

METROPOLITAN WATERWORKS AND SEWERAGE SYSTEM
NOTES TO FINANCIAL STATEMENTS
(In Thousand Pesos)

1. Corporate Information

The Metropolitan Waterworks and Sewerage System (MWSS), a government-owned and controlled corporation, was created under Republic Act No. 6234 which was approved on June 19, 1971 replacing the National Waterworks and Sewerage Authority. Its main objective is to ensure an uninterrupted and adequate supply and distribution of potable water for domestic and other purposes to its consumers at just and equitable rates. It also aims to provide sewerage and sanitation services to the public. MWSS owns and has jurisdiction over all waterworks and sewerage system of all the cities and municipalities of Metro Manila, and some municipalities of Cavite and Bulacan.

Because of the felt need for the government to adopt urgent and effective measures and to address the nationwide water crisis which adversely affected the health and well-being of the public, legislators passed into law Republic Act No. 8041, otherwise known as the National Water Crisis Act of 1995, implemented under Executive Order No. 286 dated December 6, 1995, which reorganized the MWSS. The passage of Executive Order No. 311 on March 20, 1996 encouraged the private sector's participation in the operation of the facilities of MWSS and paved the way for its privatization.

Pursuant to a process of a competitive public bidding and selection, MWSS' operations were privatized. Thus, on February 21, 1997, MWSS entered into a Concession Agreement (CA) with two private companies (Concessionaires), namely, the Manila Water Company Incorporated (MWCI) and the Maynilad Water Services Incorporated (MWSI), granting them the rights to manage, operate, repair, decommission and refurbish the Facilities in the Service Area, including the right to bill and collect for water and sewerage services supplied in the Service Area. MWCI operates on the east zone while MWSI services the west zone. The two concessionaires formally took over the operations of MWSS on August 1, 1997. In addition to the performance of the service obligations, the concessionaires are required, under the CA, to pay MWSS concession fees in consideration for such right.

As a result of the privatization in 1997, MWSS is now divided into two Offices, the MWSS-Corporate Office and the MWSS- Regulatory Office.

Due to financial difficulties, the MWSI suspended payments of concession fees to MWSS beginning March 8, 2001. As a result, disputes between MWSS and the concessionaire ensued which brought them to a process of arbitration before the Appeals Panel appointed pursuant to the CA. On November 7, 2003, the Appeals Panel issued an award declaring that there is neither a Concessionaire Event of Termination nor an MWSS event of termination and that, consequently, the CA shall continue in force and that MWSS and the concessionaire shall perform their respective obligations under the CA until the termination of the concession. The Appeals-Panel further declared that concession fees which should have been paid by the concessionaire to MWSS were due and payable to MWSS with the corresponding interest pursuant to the CA and that MWSS may draw on the performance bond in accordance with Section 6.9 (Performance Bond) of the Concession Agreement.

On November 13, 2003, MWSI filed a petition for its corporate rehabilitation with the Rehabilitation Court, submitting therewith a rehabilitation plan as required under applicable legal requirements. A stay order was then issued by the Rehabilitation Court on November 17, 2003 prohibiting the concessionaire, among other things, from making any payment of its liabilities outstanding as at the date of the filing of the petition.

After securing a favorable decision from the Supreme Court, MWSS was able to draw on the Performance Bond in the entire amount of One Hundred Twenty Million US Dollars (US\$120,000,000.00) for unpaid concession fees. On September 9, 2004, the concessionaire filed with the Rehabilitation Court a revised rehabilitation plan which was recommended for approval by the court-appointed Rehabilitation Receiver. However, the terms thereof had to be further modified in order to address the concerns raised by several creditors of the concessionaire. On April 29, 2005, the concessionaire submitted its 2005 Rehabilitation Plan incorporating therein the terms of a Debt and Capital Restructuring Agreement (DCRA) executed among the concessionaire, MWSS, Benpress Holdings Corporation, the Suez Group and the Lenders. The Rehabilitation Court approved the 2005 Rehabilitation Plan as well as other related documents, including the DCRA, on June 1, 2005.

Under Clause 2.6 (Increase in capital) of the DCRA, as part of the implementation of the Capital Restructuring, MWSS is given the right and obligation to subscribe to 1,238,476,000 Class "A" shares (the MWSS Subscription shares) representing 83.97% of the outstanding capital stock of the concessionaire (the MWSS Subscription Right), pursuant to Clause 2 (Capital Restructuring) of the DCRA, which subscription shall be paid for by MWSS by way of conversion into equity of the MWSS receivables converted into Philippine pesos based on assumed exchange rate of P54.63 to US\$1.00. Alternatively, under Clause 24 (Substitution of the MWSS) of the DCRA, MWSS is given the right, subject to the prior approval of all the lenders and the Suez Group, to assign the MWSS Subscription Right; provided, that the assignee of MWSS shall assume all the obligations and undertakings of MWSS under the DCRA in connection with, relating to or arising from, such right, including the execution of a debt conversion and subscription agreement with the concessionaire and the provision of the Financial Assistance to the concessionaire, as required under Clause 14.1 (the Financial Assistance) of the DCRA.

