



STANDARD OPERATING PROCEDURES

Project Title:

Financial Support to the iLembe District Municipality for specific Siza Water Concession
Contract Activities

Contract No.: VILP/I/035

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Version 1

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Contents

ACRONYMS AND ABBREVIATIONS	3
1 INTRODUCTION	4
1.1 Purpose	4
1.2 Objective	4
2 FINANCIAL PERFORMANCE MANAGEMENT	5

Acronyms and Abbreviations

DWS	Department of Water and Sanitation
IDM	iLembe District Municipality
NT	National Treasury
PCU	Vuthela Programme Project Coordinating Unit
SDF	Spatial Development Framework
SP	Service Provider
SW	Siza Water
ToR	Terms of Reference

1 INTRODUCTION

This report is the standard operating procedure for the contract VILP/I/035, Siza Water Concession Contract support, for the management of the Vuthela iLembe LED Support Programme. The Vuthela iLembe Project is aimed at addressing unemployment, poverty and inequality in the iLembe District Municipality through ensuring future local economic growth and inclusivity. The Siza Water Concession Contract therefore details the principles that guide Siza Water to execute and manage provision of water and sanitation services on a concession basis, as part of the Vuthela iLembe LED Support Programme economy improvement initiatives. The period of the concession contract is 30 years, and is scheduled to end in 2029. The appointed consultant (SMEC South Africa) is therefore required to review the technical, financial and legal aspects of the contract, and provide support to the iLembe District Municipality, to ensure the contract is still effective and viable for implementation under current conditions.

1.1 Purpose

The purpose of this report is to serve as the Standard Operating Procedure to assist in capacitating the IDM officials and serve as guidelines for the continuation of the financial monitoring activities.

1.2 Objective

The aim of this this standard operating procedure is to translate the concession contract document into processes. But it is to be noted that ultimately the legal and regulatory obligations of the concession contract should be fulfilled and take precedent should there be any variance between the SOP and the concession agreement. This report is in respect of sub-task 83 of the project programme which is also listed within the Terms of Reference (ToR) as follows;

- The consultant will be required to develop SOPs for the monitoring of the concession contract, which will assist in capacitating the IDM officials and serve as guidelines for the continuation of the monitoring activities. The categories to be considered for capacity building will include:
 1. Financial Performance Management

2 FINANCIAL PERFORMANCE MANAGEMENT

OBJECTIVES:	<p>WHICH ASPECT OF FINANCIAL PERFORMANCE MANAGEMENT IS THIS SOP ADDRESSING?</p> <p>This SOP addresses the management of the financial performance of the concessionaire in terms of the concession contract.</p> <p>Improved financial reporting of performance to ensure that the IDM can assess longer-term performance indicators, profitability and cost-benefit analysis.</p> <p>Another aspect to consider is to assess the operating performance, from a financial point of view to assess the underlying costs and other drivers making up the tariffs and the associated increases proposed in respect of the tariffs.</p> <p>A key financial consideration is in relation to the profit-sharing mechanism that is being applied with respect to the contract. As the project is in a mature state, and profits are being generated, a key aspect is to understand and account for the manner in which the profit-sharing mechanism is calculated, both historically, but also on a forecast basis.</p>
FUNCTIONAL PROCESS/ ACTIVITY:	<p>WHAT ARE THE ASSOCIATED ACTIVITIES?</p> <ol style="list-style-type: none"> 1. Verification of financial information provided by the concessionaire. 2. Establishment and maintenance of a standardised reporting methodology in respect of the provision of financial information relevant to the concession. This must include the following: <ol style="list-style-type: none"> a. Liaison and discussion of budgets prepared by the concessionaire; b. Confirmation that the budgets presented are agreed and valid from a forecast point of view; c. Preparation of a standardised sensitivities for the concessionaire to provide on a regular basis d. Validation of historical information on an annual basis to supporting documentation and the Audited AFS of the Concessionaire. 3. Record keeping of non-statutory financial reports. 4. Records of concessionaire reports and monitoring reports (five-year plans, situation reports, annual reports on service levels, operating procedures etc.) 5. Responsibility matrices to be established both within the IDM and the concessionaire. 6. Assessment of penalties and deductions relating to non-performance, under-performance or noncompliance (such as BEE spend etc) <p>WHAT NEEDS TO BE DONE FOR THIS SOP TO BE IMPLEMENTED?</p> <p>A standardised set of outputs and key performance indicators needs to be established and implemented (over and above what is presently</p>

