing will no longer be an option but rather a legal requirement for good governance and financial management. It will enable municipalities to be efficient and effective in the delivery of services and above all be accountable to the community that they serve.

6. DELIVERABLES/OUTPUTS FROM THE GUIDELINE

The objective of the ring-fencing exercise is to establish a business unit within the municipality's administration and under its control (separated operational entities, "SOE's") without legal and physical separation, but governed by the municipality. The SOE will be established through:

- accounting separation by determining the value of assets, liabilities, revenue and costs of the SOE and to prepare a GAAP compliant ongoing set of financial statements; and
- by operationally separating the electricity distribution business from the municipality and appointing a manager accountable for the business.

The ring-fencing guideline will produce the following high-level outputs:

- An identification of the focus areas of the ring-fenced unit that are necessary for the operation of the unit;
- Validated information that should be maintained on a regular basis;
- The exact process and value chain of the unit;
- The bottom line result of rendering the service; and
- An SOE.

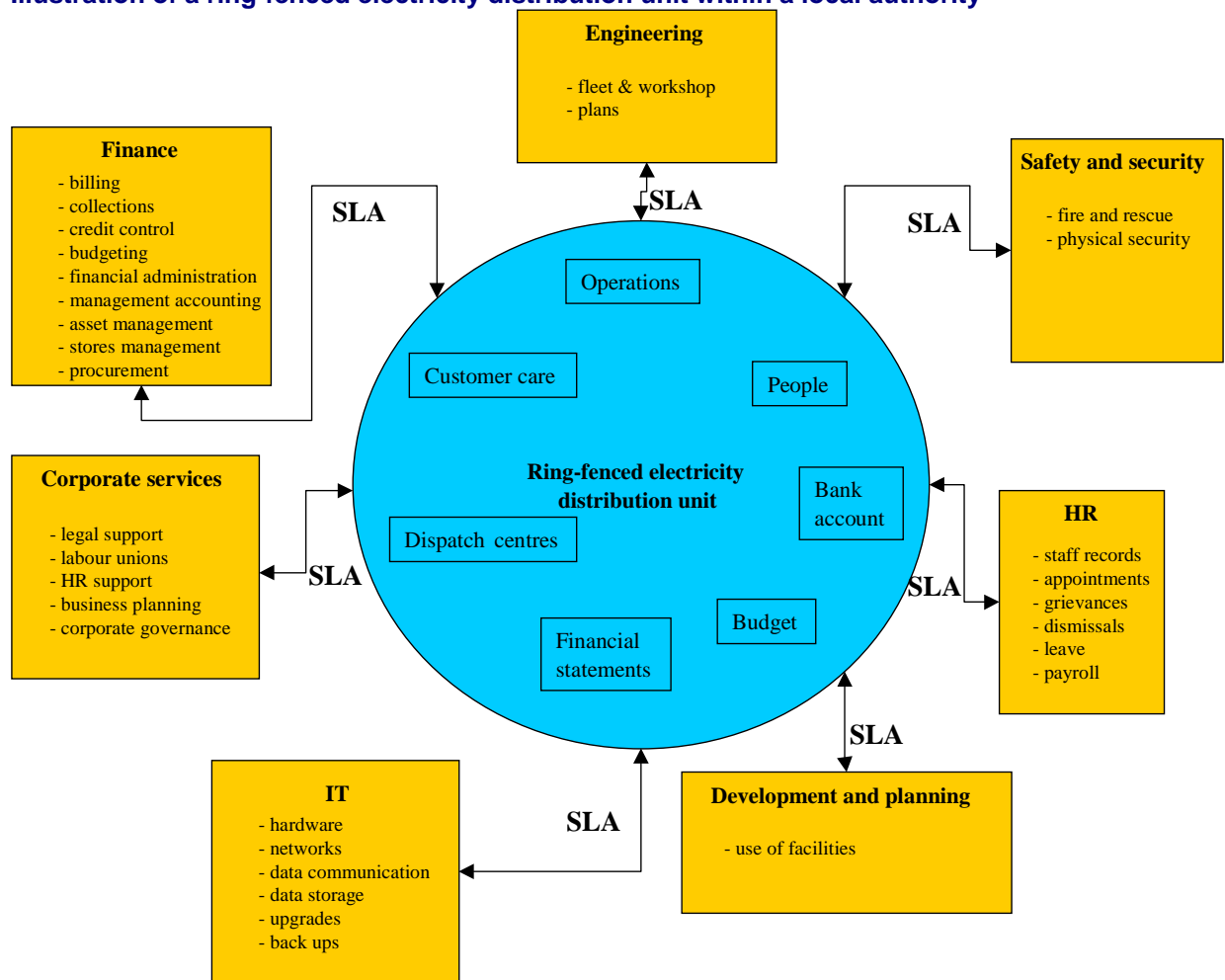
SOE

The illustration that follows show an SOE where:

- Separate financial statements and budgets for the unit are kept;
- Separate bank account for the unit is kept;
- A system of internal "Chinese walls" and service level agreements with other departments/divisions within the municipality is put in place (no physical separation needed);
- Costs included in the service level agreements are fair and reflect the true cost of the service based on consistent cost allocation principles; and
- Billing, collection, debtor accounts and cash allocations provided by finance are identifiable and quantifiable within the consolidated billing and debtor system. Note that if this cannot be achieved, the physical separation of these activities needs to be contemplated.

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Illustration of a ring-fenced electricity distribution unit within a local authority



The illustration is only one example of how the ring-fenced unit may operate. While financial separation can be effectively achieved, an equally important aspect of ring-fencing will be to introduce practices to prevent information asymmetry.

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SLA – Service level agreement

An effective ring-fencing unit can be established through the two level process described below:

- The first level ring-fencing measures include the process of identification, collection and collation of information on the activities, operations, resources, obligations, costs, income, assets and liabilities of the electricity distribution unit that is needed to deliver service at the required level as a stand-alone business.
- The second level ring-fencing measures include decisions by the local authority on the level of separation of the unit from the rest of the business. Separation could go as far as the creation of a separate legal entity with separate ownership status, i.e. corporatisation depending on the level of efficiency that will be achieved plus the amount of benefit it will provide to customers.

7. THE RING-FENCING PROCESS

The ring-fencing process in itself is rather a time consuming process than a difficult one. The key element of successful ring-fencing is to manage the process throughout all its phases in order to ensure that deliverables are made and that all the objectives are achieved. The ring-fencing process is designed to establish the total asset base of the electricity distribution unit and the operational costs as though it was to operate independently.

This guideline is based on a phased approach to ring-fencing that comprises the following phases:

- Phase 1:** Planning and mobilisation of resources.
- Phase 2:** Determining what gets ring-fenced
- Phase 3:** Identifying the focus areas of ring-fencing.
- Phase 4:** The process for collecting, collating and analysing information.
- Phase 5:** Validation of information gathered.
- Phase 6:** Documenting and maintaining the information.

The above phases provide a road map to ring-fencing and are addressed in the sections to follow.

RING-FENCING GUIDELINE

7.1 PHASE 1: PLANNING AND MOBILISATION OF RESOURCES

Aim

The aim of this phase is to establish a solid foundation and direction to the ring-fencing project. Effective project management arrangements within each municipality are critical to successfully ring-fence the electricity distribution unit.

Key activities

The key arrangements that must be in place if the project is to succeed are:

- A Project Steering Committee comprising all key stakeholder groups that the municipality need to include in the process, which will provide overall project guidance and sign-off.
- A Project Manager responsible for scheduling (project plan) and monitoring the ring-fencing activities of the ring-fencing team and ensuring the quality of the project deliverables.
- A ring-fencing team comprising of core electricity unit staff and non-core support staff that will be responsible for conducting all ring-fencing activities. The size of the team may vary depending on the size of the municipality.

Outputs

The key outputs from this phase of the work will be:

A project plan: - The project manager will develop a project plan and manage it throughout the project. The project plan consolidates all the milestones and activities for the ring-fencing project into a consistent and coherent document. This document enables the project manager to schedule milestones and activities, assign responsibilities, and identify conflicting demands and dependencies across the project. The project plan addresses all aspects in delivering the ring-fenced unit and is used to perform the following:

- Guide project execution;
- Document planning assumptions and constraints;
- Document the project approach and help identify the components of the work;
- Facilitate communication among stakeholders and build consensus and commitment;

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- Provide a baseline against which progress can be monitored;
- Assess the impact of changes;
- Document risks and approaches to mitigate them; and
- The cost for the project.