Article 3(j) of the Charter authorizes MWSS, among other things, to dispose of real and personal property, including rights and franchises, consistent with the purpose for which MWSS was created and reasonably required for the transaction of the lawful business of the same. Consistent with the privatization policies of the Republic, the MWSS Board of Trustees, in its meeting dated September 8, 2005, issued Resolution No. 2005-203 authorizing MWSS to exercise its option to assign the MWSS subscription right to a private investor. Pursuant to a process of a competitive public bidding and selection, the sponsor was awarded the right to acquire the MWSS receivables and the MWSS subscription right, subject to the sponsor's assumption of the DCRA sponsor obligations and performance of the other sponsor obligations.

On March 2, 2009, MWCI submitted a business plan proposing to increase the investments on wastewater and new water sources project and to ensure water supply security to support their request for extension of the Concession Agreement for an additional period of fifteen (15) years, from 2022 to 2037, subject to the written consent of the Republic of the Philippines (ROP) as required under Section 16.12 of the CA. Series of public consultations were conducted to inform and educate stakeholders of the

issues to warrant the extension. On April 28, 2009, per Board Resolution 2009-072, MWSS approved the extension of the concession for the East Area Concession.

Following the extension of the CA with the MWCI was the extension of the CA with the MWSI for additional fifteen (15) years. On June 24, 2009, MWSI submitted its formal proposal for 15-year extension of its Concession anchored on the following considerations:

- a. Economic benefits to consumers through the mitigation of tariff increases;
- b. Ability to undertake long-term water supply and sewerage projects to ensure adequate service and comply with more aggressive regulatory and environment requirements;
- c. Access to longer-term financing at competitive rates to fund more long-term CAPEX projects; and
- d. Ensure the long-term viability of the Concessionaire.

On September 10, 2010, Board Resolution No. 2009-180 resolved that the Concession period of the Maynilad Water Services, Inc. be renewed/extended for an additional period of fifteen (15) years, subject to the same conditions required when the MWCI was granted their extension.

SOURCES OF FUNDS

The following are the sources of funds of MWSS:

- Concession fees collected
- Rentals on leased properties
- Interest income on investments
- Loan availments from foreign and domestic financial institutions
- Collection of raw water and accounts receivable (accounts prior to privatization)

KEY PROJECTS

To ensure uninterrupted and adequate supply of clean and affordable water in Metro Manila and neighboring towns, MWSS continues to implement the following projects:

A. Foreign-Assisted Projects

Angat Water Utilization and Aqueduct Improvement Project (AWUAIP) - Phase 2

In order to secure the conveyance of raw water coming from the Angat Dam, the Project, denominated as Angat Water Utilization and Aqueduct Improvement Project (AWUAIP), was conceived.

Phase 1, which involves the construction of a 5.50 km by-pass aqueduct, was completed in January 2006 and is now operational.

Phase 2, which is on-going, involves the construction of a 9.9 kilometers aqueduct extension, the rehabilitation of existing Aqueduct No. 5 and interconnection works for the six (6) aqueducts, including the clearing of informal settlers/illegal structures along the 60-meter right-of-way of the aqueduct alignment.

Project Location : San Jose Del Monte, Bulacan
 Project Schedule : March 2010 – March 2013 (3 years)
 Total Project Cost : P6.109 Billion (as approved by NEDA – ICC)
 Total Project Cost : P6.089 Billion (cost after the bidding)
 Amount of Loan : P5.537 billion (US\$116.602 Million)
 Export-Import Bank of China

Contract Cost with China International

Water and Electric Corporation : P5.298 Billion

Project Status as of Dec. 31, 2011 : The project was awarded to China International Water and Electric Corporation and the construction works is in progress at 71.66% physical accomplishment.

B. Locally – Funded Projects

- | | | |
|---|---|-------------------------|
| 1. Angat Dam and Dyke Safety Project | - | P31M |
| 2. Sumag River Diversion Project | - | P562M |
| 3. Umiray-Angat Transbasin Tunnel
Rehabilitation Project Phase 2 | - | P454M |
| 4. Ipo Watershed Management | - | P23.056M (CY 2011 only) |
| 5. Waterproofing at MWSS Roofdeck | - | P4.058M |

1) Angat Dam and Dyke Safety Project

This project shall determine the effect on the Angat Dam & Dykes should the West Valley Fault move due to earthquake and ensure the safety of the Dam/Dykes, establish contingency measures and formulate long-term dam strengthening and stabilization.

Phase 1 (study and preliminary design):

- This was funded by PSALM in the amount of P31 million;
- The consulting services was awarded to EDCOP in joint venture with Tonkin & Taylor which was started on November 8, 2011 for a contract duration of six (6) months or until April 8, 2012; and
- Accomplishment as of December 31, 2011 is 31.50%.

Phase 2 (detailed design and remediation works):

- Fund sourcing is on-going

2) Sumag-River Diversion Project

- This will be implemented and funded by the Concessionaires under the Common Purpose Facility (CPF) framework of the Concession Agreement;

- Permitting works is on-going;
 - Procurement process is on-going for the engagement of consultants for the review of documents and Construction Management & Engineering Services (CMES);
 - Target start of construction is July 2012.
- 3) Umiray-Angat Transbasin Tunnel Rehabilitation Project Phase 2
- This will be implemented and funded by the Concessionaires under the Common Purpose Facility (CPF) framework of the Concession Agreement:
- Permitting works is on-going;
 - Same consultant for the Sumag Project will undertake the project cost update, tender documents and procurement of contractor;
 - Target start of construction is July 2012.
- 4) Ipo Watershed Management
- The project cost of P23M for CY 2011 was funded by the two Concessionaires (MWCI and MWSI);
 - A total of 560 hectares were reforested as of December 31, 2011;
 - For the next five (5) years (CYs 2012-2017), target reforestation is 900 hectares per year.
- 5) Waterproofing at MWSS Roofdeck
- Supply and installation of waterproofing and concrete topping for the roofdeck of MWSS's Administrative and Engineering Buildings were completed on March 13, 2012.