	<p>provided in the quarterly reporting) in order for the IDM to properly assess the financial performance of the concessionaire.</p> <p>Amendment to the existing financial reporting packs need to include additional supporting documentation and analysis to be provided from the concessionaire to assist with evaluation and decision making processes.</p> <p>IDM needs to develop an internal contact administration system with reliable and comprehensive record keeping system for the concession contract to manage all documents and processes mentioned above and to provide control to contract reporting and effective document review control processes.</p>
ASSOCIATED PROTOCOLS:	<p>WHICH PROTOCOLS ARE ASSOCIATED WITH THIS SOP?</p> <p>There will need to be additional elements which the concessionaire will need to include in the existing quarterly reports. These include;</p> <ul style="list-style-type: none"> • More longer-term forecasting, based on the financial model (as updated from time to time – see below) to assess the impact and profitability projections of the concessionaire. This information must be provided in a way the total overall profitability of the concession is forecasted (and updated with actuals from time to time) in order to assess the ongoing levels of performance of the concession. Increases and decreases in the performance must then be provided (including comparatives) to ensure that the profit-sharing mechanism is able to be recalibrated and adjusted (at least annually) to ensure that the profit-sharing mechanics as contained in the concession agreement are maintained. • Variations between actual performance and budget performance must continue to be provided, however more detail as to variances is required. These variances should also consider both % and ZAR variations (as is currently provided), above a predetermined limit (which the IDM will need to decide based on materiality) and these variances should be provided with detail supporting workings to provide adequate and detailed information in relation to the relative performance, not only to budget, but to the assumptions contained within the financial model as well as prior year comparatives. • Standardised sensitivities must be included in the financial model which will provide context of certain cost and revenue elements, which can then be used to assess ongoing trends and performance. <p>These sensitivities can be amended from time to time, but it is recommended that a standard set of sensitivities is prepared. This can include the following:</p> <ul style="list-style-type: none"> ○ Revenue Up / Down 5% / Water / Sewer ○ Revenue Up / Down 10% / Water / Sewer ○ Operating Costs Up / Down 5% ○ Operating Costs Up / Down 10% ○ Water Loss Up / Down 5% ○ Water Loss Up / Down 10% ○ Maintenance Costs Up / Down 5% ○ Maintenance Costs Up / Down 10%

	<ul style="list-style-type: none"> ○ Others to be added as deemed necessary • Annual reconciliation of the sensitivities by the concessionaire to provide the IDM with an ongoing assessment of the sensitivities, in order to determine the impact of long-term trends and changes in the revenue / cost matrix of the project; • Reconciliation of budget to the financial model (as prepared by the concessionaire). This must be done on an ongoing basis to ensure financial performance is consistent with financial projections; • Provision of the financial model on a quarterly basis (if possible, however as a minimum, must be annual, as with the financial reporting framework already in place); • More detailed workings in relation to developing a bottom-up approach for tariff setting, which will need to reconcile with the Top-Down tariff increases as provided for by the concessionaire. <ul style="list-style-type: none"> ○ Note that variations between the Top Down and Bottom Up will need to be adequately reconciled and agreed. ○ Both parties will be required to agree and sign off on tariff increases, also considering motivations and variations (e.g. Covid Protocols and the associated costs thereof) • Detailed information in relation to the provision of BEE compliance, subcontracting and assessments of these requirements going forward, particularly towards the end of the concession when staffing levels may be reduced (prior to hand back to the IDM). • Standardised quarterly outputs including the following <ul style="list-style-type: none"> ○ Financial Performance reporting of actuals versus budget; ○ Provision of financial model on (as a minimum) annual basis; ○ Reporting of variances between budgets and forecast information contained within the financial model ○ Sensitivity testing of the financial model ○ Adjustments of the Profit Sharing as required and informed by the financial information / financial model / forecasts
ACTIVITY OUTPUT:	<p>WHAT IS THE INTENDED OUTPUT OF THIS SOP?</p> <p>As the concession reaches maturity, it will become more critical to ensure that the financial well being of the concession, the associated costs and revenue drivers as well as the overall projected profit of the financial performance be adequately considered and understood prior to the expiry of the concession agreement. More detailed information sharing will become paramount and will require that the concessionaire provides this information on a timely and accurate basis in order to ensure that the objectives can be met.</p> <p>If this is maintained, the IDM will be able to have a better and more detailed view of the concession, the requirements that will need to be budgeted for once the assets are handed back to the IDM as well as ensuring that the overall profit sharing is in accordance with the requirement as set out.</p>

<p>ROLES AND RESPONSIBILITIES:</p>	<p>WHICH PARTY IS RESPONSIBLE FOR WHICH PROTOCOL/ACTIVITY?</p> <p>The majority of the activities will be initiated from the concessionaire. It will be their responsibility to provide for the information.</p> <p>Once this information is obtained, it will then be the responsibility of the IDM, in conjunction with relevant stakeholders such as NT, to ensure that the information is disseminated, discussed and understood both with the concessionaire, but also internally to ensure that the principles set out are achieved.</p>
<p>TIMING/FREQUENCY:</p>	<p>HOW OFTEN SHOULD THE PROCESS OUTLINED ABOVE BE IMPLEMENTED?</p> <p>As noted above, more detailed reporting will need to be provided quarterly, over and above what is currently provided. Additional activities (BEE, tariff setting etc.) should be undertaken annually.</p>
<p>APPLICABLE DOCUMENTS:</p>	<p>THE RELEVANT GUIDING LEGISLATION, DOCUMENT, CONTRACTUAL CLAUSE, OR MUNICIPAL POLICY/BYLAWS THAT GOVERNS THIS ACTIVITY</p> <p>The Water & Sanitation Concession Agreement entered by IDM and Siza Water does regulate Council to collect information in respect of the nature, operation and viability of the supply of water services and the works. This is within clause 62 of the contract agreement.</p>