Proper reporting channels: - Reporting and communication on quality and content of work conducted by the team and reviewing progress on the completion of the ring-fencing activities by the project manager to the steering committee need to be done at least on a monthly basis to ensure that all project deliverables are achieved and quality maintained.

7.2 PHASE 2: DETERMINING WHAT GETS RING-FENCED

Aim

The aim of this phase is to identify all activities of the municipality that form part of electricity distribution.

Key activities

The electricity distribution activities should be categorised in terms of:

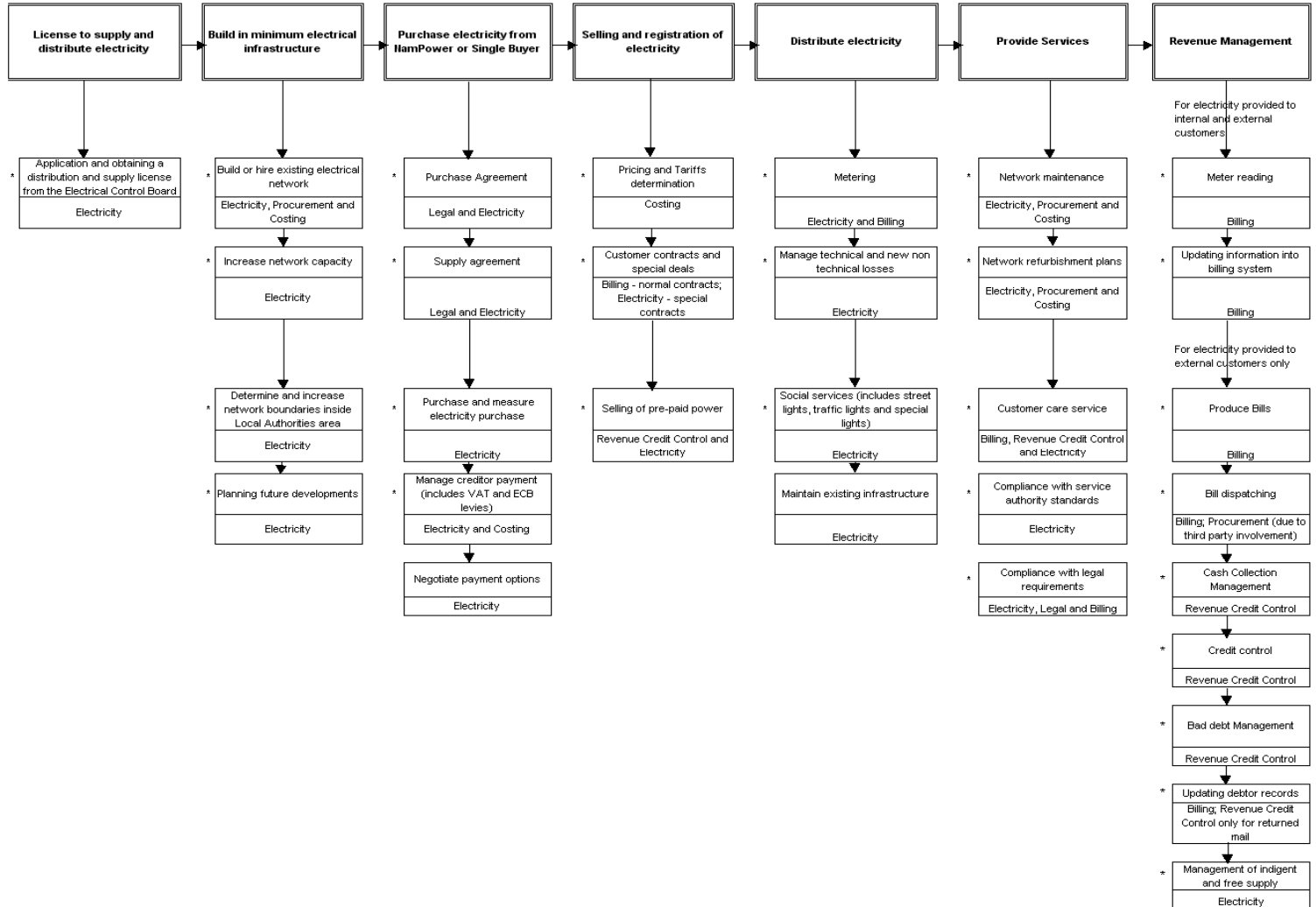
- Those activities considered being core to electricity distribution e.g.
 - Electricity purchase
 - Electricity network infrastructure and maintenance
 - Selling and distribution
- Those activities considered non-core and/or support e.g.
 - Billing and collections
 - Legal arrangements
 - Asset management
 - Information technology
 - Business planning

The categorisation of activities identified will vary from municipality to municipality, based on the responsibility assigned to it, but will not be too dissimilar in terms of type of activities being performed.

