



Reconfiguration of **Umgeni Water and Mhlathuze Water:
Extending the Boundary of UMGENI WATER to Include
Mhlathuze Water**



**RECONFIGURATION OF UMGENI WATER AND MHLATHUZE WATER:
DISESTABLISHING MHLATHUZE WATER AND EXTENDING THE BOUNDARIES OF UMGENI
WATER TO INCLUDE MHLATHUZE WATER SERVICES AREAS**

APPROVAL

TITLE	:	RECONFIGURATION OF UMGENI WATER AND MHLATHUZE WATER - EXECUTIVE SUMMARY
REPORT NO	:	UMW_RECON/1.0/1122
CONSULTANTS	:	GARNET NGUBANE & PARTNERS INC.
REPORT STATUS	:	VERSION 1.0: NOVEMBER 2022
VERSION CONTROLLER	:	MR. S. MADONSELA
COMPILE	:	GUGU MAZIBUKO
DATE	:	NOVEMBER 2022

Transaction Advisory Team: Approved for Project Team

MR. CGN NGUBANE

MR. G. MAZIBUKO

Approved for Department of Water and Sanitation/ UMGENI WATER

DWS

UMGENI

Disclaimer

This Report is addressed to the Minister of Water and Sanitation or his assigns solely for his use and benefit and may not be transmitted to any other person without his prior written consent, except in those instances where he may be obliged by law to do so;

This Report may not be relied upon by any person other than the Minister, his assigns, or relevant stakeholders (including investors) and may not be used for any purpose other than the consideration by the Minister of the Proposed Transaction. We shall accordingly not accept any responsibility for any loss or damage suffered by any person as a result of reliance on the contents of this Report;

We reserve the right to amend this Report, where necessary, in the light of any new views and/or information received during the consultation period but do not undertake any obligation to do so.

Contents

1	EXECUTIVE SUMMARY	8
1.1	BACKGROUND	8
1.2	APPROACH.....	8
1.3	LEGAL REVIEW AND IMPLICATIONS.....	9
	<i>Minister’s Powers, Functions and Implications:.....</i>	<i>10</i>
	<i>Legalities around Minister’s Consultation Process.....</i>	<i>10</i>
	<i>Legal Implications on implementation of Confirmed Positions and Options: (Sequenced Critical Path)</i>	<i>11</i>
	<i>Summary contracts and their status.</i>	<i>12</i>
1.4	STAKEHOLDER ENGAGEMENT.....	13
1.5	FINANCE.....	14
1.6	TECHNICAL AND GIS	17
	<i>Mhlathuze Asset Base</i>	<i>17</i>
	<i>Umgeni Asset Evaluation and Condition Assessment</i>	<i>17</i>
	<i>The Reconfigured Umgeni Water Board (including Mhlathuze Water service areas)</i>	<i>18</i>
1.7	GOVERNANCE AND INSTITUTIONAL ARRANGEMENTS	19
	<i>Governing Board Proposals.....</i>	<i>20</i>
	<i>Management Arrangements Proposal.....</i>	<i>20</i>
	<i>Emerging Institutional Arrangements.....</i>	<i>21</i>
	<i>Emerging Operating Business Model – Functional Structure.....</i>	<i>23</i>
1.8	HUMAN RESOURCES AND LABOUR.....	24
	<i>Assessment framework.....</i>	<i>25</i>
	<i>Legal context for the transfer.....</i>	<i>25</i>
	<i>Function and organogram</i>	<i>26</i>
	<i>Summary of findings</i>	<i>26</i>
1.9	RECONFIGURATION ACTION PLAN	29
2	INTRODUCTION TO THE DUE DILIGENCE REPORT	39
2.1	BACKGROUND AND OBJECTIVE	39
2.2	PROJECT ENVIRONMENT AND LIMITATIONS OF THE WORK PRODUCED.....	40
2.3	PROJECT LOGIC	40
2.4	PROJECT TASKS, OUTCOMES AND KEY DELIVERABLES	42
3	APPROACH AND INTENDED OUTCOMES.....	44
3.1	DUE DILIGENCE FRAMEWORK (WATER CONTEXT)	45
3.2	PRINCIPLES FOR THE RECONFIGURATION PROCESS	46
3.3	STAKEHOLDER ENGAGEMENT.....	46
3.4	APPROACH TO STAKEHOLDER ENGAGEMENT.....	46
3.4.1	STAKEHOLDER PARTICIPATION LEVELS	47
3.4.2	INITIAL ENGAGEMENTS AND OUTCOMES.....	48
3.5	STRATEGIC WATER VISION AND RATIONALE FOR CHANGE	49
3.6	THE KZN WATER SERVICE PERSPECTIVE	51
3.6.1	THE KZN WATER BOARDS AND UTILITIES	52
3.7	UN-SERVICED AREAS	55
4	GOVERNANCE AND INSTITUTIONAL	56
4.1	WATER BOARD MANAGEMENT AND GOVERNANCE CONTEXT	56
4.2	INSTITUTIONAL ARRANGEMENTS CONTEXT.....	57
4.3	GOVERNANCE AND INSTITUTIONAL ARRANGEMENT IN MHLATHUZE WATER	58
4.4	GOVERNANCE AND INSTITUTIONAL ARRANGEMENTS IN UMGENI WATER	58
4.5	HIGH LEVEL ANALYSIS AND PROPOSED POSITIONS FOR CONSIDERATION	59

4.5.1	PROPOSED GOVERNING BOARD ARRANGEMENTS	59
5	FINANCE	64
5.1	BUSINESS OVERVIEW	64
5.1.1	MHLATHUZE CUSTOMERS	64
5.1.2	UMGENI WATER CUSTOMERS.....	64
5.1.3	UMGENI WATER – BUSINESS PLAN ANALYSIS	65
	<i>Forecasts</i>	65
	<i>Cost Drivers</i>	65
	<i>Cash Flow</i>	65
5.2	UMGENI RISKS.....	65
5.3	RECONFIGURED ENTITY – VALUE CREATION	66
5.3.1	IMPACT ON WATER QUANTITIES.....	66
5.3.2	ORGANISATIONAL AND SYSTEMS.....	66
5.4	IMPACT OF RECONFIGURATION ON GROSS PROFIT	67
5.4.1	GROWTH TRENDS FOR THE ENTITIES	67
5.4.2	GROSS PROFIT	68
5.4.3	GROSS PROFIT MARGIN	69
5.5	IMPACT OF RECONFIGURATION ON NET PROFIT	70
5.5.1	NET PROFIT.....	70
5.6	IMPACT OF RECONFIGURATION ON BALANCE SHEET	71
5.6.1	NET ASSET VALUE	71
5.6.2	WORKING CAPITAL.....	72
5.7	IMPACT OF RECONFIGURATION ON CASH FLOWS	72
5.7.1	CASHFLOW	72
5.7.2	WRITING OFF OF MHLATHUZE DEBTORS ON RECONFIGURATION	73
5.8	RISKS AND FINDINGS.....	73
5.8.1	GENERAL RISKS	73
5.8.2	CONTINGENT LIABILITIES	74
5.8.3	SHORT AND LONG-TERM INTEREST BORROWINGS	74
5.8.4	ACCOUNTS RECEIVABLE	74
5.8.5	SCENARIO ANALYSIS	75
6	TECHNICAL AND GIS	76
6.1	MHLATHUZE WATER:	76
6.2	MHLATHUZE ASSET BASE.....	76
6.3	ASSET VERIFICATION.....	77
6.4	ASSET CONDITION ASSESSMENT AND ANALYSIS:.....	77
6.5	BULK RAW WATER SUPPLY	79
6.6	BULK WASTE WATER DISPOSAL	79
6.7	OTHER AGREEMENTS:	79
6.8	UMGENI WATER:.....	80
6.9	THE RECONFIGURED UMGENI WATER BOARD (INCLUDING MHLATHUZE WATER SERVICE AREAS)	81
7	HUMAN RESOURCES AND LABOUR	84
7.1	FRAMEWORK AND DELIVERABLES	84
7.2	MHLATHUZE WATER BOARD	85
7.2.1	LEGAL CONTEXT FOR TRANSFER OF STAFF WITH FUNCTIONS.....	85
7.2.2	FUNCTIONS AND ORGANOGRAM.....	85
7.2.3	EMPLOYMENT ARRANGEMENTS.....	87
7.2.4	CONDITIONS OF SERVICE	88
7.2.5	POLICIES IMPACTING ON CONDITIONS OF SERVICE	88
7.2.6	EMPLOYEE BENEFITS	89

7.2.7	LABOUR AGREEMENTS.....	90
7.2.8	JOB GRADING AND REMUNERATION	91
7.3	UMGENI WATER BOARD.....	91
7.3.1	LEGAL CONTEXT FOR TRANSFER OF STAFF WITH FUNCTIONS.....	91
7.3.2	FUNCTIONS AND ORGANOGRAM.....	91
7.3.3	EMPLOYMENT ARRANGEMENTS.....	92
7.4	CONDITIONS OF SERVICE	93
7.4.1	EMPLOYMENT BENEFITS.....	93
7.4.2	LABOUR AGREEMENTS.....	93
7.4.3	JOB GRADING AND REMUNERATION	94
7.5	SUMMARY OF FINDINGS	94
7.5.1	EMPLOYMENT ARRANGEMENT	94
7.5.2	POLICIES IMPACTING ON CONDITIONS OF SERVICE	95
7.5.3	EMPLOYMENT BENEFITS.....	95
8	LEGAL AND REGULATORY	98
8.1	INTRODUCTION	98
8.2	AREAS THAT REQUIRE LEGAL COMPLIANCE	98
8.3	SUMMARY OF LEGAL IMPLICATIONS.....	99
8.3.1	MINISTERIAL PREROGATIVE TO DISESTABLISH	99
8.3.2	VALUATION AND REGISTRATION OF ASSETS	100
8.3.3	HUMAN RESOURCES AND LABOUR.....	100
8.3.4	EXISTING CONTRACTS AND AGREEMENTS.....	100
8.3.5	LITIGATIONS, AGREEMENTS AND CONTRACTS	100
9.	CONCLUSION AND WAY FORWARD	104

List of Acronyms

BP:	Business Plan
CMS:	Catchment Management Strategy
CMA:	Catchment Management Agency
CMS:	Catchment Management Strategy
DD:	Due Diligence
DDG:	Deputy Director General
DWS:	Department of Water and Sanitation
GIS:	Geographic Information Systems
GAAP:	Generally Accepted Accounting Principles
GRAP:	Generally Recognised Accounting Practices
IWRM:	Integrated Water Resource Management
MFMA:	Municipal Finance Management Act
NWA:	National Water Act
NSDF:	National Spatial Development Framework
NSDP:	National Spatial Development Perspective
NWSMP:	National Water and Sanitation Master Plan
MW:	Mhlathuze Water
PFMA:	Public Finance Management Act
RWU:	Regional Water Utility
ToR:	Terms of Reference
UW:	Umgenti Water
WB:	Water Board
WMA:	Water Management Area
WRMS:	Water Resource Management Systems
WSA:	Water Services Act
WSA:	Water Services Authorities
WSDP:	Water Services Development Plan
WUA:	Water User Association

1 Executive Summary

1.1 Background

The Department of Water and Sanitation as part of its water services sector regulatory function and institutional oversight has embarked on the reconfiguration of Umgeni Water and Mhlathuze Water with the intention to improve water services governance and institutional performance within the sector in KZN. Further, the intention is to strengthen and ensure integrated and sustainable provision of water services within jurisdictional areas covered by both Water Boards. This process marks the beginning of the ultimate objective, which is the establishment of a single Regional Water Utility in KZN. The Constitution, Water Services Act, 108 of 1997, Public Finance Management Act, 1 of 1999, National Water Act, 36 of 1998, King IV Report on Corporate Governance, 2016 as amended, all provide amongst others, the legal basis and general framework for the proposed reconfiguration process.

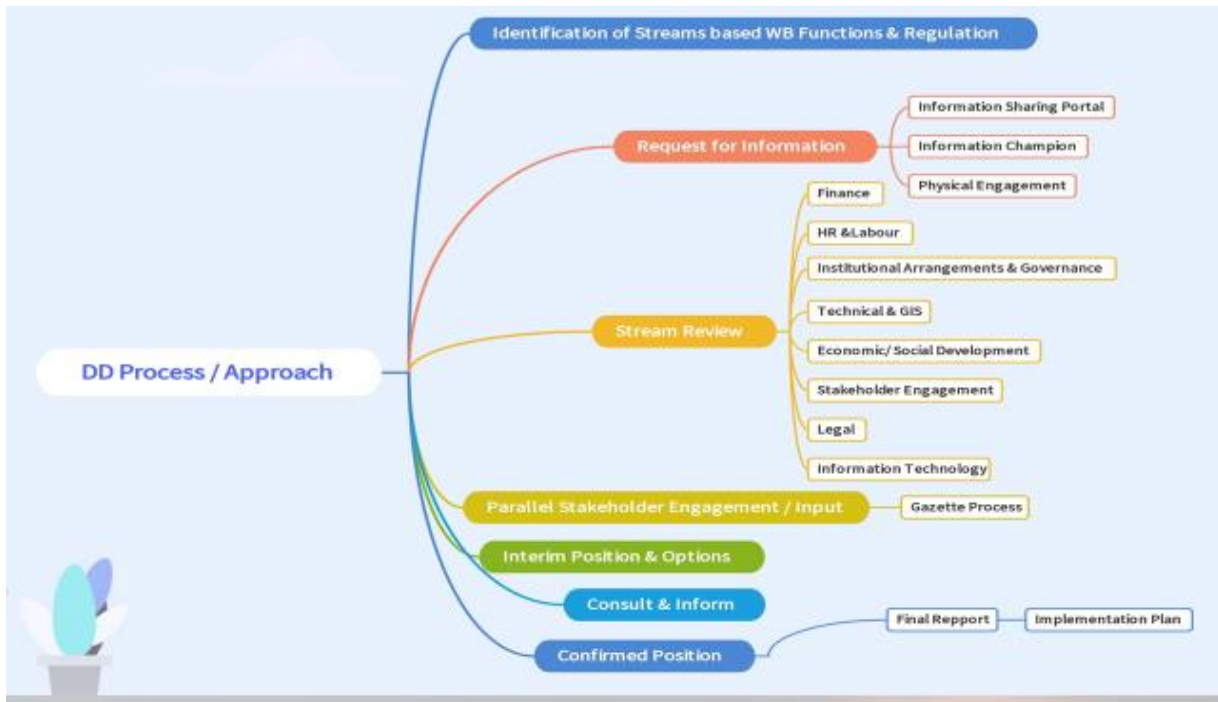
In execution of this task and at the instruction from the Department of Water and Sanitation, Umgeni Water through its panel of Services Providers appointed a legal firm Garnet Ngubane and Partners Incorporated to do a Due Diligence (DD) process that will provide legal advice, possible future outlook scenario as well as impact assessment of the reconfigured Umgeni Water and Mhlathuze Water Boards. While the Due Diligence process is predominantly legal, the nature of the business of Water Boards dictates that other disciplines are considered in order to provide a detailed assessment that will inform and advise if the Minister acted reasonably and within the confines of the law up to this point and moving forward. Secondly, to ascertain that the Minister's actions do not jeopardise the sustainability and financial viability of the boards as well as the interests of consumers and creditors. The current Due Diligence process as well as post reconfiguration, must accommodate the latter requirements.

Based on understanding of the considerations stated above. The process requires that, there must be reasonable appreciation and allowance of time for the DD process to unfold. Secondly, there must be reasonable allowance of sufficient opportunity to engage all stakeholders and their input at various levels according to the impact they have in the Water Board business.

1.2 Approach

The approach to this Due Diligence process, appreciates the integrated nature of the water business in terms of its management, use and sustenance for future generations. The Water Board value chain primarily comprises of abstraction of water, treatment, distribution, use, billing and collection, wastewater treatment, effluent management and wastewater discharge.

In an unpacked Water Board value chain lies a series of functional area streams that are key determinants of institutional sustainability and viability of these institutions. The diagram below indicates the approach to the Due Diligence process highlighting these key functional area streams. The analysis of these streams as part of the Due Diligence, give an emerging possible future outlook of a reconfigured institution taking into account the consultation of legally prescribed stakeholders as well as regard of creditors and consumers including their contribution towards the infrastructure of the disestablished Water Board. This report seeks to unpack the implications of an intended objective of disestablishing Mhlathuze Water Board, transfer all assets and liabilities to Umgeni Water Board and extend the boundaries of Umgeni Water Board to include those of a disestablished Mhlathuze water.