2. Basis of Financial Statement Preparation

The Administrator has the inherent authority to issue Financial Statements of MWSS pursuant to Section 8 (g) of Republic Act No. 6234, the MWSS Charter.

The accompanying financial statements have been prepared in conformity with generally accepted state accounting principles in the Philippines.

The financial statements of MWSS have been prepared using the historical cost basis and are presented in Philippine pesos, which is the System's functional and presentation currency. All values are rounded to the nearest thousand. The financial statements of the MWSS Corporate Office and the Regulatory Office are consolidated in this report.

3. Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year.

4. Summary of Significant Accounting Policies

Cash and cash equivalents

Cash in banks earn interest at the respective authorized government depository bank rates. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less from dates of acquisition and that are subject to an insignificant risk of changes in values. Cash equivalents are for varying periods of up to three months depending on the immediate cash requirements of the System, and earn interest at the respective investment rates. Due to the short-term nature of the transaction, the fair value of cash and cash equivalents and short-term investments approximates the amount at the time of initial recognition.

Receivables

Receivables are recognized and carried at original billed amount. Provision for doubtful accounts on water/sewer accounts receivable prior to privatization is maintained at a level considered adequate to provide for potential losses on receivables. The level of this provision or allowance is based on management's evaluation of collection experience and other factors that may affect collectability.

Property, plant and equipment

Property, plant and equipment (PPE), except those fully depreciated and those classified as administration equipment, are stated at appraised value based on the appraisal conducted in 1995 by Cuervo Appraisers, Inc., an independent appraiser hired by MWSS for that purpose, less impairment in value. Appraisal increments are recorded as appraisal capital. Additional PPE acquired after said appraisal were recorded at cost. In 2006, another appraisal was conducted by Cuervo Appraiser Inc. Appraisal increments were recorded in the books in 2007.

Depreciation of PPE commences once the properties become operational and available for use, and are calculated on a straight-line basis over the estimated useful lives of the property, plant and equipment.

Minor repairs and maintenance costs are expensed when incurred, while major repairs and/or those repairs that will prolong the useful lives of the assets are capitalized.

When property and equipment are retired or disposed of, the cost and the related accumulated depreciation, amortization and accumulated provision for impairment losses, as the case may be, are removed from the accounts and any resulting gain or loss is recognized in profit or loss.

The useful lives and the depreciation and amortization methods are reviewed periodically to ensure that they are consistent with the expected pattern of consumption of the future economic benefits embodied in the items of property, plant and equipment.

Construction in-progress

Construction in-progress is stated at cost. While the construction is in progress, project costs are accrued based on the contractors' accomplishment reports and billings. These represent costs incurred for technical services and capital works program contracted by the System to facilitate the implementation of the project. While the construction of the project is in progress, no provision for depreciation is recognized.

Construction in-progress is transferred to the related Property, Plant and Equipment account when the construction or installation and related activities necessary to prepare the property, plant and equipment for their intended use have been completed, and the property, plant and equipment are ready for service.

Long-term foreign loans

Long-term foreign loans are recorded in peso based on the exchange rate at the time of withdrawal and are revalued at the end of each reporting date.

Impairment of financial assets

An assessment is made at each reporting date to determine whether there is any indication of impairment of assets, or whether there is any indication that an impairment loss previously recognized for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use or its net selling price.

An impairment loss is recognized only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to operations in the year in which it arises.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in profit or loss, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however, not to an amount higher than the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. In 2004, an impairment loss was recognized by MWSS for the Umiray-Angat Transbasin due to damages caused by typhoons. Since said impairment was effected in the books only in 2005, it was charged directly to Retained Earnings of that year.

Leases

A lease where the lessor retains substantially all the risk and benefits of ownership of the asset is classified as an operating lease.

Revenue recognition

All Concession fees billed/collected/received from the Concessionaires are treated as operating revenue.

Concession fees – Debt Service and Progress Billings are concession fees received from the Concessionaires that are intended for MWSS loan amortization and payments to contractors/suppliers, respectively. These are pass-on payment without any margin in favor of MWSS. Concession Fee – COB is the annual Current Operating Budget being paid by the concessionaires to MWSS for administrative expenditures subject to annual Consumer Price Index adjustment.

Foreign currency-denominated transactions

Foreign currency-denominated transactions are recorded using the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the closing exchange rate at reporting date. Foreign exchange gains and losses arising from foreign currency fluctuations are recognized in profit or loss for the period.

Subsequent events

All post year-end events up to the date the financial statements are authorized for issue that provide additional information about the System's position at reporting date (adjusting events) are reflected in the financial statements. Any post year-end event that is material and not an adjusting event is disclosed in the notes to the financial statements.