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The activities need to be recorded in a structured manner that is easily understandable. It is recommended that the activities be mapped to an electricity distribution value chain of the municipality. The key activities identified need to be grouped and expanded upon to form the value chain. The following example value chain can be used as starting point:

VALUE CHAIN



Supporting Services: HR, Administration (Office of the CEO and IA), Finance (Procurement, Budget and IT), Town Planning, Legal, Stores

Thereafter each activity needs to be unpacked in terms of assets, liabilities, resources, budget, costs, etc.

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Outputs

The key outputs from this phase of the project will be:

- An electricity distribution value chain for the municipality; and
- A complete list and understanding of activities performed at the local authority with regard to electricity distribution. Each of the core and non-core activities does have cost implications that need to be included in the ring-fenced unit's costs

7.3 PHASE 3: IDENTIFYING THE FOCUS AREAS OF RING-FENCING

Aim

The aim of this phase is to identify the various focus areas of ring-fencing pertaining to those activities that are considered necessary for the independent and successful operation of the electricity unit. The activities identified during the previous phase should then be mapped to each focus area, in order to provide the ring-fencing team with a matrix of information that needs to be collected, maintained and reported to the various stakeholders.

Key activities

The first key activity is to identify the focus areas that need to be taken into account during the ring-fencing exercise. The following focus areas are given as a guideline in the ring-fencing exercise:

Technical/Operations

Operations refer to those normally associated with the technical services division/department/unit of the municipality and may currently be managed separately within the electricity section, or may be shared with other technical services such as water or sanitation. Operations include network operations, retail operations, customer care and IT infrastructure.

Financial

Financial statements:

The financial statements of the unit should be compiled and all elements thereof adequately quantified. The main objectives of compiling and maintaining separate financial statements for the unit are:

- to reflect the current financial position of the electricity unit
- to establish cost estimates in the absence of actual cost that would reasonably reflect the likely cost of operating the unit independently
- to identify and quantify all hidden and stranded costs

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Assets:

Assets represent both current and non-current assets utilised by the unit in delivering service. The objectives of ring-fencing the assets of the unit are:

- to identify the total assets utilised by the electricity unit
- to compile and maintain a separate asset register

Equity and liabilities:

Equity and liabilities represent the funding of the assets utilised by the unit in delivering service, and should be ring-fenced together with the assets.

Management reporting:

Ring-fencing the electricity unit includes the determination of the operational costs and total asset base of the unit, and will bring about improved management information for proper decision-making. The objective of including this element in the ring-fencing process is to design a reporting system albeit a temporary mechanism that can be used by management to be operationally effective in its decision-making processes. If the entity is ring-fenced as a business unit within the local authority then the authority would invariably still remain as the decision-maker but may allow greater accountability on the part of the Head of the unit. In this case clear lines of decision-making must be established and reporting frameworks developed and adhered to.

Human Resources (HR)

In ring-fencing the human resources element the following objectives should be met:

- To determine the exact staff complement of the electricity unit, including the support staff complement and their proportional utilisation towards electricity.
- To determine the exact personnel cost of the unit, including benefits and bonuses.
- To establish and maintain separate and accurate personnel records.

The human resources system ring-fencing process will be one of the most difficult exercises due to the fact that most municipalities are currently in the process of being amalgamated. The exercise never the less has to be conducted, as human resources are probably the most costly line item apart from electricity purchases in the income statement of the unit.

Legal

Legal issues pertaining to ownership of facilities, networks, liabilities, contracts etc. need to be identified, cataloged and managed as part of the ring-fenced unit's responsibilities.

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Support Services

The support services associated with and relevant to electricity distribution must be carefully identified and costed. These services should not be physically separated from the division providing the service, but should rather be virtually separated and the costs thereof included in the total cost of the unit. The ring-fencing exercise requires the following objectives:

- To identify all the relevant support services associated with the electricity unit.
- To establish the costs of the support services.