The sections that follow in this report, is an analysis of the identified key functional streams that must be considered for the proposed reconfiguration. It must be noted, as stated above, that this report sets the platform for reflection of the current picture and consideration of interim proposals and positions. These must be used to advise the Minister, inform and consult stakeholders. Out of the consultation there will be confirmed positions for reconfiguration. The confirmed positions will form part of the critical path/ implementation plan that is appropriately sequenced.

The identifiable key functional streams guiding the Due Diligence process, include the following:

- Legal review and implications.
- Stakeholder engagement review and implications.
- Financial review and implications.
- Infrastructure capacity review and implications
- Governance and Institutional Arrangements review and implications.
- Human Resource and Labour review and implications.
- Integrated Water Resource Management (IWRM) review and implication

1.3 Legal Review and Implications

The Legal Stream is a cross cutting function in the reconfiguration process, providing advice and having an opinion on findings and implications in all work streams. It addresses the legal implications emanating from the activities of the various streams as well as the Department's initial actions around the reconfiguration process. The role of the legal function in the reconfiguration process is four-fold, viz.

- The legalities around the decision and actions of the Minister to reconfigure the two Water Boards. There is a need to ascertain the Ministers powers, functions, actions and process up to the current state.
- The legalities around the Ministers actions in fully consulting the legally prescribed stakeholders and reflecting due regard for interests of creditors and consumers, including their direct or indirect financial contributions towards the water infrastructure.
- Taking into account the existing litigations and their implications in the reconfiguration process, the existing contracts and their conditions, in particular, the extent to which the receiving entity will be materially affected.
- Lastly, the associated reconfiguration processes and action during implementation that require legal support, e.g. the Asset Inventory, Evaluation, Registration and Transfer.

Minister's Powers, Functions and Implications:

The right to access to sufficient water¹ as provided for in the Constitution is the initial legislative framework or platform that embolden the Minister's actions. It further stipulates that the state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of, for purposes of this instruction, the right to access to water².

This particular Constitutional provision give way for the provisions of the Water Services Act³. The Minister is granted in terms of the Water Services Act⁴, through a notice of a gazette, the powers to establish a water board, give it a name or approve a change of its name, determine or change its service area and disestablish it.

In so far as the powers of the Minister acting as described in the paragraph above are concerned. The Minister has indeed acted within the powers granted in terms of the Water Services Act, 107 of 1999. ⁵The Minister has, by notice of a gazette reflected his intentions to disestablish Mhlathuze Water, transfer its assets and liabilities to Umgeni Water and extend the boundaries to include those of Mhlathuze Water. The Minister has further, through the Gazette, given reasons for the institutional change. Supported by Constitutional provisions of "Everyone has the right to sufficient water and the functions granted through the Water Services Act, the Minister has acted in a manner that support the Integrated Water Management vision and promotion of water as a driver for Social and Economic Development.

Legalities around Minister's Consultation Process

The legality of the powers and functions above are, however, subject to satisfaction of bullet 2 in section 1.3 above. Evidence of engagement and reflection of "showing regard" for interests of creditors and consumers must be presented. The input from these stakeholders must equally be reflected in the Due Diligence report and critical path implementation plan as identified, discussed and agreed.

¹ The Constitution of the Republic of South Africa, 1996 at s 27(1)(b).

² Ibid, at s 27(2).

³ Water Services Act, 107 of 1997.

⁴ Ibid, at clause 1- s (28).

⁵ Government Notice 2673, 3 November 2023

Generally, it is common cause that the Minister has, through the Department of Water and Sanitation, organised and engaged a number of stakeholders around this subject matter. However it is imperative that an analysis of these engagements is done and tested against the provision of the Water Services Act, 107 of 1999. The stakeholder engagement road map, recorded engagement meetings, discussions and agreed outcomes have not been formally made available for input into the Due Diligence report process. It is currently improbable due to limited evidence. It is therefore requested that the Department makes this piece of information available for input. Alternatively, the information could be made available as part of stakeholder engagement and discussions for confirmed reconfiguration positions and options moving forward.

Further, in so far as the disestablishment of a Water Boards is concerned, Mhlathuze Water has existing water use charge agreements with industries within the water management area. Some of the industries have contributed to maintenance and augmentation of Mhlathuze Water's infrastructure. It therefore becomes imperative that, evidence of these contributions is reflected in the report, implementation plan and transfer process as prescribed in section 46(4)(b). Due to time limitations. This has not been adequately addressed. Equally, noting Mhlathuze comments and input on initial engagement. Further engagements, discussions and agreements are required as part of Position and Options engagements moving forward.

Other than the two legal elements indicated above. Two other elements are important for consideration, i.e. legal implications during the implementation of reconfiguration and the implications on the transferability of the existing agreements between Mhlathuze and its clients.

Legal Implications on implementation of Confirmed Positions and Options: (Sequenced Critical Path)

The legal context means that the following principles are adhered to during implementation and after the reconfiguration process.

- **HR and Labour:** All transfers must be subject to Section 197 of the labour relations Act. Further, the Labour agreement reached with the Unions.
- **Immovable Assets:** With the authority from the Minister of Finance, an asset inventory shall be developed for all immovable assets of the institution that is earmarked for disestablishment.
 - All immovable assets for transfer shall be subject to re-evaluation before being added into the balance sheet of the re-configured institution.
 - All immovable assets shall be subject to registration with the Deeds Office for transfer into the re-configured institution. Legal requirements here demand that the Land Reform Act and the related regulations are followed.
 - All immovable assets shall be transferred "voetstoots" into the re-configured institution.
- **Existing Contracts:** All existing contracts including water supply contracts shall be subject to assessment/engagement with parties for transferability into the re-configured institution.

- **Financial Arrangements:** All creditors and debtors shall be informed of pending institutional re-configuration for their input and decision making moving forward.
- **Stakeholder Engagement:** All identified and categorised stakeholders shall be engaged at the appropriate level in line with the functional impact they have on the water management function.

Summary contracts and their status.

It should be noted these are not all contracts. But an indication of some of the agreements. These should further be unpacked as part of structured engagements.

No.	Clients Name & Type of Service	Comment
1.	<p>uMgungundlovu District Municipality for Howick Waste Water Treatment to operate and maintain the facilities. Effective as of the 1st of July 2009 for a period of 5 years until 30 June 2015.</p> <p>Another Bulk water Supply Agreement was concluded, effective as of the 1st of June 2014 for a period of 20 years until the 30th of June 2034.</p> <p>1st Addendum for the transfer of UW's employees as a going concern to the Municipality, should the municipality decide to take over the operations and management of the plant before the contract expires, was effective as of the 20th of February 2015, to remain valid for the duration of the main agreement.</p> <p>2nd Addendum, concluded on the 8th of July 2015, to remain valid for the duration of the main agreement whereby;</p> <ul style="list-style-type: none"> - Section 5.4.2 of the main agreement was deleted <i>"augmentation or up-grading or increasing the design capacity of the Bulk Waste Water Works"</i> - Section 10 of the main agreement was amended to add 3 subsections: - <i>"10/1 UW shall provide an expenditure programme ..."</i> - <i>"10.2 UW shall bear the costs...."</i> - <i>"10.3 In the event that the contract is terminated before UW has not fully recovered the capital investment made.....The Municipality shall pay Umngeni Water....."</i> 	<p>The validity and enforceability of the contract will not be affected by the reconfiguration process.</p> <p>The agreement will therefore, post reconfiguration remain valid and enforceable.</p> <p>Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.</p>
2.	<p>uMgungundlovu District Municipality for Umkhambathini Waste Water</p> <p>Effective as of the 1st of July 2014 for a duration of 20 years until 30 June 2034</p> <p>Cessionary Agreement between Umgungundlovu Municipality (Cedent) and Umngeni Water (Cessionary) wherein cedent cedes cessionary rights, title and interest in and to payments or monies due by the cedent to Preben Naidoo & Associates Effective as of 17th of February 2010 until the project is concluded. (The Agreement was concluded on the 24th of August 2014.)</p>	<p>The validity and enforceability of the contract will not be affected by the reconfiguration process.</p> <p>The agreement will therefore, post reconfiguration remain valid and enforceable.</p> <p>Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.</p>
3.	<p>uMgungundlovu District Municipality for Mpophomeni Waste Water for the construction, upgrade, operating and maintenance for Mpophomeni</p>	<p>The validity and enforceability of the contract will not be affected by any material change in the ownership structure of Mhlathuze Water</p>

No.	Clients Name & Type of Service	Comment
	<p>Effective as of the 1st of July 2014 for a period of 20 years until the 30th of June 2034</p> <p>Addendum to amend main agreement and further instruct Umgeni Water to construct the sewer trunk main supply sewage to the Treatment Plant and the monthly management fee will be calculated in accordance with paragraph 9 of the main agreement.</p>	<p>The agreement will therefore, post reconfiguration remain valid and enforceable.</p> <p>Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.</p>

1.4 Stakeholder Engagement

Part of legal implications of the reconfiguration process is the engagement of stakeholders as indicated in section 1.3 above. However, the manner in which stakeholders are engaged is important as it determines outcomes of engagement. The engagement of the stakeholders comes at various levels depending on the role and the impact that the stakeholders have on the water board functions and intended outcomes.

The principled approach to stakeholder engagement is centred on understanding Who the stakeholders are?, Why engagement them?, When should they be engaged? and How should they be engaged? The water services act differentiate between stakeholders that should be consulted and those whom the Minister must take regard of. The other elements of engagement is to inform, involve, collaborate and empower.

In the context of reconfiguration of the two institutions, the process cuts across all these elements of engagement depending on the role played by the stakeholder and the intended outcome. Based on the approach, the initial process was predominantly around informing the stakeholders on the decision of the Minister to reconfigure as well as inform them around the formal process to be followed. While the latter was the intention, there were equally elements of consulting therefore exchanging input that should be considered in the report and reconfiguration process, ultimately. The following is a list of meetings/stakeholder engagement meetings:

- UW/MW stakeholder session – 16 November
- Umgeni Staff Information Session – 22 November
- DWS Public Meeting – 23 November
- UW/MW client engagement – 23 November
- Mhlathuze Stakeholder Indaba – 24 November
- Mhlathuze website Gazette Publication - 25 November
- Workstream meetings with uMhlathuze Water Board

Further, through this form of engagement, and to limited extent consultation, the Minister had engagements through the gazette process with structures such as Amakhosi, Water Services Authorities and Investors.

As part of showing regard, consultation and collaboration in the reconfiguration process. The first report of the Due Dilligence must be used as basis for comprehensive engagement that should result in fully informed positions and options. These should in turn form the final Due

Diligence and inform the critical path action plan for implementation. The latter has not been fully addressed as alluded to in section 1.3 above. It is expected that this will be fully addressed as part of Positions and Options activities.

1.5 Finance

Water Boards are run as businesses, therefore, other than legal matters and engagements of stakeholders. Financial viability, protection and sustenance of investments becomes a critical factor in decision making for the proposed reconfiguration. The sections below provide a summary of the current financial health of the two institutions, investment outlook as well as financial implications moving forward as a reconfigured institution.

Based on the historic analysis of Mhlathuze Water and of the projected performance of the two entities, it is our recommendation that the proposed reconfiguration of Umgeni Water and Mhlathuze Water proceed. It is also our considered view that this will be in the best interest of both entities and KZN as whole.

Our analysis has shown that Mhlathuze Water is a profitable entity. Revenues have grown at an average rate of 5% over the past 5 years. In addition, gross earnings have increased by 19% since 2018. This high quality of earnings is projected to continue into the near future. In comparison, Umgeni Water has achieved a 14% revenue growth over the same period, with only a 2% earnings growth.

It is important to note that Umgeni Water's revenues, earnings and total assets are almost 8 times those of Mhlathuze. Therefore, Mhlathuze Water's growth figures are off a small base. While this is so, the relative size is also an important factor in supporting the recommendation for the reconfiguration as it implies that the impact of the merger on Umgeni would be minimal. Mhlathuze revenue would form only 14% of the combined revenues post reconfiguration.

In addition to the above, Mhlathuze possesses healthy and growing cash reserves in the form of short-term deposits. It has demonstrated the ability to fund its capital needs from cash generated from operations with no additional debt or equity raised in the past 5 years. The current interest-bearing debt is being serviced well, and as of June 2022 only R36 million remains from an initial amount of R150 million.

While Mhlathuze's debtors collection is itself not pristine at 69 days, it is better than Umgeni's which sits at 83 days. The bulk of the debtors dragging the figure down lies with the Department of Water and Sanitation, which presents an opportunity for Umgeni to resolve the issue upon the merger and immediately get the debtors days down to 45 days.

The single most benefit that the new entity will enjoy is that Mhlathuze Water possesses a wastewater treatment plant capacity that becomes an important element in ensuring revenue growth going forward. This is brought-in through experience from industries nestled around this region that use a lot of water for their business activities. Wastewater treatment is a significant portion of Mhlathuze's revenue (34%). This capacity of Mhlathuze can be increased to provide a significant revenue stream for Umgeni Water. On the other hand, Umgeni Water largely concentrate on municipal water supply since the majority of its clients are Water Services Authorities. An inherent benefit of the reconfiguration is a broader market reach into

Mhlathuze’s industrial/business customer base. Over and above the existing customers, there is the potential to reach out to new clients in the Umgeni stronghold leveraging on the knowledge of the market of Mhlathuze’s transferred capacity.

Overall, the impact as projected is positive. Projections of the combined entities show positive earnings and growth. The performance is expected to grow stronger as the synergic benefits of the merger are fully incorporated. In order to effectively keep track of the impact and progress of the merger through key performance metrics, it is important that the reporting of Mhlathuze be kept separate in the interim. Hence the proposed “Ring-Fenced North Easter Region”. This is narrated in the Governance and Institutional Arrangements section of the report.

There are concerns though that need to be mapped as risks and addressed as the process unfolds. Mhlathuze has an outstanding debt of approximately R36m (as at June 2022). This debt will either need to be repaid prior to the reconfiguration or taken over by the new entity. Repayment will decrease Mhlathuze’s cash reserves from R714 million to R678 million, which is in itself not a significant concern. Should Umgeni prefer taking over the R36m debt obligation, the impact is even more insignificant considering the size of Umgeni’s balance sheet. On the other hand, Mhlathuze incurs an interest of 10.45% on the debt and yet only gains an effective rate of 3.3% on its cash reserves, which might be a reason to pay off the debt from current cash reserves.

Even with delayed maintenance and expansion plans, Mhlathuze’s infrastructure remains in good working condition. As such, no additional capital outlays other than those already projected and budgeted for will be necessary. The aforementioned maintenance delays still need to be addressed as these might pose supply issues going forward. Umgeni’s maintenance record is better and as such it is envisaged that the related policies will benefit Mhlathuze and with it the new combined entity as a whole. Maintenance plans need to be continuously monitored in order to sustain growing demand.

Mhlathuze brings with it its own water sources, meaning no additional constraints will be placed on the existing Umgeni water resources or allocations.

A number of issues complicate the process to reconfigure the two water boards. Bonds that are currently active at Umgeni Water represent one of the issues that must be carefully dealt with. Issued on 09 March 2016 and listed on the Johannesburg Stock Exchange, Umgeni’s UG26 Bonds are plain vanilla fixed-coupon bonds with a 11.31% coupon rate. The bonds have a nominal value of R935 million and make up Umgeni’s senior unsecured debt which is to be redeemed in March 2026. As of 01 September 2022, the bonds’ affirmed rating is AA+(zaf) on the Fitch Long-term National Scale Rating. This rating was affirmed after the reconfiguration considerations had been made public, thus knowledge of the reconfiguration has not had a negative impact on the rating of the bonds.

After a detailed analysis of the UG26 bonds and the RSA government issued R186 Bonds which mature in December 2026, we can confirm the movements in the price and yield of Umgeni’s UG26 bonds between August 2018 and January 2023 have been in line with the movements in the general bonds market in South Africa. There has been no indication of the UG26’s

performance deviating from the general market trends even after the news of reconfiguration became public.

Based on our assessment, the possibility of reconfiguration has not had a negative impact on the performance of the bonds. With the reconfiguration generally expected to benefit Umgeni, we expect no negative impact on the bonds.

We recommend that in the initial stages Mhlathuze remains an independent ring-fenced function (independent business unit). Furthermore, its different geographic location already makes a case for a separate reporting unit as proposed in the Governance section of the report. This will allow focused monitoring of its financial performance more effectively. Mhlathuze has a different clientele from that of Umgeni and has, to date, been performing well. The current performance could be destabilised if it were completely assimilated into Umgeni operations at once.