Borrowing costs

Borrowing costs are generally expensed as incurred. Borrowing costs that are directly attributable to the acquisition, development, improvement and construction of fixed assets (including costs incurred in connection with rehabilitation works) are capitalized as part of the cost of the asset. The capitalization commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Capitalization of borrowing costs ceases when substantially all activities necessary in preparing the related assets for their intended use are complete.

Judgments and use of estimates

The preparation of the accompanying financial statements in conformity with PFRS requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The estimates and assumptions used in the accompanying financial statements are based upon management's evaluation of relevant facts and circumstances as of the date of the financial statements. Actual results could differ from such estimates.

PAS 1, *Presentation of Financial Statements*, which was adopted by the System effective January 1, 2005, requires disclosures about key sources of estimation, uncertainty and judgments management had in the process of applying accounting

policies. Management believes the following represent a summary of these significant estimates and judgments:

Use of estimates

Key assumptions concerning the future and other sources of estimation and uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Estimating allowance for doubtful accounts

The System maintains allowances for doubtful accounts at a level considered adequate to provide for potential losses on receivables. The level of this allowance is based on management's evaluation of collection experience and other factors that may affect collectability. The amount and timing of recorded expenses for any period would, therefore, differ depending on the judgments and estimates made for the year.

Estimated useful lives of property, plant and equipment

The System estimates the useful lives of its property, plant and equipment based on the period over which the assets are expected to be available for use. The System reviews annually the estimated useful lives of property, plant and equipment based on factors that include asset utilization, internal technical evaluation, technological changes, environmental and anticipated use of the assets tempered by related industry benchmark information. It is possible that future results of operation could be materially affected by changes in the System's estimates brought about by changes in the factors mentioned.

Contingencies

The System is currently involved in various legal proceedings. The estimate of the probable costs for the resolution of various claims is established in consultation with the in-house lawyers and the Government Corporate Counsel handling the case.

5. Cash and cash equivalents

Cash and cash equivalents consist of the following:

	2011	2010
Cash	1,583	1,717
Cash equivalents	1,411,324	4,383,059
	1,412,907	4,384,776

The decrease in *cash equivalents* was due to full settlement of BNP Paribas loan that matured in the First Quarter of the year.

6. Accounts receivables, net

This account consists of:

	2011	2010
<i>Trade/business</i>		
Receivables from customers-water, sewer, including raw water accounts	1,126,099	1,117,538
Receivables from concessionaires	538,772	555,040
	1,664,871	1,672,578
Allowance for doubtful accounts	(1,117,002)	(1,117,002)
	547,869	555,576
<i>Non-trade receivables</i>		
Intra-agency receivables	1,134,412	820,436
Inter-agency receivables	25,107	16,754
Due from officers and employees	66,497	66,276
Loans receivables	54,277	54,563
Interest receivables	1,520	2,014
	1,281,813	960,043
	1,829,682	1,515,619

The *Receivables from customers-water, sewer, including raw water* accounts represent the balance of accounts receivables prior to the privatization of MWSS in the amount of P1.117B, the collection of which is highly improbable. Thus, Management set-up the provision for bad debts account for the same amount. Meanwhile, Management is presently considering the process of writing-off the account in accordance with the required procedures, such as the congressional approval.

The *Receivables from concessionaires* represent concession fees for Current Operating Budget, Debt Service and Progress Billing that are outstanding as of balance sheet date.

Intra-agency receivables are receivables from the MWSS Regulatory Office consisting of electric bills, telephone bills and share in dividends paid to the National Government plus other accounts such as share in janitorial, security and other expenses.

Inter-agency receivables represent collectibles from other government agencies such as the Department of Public Works and Highways (DPWH), Office of the Government Corporate Counsel (OGCC), Supreme Court, Manila International Airport Authority (MIAA), Local Water Utilities Administration (LWUA) and the City of Manila for office rental, electric and water bills. Some of these accounts are classified as dormant. The Management created a task force to work out on all inactive and dormant accounts to be written –off in the books of account.

7. Other receivables

This account consists of the following:

	2011	2010
Receivables from MWSI	5,509,501	5,225,891
Receivables from MWCI	141,172	160,005
Others	24,688	21,801
	5,675,361	5,407,697

Details of the *Receivables from MWSI and MWCI* are as follows:

	2011	2010
MWSI		
Cost of borrowings	4,022,352	3,797,066
Penalty on delayed remittance of Concession fees	1,118,315	1,118,315
Inventory held in trust	158,480	98,050
Penalty for non-payment of borrowing costs	95,247	95,247
Guarantee deposits	94,996	94,996
Mabuhay Vinyl	4,994	4,994
LMG Chemphil	4,627	4,627
Other receivables	10,490	12,596
	5,509,501	5,225,891
MWCI		
Guarantee deposits	65,583	72,210
Inventory held in trust	43,747	43,747
Penalty on delayed remittance of Concession fees	13,182	13,182
LMG Chemphil	7,730	7,730
La Vista	591	591
Other receivables	10,339	22,545
	141,172	160,005

Cost of borrowings include the principal, interest and finance charges such as bank conversions, documentary stamps, cable charges and penalties.

The increase in the *Inventory held in trust* of MWSI represents the transfer of inventory account to receivables amounting to P60.43M.