The second activity will be to build a ring-fencing requirement matrix from all the activities identified in the value chain (Phase 2) to the focus areas identified. This will enable the user of the matrix to identify the areas and its activities that need to be taken into account to successfully cover all aspects of the service delivery when collecting the information for reporting purposes.

An example ring-fencing requirement matrix is included below:

Function/activity		Focus area				
		Technical	Finance	HR	Legal	Support
	Purchase electricity:					
1	Purchase agreement		4	4	4	
2	Measure electricity purchase	4	4			4
3	Manage creditor payments		4	4	4	4
4	Negotiate payment options		4	4	4	
	Build network infrastructure:					
1	Network assets acquisition	4	4	4	4	4
2	Network capacity	4				
3	Network boundaries	4				
4	Planning for future demand	4	4			

The project manager can successfully plan the activities necessary for the next phase from the completed matrix.

A high-level business plan addressing all aspects of the distribution value chain should also be drafted to ensure focus on relevant matters in future.

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Outputs

The key output from this phase of the project will be:

- to define and list the various focus areas of the ring-fencing exercise that are considered necessary for the independent operation of the unit;
- A ring-fencing requirement matrix; and
- The framework for a business plan for the ring-fenced business unit

7.4 PHASE 4: THE PROCESS FOR COLLECTING, COLLATING AND ANALYSING INFORMATION

Aim

The aim of this phase is to collect, collate and analyse all the necessary information, in a uniform manner, of each identified activity based on the focus areas identified during phase 3.

Key activities

A good starting point in obtaining the necessary information is the financial statements as it covers or rather should cover the full operational and capital costs of the electricity distribution unit. A separate set of financial statements for the ring-fenced unit should be maintained.

Operations

As previously stated the operations pertain to the technical aspects of the service delivery, and the information needs to be gathered and maintained to ensure proper management and forward planning by the unit. The technical data to be gathered will include that necessary for tariff determination purposes. Refer to Section A of the Annexure for the information to be gathered and maintained.

Financial Statements:

Ring-fencing the electricity distribution unit should ultimately lead to the opening of a balance sheet, which provides the unit with the necessary baseline from which to function. The income statement depicts the activity and transactional outcomes over specified periods. The income statement and the balance sheet will enable the unit to compile the cash flow statement.

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The following key aspects to the financial statements need to be discussed and agreed with the finance department of the municipality before the financial statements are compiled:

- The method of asset valuation as prescribed in the ORM and the identification of the source of funding for the ring-fenced assets
- The method of allocation of cost and income to the ring-fenced unit based on the ORM requirements
- Budget re-allocations for the ring-fenced unit including previous arbitrary allocations
- Estimates and basis for estimation where actual figures are not available

The following approach is recommended for asset to be disclosed at depreciated replacement value:

- A detailed inventory of all movable and immovable assets should be done as a point of departure
- The assets should be recorded in a separate asset register that should be updated for asset movements (including the updates in NENA)
- The backlog depreciation should be calculated by taking into account the date of purchase, the cost and the depreciation rate using the straight line method
- The provision of the replacement cost of the assets will be a function of the ECB in order to avoid different prices, and the assets should be re-valued annually base on the replacement cost
- The accumulated depreciation needs to be adjusted for each revaluation done
- The source of funding need to be allocated to each asset in order to successfully unbundled the loans redeemed and other capital receipts accounts, and alignment thereof with the accumulated depreciation calculated
- The ECB will approve the replacement cost values of the assets and the updates thereof

The following supporting information to the financial statements should be gathered and maintained on a regular basis:

- A complete asset list of all the unit's assets in place, including date of acquisition, method of finance, location and legal ownership;
- A schedule of investments pertaining to the unit and the basis of valuation;
- Accurate electricity debtor and creditor records;
- A list of inventory;
- Bank reconciliations;
- Funds and reserves supporting schedules;
- A register of loans; and
- The bad debt provisions.

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The following reconciliations should be compiled on a regular basis as a control measure:

- Bank reconciliations;
- Consumer debtor reconciliations;
- Trade creditor reconciliations.

Human Resources

It is essential for human resource information to be both complete and accurate, as it will form a large portion of the cost input in the income statement. The following information needs to be collected and maintained:

- Approved and current staff structure;
- Separate permanent records of all the unit's staff; and
- A separate record of all the salary costs of the unit including proportional allocations of non full time support staff costs.