Water use charges (tariffs) for Mhlathuze are lower than those of Umgeni. It would seem that a reconfigured entity has a reasonable opportunity to increase revenue by matching the Mhlathuze tariffs to Umgeni's. However, given the existing agreements customer concerns regarding this and the existing customer agreements, it is our recommendation that the tariffs remain the same and reviewed annually for opportunities to increase that may arise. Any change in the charges, will of course, require relevant and affected stakeholder engagement as well as the consideration of the existing water supply charges agreements.

There is a need to remeasure and register Mhlathuze assets and liabilities in the new combined entity. Given the upcoming financial year end for both entities in June 2023, we recommend that the asset registration and transfer processes commence as soon as possible to enable full reporting from the beginning of the new financial year.

In line with the general consensus on the advantages of a single water board in the KZN region, another step towards this integrated water management solution could be the incorporation of uThukela Water. This would also bridge the geographic gap between Mhlathuze and Umgeni that is currently serviced by uThukela Water. Further expansion can see the consideration of areas that are not currently serviced by either entity.

1.6 Technical and GIS

Mhlathuze Asset Base

The financial figures and viability issues referred to in section 1.5 above are all on the back of the infrastructure that deliver water services to clients for profit. It is therefore important that the state of infrastructure and the implications of a reconfigured institution are considered. The summary below is an indication of this consideration

Based on spatial information generated by the Garnet Ngubane team, data was added to Mhlathuze assets and imported into the GIS. The Fixed Asset Register was used to ascertain the total asset value. Based on all Active Assets the table below applies:

Net book value as @ 31 October 2022	Insured Value	Replacement Cost
R958,360,282.13	R1,292,626,964.73	R1,370,211,727.83

The major contributors to the Total Net Asset Value are highlighted below, and the distribution of Asset Value (Based on Net Book Value) is indicated below:

- Nsezi Water Treatment Plant 39.80% (Excluding the current Augmentation Project)
- Weir Pump Station 25.23%
- Alkastrand Effluent 6.92%

Assets which were inspected during the Site Visit were determined based on the higher asset values. A major augmentation project is currently ongoing at the Nsezi water treatment plant.

Umgeni Asset Evaluation and Condition Assessment

The Fixed Asset Register dated October 2022 was used to evaluate the Asset Value Distribution. The 'Asset Class' has been used to group different classes of assets. These groupings have been evaluated and represented in graphs to display the Value Distribution attributed to the different Asset Classes. The main contributors to the Total Asset Value of Umgeni Water are listed below:

Asset Class	% of Total Asset Value
Pipelines	30%
Water Treatment Plant Assets	27%
Pumps and Associated Equipment	9%
Wastewater Treatment Plants	8%

The Reconfigured Umgeni Water Board (including Mhlathuze Water service areas)

Impact on Water Quantities

Based on the estimated capacities of the individual entities, the following combined quantities will apply:

ENTITY	Abstraction m3/annum	Supply m3/annum
UMGENI	563.26	515.05
MHLATHUZE	49.37	49.37
COMBINED CAPACITY	612.62	564.42
Increased Capacity	8%	9%

The increase in Bulk Water Supply Capacity of Umgeni Water a combined entity will be approximately 9% in total.

Impact on Asset Condition:

The distribution with regards to general condition classification related to all assets within Mhlathuze Water were found to be in a good condition. As defined by the International Infrastructure Management Manual – Version 3.0, more than 70% of the value of the assets are classified as ‘GOOD’. This implies that the assets are generally in an “Acceptable physical condition but not designed to current standards or showing minor wear”. Deterioration has minimal impact on asset performance. Minimal short-term failure risk but potential for deterioration or reduced performance in medium term (5 – 10 years). Only minor work required (if any). Based on the condition assessments done on both Mhlathuze and Umgeni, it is expected that a slight increase in maintenance cost will be incurred over the short term due to the implementation of the Preventative Maintenance Programme. Should this aspect however not be addressed, this could lead to breakdowns, service interruptions and increased cost over the medium term. The additional cost associated with implementation of the maintenance program is expected to be offset against a number of benefits as a result of improved and more effective Centralised Services.

Overall Impact

The reconfiguration of Umgeni Water and Mhlathuze Water to improve water services governance and institutional performance within the sector is achievable. The extension of the boundaries of Umgeni Water to include those that are currently under Mhlathuze Water to form a single Water Board and the disestablishment of Mhlathuze water could achieve the following as intended:

Consolidation of financial resources, assets and skills for key water service infrastructure development.	This report addresses the identification, verification and high-level condition assessment of assets within both Umgeni and Mhlathuze
---	---

	<p>Water. Synergies could be explored in terms of the following:</p> <ul style="list-style-type: none"> • Better governance and control by Umgeni Water. • Centralised Services could lead to better control over maintenance planning (CMMS) and execution, centralised spares holding, increased buying power by the larger combined entity, centralised management staff. • Increased training capability and capacity offered through Umgeni Water.
Increase of water supply areas for Umgeni (Increased revenue);	Mhlathuze Water's main income stems from a number of large key industrial off-takers. If well managed these could provide a very good reliable source of stable income. The potential in Richards Bay for future expansion and industrial development is very good. This could also lead to large sources of increased revenue.
Assist with expanding access to un-serviced areas therefore improving water services delivery targets within the province; and	The Mhlathuze Water operations are predominantly centralised around Richards Bay. There are extensive un-serviced areas within Mhlathuze's footprint. With Umgeni Water's backing, economies of scale will apply and will enable better opportunities for improving bulk water distribution to un-serviced areas.
Institutional realignment objective of water management institutions. In this context, it is the ultimate establishment of a single Water Board or a Regional Water Utility (RWU).	From a technical perspective, realignment will lead to standardisation across all service levels

1.7 Governance and Institutional Arrangements

Sustainable institutional water infrastructure management and continued financial profits, equally depends on the manner in which the institution is governed, managed and how institutional arrangements are set up. Part of institutional viability and sustainability is set or embedded on clear Governance and Management Arrangements as well Institutional Arrangements. Governance and Institutional arrangements refers to a set of legislation, policies, structures, appropriate activities and/or actions that help manage water institutions and ensure effective discharge of functions. Therefore, giving effect to the intended institutional vision and objectives within the sector.

The discharge of good governance and effective management of the institution comes at two levels, viz, Board Level and Executive Management. At Board Level, the Board Members are obliged as part of their fiduciary duties to act in the best interest of the institution, take due care, skill and diligence. Through applying Corporate Governance Principles as outlined in King IV Corporate Governance Report, the Board Members must help achieve ethical culture within the

institution, ensure good performance of the institution, effective control and legitimacy of the institution. Further, section 50 and 51 of the Public Finance Management Act, 1 of 1999 stipulates and clarify the role of the Accounting Authority in relation to the management of Public Entities. These are predominantly centred on fiduciary duties of the Board / Accounting Authority.

In the context of the intended reconfiguration of the two Water Boards and the achievement of governance elements indicated above. There are important functions and principles that the current boards are obliged to continue to espouse, viz:

- Continued provision of Bulk Water Supply (Primary functions) and the provision of Municipal Water Services Functions (Secondary functions) as well as any other functions appropriately agreed upon;
- Ensure strategic support to the reconfiguration process without jeopardising the normal operations of the institutions.
- Ensure that there is no governance and leadership vacuum during the reconfiguration transition;
- Ensure legitimacy of the two Water Boards by acting appropriately and showing regard for the viability of the institutions as well as interests and investments of affected stakeholders
- Continue to promote ethical behaviour across the institutions.

Governing Board Proposals

Mhlathuze Water recently (December 2022) had its Board term of office extended until completion of the reconfiguration process. Umgeni Water has its Board term of office coming to an end in April 2023. Following the completion of the stakeholder engagement process with confirmed positions and options for the reconfigured UM Water. It is proposed that the Minister considers appointing a board that will govern and lead the new institution.

It is further proposed that a full Governing Board appointment process as outlined in section 35 of the Water Services Act, 107 of 1997 be followed.

Continuity and prevention of loss of institutional memory is important in any governance and institutional transformation. It is therefore proposed that the Minister intentionally considers retaining a combined 25% of the current board members in order to ascertain institutional memory in the new reconfigured UW Board of Governors.

Management Arrangements Proposal

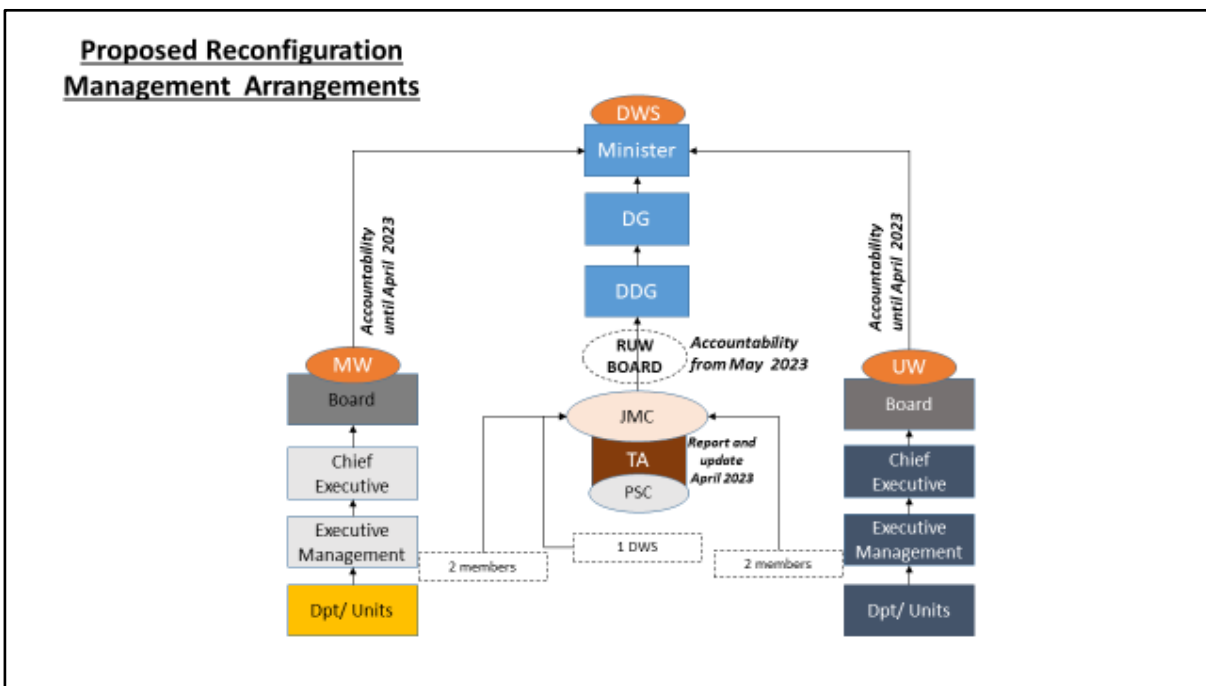
The reconfiguration process comes with a number of challenges and strategic decisions that should be made from a management perspective and as ratified by the Board.

Mhlathuze and Umgeni Water reconfiguration present a very unique yet challenging process in that it is a Due Diligence process but equally it needs some of its proposed options implemented simultaneously in order to ensure continued operations of the institution and implementation of critical path action plans for reconfiguration. Based on this understanding, it therefore becomes imperative that an appropriate structure comprising of representative of both

institutions is set up to drive the implementation process, particularly the action plans tied up to the set completion date.

A Joint Management Committee (JMC) is therefore proposed. In principle, the function of the JMC is to implement the action plans and to ensure that every decision taken is implemented within the specified time.

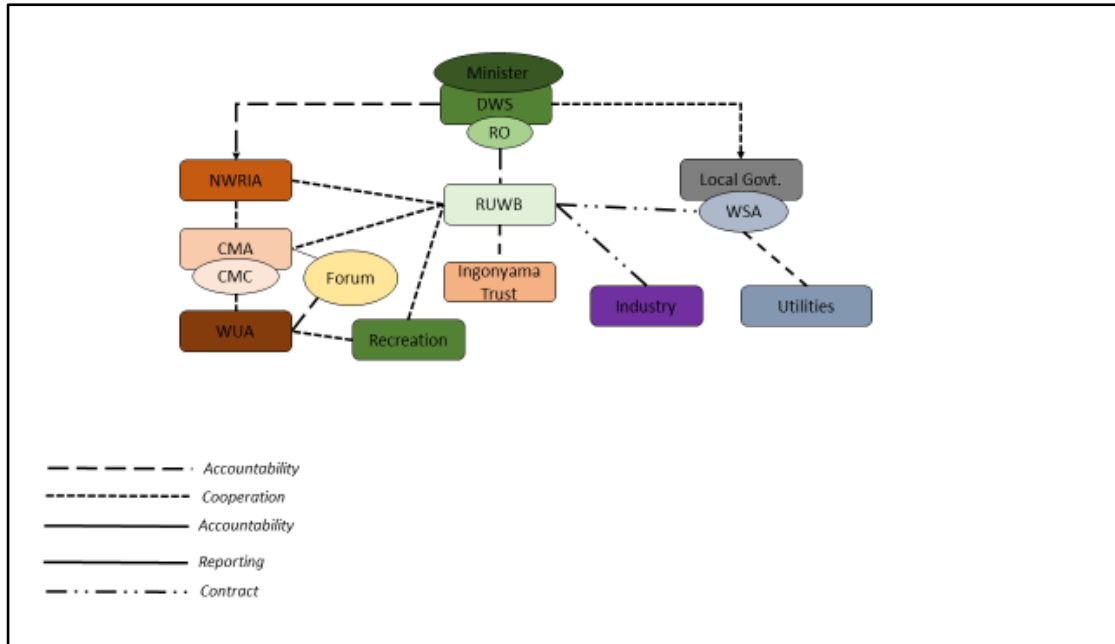
It is proposed that the JMC be composed of at least 2 members from each of the two institutions, one member from DWS and the TA. The JMC will report to both boards in association with the TA. The PSC will continue to provide strategic support and guidance to the process. The JMC will cease to exist or function when the new board of a reconfigured UW starts its term.



Emerging Institutional Arrangements

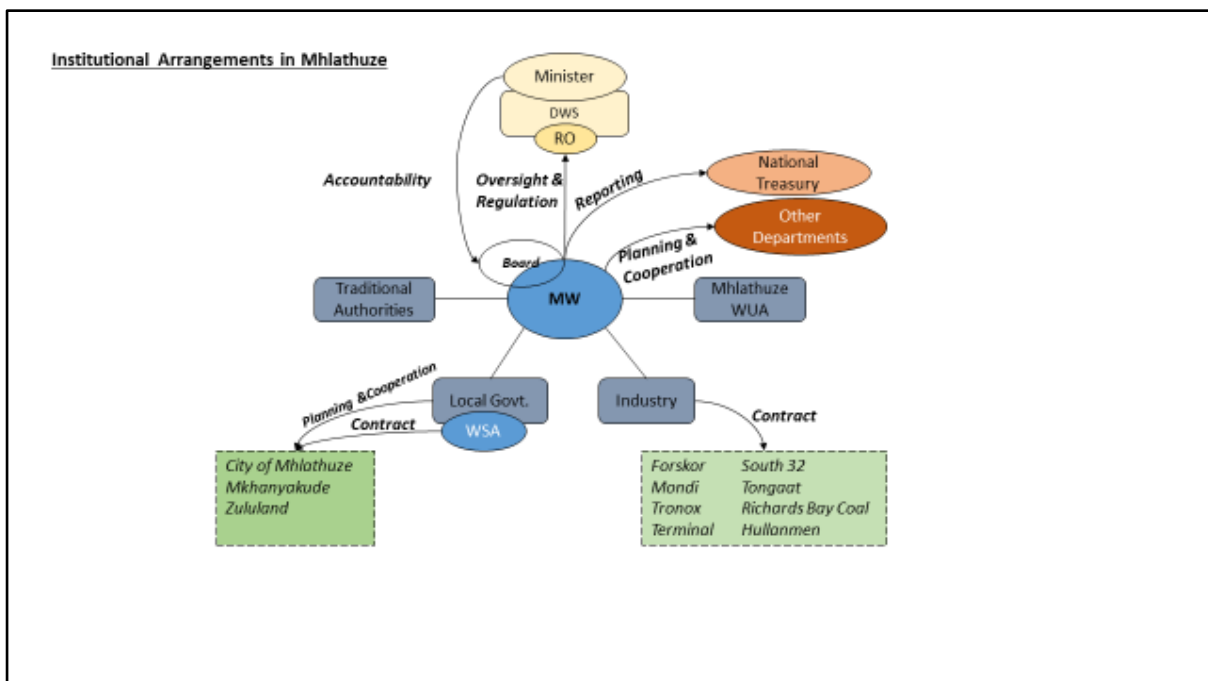
The reconfigured Umgeni Water Board will not exist in a vacuum or in silo. But it will establish institutional relations and management arrangements that will help support sustainable management of water and the provision of services. It is proposed that the water board considers and strengthen these emerging arrangements.