Inventory held in trust represents costs of inventories turned-over to the concessionaires upon commencement of the Concession Agreement. Under Sec.16.12 of the Concession Agreement, upon the expiration of the Concession, the Concessionaires shall transfer to MWSS the inventory having a value (adjusted for CPI) at least equal to the Inventory made available to the Concessionaire on the Commencement Date.

Guarantee deposits are customer deposit prior to the privatization of MWSS. The amounts were withheld by the two concessionaires from the collection of accounts receivable from water and sewer services of MWSS on the onset of the privatization where the two concessionaires were authorized to collect. Management and the two concessionaires are presently coordinating and in the process of reconciliation to arrive at the amount of guarantee deposit to be refunded to MWSS.

8. Inventories

This account consists of the following:

	2011	2010
Construction materials	-	60,430
Office supplies and printed forms	531	739
Auto parts and supplies	118	77
IT supplies and accessories	88	17
	737	61,263

Construction materials represent materials available for use in the projects. Decrease of construction materials was due to reclassification of the Inventory account to Other Receivables from MWSI - Inventory Held in Trust.

9. Prepayments

This account consists of the following:

	2011	2010
Advances to suppliers/contractors	564,383	895,212
Prepaid expenses	34,076	29,261
Deposits on letters of credit	2,888	2,888
	601,347	927,361

Advances to suppliers/contractors include the balance of the 15% mobilization costs paid to the contractors/suppliers/consultants of civil works/goods/consultancy services, subject to periodic recoupment.

10. Property, plant and equipment, net

The details of property, plant and equipment (PPE) are as follows:

	Building, Plant Equipment and Transmission Lines	Office Furniture and Other Equipment	Trans- portation Equipment	Land & Land Improve- ments	TOTAL
Cost					
January 1, 2011	61,462,292	1,252,944	619,529	12,780,233	76,114,998
Additions	14,426	1,175	-	34,206	49,807
Adjustments					
Transfers/capitalization	6,412	-	34,965	-	41,377
December 31, 2011	61,483,130	1,254,119	654,494	12,814,439	76,206,182
Acc. Depreciation					
January 1, 2011	(34,665,779)	(906,502)	(405,900)	-	(35,978,181)
Depreciation expense	(1,451,592)	(71,561)	(36,824)	-	(1,559,977)
Adjustments	(3,447)	-	(31,468)	-	(34,915)
December 31, 2011	(36,120,818)	(978,063)	(474,192)	-	(37,573,073)
Carrying Amount December 31, 2011	25,362,312	276,056	180,302	12,814,439	38,633,109
Cost					
January 1, 2010	61,138,831	1,247,950	592,124	12,779,936	75,758,841
Additions	81	3,704	-	297	4,082
Adjustments	9,230	-	-	-	9,230
Transfers/Capitalization	314,150	1,290	27,405	-	342,845
December 31, 2010	61,462,292	1,252,944	619,529	12,780,233	76,114,998
Acc. Depreciation					
January 1, 2010	(33,066,701)	(807,772)	(330,192)	-	(34,204,665)
Depreciation expense	(1,465,196)	(85,791)	(46,080)	-	(1,597,067)
Adjustments	(133,882)	(12,939)	(29,628)	-	(176,449)
December 31, 2010	(34,665,779)	(906,502)	(405,900)	-	(35,978,181)
Carrying Amount December 31, 2010	26,796,513	346,442	213,629	12,780,233	40,136,817

11. Construction in-progress

The movements in this account follow:

	2011	2010
Balance, beginning	1,010,505	1,237,083
Additions/New Project	2,620,381	302,555
Transfers/capitalization	(41,377)	(342,845)
Reclassification/Adjustments	1,408	(186,288)
Balance, end	3,590,917	1,010,505

The increase in *Construction in Progress* represents the implementation of Angat Water Utilization and Aqueduct Improvement Project (AWUAIP) Phase 2.

12. Investments

This account consists of the following:

	2011	2010
Stocks and bonds		
NAPOCOR bonds	106,465	457,852
Home Guaranty Corp. bonds	19,008	19,008
MERALCO stocks	2,152	2,152
PLDT investment plan	373	373
	127,998	479,385
Miscellaneous		
Special reserve fund	318,412	299,371
Sinking fund	29,510	29,510
	347,922	328,881
	475,920	808,266

The *NAPOCOR bonds* are Government Securities with an interest rate of 3.25% to 3.85% per annum and will mature on November 2012.

The *special reserve fund* with the Bureau of Treasury, which is intended as guarantee for the financial obligations of MWSS during the concession period, was established in pursuance to Article 2.1 of the Memorandum of Agreement (MOA) between the Department of Finance (DOF) and MWSS.

13. Other assets, net

This account consists of the following:

	2011	2010
Unserviceable assets	272,961	231,850
Research and development	157,267	157,267

MWSS Share in Angat Dam construction	46,774	54,897
Garnished accounts	11,461	11,461
Guarantee deposits	10,728	10,728
Dormant accounts	897,256	938,417
	1,396,447	1,404,620
Allowance for dormant accounts	(519,000)	(519,000)
	877,447	885,620

Unserviceable assets are the costs of construction materials and supplies that can no longer be used in projects due to obsolescence or assets which are no longer operational. Management is working out on its disposal.

Dormant accounts are accounts prior to the privatization in 1997. These include balances of accounts carried over since the time of the old National Waterworks and Sewerage Administration (NAWASA).