Most of the current information technology systems will be able to assist in documenting the above information.

Legal obligations

The ring-fencing exercise should take cognisance of all contractual obligations that the electricity distribution unit may have to bear. These could be in the form of leases, staff contracts, national and provincial government legislative requirements, local by-laws, etc. The process of obtaining the legal documents will not be difficult unless the documents were misplaced. All documents obtained should be scrutinised to ascertain the current rights and obligations, costs and expiration dates. A list of legal documents should preferably be compiled and maintained, including a complete contract register.

Support Services

The ring –fencing of support services that are centralised or shared is probably the most difficult. There is no absolute guideline for allocating support services into a ring-fenced unit. Some of the support/shared services will normally include:

- HR
- Finance
- Legal
- Security
- IT
- Procurement

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It is recommend that support costs be allocated based on the methods set out below. These might well change once the service level agreements have been put in place:

Cost	Allocation method
Accommodation	Floor space
Council expenses	Income
Administration charges	Income
Engineers charges	Income
Human resources support	Staff numbers
Treasury charges	Income
IT	Income
Municipal services	Income

Once all the subsidised/support costs are calculated, service level agreements can be entered into which will determine the fee for services rendered with escalation charges in future. This fee will replace the current allocated costs in the income statement.

Outputs

The key outputs of this phase will be the completed Schedules of the Annexure, including a set of financial statements and information with regard to the ring-fenced unit.

7.5 PHASE 5: VALIDATION OF THE INFORMATION GATHERED

Aim

The aim of this phase is to verify the asset, liability, personnel, contracts and other information gathered.

Key activities

This phase should be undertaken in conjunction with phase 4, as it will save time. Validation normally requires checking and re-checking of information to ensure accuracy and completeness and should be conducted by staff independent from the gathering process, preferably by internal or external auditors.

Outputs

The output of this phase will be validated information.

7.6 PHASE 6: DOCUMENTING AND MAINTAINING THE INFORMATION

Aim

The ring-fencing exercise should preferably include the design and implementation of an information database for the documentation of all information gathered, that should have accountability for continued maintenance thereof assigned once in operation.

In the event that a database cannot be implemented, detailed manual records should be kept and updated on a regular bases.

Key activities

The database/manual records should constantly be updated with changes to the information such as assets and personnel movements. Financial statements should be compiled from information contained in the database/manual records.

Outputs

Continuously updated information on the ring-fenced unit.

8. CONCLUSION

Once the electricity distribution unit is ring-fenced and the opening balances have been calculated, it will provide the bottom line of the costs required rendering the required service. The financial information, asset valuations and operational information need to be constantly updated to provide SOE management information and to ease reporting to the ECB.

Once the ring-fencing exercise has been completed, it is recommended that municipalities assess if an internal business unit within the administration of the municipality is the most appropriate service delivery mechanism for rendering electricity services.

The ring-fencing exercise would in addition to determining the actual cost of providing the service, highlight challenges and gaps in respect of rendering the service through an internal business unit, such as capital expenditure priorities and the elimination of service backlogs. An assessment of these challenges and gaps and possible mechanisms for addressing them is critical to ensure effective, efficient and affordable electricity services.

A wide range of service delivery mechanisms (usually referred to as alternative service delivery mechanisms or partnerships) in addition to rendering the services through an internal business unit are available to municipalities.

Alternative service delivery mechanisms of partnerships for electricity services can take a variety of possible forms. In one context, the options range through Public/Public Partnerships, Public/Private Partnerships, Public/NGO Partnerships and Public/Community Partnerships. Within this context a range of contracting options are available which cover corporatisation, service contracts, lease contracts, management contracts, build-operate-transfer (BOT), concessions and full privatisation. Each one of these contracting options has a range of variations that can then be applied or certain features of different options can be combined to provide an appropriate solution.

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These alternative service delivery mechanisms / partnerships can briefly be described as follows -

Public/Public

In this option, two or more public organisations team up to provide the necessary services. This could be adjacent municipalities who combine to utilise their resources and available expertise on a more efficient basis thus benefiting from their combined abilities to provide and the synergy effect of developing a critical mass. Alternatively, an established and focused government organisation could use its resource base and depth of skills and knowledge to support a municipality lacking in such resources.