The structure below gives an indication of high level and general institutional arrangements in the KZN water sector focusing mainly on Water Boards. The diagram below illustrates emerging institutional arrangements relevant for the management of water services from a Regional Water Utility Perspective.



Umgeni further has arrangements with Ingonyama Trust Board (ITB) which addresses land use management in relation to developed water infrastructure. The emerging arrangements that are required to support the envisioned Regional Water Utility build on what already exists within Umgeni, and will ensure a broader perspective that caters for all development needs. It is important that these are enhanced in order to ensure integrated water management to the benefit of Umgeni Water Board.

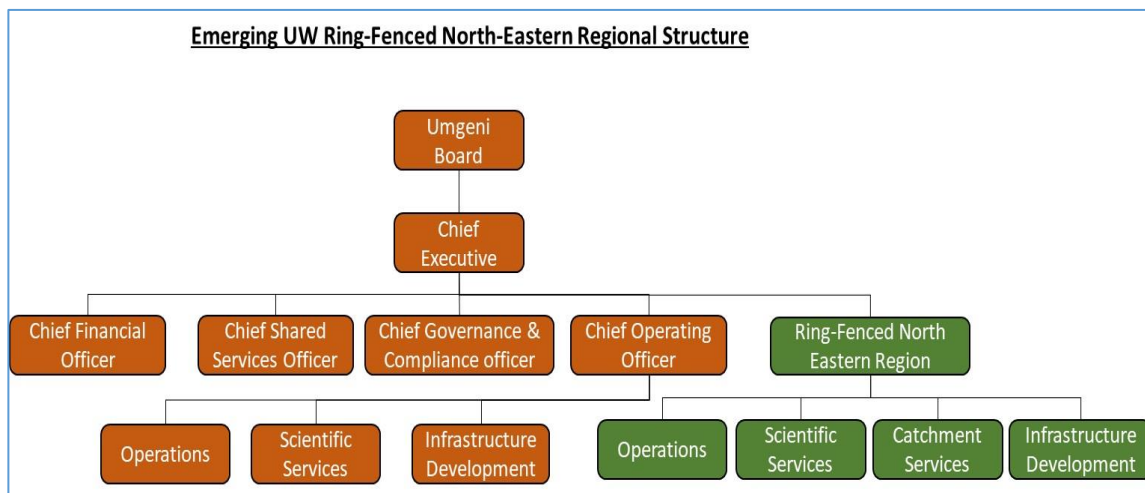
The institutional arrangements below represent the current status in Mhlathuze. The lines connecting the different institutions denote specific roles and responsibilities that are important for the delivery of water services. The regulatory and oversight arrangements are standard.



Emerging Operating Business Model – Functional Structure

The emerging operating model structure begins to address the intended objective of a single water utility within KZN. There is an emerging distinct Regional Structure that addresses the North Eastern Region water services areas in KZN. In line with water resource management areas (WMA), it follows the current political boundaries. There is one current function by UW which, crosses the political boundary, i.e. in Gert Sibande District Municipality where the water board provides section 30 water management services. This is a laboratory services function.

In line with the reconfiguration process, this distinct regional structure should be a Ring-Fenced North Eastern Regional Structure under UW. It is proposed that it be an extension of UW operations servicing areas up until the KZN / Mpumalanga political border, with one exception of current Gert Sibande District arrangement for water management services in terms of section 30 of the WSA. The proposed Ring-fenced North Eastern Regional structure of UW should be effective from the date of transfer in line with the proposed project Action Plan. The organogram below provides a proposed high-level addition of the Ring-fenced North Eastern Regional Structure into the current structure of UW. The new board supported by the TA will address the emerging the positions, functions and HR and Labour issues. The principle is that all assets and liabilities move “voetstoots” to UW protected by section 197 of the LRA. The latter is clarified in detail by the HR section of this report.



The emerging ring-fenced North Eastern Region operations carries with it, a lot of elements and responsibilities that make it imperative for UW Board of Governors and executive management to consider. The proposed structure is not about the levels of reporting or positions that exist either within Mhlathuze or Umgeni Water, rather it is about the strategic arrangement of functions in order to first, avoid water service delivery disruptions in areas previously serviced by Mhlathuze. Second, to enable, in the short term, the conclusion of the reconfiguration and hence the migration process. These include the reporting lines in terms of the structure and

expected functions to be implemented. The following identified elements characterising this region makes it imperative that it be managed at an executive level:

- The region is identified as one of the key economic hubs meant to drive Economic Development in the KZN region and the country as a whole, therefore needing integrated and sustainable water management services as a cross-cutting feature to support this development vision.
- **National Spatial Development Framework** – the framework identifies the region as one of the key economic hub and investment area. It is further identified as a national resource production heartland, national eco-resource production regions and national Ocean and aquaculture production regions.
- **National Spatial Development Perspectives** – the framework identifies the region as an economic investment region to drive economic growth and help control migration and congestion into the key major cities by providing alternative employment centres.
- **Mega Projects** – currently the region houses one of the two Mega Housing development projects in KZN as guided by Human Settlements’ Breaking Ground Policy (BNG). The project entails development of housing development and development of business and industrial zones to complement the developed settlement areas. For this reason:
 - The region presents a very strong Waste Water Treatment element, as it services a number of industries discharging waste water. This is an important element that should be managed at a high level as its negative impact could have dire implications for the water resource Catchment Management Area. This waste water treatment strong element must be spread across UW operational areas.
 - The region is in a Water Management Area that is currently seeing a lot of changes in terms Catchment Management. There is currently a process to establish a Catchment Management Agency (Phongola - Mthavuna CMA) as well as Mhlathuze WUA. Integrated Catchment Management Strategy development and planning makes it imperative that UW is represented in these processes. Secondly, noting the capacity and magnitude of the region, DWS and the CMA could consider delegation of some of catchment management functions as a business to the water board, therefore strengthening the Regional Water Utility function.

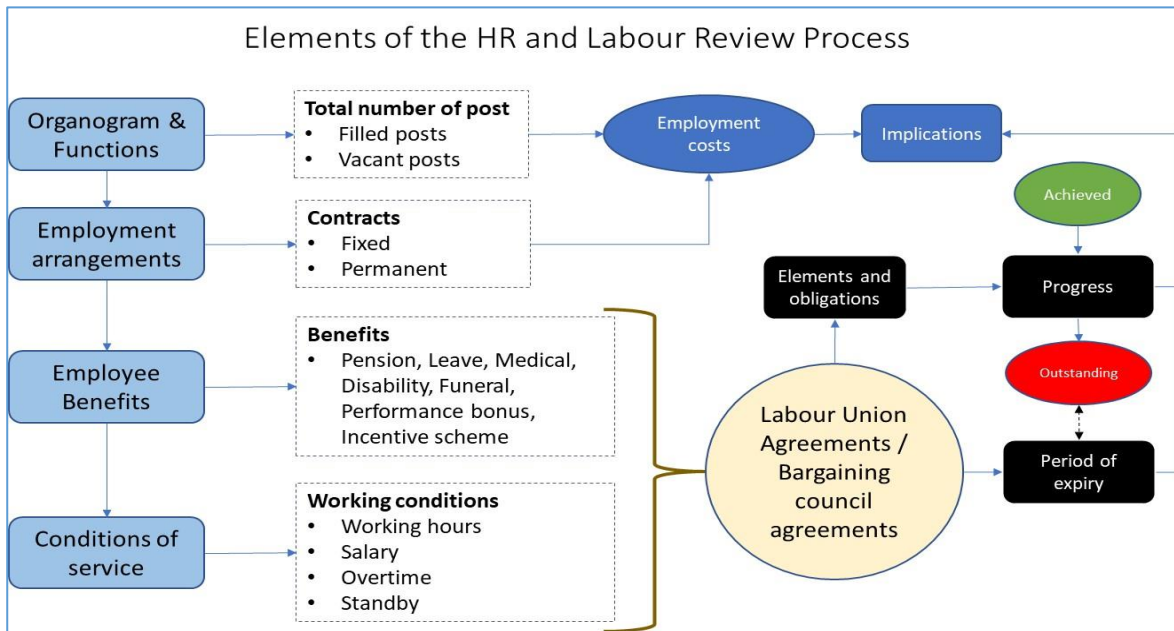
The sensitivity of some of these functions makes it imperative that it be managed at an executive level.

1.8 Human Resources and Labour

Effective governance, management and institutional arrangements inform form, structure and appropriate human capital to all become part of creating viable and sustainable water management institutions, in this context, the Water Board. The sections below provide an indication of human resource and labour implications on reconfiguration.

Assessment framework

For the purpose of this analysis, the following framework has been adopted that provide a holistic view of the HR and Labour considerations relevant to the migration of staff as part of reconfiguration.



The left-hand side of the diagram shows the various areas of human resource management starting with the arrangement of functions and posts, the employment arrangements applicable within Mhlathuze, the actual benefits available to employees, and concludes with a brief overview of conditions of service. The second component is a review of the existing labour union arrangements that are currently active. Questions to consider include: what are the key elements and obligations, the expiry and /or time period of the agreements, progress on areas identified in the agreements as well as outstanding issues. The third component of the framework looks at the costs of employment with conditions of service and employment benefits in mind.

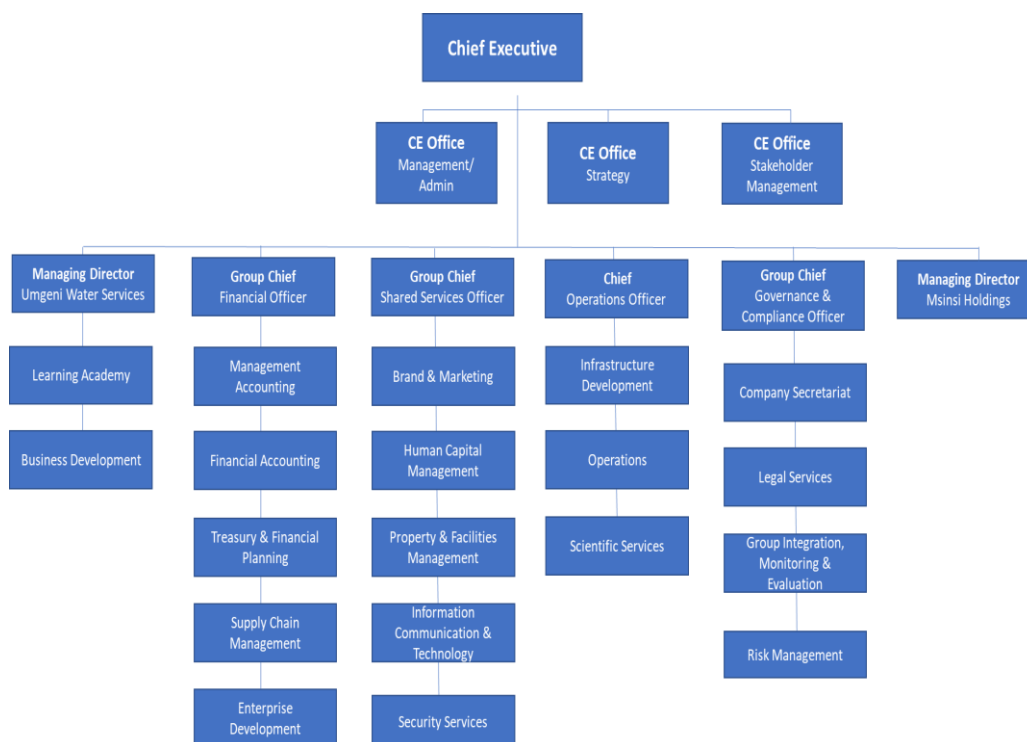
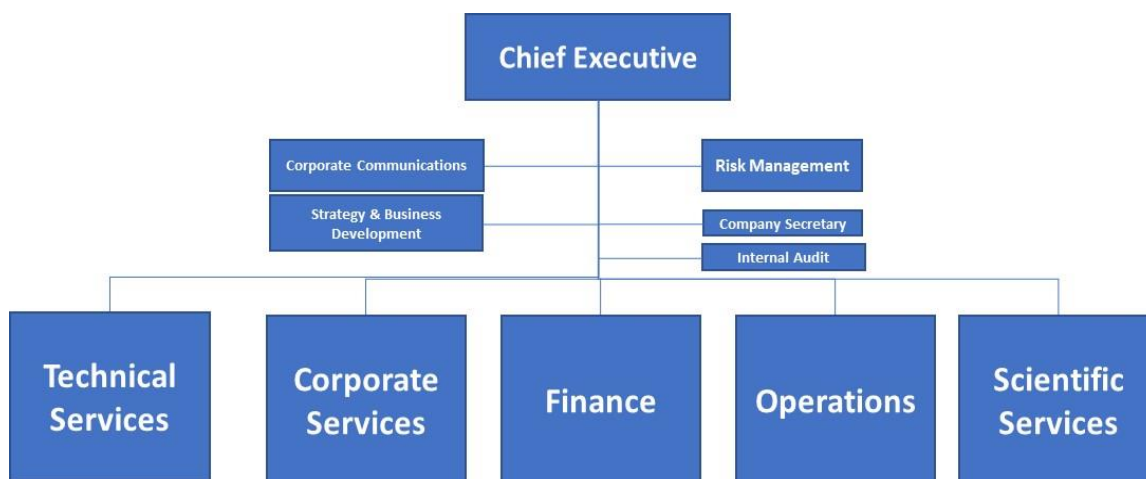
Finally, the framework considers the future implications arising as a result of current costs of employment together with outstanding issues that still require implementation in line with the agreements.

Legal context for the transfer

The implications of the sections cited above are that Umgeni Water should ensure that all processes relating to employee remuneration that are currently (if any) mooted within Mhlathuze, are put on hold. Postponing the resolution of the outstanding issues should not be construed to mean that such outstanding initiatives will be shelved forever, rather that Umgeni will first then align its systems to conclude such once employees have been transferred. In any event, Sections 197 (2) indicates that a transfer does not interrupt an employee's continuity of service and an employee's contract of employment continues with the new employer as if with the old employer.

Similarly, Section 197 (3) requires that employee retain conditions of service and benefits that are substantively similar to those they enjoyed while employed by entity being sold. Moreover, employees may be transferred to a new pension or provident fund if the criteria in Section 14(1) (c) of the Pension Funds Act of 1956 are satisfied.

Function and organogram



Summary of findings

Given the planned transfer of functions, assets and staff to join Umgeni Water, a few observations could be made that relate to HR policies in general. The first is that HR policies currently applicable within Mhlathuze Water will no longer apply. The reason for this is that

Mhlathuze Water as an entity will cease to exist once disestablished. The second observation is that conditions of employment that will apply hence forth will be those currently applied by Umgeni Water.

The arrangement of functions is not seen as a serious challenge, despite the fact that there are variances. Especially, with regard to how the operations functions are arranged within Umgeni. The COO is responsible for all technical functions including scientific services, operations and technical services. For Mhlathuze this are all stand-alone functional unit.

Mhlathuze grade salary scales are up to a grade E2 (grade 3), whereas Umgeni Water scales extend to Grade 2 (E4/ E5). Mhlathuze salary scales are based on total cost to company wherein the medical aid employer's contribution is included in the cost to company and Provident Fund contributions are calculated based on percentages ranging from 65% to 82% of the total cost to company. The employee selects the percentage for pensionable earning. Employer contribution to pension/ provident fund is deducted from total cost to company to quantify the cash salary and the cash salary is utilized for calculation of other allowances such as overtime.

Key summary points are tabulated below.