14. Payable accounts

This account consists of:

	2011	2010
Accounts payable	682,060	664,414
Interest payable	124,598	302,175
Due to officers and employees	120,214	120,720
	926,872	1,087,309

Accounts payable includes accrued maintenance and other operating expenses and local counterpart of loans payable.

Due to officers and employees refer to accrued personal services and COLA of incumbents to be paid the following year. These also include unclaimed gratuity/terminal leave pay of former MWSS employees which were taken up in the books prior to 1997.

15. Inter-agency payables

This account consists of payables to the:

	2011	2010
BTr	247,406	235,091
BIR	10,029	1,716
GSIS	1,934	1,508
Pag-IBIG	466	305
Other GOCCs	454	507
	260,289	239,127

Payable to the Bureau of Treasury pertains to the guarantee fee on existing loans.

16. Intra-agency payable

This account represents the share of the MWSS-Regulatory Office in the concession fee received from the concessionaires for their current operating budget as provided in the CA.

17. Other liability accounts

This account includes 10% retention from contractors' claims, unreturned borrowed materials, cost of flushing, attorneys' fees, guaranty deposits and depository liabilities. It also includes liabilities with existing law suits and money claims such as cost of living allowance, contract collectors early retirement pay and retirement claims of former MWSS-CO employees under RA 1616 pursuant to Supreme Court Decision GR No. 164542 dated December 18, 2007, released to MWSS on March 12, 2008 and taken up in the books in September 2008.

18. Long-term liabilities

This account consists of domestic and foreign borrowing, as follows:

Source	Maturity Date	Currency	Annual Interest Rate	2011	2010
Domestic					
DBP/LBP	12/31/18	P	4.50%	2,008,929	-
SPIAL	05-15-26	\$	9.65%	374,869	386,057
ADB 1746-PHI	02-01-22	P	floating	194,029	193,840
NHA		P	floating	98,795	98,795
IBRD 1272/1282	07-15-20	\$	8.50%	63,442	63,380
				2,740,064	742,072
Foreign					
BNP Paribas	11-26-11	\$	floating	-	6,582,750
ADB 1379-PHI	07-15-20	\$	floating	2,579,644	2,747,455
ADB 986-PHI	10-01-14	\$	floating	2,085,940	2,474,678
JBIC (OEFC)	02-20-20	Y	2.70%	1,984,782	1,849,205
IBRD 4019-PH	07-01-16	\$	floating	595,108	718,597
China Eximbank					
AWUAIP II	01-21-30	\$	libor rate	2,552,378	529,899
ADB 947-PHI	12-15-12	\$	floating	193,139	350,484
ADB 1150-PHI	10-15-16	\$	floating	293,572	313,946
French Protocol	12-31-18	FF	3%-6.8%	109,601	133,249
IBRD 4227 PHI	09-15-17	\$	floating	43,223	49,109
ADB 2012-PHI	08-15-13	\$	libor rate	23,559	27,710
				10,460,946	15,777,082
Total				13,201,010	16,519,154

Current Portion -

Asian Development bank (ADB)	1,069,091	916,981
Int'l. Bank for Reconstruction & Development (IBRD)	122,528	114,548
French Protocol	23,548	23,565
Special Project Implementation Assistance Loan (SPIAL)	11,567	11,556
	1,226,734	1,066,650
Non-Current Portion	11,974,276	15,452,504

On February 10, 2011, the MWSS Board of Trustees unanimously passed Board Resolution no. 2011-017 approving the *P2.250 Billion floating rate Bond Issuance under the DBP-LBP Club deal Arrangement*. The bond issuance was guaranteed by the National Government. The proceeds were used to partly finance the MWSS' maturing 7-year USD 150M 9.25% Fixed rate Bond with the BNP Paribas which matured last March 14, 2011. The bond was drawn in full on March 30, 2011 and payable in seven (7) years. Interest rate was based on the higher of the BSP Reverse Repurchase (RRP) Facility or BSP Overnight Borrowing Rate.

The *Special Project Implementation Assistance Loan (SPIAL)* is a portion of the National Government's multi-currency loans from the ADB under Loan Nos. 779 & 780. This was relented to MWSS to partly finance the following projects: Manila Water Supply Rehabilitation Project I (MWSRP I), Manila Water Supply Project II (MWSP II), and Metro Manila Sewerage Project (MMSP).

ADB Loan No. 1746 PHI is a sub-loan agreement entered into by and between the Department of Finance and the MWSS on October 13, 2003 for the implementation of the Pasig River Environmental Management and Rehabilitation Sector, a sanitation component of the loan.

NHA Loan was transferred by NHA to MWSS before the privatization that financed the transfer of water and sewer systems of Tondo Foreshore, Dagat-Dagatan and Kapitbahayan. The validity of the account is still subject to confirmation and subsequent preparation of MOA between MWSS, NHA and the two concessionaires.

International Bank for Reconstruction and Development (IBRD) Loan No. 1272/1282-Manila Urban Development Project – are likewise a national government loan relented to MWSS on October 1, 1976. Per subsidiary loan agreement dated October 1, 1976, MWSS shall repay the principal of the subsidiary loan that started on November 15, 1981.