Public/Private

A public/private partnership is a contract created between the municipality and a selected private contractor to undertake a defined service. The municipality would make the assets necessary for the provision of the defined service available to the contractor (but still retain full ownership of these assets) and the contractor would be required to perform to agreed standards. This creates one of the disadvantages of the public/private partnership in that the requirements of the contract have to be clearly defined and changes to these requirements leads to a renegotiation of the contract. The private sector contractor can, however, bring flexibility to the approach of service provision and can generally access operating and investment capital.

Public/NGO

In this case, the municipality would contract with an NGO to provide specific services in the provision of the overall service. Due to the restricted capacity of most NGO's this would be unlikely to extend to the full service provision. This approach, however, has considerable advantages in that it will generally involve local stakeholders and will assist with the building of capacity within the NGO. The negative aspects of this partnership form would be the probable lack of relevant skills and difficulty of the partnership to raise external funding for the on-going work. Problems have also been experienced elsewhere due to the NGO not generally being registered as a legal entity.

Public/Community Based Organisation

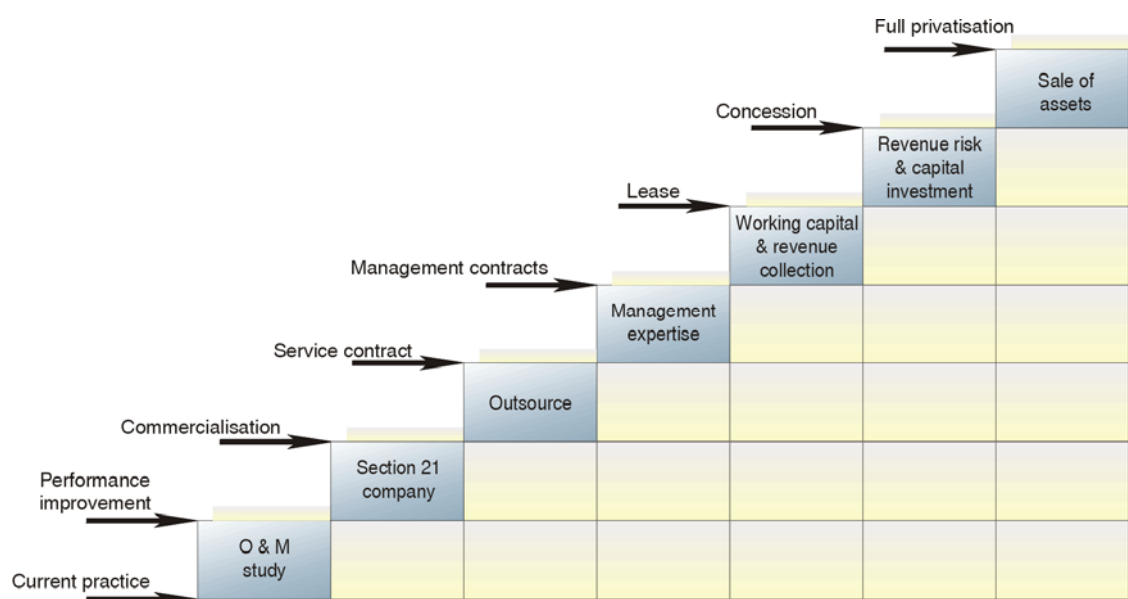
In this instance, the municipality would contract the community (formalised or given legal status by a constitution, i.e. voluntary association) to manage the distribution, supply or cost recovery. This generally requires clearly defined communities of a size where communication and consensus can be readily achieved. If it can work, it assists the community by creating an income base that can be used to fund other needs and ensures that as much of the money as possible goes back into the community. Again, this form of partnership does not facilitate the accessing of funding for capital expenditure and experience has shown that it is not always sustainable particularly when the original leaders move on and their successors are not as committed or capable.

RING-FENCING GUIDELINE

The range of contracting options that can be used to give effect to the above-mentioned alternative service delivery mechanisms / partnerships is also briefly described.

However, the more sophisticated forms of contract are not, however, likely to be appropriate to the NGO or CBO partnerships.