Key elements	UMgeni Water	Mhlathuze Water	Comment
Organogram and functions	Primary and secondary functions aligned to requirements in terms of Water Services Act; Significant revenue base to expand services	Primary and secondary functions aligned to requirements in terms of Water Services Act; Reach of services limited – infrastructure require expansion	Residential for Mhlathuze base largely rural and require access to water and sanitation, Umgeni is largely urban with a small rural portion. Functions and capacity could easily integrate. Mhlathuze strong on waste water collection and disposal.
Senior Posts	Acting CE, Shares Services, Brand and Marketing Management, Human Capital Management and Management Accounting	Acting CE and CFO	Reconfiguration provides an opportunity to resolve vacant posts, Proposed regional perspective provides opportunity to refocus Mhlathuze (senior posts) including CE and CFO posts

Key elements	UMgeni Water	Mhlathuze Water	Comment
Employment arrangements	Further analysis of Umgeni employment arrangements required.	Combination of permanent and fixed term contracts, Fixed term contracts mainly at senior level	Mhlathuze - Some fixed term contracts to expire. Capacity requirements within Umgeni needs assessment to facilitate absorption of staff from Mhlathuze. Employment arrangements could recognise Mhlathuze as a region of Umgeni Water with a Regional Mgr and CFO.
Employment benefits	Superior benefits, including disability, spouse / family benefit and a 100% compulsory medical aid scheme.	Benefits will improve as a result of reconfiguration.	Common benefits include: Pension & Retirement Fund, Housing Allowance, and Medical Aid Scheme. Significant variances exist with Umgeni showing better benefits – these will be explored as part of the planning process for the migration.
Conditions of service	Common conditions of service	Common conditions of service	Seemingly, there are variances with regard to working hours, overtime, shift allowance, and standby policies that will require smoothing.
Labour Union Agreements – SAAWU Bargaining Council	Subject to water sector collective agreements.	Subject to water sector collective agreements.	Not clear if Umgeni and Mhlathuze have equally implemented agreements reached so far. Benefits and conditions of service applicable seem to vary – perhaps due to size and scope of activities.

1.9 Reconfiguration Action Plan

The project to reconfigure Umgeni Water and Mhlathuze Water is complex and involves a number of different; yet interdependent processes. The due diligence assignment is the initial step toward ensuring that the status quo of the various areas of focus relevant for the completion of the process are well understood, and that a well-structured, time-sensitive action plan is developed and put in place to facilitate successful implementation of the amalgamation of the two institutions. The Minister is clear about the national objective of developing boundary based, single and efficient regionalised water boards. The two institutions, Umgeni Water and Mhlathuze Water are at the fore front of government initiatives to enhance water service delivery and improve access to all residents from a regional perspective.

This action plan builds on the due diligence report as well as the regional water service delivery requirement that include servicing both existing clients together with the need to improve /enhance access to water services by all KZN populace. Some of these areas have been covered in the main due diligence document and the focus of this action plan are the following areas that serve as critical milestones toward establishing a single water board in KZN:

- Stakeholder engagement and consultation on the process
- Governance and institutional arrangements to support the transition toward a single water board, as well as related management structures
- Finance and related matters emanating from the transfer of functions, staff and assets from Mhlathuze Water to Umgeni Water
- Technical matters, including assessments on existing Umgeni assets as well as the registration of all confirmed assets to inform the balance sheet of the receiving entity.
- Legal matters, including implications arising out of the existing legislative framework for finance, labour, corporative governance as well as Ministerial powers to initiate the process together with the related consultative requirements associated with the process under discussion.
- Human resources and labour matters that need to be addressed prior and after the reconfiguration process

Given the short timelines of this project, activities contained in this action plan are synchronised to achieve efficient use of time. For that reason, the legal issues that are critical in this process cut across the various focus areas mentioned above. Consequently, legal matters pertaining to the process are addressed singularly in one report. Moreover, stakeholder engagement and consultation is a priority in terms of existing legal framework in the water services sector, and therefore, specific actions are planned to cater for specific requirements in this regard.

The sub-sections that follow narrate each area of focus in detail indicating the approach, activities and expected outcome of each. It is important to note here that the action plan is laid out in order of priority, starting with the most pressing action (critical milestone) leading to subsequent milestones with respect the set timeline.

Stakeholder engagement: The water service sector has a human face and therefore lends itself to legislative requirements for participation, consultation and information sharing throughout the process. In compliance with these requirements, the transaction advisor to the due diligence

project has involved representatives of DWS as well as Umgeni and Mhlathuze water boards and to a lesser extent (due to time constraints), labour and investors. Such limited engagement was born out of the need to conclude the due diligence report within prescribed time constraints. Notwithstanding, stakeholder engagement is a constant feature of the reconfiguration process and for the purposes facilitating successful implementation of the process, the following critical engagement processes are planned:

1. Due diligence workshop – this process is the first activity of the action plan, and entails presentation and discussion of the due diligence report to DWS, Mhlathuze Water and Umgeni Water. It is important to note here that Umgeni Water is the sponsor of the project, while the Minister is the initiator and the custodian carrying the water service mandate in terms of the Water Services Act. The primary objective of this focus area of the action plan is to discuss the report and gain rapport on its contents, including developing common ownership among key participants. A precursor to this meeting are subject matter expert meetings that are taking place and were planned for the month of January. As part of this action plan the meetings are expected to culminate into a stakeholder workshop as mentioned above.

The deliverable for the above workshop is intangible, and yet critical in ensuring that critical stakeholders speak with one voice and assume ownership of the contents and positions contained in the report.

2. Stakeholder engagement workshops/ meetings – the objectives and intent of this activity of the action plan are clearly defined in the stakeholder engagement work stream work plan in the due diligence report. However, the planned reconfiguration process requires that the broader stakeholder populace is engaged actively in the process to reconfigure the two entities. Primary participants are creditors and consumers. In the case of Umgeni Water, the bulk water service consumers (businesses and municipalities) including investors. Moreover, since the strategic intent of the reconfiguration process is to improve/ enable access to water users in rural communities as well as emerging small-scale businesses, this focus area of the action plan will also involve rural communities through existing traditional authorities. With regard to investors, it is important to discuss the implications of the reconfiguration process on the following:
 - a. Status of the due diligence process
 - b. Implications of reconfiguration on investments

The above activities are mainly about creating common understanding of the process through sharing the outcome of the due diligence, as well as creating a platform for stakeholders to engage on specific emerging positions toward establishing a single water board.

Governance and institutional arrangements: Once a common understanding has been established amongst critical stakeholders, transitional governance and management arrangements should be put in place. The idea here is that the reconfiguration process should not impact negatively on service delivery, and that the business of water services must continue as usual. With this in mind it is important to allocate specific transitional management roles to specific managers from both water boards. Reporting to the existing boards, the transitional project management structure will oversee and coordinate concurrent activities that must be

performed to achieve a smooth transition. To ensure that services are not negatively impacted, it is proposed that the transaction advisor continue coordinating all activities at a planning and operational level. Timelines are of primary importance (*07 January 2023 – 30 April 2023*) here, in line with the Minister' gazette as well as the termination of the term of office of the existing two boards.

The practicalities of setting up a joint transitional project management structure fall within the ambit of the existing boards and DWS.

Finance and related matters: The due diligence report identifies specific implications to Umgeni Water as a receiving entity that are associated with merging the two entities. However, the associated asset valuations have not been performed, owing to the short time period (4 weeks) allocated for the status quo assessment phase of the due diligence project. Valuations as well as financial implications of existing contracts remain a critical step that must be performed prior to the actual transfer of assets. The balance sheet of the new institution must reflect the values of the acquired assets as well as the contractual obligations to be inherited. In short, all assets must be identified and registered accordingly in the asset register of the acquiring entity.

Technical assessments: While mapping of assets has been done, what remains is the actual assessment of assets to ensure that the valuations process is informed by mapped assets, as well as an audited asset register. The technical work stream is part of this action plan, and all assets should be confirmed and registered accordingly. It must be noted that this activity is linked to the finance asset valuation activity that informs the balance sheet. The PFMA processes come to mind in this regard, that provide directives to the transfer, management and valuation of assets owned by public institutions. Implications here go further to include the financial implications of expanding the existing water services infrastructure to facilitate access to water services even for the rural communities. Questions need to be asked around what are the cost margins, how funding is sourced, and what is allowed within the current reserves?

Human resources and labour: The importance of the various areas discussed above cannot be over emphasised. However, human resources and labour issues are sensitive, given the uncertainties associated with the transfer of staff to a new institution as well as requirements to ensure that change management takes place. In this regard, a few issues need to be addressed upfront. These include strategic agreements with labour unions that are active in the water services space. The agreements need to cater for the existing collective agreements signed between the unions and the two water boards. Section 197 of the Labour Relations Act comes to mind in this instance. Therefore, all substantive matters under the current collective agreement affecting Mhlathuze Water employees must be addressed and/ or agreed to prior to the transfer taking place. It is not in the ambit of this action plan to decide whether a short-term agreement is signed between the two water boards before the transaction is carried forward or not. Rather, the critical nature of human resources and labour arrangements are emphasised here to avoid unnecessary hiccups in the near future.

Legal matters: As indicated above, legal matters cut across all focus areas mentioned above. Nonetheless, this action plan cannot ignore the importance of this work stream of the project.

For each area discussed briefly above, legal implications will be thoroughly identified and discussed to ensure compliance with the Constitution and the relevant legal framework.



Stream	Issue	Action	Responsibility	Due Date	Comment
1. Due diligence workshop	<ul style="list-style-type: none"> Present, discuss and agree on positions presented in the DD Common understanding and ownership of the report 	<ul style="list-style-type: none"> Set up and coordinate workshop Invite DWS, Mhlathuze and Umgeni. 	<ul style="list-style-type: none"> TA (Umgeni) 	10 th February 2023	<ul style="list-style-type: none"> The DD report is a consultative document – DWS, Umgeni and Mhlathuze must agree on all positions taken.
2. Stakeholder engagement	<ul style="list-style-type: none"> Communication, awareness, involvement 	<ul style="list-style-type: none"> Coordinate consultative meetings / workshops 	<ul style="list-style-type: none"> TA (and Umgeni) 	<ul style="list-style-type: none"> End February 	<ul style="list-style-type: none"> Customers / creditors must be appraised of the latest developments
3. Governance and Institutional Arrangements	<ul style="list-style-type: none"> Transitional Board Governance of Mhlathuze Appointment of newly Reconfigured UW Board. 	<ul style="list-style-type: none"> Transitional Governance Arrangements for MW. Appointment of newly reconfigured UW Governing Board 	<ul style="list-style-type: none"> Minister – process supported by DWS 	<ul style="list-style-type: none"> 05th December 2022 (Extended MW Governing Board) January 2023 - 30 April 2023 (Reconfigured UW Board of Governors) 	<ul style="list-style-type: none"> The Minister must consider extending the term of office for current MW Board of Governors until reconfiguration process is finalised⁶. The term of office for UW Board of Governors is coming to an end in April 2023. It also coincides with that of MW as recently extended. <ul style="list-style-type: none"> The Minister must consider and

⁶ See, Minister's response to Media Enquiry on the term of office for Mhlathuze Water's Governing Board. The Board's term of office has been extended until completion of the reconfiguration process, which is anticipated to be end April 2023.

Stream	Issue	Action	Responsibility	Due Date	Comment
					<p>approve the appointment process for new reconfigured UW Board of Governors. The Process must commence in January 2023 for completion in April 2023. New Board Members to start beginning of May 2023.</p> <ul style="list-style-type: none"> ○ The Minister must consider retaining at least a combined 25% of the old board in order to retain institutional memory in the new board.
4. Governance and Institutional Arrangements	Management of the reconfiguration process.	Establishment of a Project Management Committee (PMC).	Current Boards of MW and UW	January 2023 – end April 2023	<ul style="list-style-type: none"> ● The PMC is a project implementation and management structure working collaboratively with the TA to help implement approved decisions leading to completion of the Reconfiguration process.

Stream	Issue	Action	Responsibility	Due Date	Comment
					<ul style="list-style-type: none"> ○ <i>The composition of the PMC</i> ○ <i>The Functions of the PMC</i> <ul style="list-style-type: none"> ○ <i>Key performance agreements and Non-disclosure agreements.</i>
5. Finance and Legal Streams	All creditors and debtors from both institutions need to be informed of the pending institutional change.	Both the UW and MW must inform the debtors of the pending institutional reconfiguration.	<ul style="list-style-type: none"> • MW & UW • TA Financial and Legal Streams 	First Week of February 2023	<ul style="list-style-type: none"> • All creditors' accounts that are outside of payment terms must be up to date prior to transfer • All Creditors, after consultation with them, must express in writing of the acceptance or rejection of institutional change and new payment arrangements. • All debtors must be consulted of the pending institutional change. They should be appraised of the reconfigured financial change and the institutional ability to continue servicing the debt.

Stream	Issue	Action	Responsibility	Due Date	Comment
					<ul style="list-style-type: none"> UW Board must acknowledge and accept debt and new arrangements to be made.
6. Legal Stream / Finance Stream	Existing contracts, including water supply contracts.	<ul style="list-style-type: none"> Both UW and MW must assess the existing contracts of their transferability and possibility alternative agreements where possible. Litigations 	<ul style="list-style-type: none"> MW & UW TA - Legal Stream 	3 rd Week of February 2023	<ul style="list-style-type: none"> Both institutions supported by PMC and TA must lead the process to individually engage / assess the agreement conditions and tariffs moving forward. The engagement objective must be to eliminate perceptions of high tariffs and instil confidence on continued supply of service. The objective should be to complete most litigations that can be finalised before completion of the reconfiguration process.
7. Finance and Technical Stream	Re-evaluation of fixed assets	<ul style="list-style-type: none"> Re-evaluation of Mhlathuze assets which will then be added on the balance sheet of the re-configured entity 	<ul style="list-style-type: none"> TA-Finance and Technical Stream 	1 st week of February 2023	<ul style="list-style-type: none"> True value of the assets will be identified. Journal entries will be passed for differences and adjustment of useful life
8. Technical Stream and Institutional arrangements.	Current water services functional arrangements with	<ul style="list-style-type: none"> Inform WSA of the pending institutional change and implications moving forward. 	<ul style="list-style-type: none"> MW TA - Technical and Institutional 	End February 2023	<ul style="list-style-type: none"> MW supported by TA to lead engagements with City of Mhlathuze regarding current water

Stream	Issue	Action	Responsibility	Due Date	Comment
	Water Services Authorities.		Arrangements stream		<p>plant management arrangements moving forward. During the last stakeholder engagement meeting. The current Municipal Manager had raised issues regarding potential impact of institutional and governance arrangements change.</p> <ul style="list-style-type: none"> The current arrangements has equally implications on HR & Labour matters, which must be considered.
9. Technical / Institutional arrangements/ Legal	Asset Inventory and Transfer date	<ul style="list-style-type: none"> Identification, capturing and alignment of asset inventories for transfer. Registration process and Asset transfer. 	<ul style="list-style-type: none"> MW & UW TA – Technical and Institutional Arrangements stream 	<ul style="list-style-type: none"> End March 2023 Asset Inventory Targeted registration date – 30 June 	<ul style="list-style-type: none"> The objective is the registration and transfer of assets with the Deeds office. The transfer is from Mhlathuze Water Board to Umgeni Water Board. The target transfer date 30 June 2023. However, the asset inventory must be finalised by March 2023. The objective is to have the effective transfer date coincide with the financial year end. The new financial year when it

Stream	Issue	Action	Responsibility	Due Date	Comment
					<p>starts, it must include the transferred assets.</p> <ul style="list-style-type: none"> Noting the bullet point above, the implications are the conveyancer needs to start the transfer process immediately as the Deeds office has backlog caused by Covid 19.
10. HR and Labour/ Legal	Agreement with Labour Unions	<ul style="list-style-type: none"> Consult labour unions, discuss with existing bargaining council agreements Agreement in terms of section 197 	<ul style="list-style-type: none"> TA & MW 	End March 2023	<p>The objective is to consult, discuss and agree on the terms of transfer to the new entity in terms of Section 197</p> <ul style="list-style-type: none"> As soon as the Transitional Board and Transitional Management Committee are in place, labour union consultations must begin in earnest Signed agreement covering the terms of transfer in terms of Section 197
	Valuation in terms of section 197	<ul style="list-style-type: none"> Leave pay accrued Severance pay and payments that would have been made to employees by old employer 	Transitional Management Committee supported by the TA		

2 Introduction to the Due Diligence Report

2.1 Background and objective

The Department of Water and Sanitation (DWS) as part of its water services sector regulatory function and institutional oversight has embarked on the reconfiguration of Umgeni Water and Mhlathuze Water with the intention to improve water services governance and institutional performance within the sector. Further, the intention is to strengthen and ensure integrated and sustainable provision of water services within the jurisdictional areas covered by both Water Boards. The latter will ultimately firm up the integrated water management objective (Hydrological Cycle) as well as balance Water Use by various sectors to drive Economic and Social development. This process marks the beginning of the ultimate objective, which is the establishment of a single Regional Water Utility in KZN. Equally, the process entrenches part of the water vision, i.e., decentralised water management principle amongst others. The Constitution, Water Services Act and to a lesser extent the National Water Act provide the legal framework for the proposed process. There are other policy frameworks, principles and strategies such as Corporate Governance Principles that become relevant for this process.