The Banque Nationale de Paris (BNP) Paribas Loan was obtained on March 26, 2004 to finance/refinance the system's maturing obligations brought about by non-payment of MWSI in its obligation and arbitration related expenses for the year 2004. Part of it was used to finance BNAQ I Project. It is a seven (7) year fixed rate note amounting to US \$150M, which matured and fully settled during the 1st quarter of CY 2011.

ADB Loan No. 1379 PHI was obtained on November 27, 1995. The primary objectives of the project were to divert an average annual flow of about 15.7 cubic meters per second from the Umiray river basin to the Angat reservoir and to augment the treated

water supply capacity of MWSS by about nine cubic meters per second by 1999. The secondary objective of the project was to reduce Non Revenue Water (NRW) by providing support for leak detection and repair activities. It is a twenty (20) year loan with a grace period of five (5) years which will mature on July 15, 2020.

ADB Loan No. 986 PHI– Angat Water Supply Optimization Project was obtained on December 18, 1989. The objectives of the project were to maximize the capacity of the main water supply source of the MWSS and to meet projected water demand in the project area through construction of additional supply, treatment and distribution facilities. It is a twenty (20) year loan with a grace period of five (5) years which will mature on October 1, 2014.

JBIC Loan PH 110 – contracted by Japan and the national government of the Republic of the Philippines in 1990 intended for Angat Water Supply Optimization Project. The proceeds of the loan were treated by MWSS as government equity for drawdown incurred before privatization and as loan after privatization.

IBRD Loan No. 4019 PH - Manila Second Sewerage Project - was obtained on June 19, 1996. The objectives of the project were to assist the Borrower to a) reduce the pollution of Metro Manila waterways and Manila Bay; b) reduce the health hazards associated with human exposure to sewerage in Metro Manila; and c) establish a gradual low-cost improvement of sewerage services in Metro Manila by expanding the Borrower's septage management program. It is a fifteen (15) year loan with a grace period of five (5) years which will mature on July 1, 2016.

China Eximbank - Angat Water Utilization and Aqueduct Improvement Project Phase II (AWUAIP-II) is being financed through a loan from the Export-Import Bank of China on May 7, 2010 in the amount of US\$116,602,000. The Angat Water Utilization and Aqueduct Improvement Project Phase 2 is an offshoot of the Angat Water Utilization and Aqueduct Improvement Project (AWUAIP). To be implemented by the MWSS, the AWUAIP is targeted to maintain and optimize the water conveyance from Angat Dam to the Water Treatment Plants via the Ipo Dam-Bicti-La Mesa Portal system. The project involves the rehabilitation of AQ-5, which supplies half of the raw water for Metro Manila, as well as the construction of AQ-6 in order to recover around 394 million liters of raw water lost to leakages. AWUAIP Phase 2 on the other hand involves the construction of the remaining 9.9 km section of AQ-6, and the rehabilitation of AQ-5. The AQ-6 extension aims to completely recover the lost water due to leakages in AQ-5. Repayment period is fifteen (15) years on a semi-annual basis starting January 21, 2015 and will mature on January 21, 2030.

ADB Loan No. 1150 PHI – Manila South Water Distribution Project – was obtained on January 23, 1992. The primary objective of the project was to improve the water supply services of MWSS in the project area. The secondary objective was to reduce the use of ground water, to prevent saline intrusion and land subsidence, as the main source of water for the remaining population not served by MWSS in the project area. It is a twenty (20) year loan with a grace period of five (5) years which will mature on October 15, 2016.

The French Protocol is a French Treasury Credit Facility from the French Republic intended to finance the implementation of the Rizal Province Water Supply Improvement Project (RPWSIP) payable within a period of ten (10) years that started December 2002.

IBRD 4227 PHI was part of the Water Districts Development Project funded by a loan from the World Bank-IBRD. MWSS entered into a subsidiary loan agreement with the Republic of the Philippines through the Department of Finance for a \$2.3 Million from said IBRD loan. Repayment period is 15 years on a semi-annual basis starting March 15, 2003 and ending on September 15, 2017 per Schedule 3 of the Loan Agreement between the Republic of the Philippines and the International Bank for Reconstruction and Development dated May 15, 1999.

ADB Loan No. 2012 PHI – MWSS New Water Source – was obtained November 24, 2003. The objective of the project was to provide the Borrower with consulting services to a) prepare and design projects for the development of new water sources for Metro Manila and b) improve the Borrower’s capacity for financial management, accounting, and fiscal control. It was a seven (7) year loan with a grace period of four (4) years which will mature on August 15, 2013.

19. Deferred credits

This account consists of:

	2011	2010
Deferred credits to income	2,228,204	1,643,280
Others	398,183	709,293
	2,626,387	2,352,573

Deferred credits to income account represent a) annual income concession fee – corporate operating budget received in advance from concessionaires usually at the early part of the year and amortized equally over a period of twelve months to the appropriate income account, and b) penalty for non-payment/deferment of Debt services of MWSI computed based on 364 T-bills rate which is still being disputed by the MWSI.

20. Donated capital

This account represents the costs of waterworks facilities turned-over by private subdivisions by way of a Deed of Donation. It also includes the grant from the Japan International Cooperation Agency (JICA) for the rehabilitation of Balara Water Treatment Plant.