Each type of contract can either be seen as an independent concept or they can be seen as a progressive method of developing more sophisticated approaches as the capacity of the authority grows with experience. This concept is reflected in the following diagram -



Commercialisation

Also known as Corporatisation, this option is aimed at creating a ring-fenced operation which operates in the same way as a private company but which remains under the ownership control of the authority. The benefits of this approach are that all aspects that contribute to the provision of the service are put into the new entity and the staff of the organisation is given more responsibility for the provision of the service. This creates a flexibility of approach that benefits the organisation and the customer. As with any company, management presents its business plan to the Board of Directors, in this case the municipality or its nominated representatives, and is then required to perform against the approved plan.

Service Contract

This contract form is generally used to outsource specific elements of a service such as meter reading, equipment maintenance, etc. It is normally a short-term contract, between 1 and 3 years, and the requirements of the contract can be very clearly defined.

RING-FENCING GUIDELINE

Management Contract

A management contract is used when there is a need to bring in management expertise into the service provision function. Such contracts are generally for 3 to 5 year duration and the contractor is responsible for providing the defined service as well for taking management responsibility for such provision.

Lease Contract

A municipality may wish to make a particular facility, or group of facilities available to a contractor against payment of a lease fee and a contract for the supply of a particular service. Such a contract would be for a period in excess of 3 years and the contractor would be responsible for providing all the operating capital including maintenance and possible upgrade costs while the municipality would remain responsible for any capital investment required for extension or rehabilitation. This option is similar to the build-operate-transfer (BOT) type of contract that is often used to construct and finance a particular facility.

Concession

A concession contract is normally for a period of 25 to 30 years and the contractor is responsible for providing the specified service as well as for providing all funding required for the necessary upgrades to the system. The requirements of a concession contract would be for the contractor to provide the predetermined service to the standards defined in the contract. The contractor would also be responsible for obtaining the revenue from the customers supplied and taking full risk on his ability to generate the required income.

Full Privatisation

National policy in Namibia may not support the privatisation of what is an essential basic service. It may, however, be appropriate for non-core elements of the electricity service to be privatised where such a service can also provide a service to the private sector or to other municipalities. An example of where this has happened elsewhere would be the scientific and laboratory services.

Irrespective of which form of partnership or which form of contract is adopted there is certain principles that have to be applied. The first of those is that the procurement process has to be based on all available information being made available to the prospective contractors. As part of this procurement it is also preferred practice that a competitive bidding process be used where the bidders all receive detailed information on the existing conditions and the requirements of the contract. Linked with this is a clear bidding document, which defines the process to be followed, and the information required from each bidder.

The position of the affected staff has to be very clearly spelled out in the terms of any contract. It would be normal to require that any entity which takes over the responsibility for the service provision has to take over all the staff attached to the existing operation on, at least, the same or similar terms and conditions as they enjoy at present. An alternative approach would be for the staff to be seconded to the appointed operator.

RING-FENCING GUIDELINE

Any contract requires monitoring to confirm that the appointed contractor conforms to the requirements of the contract. Allowance has to be made, therefore, for the municipality to identify a person or persons who will undertake this task on their behalf.

When a municipality decides to investigate these service delivery mechanisms, their appropriateness for the rendering of electricity services each mechanism should at least be assessed against the following –

- The direct indirect costs and benefits of the service delivery mechanism including the expected effects on the environment, human health, well-being and safety;
- The capacity and potential future capacity of a service delivery mechanism to furnish the skills, expertise and resources for the provision of the service;
- The views of the local community and organised labour;
- The likely impact on development and employment patterns in the municipality;
- The ability of the service authority or service provider to obtain the capital required for investment given the municipality's current obligations and anticipated sources of revenues;
- The ability of potential public and private sector partners to economically provide the required capital and extend service delivery, within standards, to all eligible recipients and receive a reasonable return on its investment;
- The effect on tariffs, both short and long term;
- The effect on the technical quality of the service delivery;
- The effect on staff;
- The likely response from other stakeholders;
- Cost recovery efficiency and/or the potential effectiveness of cost-recovery initiatives to an expanded universe of service recipients;
- The service delivery efficiency of each alternative;
- Probable risk sharing between public and private sectors;
- Requirements for monitoring, accountability and good governance;
- Implementation process and time required; and
- Attractiveness to potential external partners.

In addition to the above the legal, regulatory, institutional and risk related matters, including all legislation that may affect implementation of any one of the service delivery mechanisms, together with any government policies should be assessed.

However, as the consideration of and election of an alternative service delivery mechanism is a complicated and far reaching it is recommended that relevant professional services and expertise are utilised.