A number of factors that are currently prevalent in the two water management areas (Umgeni Water and Mhlathuze Water) inform the decision by the Minister of Water and Sanitation to publish a gazette that initiates communication and consultation on the WMA reconfiguration process described above, as well as issue an instruction to Umgeni Water to initiate the due diligence process. The factors can be described as broad social and economic development challenges, and include the following:

- Population growth (and the need to expand current water services and sanitation systems)
- Need for rehabilitation of existing infrastructure
- Need to improve/ increase access to water and sanitation services to rural households
- Need to facilitate economic growth and job creation
- Ensuring efficient and sustainable management of scarce resources
- Ensuring affordability of water and sanitation services to (government, business/ industry and households), as well as,
- Facilitating transformative economies of scale.

Given the challenges listed above, the following objectives are the focus of this reconfiguration assignment:

- Consolidation of financial resources, assets and skills for key water service infrastructure development and integrated management;
- Increase of water supply areas for Umgeni (water user base and increased revenue);
- Assist with expanding access to un-serviced areas therefore improving water and sanitation service delivery targets within the province; and
- Institutional realignment objective of water management institutions. In this context, it is the ultimate establishment of a single Water Board that will ultimately become the Regional Water Utility (RWU) in KZN.

Successfully achieving the above objectives is expected to facilitate the provision of universal and equitable access to reliable water supply and sanitation services, as well as the use of water to drive economic and social development. Retrospectively, sustainable provision of water services positively impacts the protection, management and development of the water resources in a manner that supports justifiable and ecologically sustainable economic and social development.

2.2 Project Environment and Limitations of the Work Produced

The implementation of this work and ultimately the associated actions taken, including reports produced, is against a number material conditions that should be fully understood and appreciated. The latter will help achieve a common understanding of the work ahead, the most appropriate approach and the phased outcomes leading to the ultimate objective, that is the reconfiguration of the two Water Boards as outlined above. The narrative below, indicates some of the environment and material conditions that must be understood.

Time allocated for the Project: Time allocated to do the review analysis and recommendations on both water boards had a deadline of the 30th November 2022. The initial kick-off meeting for this work was on the 30th October 2022. The initial key activity for the project, was the identification of the work streams and Request for Information (RFI) to assist with the review process to establish the status quo of the reconfiguration institutions and implications moving forward. The RFI documents for review were mostly received as from 15th – 20th November 2022, with the remainder of time being left for activities leading to the deadline of 30th November 2022 for a Due Diligence Report covering all the work streams. Noting the magnitude of work to be done and the time allocated. It is clear that it was not sufficient to address or cover the anticipated deliverables.

Expected Deliverable as a result of limited time: Guided by the conditions indicated above. It was proposed and agreed that the initial review focus, analysis and recommendations should largely be on Mhlathuze Water Board, as the institution being disestablished. Umgeni Water Board as the receiving institution and whose borders are being extended, should be aware of what they are receiving as an institution and how will they integrate moving forward. A more detailed review will follow with Umgeni then an integrated analysis and recommendations for a reconfigured Umgeni Water Board. While this was the indication, it would seem not every stakeholder in the set project management arrangements was of the same view until it was clarified.

Limitations in the arrangements to receive RFI: While most of the information was received as requested, it must be stated that there was limited efficiency in how the information was requested and received. Most of the time was lost during this period, where some of the information was received closer to the date and some of the information was not received. It is believed, this part can still be improved.

2.3 Project logic

The ToR is clear on the purpose and outputs of this appointment – specifically the development and updating of a reconfiguration plan to support the transfer of Mhlathuze Water as a going concern, together with its functions, assets and staff to UMGENI WATER. The logic of the project follows two pronged processes, i.e. the Ministerial process of gazetting the disestablishment of Mhlathuze Water and the extension of the boundary of UMGENI WATER to include areas currently serviced by UMGENI Water. Secondly the Due Diligence process based on the understanding of the General Water Board Functions and work streams. An action plan with activities and time frames is the other deliverable that gives guidance on the implementation of the reconfiguration process.

This clear direction provided in the ToR has helped to define the project logic. The logic can simply be described in the diagram below in Figure 1, which can be paraphrased as follows:

- 1. Clarify the legal mechanism and considerations for reconfiguration of the two water boards:** this includes understanding policy, legal and strategic requirements, the scope of the service currently provided by Mhlathuze Water, and the communication arrangements that need to be effected. It is our understanding that much of this clarification has been undertaken by the DWS. It will be useful to briefly review this understanding, to confirm the basis and process of reconfiguration.
- 2. Understand the current water services functions to be transferred:** this forms the first part of the appointment – understanding the status quo arrangements and to give effect to the function as it currently exists. This part of the study includes an assessment of the effectiveness and efficiency of

the current arrangements. Since reconfiguration seeks to consolidate and improve service, recommendations will form part of the reconfiguration plan.

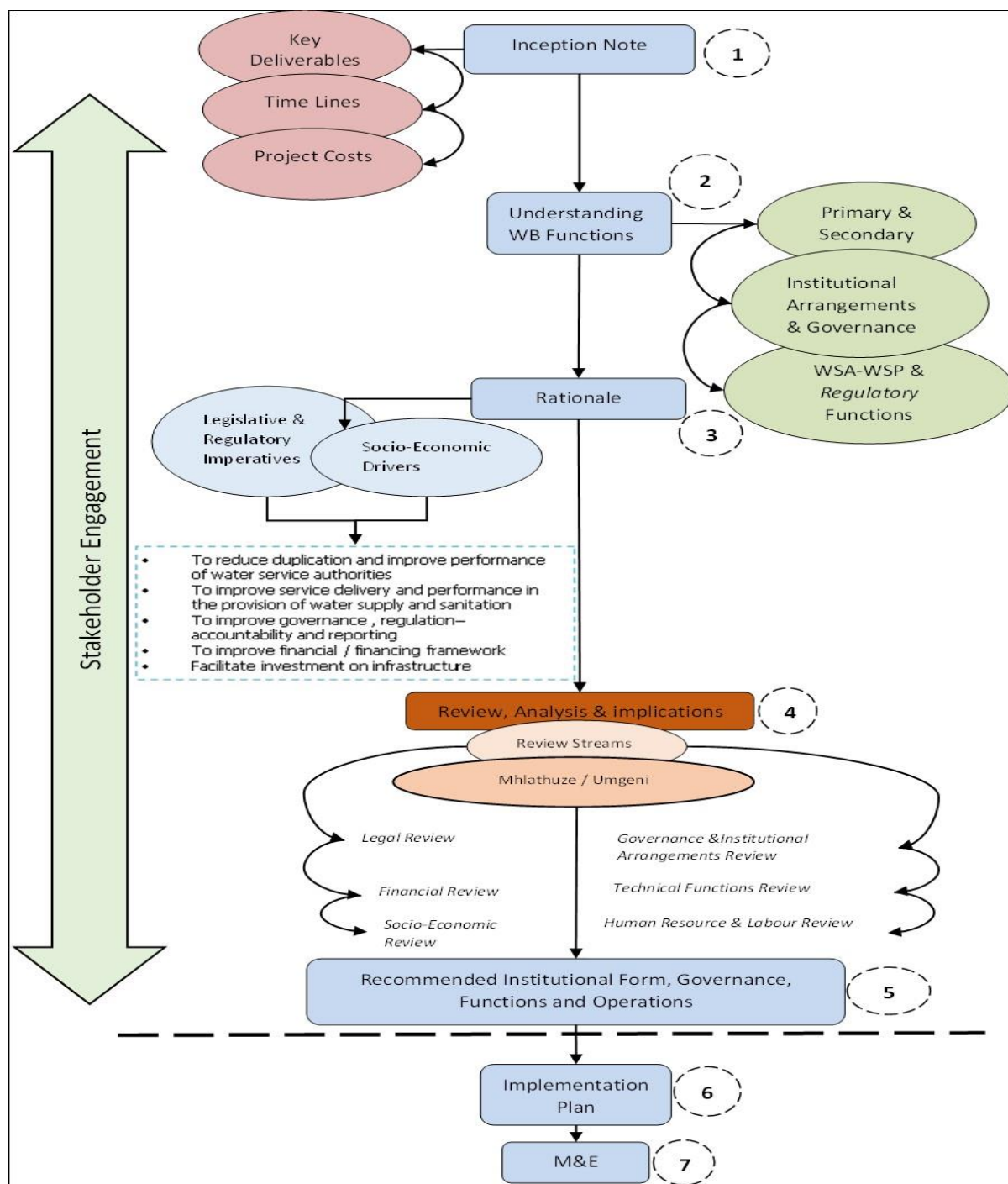


Figure 1: Project Logic

- Understand the strategic and policy significance of the function:** this part of the appointment determines the significance of the function to the broader National Water Service Strategy and its service delivery objectives. In other words, how does the reconfiguration help achieve service delivery mandate of government, and how the function should be implemented, to give effect to those objectives.
- Develop an understanding of the institutional-financial-organisational arrangements to give effect to the function and how these integrate with the existing UMGENI WATER arrangements:** this part

develops the detailed institutional and business models for the function, including the financial implications and arrangements, as well as the organisational design, systems and legal-compliance arrangements to be considered to effect the transfer.

5. **Develop a detailed understanding of the mechanisms to establish the necessary systems and structures:** this includes a series of migration strategies and plans to effect the transfer of Mhlathuze Water as a going concern - the transfer of assets and staff, change management (both internal and within the sector / industry), financial and funding arrangements, and an integrated reconfiguration plan that provides the blueprint to transferring the functions.
6. **Engagement and communication:** consultation on each step of the process in order to gain understanding from the sector and key partner institutions at each step of the way, including communication aimed at managing the sensitivities associated with the impending staff transfer.
7. **Combination of the above into a reconfiguration plan with recommendations:** this feasibility study will describe the necessary arrangements required by Umgeni Water to assume the function, the risks and implications of doing so, the process and implementation plan, and will develop a recommendation on the assignment of the function.
8. **Consolidate all legal requirements pertaining to the extension of the boundary of Umgeni Water to include Mhlathuze Water:** In the light of the above logical approach, the project work streams relevant for the completion of this assignment are arranged in the diagram below that illustrates the interconnectedness of the institutional analysis and assessment process.

The logic encapsulates all institutional aspects necessary for the completion of the due diligence project such as this one. The institutional aspects referred to here are organised into project work streams, each with specific deliverables and outcomes as detailed below.

2.4 Project Tasks, Outcomes and Key Deliverables

The due diligence project is constituted by a number of tasks, that together capture the institutional aspects relevant to perform the due analysis and assessment. The understanding of the functions of the water boards and the description of services described in the Terms of Reference were used as the basis for the project activities and deliverables. Our approach is therefore grounded on an information collection activity that forms part of the project management tasks. Detailed descriptions of tasks are summarised in the table below.

Task	Description	Deliverable	Outcome
1. Project Management	<ul style="list-style-type: none"> • Project set up and work preparations • Information collection • Coordinate meetings 	<ul style="list-style-type: none"> • List of contacts • Letters requesting information • Meeting schedule 	<ul style="list-style-type: none"> • Progress reports • Share point, Information database • Minutes
2. Technical and GIS	<ul style="list-style-type: none"> • Map existing infrastructure • Produce GIS maps of the areas of service 	<ul style="list-style-type: none"> • GIS maps • Narrative report on schemes and infrastructure 	<ul style="list-style-type: none"> • Consolidated GIS information on all infrastructure in the area of service
3. Institutional and Governance	<ul style="list-style-type: none"> • Status quo assessment • Develop and propose institutional options 	<ul style="list-style-type: none"> • Status quo report • Model/ options analysis • Organisational structure 	<ul style="list-style-type: none"> • Interim / future institutional arrangements • Org structure integrating MW functions
4. Social and economic impact	<ul style="list-style-type: none"> • Socio- economic profile/ demand and supply • Affordability assessment 	<ul style="list-style-type: none"> • Status quo report – economic profile 	<ul style="list-style-type: none"> • Implications and long term investment options

Task	Description	Deliverable	Outcome
	<ul style="list-style-type: none"> Assess socio-economic impact – ECBA Assess technical efficiency of reconfiguration 	<ul style="list-style-type: none"> Demand /supply and related impact on tariff Economic Cost Benefit Analysis 	<ul style="list-style-type: none"> Borrowing /funding options for expansion projects
5. Financial assessment	<ul style="list-style-type: none"> Financial analysis and assessment (include all critical areas of finance) Asset valuation 	<ul style="list-style-type: none"> A comprehensive due diligence report and valuation report 	<ul style="list-style-type: none"> Perspective on the financial viability of the reconfigured water boards
6. Human Resources and Labour	<ul style="list-style-type: none"> Assess status quo of human resources (including administration of all HR processes) Assess organisational capacity, policies and procedures Conduct consultation with relevant stakeholders Assess legal requirements impacting on staff transfers 	<ul style="list-style-type: none"> HR and Labour due diligence report HR consideration for the transfer of staff Report on internal and external consultations Organogram for the reconfigured water board 	<ul style="list-style-type: none"> Migration plan and change management strategy
7. Legal and regulatory	<ul style="list-style-type: none"> Legal research on legislation / regulation relevant to all work streams Legal assessment, review and drafting of legal opinion on key findings 	<ul style="list-style-type: none"> Legal due diligence Legal compliance report Identify and review contracts 	<ul style="list-style-type: none"> Opinion on the status of contracts Legal report / opinion on compliance of transfer process requirements across work streams
8. Information Technology	<ul style="list-style-type: none"> Review of systems - hardware and software Assess existing capacity 	<ul style="list-style-type: none"> Migration and integration plan 	<ul style="list-style-type: none"> Status quo report Migration and integration plan

Figure 2:DD Project Tasks and Deliverables:

3 Approach and Intended Outcomes

Primarily the lifeblood of the Water Boards is the sale of Bulk Water and Waste Water Treatment for its clients, i.e. largely Water Services Authorities, Industries, Mines and Agriculture to a limited extent. At a secondary level, Water Boards may provide water management service to Water Services Authorities and other clients provided these functions do not jeopardise the performance of the primary functions. Section 29 and 30 of the Water Services Act provide an enabling framework for these functions. The realization of the functions referred to here, are driven by the water infrastructure, i.e. water schemes, wastewater treatment works, etc. that in the end are a source of revenue for the viability of the Water Boards.

In the context of the DD process on Mhlathuze and Umgeni, the approach started with a detailed audit of the infrastructure that drives the business of Mhlathuze and Umgeni Water. The structure below provide an overall approach to the DD process and ultimately the proposed appropriate institutional options that will be carefully integrated into Umgeni Water. The review also includes assessment of Umgeni's position as the receiving institution.

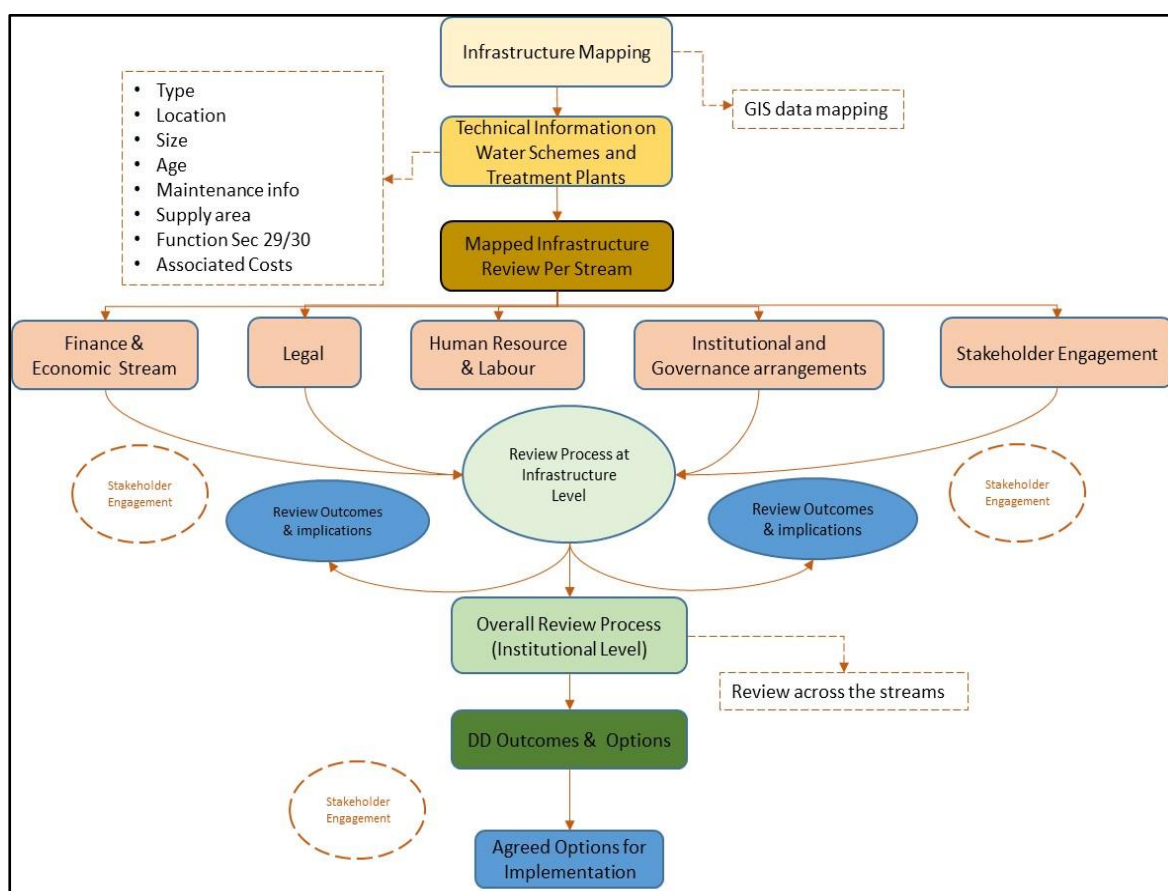


Figure 3: Approach to the due diligence process

Through the technical team, the process started with a detailed mapping of the infrastructure through GIS data mapping. It is a mapping of all water infrastructure, i.e. water schemes and water treatment plants. The data captured covered at least the following amongst others, location type, size, Age, maintenance info, supply areas, function, associated costs, etc.