21. Prior-period adjustments

Details of this account are as follows:

	2011	2010
Closing of payables	-	23,790
Collection of deferred income	-	19,309
Capitalization of assets	-	16,179
Adjustment of receivables/payables	-	12,954

Adjustment of concession fee	988,486	3,198
Payment of prior years' rental	2,238	1,911
Closing of dormant account	-	997
Collection of prior years' water accounts	23	107
Reversal of accruals	11,380	(1,223)
Payment of prior years' expenses	(73,562)	(12,710)
Adjustment on loans payable	-	(44,704)
Adjustment of construction in-progress	-	(162,850)
Dividend paid to the Bureau of Treasury	-	(195,882)
Adjustment of depreciation	(34,915)	(208,668)
Adjustment of PPE-Land	34,206	-
Income/expense adjustments	(44,361)	(221,022)
	883,495	(768,614)

22. Personal services

This account is comprised of the following:

	2011	2010
Salaries and wages – regular	65,981	61,064
Subsistence, laundry & quarter allowance	16,003	14,553
Representation allowance	12,517	13,124
Life and retirement insurance contributions	8,170	7,844
Provident fund benefit	8,127	7,088
Longevity pay	6,602	10,169
Productivity incentive allowance	6,467	19,533
Cash gift/13 th month pay	4,672	4,871
Transportation allowance	3,407	2,156
Honoraria	2,399	6,601
PERA	2,386	2,117
Additional compensation	2,271	3,036
Year end bonus	2,142	9,535
Hazard pay	1,855	1,946
Terminal leave benefits	1,389	1,157
Salaries and wages - contractual	1,212	3,194
Clothing allowance	777	796
PHILHEALTH contributions	706	704
Pag-IBIG contributions	238	268
ECC contributions	238	268
Other personnel benefits	39,977	36,614
Other bonuses and allowances	20,745	41,827
	208,281	248,465

23. Maintenance and other operating expenses

This account consists of the following:

	2011	2010
Security services	21,513	22,326
Taxes, duties and licenses	13,560	14,833
Auditing services	10,583	5,038
Electricity expenses	10,544	16,411
Consultancy expenses	9,604	28,681
Extraordinary and miscellaneous expenses	6,526	35,173
Survey expenses	5,854	17,058
Insurance expense	4,992	6,486
Janitorial services	3,484	3,438
Communication expense	3,056	3,348
Other professional services	2,483	5,944
Training expenses	2,477	10,919
Office supplies expenses	1,697	2,446
Gasoline, oil and lubricants	1,682	3,056
Repairs and maintenance	846	1,347
Advertising expenses	686	723
Other supplies expenses	669	653
Rent expense	631	805
Representation expenses	462	1,403
Travelling expenses	436	502
Subscription expenses	174	206
Drugs and medicines expenses	218	5,055
Water expenses	120	177
Fidelity bond premiums	86	92
Membership dues and contributions to organization	55	34
Printing and binding expenses	12	6
Postage and deliveries	6	3
Scholarship expenses	-	10,982
Environmental/sanitary services	-	158
Donations	-	23
Confidential expenses	-	-
Other maintenance and operating expenses	3,229	30,936
	105,685	228,262

24. Financial expenses

This account consists of:

	2011	2010
Interest expenses	241,002	271,458
Other financial charges	39,276	50,708
Documentary stamp expenses	450	217
Bank charges	766	193
	281,494	322,576

25. Subsequent events

MWSS is still pursuing the disputed claims on cost of borrowings from Maynilad Water Co., Inc. relative to the BNP Paribas loan. Should MWSS be able to collect additional cost of borrowings, the said amount will be used to pay the new loan with LBP/DBP Bonds Facility.

26. Contingent liabilities

The System has pending court litigations concerning project contracts and land disputes totaling P29.71M prior to its privatization in 1997. The MWSS has also disputed the real estate taxes charged by the local government of Quezon City in the amount of P264M. In 2010, the Quezon City government auctioned some of the properties located in the area. To prevent the inclusion of MWSS property in the auction held in December 2010, the System deposited P30M. The legal issues on the matter are elevated before the Supreme Court and subsequently a temporary restraining order (TRO) was issued on January 21, 2011 enjoining Quezon City government from proceeding with the levy of the subject properties until further orders from the court.

27. Report on the Supplementary Information Required Under Revenue Regulation No. 15-2010

In compliance with the above regulation, MWSS' taxes and withholding taxes paid and accrued during the year are categorized as follows:

	<u>CO</u>	<u>RO</u>	<u>TOTAL</u>
Corporate income taxes:			
Paid in 2011	-	-	-
To be paid in 2012	-	-	-
Total	-	-	-
Add: Taxes paid in 2011:			
On compensation	5,254	3,505	8,759
Final Withholding Tax (FWT) on Loans - BIR Form 2306	1,435	-	1,435
Real Property Taxes	10,859	-	10,859
Input VAT	4,542	-	4,542
ITW on Suppliers & Contractors	141,691	889	142,580
Output Vat	9,921	-	9,921
Total	173,702	4,394	178,096
Add: Taxes Withheld (To be paid in 2012)			
On Compensation - Per diem/salaries/OT	3,466	1,313	4,779
Input VAT	216	-	216
ITW on Suppliers & Contractors	401	42	443
Output VAT	556	1,355	1,911
Total	4,639	2,710	7,349
Total taxes paid and accrued	178,341	7,104	185,445