This information was shared across the review streams as depicted in the diagram above to use as the basis for review and audit at an infrastructure level and ultimately at an overall institutional level.

3.1 Due Diligence Framework (Water Context)

The successful reconfiguration of the boundaries and the ultimate creation of a single Water Board in KZN is dependent on a number aspects and elements that all interested and affected stakeholders must consider and agree. In this context, Umgeni Water as the institution extending its boundaries to include those of Mhlathuze water as well as its assets and liabilities. It is duty bound to exercise care in fully investigating and auditing what it is inheriting from Mhlathuze Water. This is the Due Diligence process (DD). Equally, certain legislative frameworks serves as the basis for doing the DD process. Some of the legislation and policies include the PFMA, MFMA, GRAP, WSA and the Constitution (list not exhaustive).

The process begins with the understanding of the integrated picture of the Water Services business, i.e. abstraction, treatment, distribution, use, billing and collection, wastewater treatment, effluent management and wastewater discharge. The first and the last water services activities have direct impact on Water Resource Management functions as outlined in the diagram above and below. This impact must be managed in a cooperative manner that promotes integrated water management.

The DD process focuses on the investigation and audit of the actual activities of the water services business in line with the regulated primary roles and functions of the Water Board, including the associated support mechanisms and structures. The diagram below outlines the regulated primary roles and functions as well as the associated mechanisms and structures that determine the compliance and viability of the Water Boards.

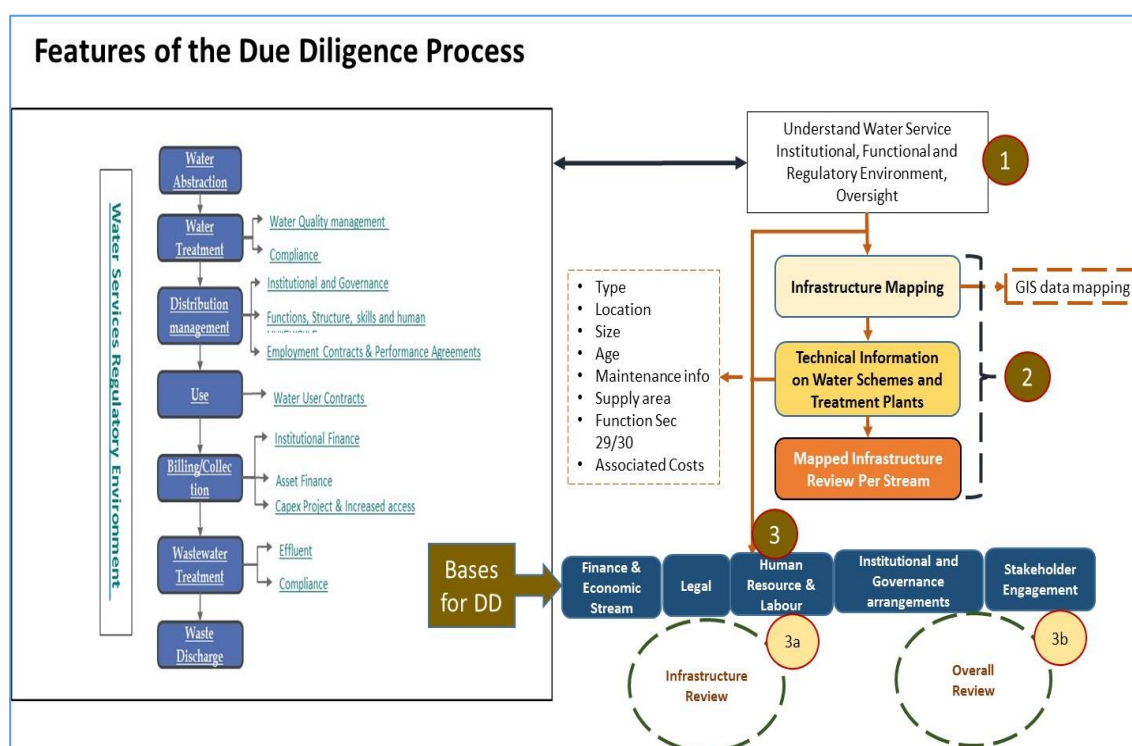


Figure 4: Water Services Regulation & Institutional Oversight and Due Diligence Process Elements

Guided by the water services regulatory and oversight environment depicted in the diagram above, the Due Diligence review streams were identified. The streams form the basis of the review process leading to decision making for appropriate reconfiguration of the two Water Boards. The identified review streams include Finance, Economic, Human Resource and Labour, Institutional and Governance Arrangements, Stakeholder Engagement, Technical/Engineering and Information Technology.

Ultimately the DD process integrates the elements of the analyses listed above, as well as take into account the current status and challenges, the implications of reconfigured boundaries and then propose a feasible institutional design, organisational, technical and financial models, including governance

options. A stakeholder engagement process that appreciates the critical role that stakeholders play in water service delivery as well as their potential impact on the current DD process is an underlying feature that cuts across all project activities.

3.2 Principles for the Reconfiguration Process

The reconfiguration process, in this context, is about the extension of one institution's boundary to include those of the institution that is being dis-established. There are therefore those foundational principles which, if not addressed or adhered to, shall render the reconfiguration process unsuccessful or will not move forward to conclusion.

Below is an indication of the identified principles that must be considered and adhered to. It should further be noted that the list is not exhaustive:

- **HR and Labour:** All transfers must be subject to section 197 of the labour relations Act.
- **Immovable Assets:** An asset inventory shall be developed for all immovable assets of the institution to be disestablished.
 - All immovable assets for transfer shall be subject to re-evaluation before being added into the balance sheet of the re-configured institution.
 - All immovable assets shall be subject to registration with Deeds Office for transfer into the re-configured institution.
 - All immovable assets shall be transferred "voetstoots" into the re-configured institution.
- **Existing Contracts:** All existing contract including water supply contracts shall be subject to assessment/engagement with parties for transferability into the re-configured institution.
- **Financial Arrangements:** All creditors and debtors shall be informed of pending institutional re-configuration for their input and decision making moving forward.
- **Stakeholder Engagement:** All identified and categorised stakeholders shall be engaged at the appropriate level in line with the functional impact they have on the water management function.

The following sub-section on stakeholder engagement are informed by the principles identified and described above.

3.3 Stakeholder Engagement

In support of the Due Diligence process, a stakeholder engagement process was equally followed as well in developing an engagement and communication strategy. This is an underlying feature throughout the approach to the process. There were few elements to it: the first was identifying stakeholders and developing a strategy for engagement with critical stakeholders during the project, developing a communications strategy for implementation to support the transition phase once the assessment process is complete. The other element is stakeholder engagement for awareness creation during and after the Minister's gazetting process. Ongoing engagement and communication continue to form a critical part of this reconfiguration process, owing to the sensitive nature of the envisioned change and the legal requirements pertaining to consultation with labour.

3.4 Approach to Stakeholder Engagement

Stakeholder engagement is an underlying feature across the reconfiguration process. In order for this process to be valid or legitimate, it needs to reflect that all the stakeholders were identified, engaged and informed. Secondly, engagement should be according to the impact or the role that they play in the water functions. Therefore, in principle the approach to stakeholder engagement was divided as follows:

- Who are the stakeholders in this process? The following categories emerged:
 - Government
 - National and Provincial government
 - Water Services Authorities
 - Municipalities

- Communities
- Industry & Business
- Recreation
- What is their impact on the water management function?
 - Policy and regulation
 - Joint strategy development and planning
- How do we engage them in the process?
 - Structures
 - Communication tools

The structure below gives an indication of the principled approach to stakeholder engagement.

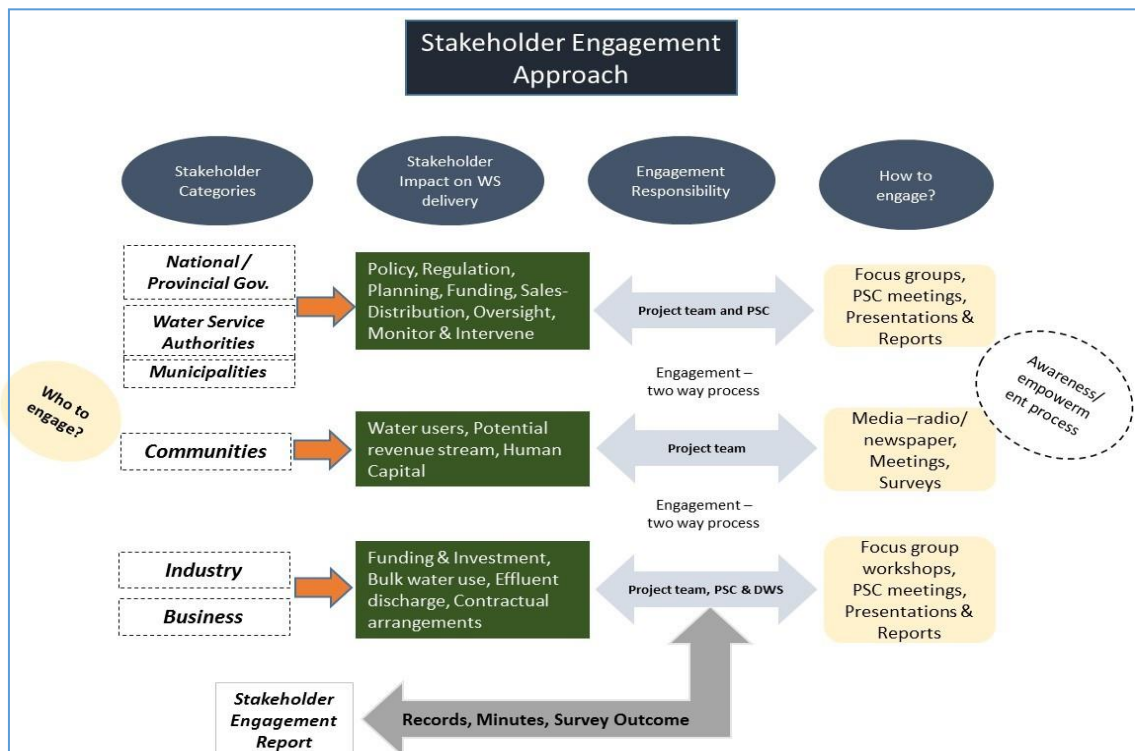


Figure 5: Stakeholder Engagement Approach

3.4.1 Stakeholder Participation Levels

Further to these categories, there was an establishment of the level at which they will be engaged. This is based on the understanding that there is no single message for all stakeholder, but it is shaped by an understanding of the role and impact they have on the water function. The table below gives an indication of the levels of engagement.

LEVELS OF PUBLIC PARTICIPATION	
Inform	To provide the public with balanced and objective information to assist them in understanding the problem, alternatives, opportunities and/or solutions.
Consult	To obtain public feedback for decision-makers on analysis, alternatives and/or decisions.
Involve	To work directly with the public throughout the process to ensure that public concerns and aspirations are consistently understood and considered in decision making processes.

LEVELS OF PUBLIC PARTICIPATION	
Collaborate	To partner with the public in each aspect of the decision including the development of alternatives and the identification of the preferred solution.
Empower	To place final decision-making in the hands of the public.

3.4.2 Initial Engagements and Outcomes

The initial meetings of stakeholder engagements have been at “INFORM” and “CONSULT” level where stakeholders were given information that will assist them fully understand the process. The consult level is based on the Minister’s Government Gazette where stakeholders are expected to provide written comments on the Gazette. The following is an indication of some of the “Inform and consult” meetings as well as stakeholder input.

3.4.2.1 List of Key Engagements

A detailed workplan for stakeholder engagement has been developed, and so far, stakeholder engagement activities that have been conducted include the following:

- UW/MW stakeholder session – 16 November
- Umgeni Staff Information Session – 22 November
- DWS Public Meeting – 23 November
- UW/MW client engagement – 23 November
- Mhlathuze Stakeholder Indaba – 24 November
- Mhlathuze website Gazette Publication - 25 November
- Workstream meetings with uMhlathuze Water Board

3.4.2.2 Important Issues raised for consideration in the Reconfiguration process

- Tariff related concerns stemming from the fact that Umgeni Water has higher tariffs when compared with uMhlathuze Water.
- How will the tariff increase affect the normal low income earning citizens if there is an increase?
- Fear of operation and service being unstable during the Reconfiguration process;
- Credit related Risk in terms of balance sheet particularly at Umgeni if they inherit Mhlathuze;
- Duration of Reconfiguration?
- Job Opportunities if any after the reconfiguration

3.5 Strategic Water Vision and Rationale for Change

Water is central to human needs, equitable growth and development. It is one of the key drivers of sustainable economic growth through contribution to activities such as agriculture, manufacturing, mines, energy and transport. It equally contributes to social activities such as productive use of water within households (poverty alleviation), water for drinking, sanitation and health, etc. Water should therefore be managed in a manner that is sensitive to and supportive of the many competing demands that is placed on it. Further, the management activities should not compromise the requirements of the future generations as well as ecological requirements. Based on these elements, water should be central to integrated planning and development processes of a country. The diagram below, gives a picture on how South Africa as a country is approaching this objective in a cooperative manner. Equally, what mandates are given to various role players to achieve this objective, including the powers of the Minister.

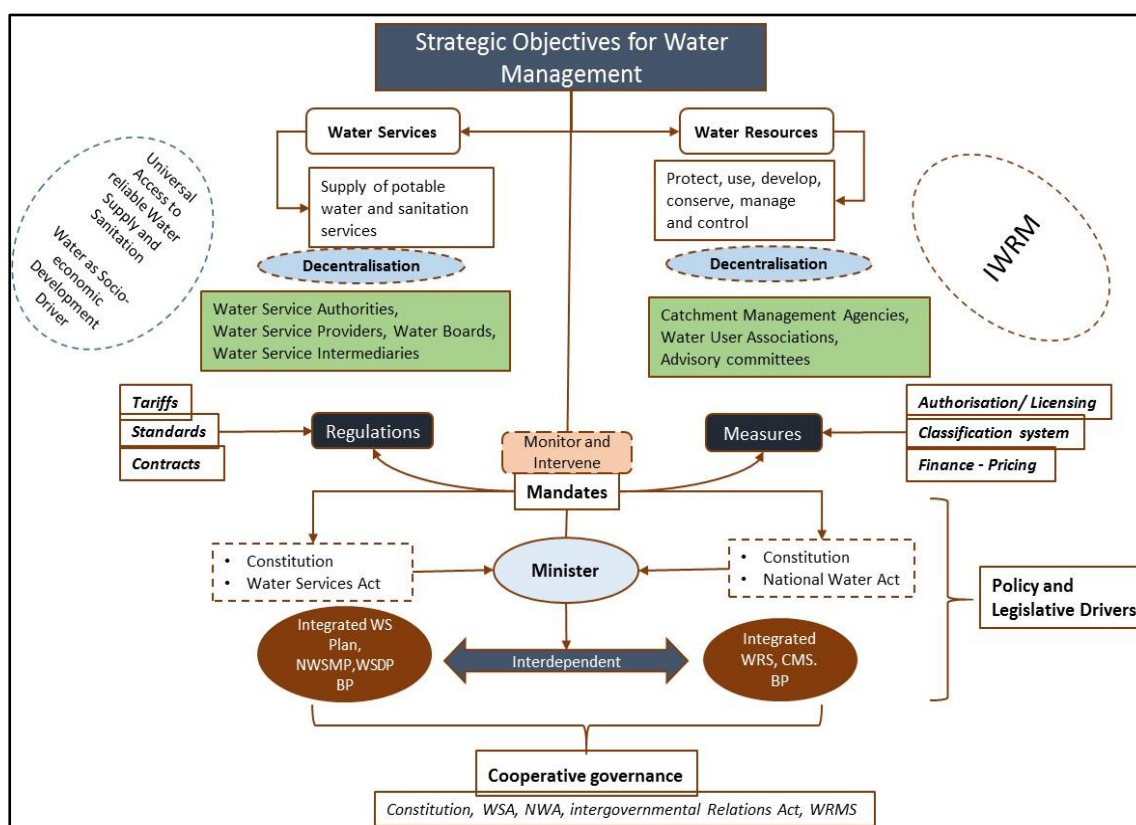


Figure 6: Integrated Water Management Picture

The reconfiguration objective as pioneered by the Minister and his department is premised on the water services broad principles / objectives as outlined in the diagram above. This refers to sustainable supply of potable drinking water and access to dignified sanitation, decentralised management of water services, regulation and oversight by the department of Water and Sanitation. Cooperatively linked to these objectives is the role of sustainable Water Resource Management, which ensures sustainable raw bulk water supply from the rivers, streams, dams, etc. Water Resource Management, sets measures that help set water services regulations amongst other functions.

Both the Water Services Act and the National Water Act (DWA, 1998) provide the legislative context for water services and water resources management (WRM) respectively. The policy framework emerging from these two pieces of legislation addresses three important concepts that have shaped the direction of the water sector, namely, integrated water resources management (IWRM), the principle of equity in access to water, and the promotion of institutional decentralisation to bring about greater effectiveness (Savage et al., 2008:5).

Water Boards that are financially viable, secondly, have infrastructure that functions at an optimum level and lastly, have strong institutional and governance arrangements are a necessity to realise the objectives as depicted in the diagram above. The recent reports on the state of institutional functionality of some of the Water Boards, financial viability and their lack of capacity to meet water supply demands amongst others; makes it imperative for the Department of Water and Sanitation to seek appropriate interventions from a regulatory and oversight perspective. Further, the Minister has powers through the Water Services Act to put intervention measures that may help ameliorate these challenges amongst others.

In terms of section 28 of the WSA, the Minister has the powers to establish or dis-establish a Water Board as well as change the boundaries of an existing Water Board. Further, section 46 of the same Act allows the Minister to transfer any or all of the assets and liabilities to another water board / water services authority. In doing so, the Minister must take into account the interests of creditors and consumers; and any financial contributions directly or indirectly made by consumers towards the infrastructure of the Water Board. The Minister must equally consider the profit element of the investors in the process of exercising these powers. It should however be noted that, it is not always the negative context that would compel the Minister to exercise these powers. In certain circumstances, it would be the Integrated Water Management objectives and other principles. The diagram below further highlights some of the drivers and the intended outcomes.

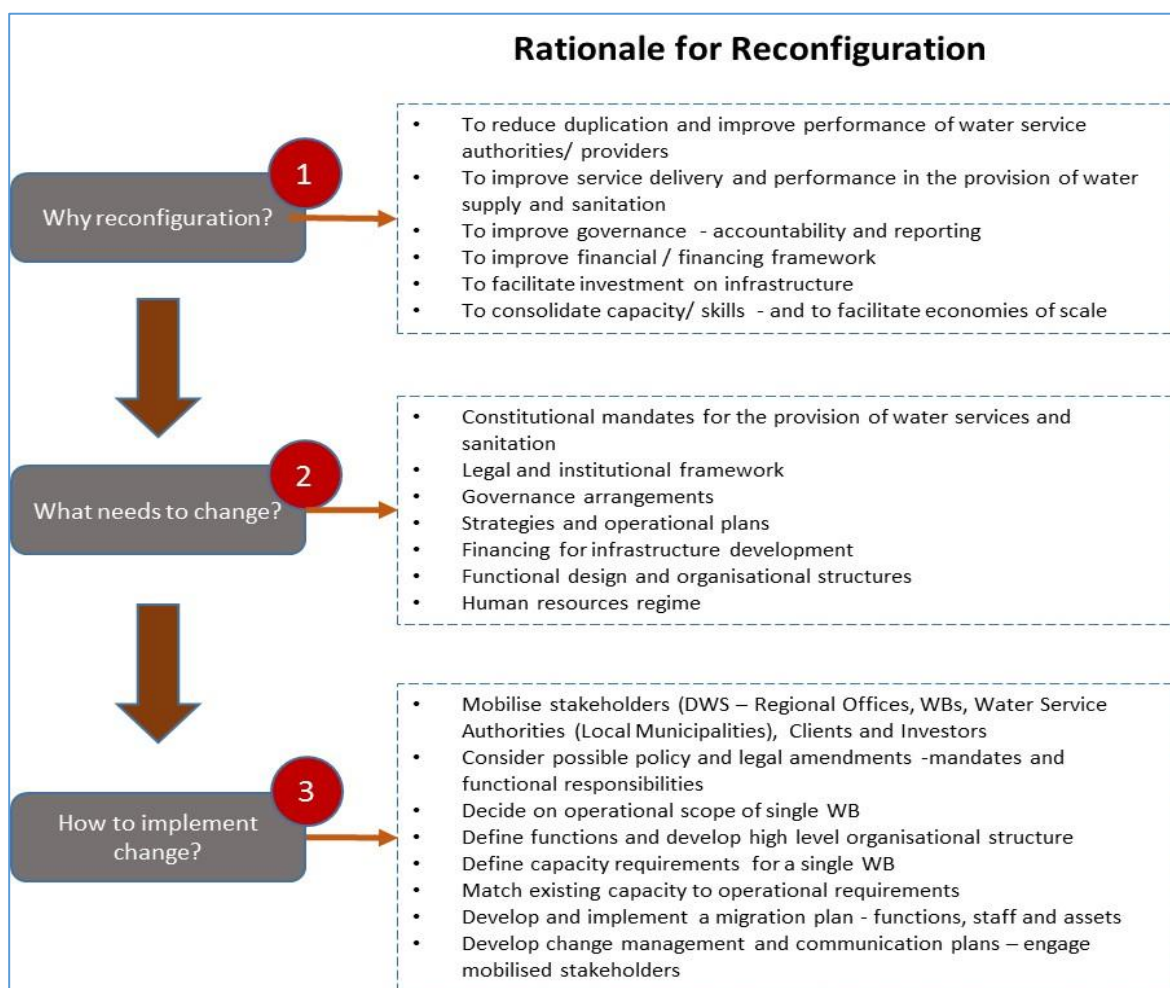


Figure 7: Strategic Rationale for Reconfiguration - Adopted from Institutional Reform and Realignment

Noting the above, the framework for water sector infrastructure funding models was designed to meet the challenges presented by the current and growing imbalances that exist between the supply of and demand for water in South Africa (Ruiters, 2011, 2013; Ruiters and Matji, 2015). South Africa has

undertaken preliminary institutional reforms, mainly the broader water sector policy and legal measures, many of which can be achieved by the stroke of a pen. What lags are regulatory and governance reforms; these have taken much more time to bear fruit. For instance, effective regulation in the whole water value chain requires building institutions/entities that challenge established vested interests. Governance improvements, particularly in state-owned enterprises (SOEs), require aligning internal and external incentives, which again require broader reforms of the external environment for water infrastructure service providers.

In the context of Mhlathuze it is a combination of these objectives and principles as well as some institutional and governance challenges that continue to thwart the viability of Mhlathuze Water Board. In the context of Umgeni, it is the current institution's financial and technical ability to extend its boundaries therefore increasing water services provision efficiency across the water management areas. This is reflected in diagram above. It is around this context that the Minister has considered and approved the reconfiguration of Mhlathuze and UMGENI WATER through the disestablishment of Mhlathuze and the extension of UMGENI WATER boundaries to include that of former Mhlathuze.

The extension of UMGENI WATER boundaries to include those of Mhlathuze water, means an institutional and governance change for both Water Boards. It further means the following:

- Transfer of assets as outlined in section 46 of the WSA to UMGENI WATER ;
- A need for a strategic assessment of the implications for UMGENI WATER in terms of:
 - Financial viability,
 - Human resources and labour,
 - Legal aspects, and;
 - Stakeholders who may be affected by the institutional change, etc.

Primarily section 28(1)-(4) as well as section 46(1)-(5) provide the basis for the due diligence process. The outcomes of the due diligence process will assist Umgeni Water understand what it is co-opting from Mhlathuze Water. Therefore, make most the appropriate institutional management and governance decisions and options on now extended areas of operations, "new" infrastructure, HR & labour, existing agreements and contracts, institutional finances, stakeholders (as categorised), etc.

Noting the limitations of the project as indicated above, it should be noted that while there is reference in terms of review and analysis to Umgeni Water. The initial review largely covered Mhlathuze Water as the institution to be disestablished. Although the implications UW are fully addressed in the Action Plan.

3.6 The KZN Water Service Perspective

Chapter 3 of the report gives an indication of the broad water management vision of integrated water management, the strategic objectives for water management as well as the rationale for need for institutional change in the water services sector, in this context, Water Boards.

Looking at the rationale for institutional change in the bulk water services sector, KZN provides an appropriate environment to implement this process. This is further supported by the outcomes of the recent Institutional Reform and Realignment project, which proposed a single regional water utility for KZN. The reconfiguration process of the two water boards is a precursor to the main objective, which is a single regional water utility in KZN.

In order to fully understand the proposed institutional options and arrangements for reconfigured UW. It is important to understand the current KZN regional water perspectives as the base for reconfiguration arrangements. The sections below provides the current KZN water services perspectives.

3.6.1 The KZN Water Boards and Utilities

KwaZulu-Natal Province has a total geographical area of 94 359km² consisting of approximately 11.1 million people and 2.9 million households. There is a total of 54 municipalities of which 14 are Water Services Authorities.

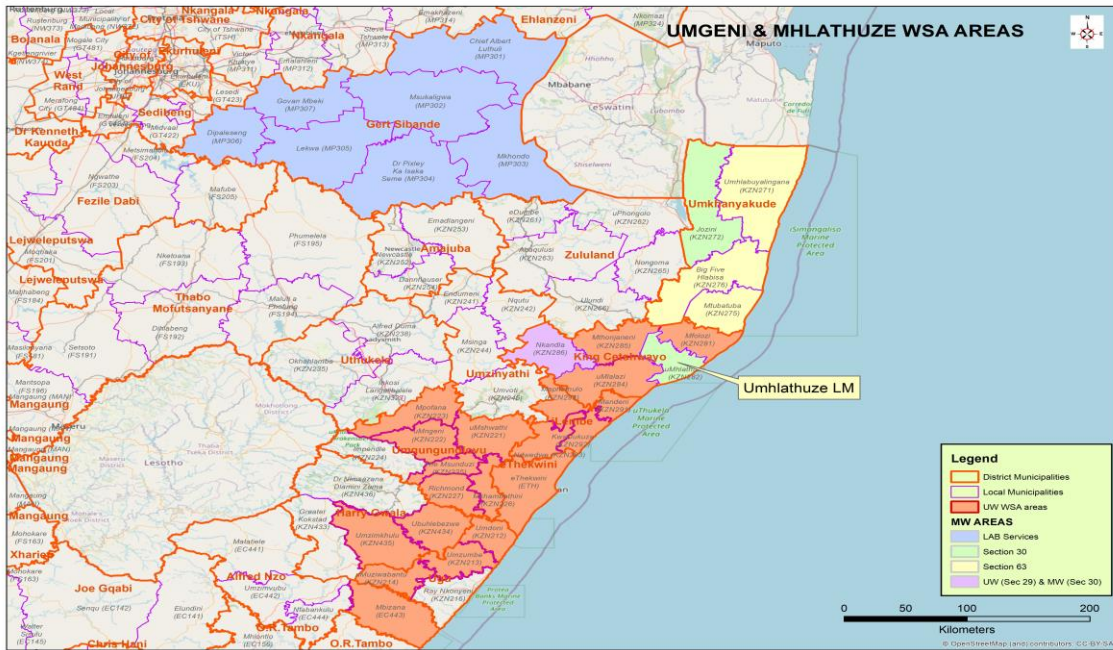


Figure 8: UM and MW service area map

The water service areas covered by the two water boards are illustrated in the map above. Mhlathuze Water’s area of supply covers some 37 000km² stretching from the uThukela River in the South and up the East Coast to the Mozambique and Swaziland borders, around Vryheid and back to the uThukela River. The entity predominantly operates in the Mkhanyakude District Municipality, City of uMhlathuze

Municipality, Gert Sibande Municipality and Zululand District Municipalities. It is supplied by three dominant water sources namely: Mhlathuze River, Lake Mzingazi and Lake Nsezi.

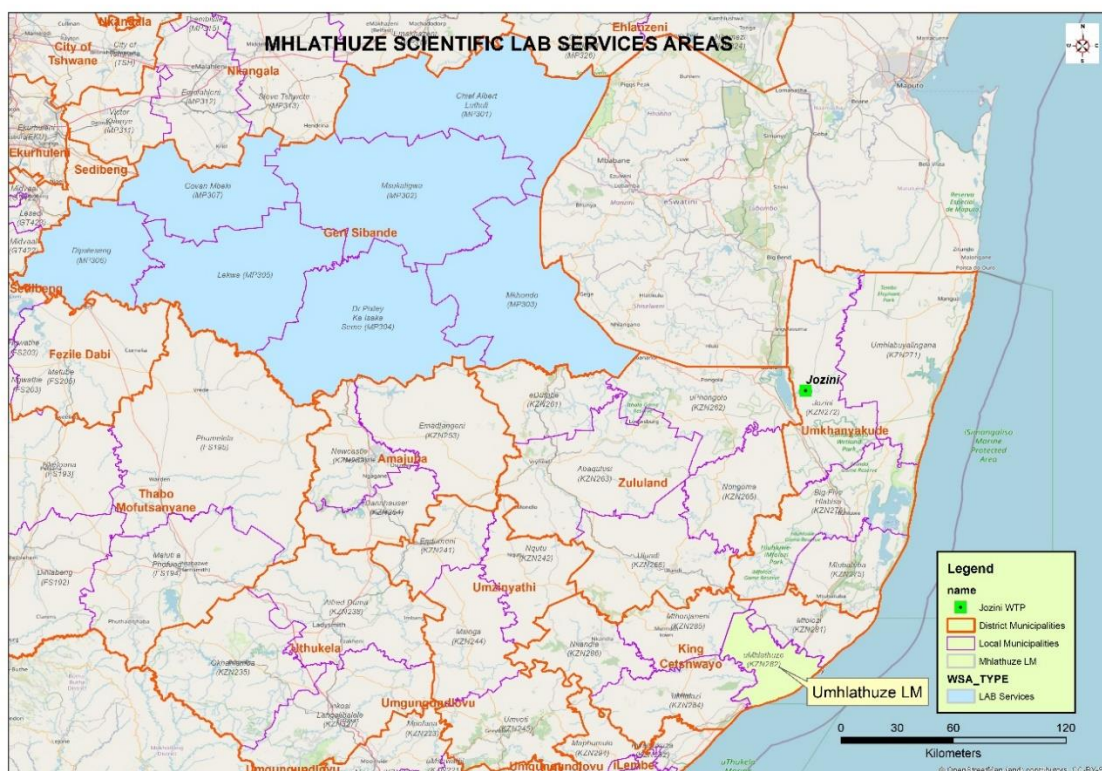


Figure 9: Mhlathuze Service area map showing Umkhanyakude and Gert Sibande

Mhlathuze water’ areas of services include untreated, purified and clarified water supply, disposal of industrial and domestic wastewater and scientific services. Its major commercial clients include Foskor, Mondi, Mpact, Richards bay Titanium (Rio Tinto), Tongaat Hullet, Hulamin Operation, South 32 and Tronox.

Table 1: Supply areas, population and households by KZN Water Utilities

Water Utility/ Municipality	Supply Areas	Population	Households
Umgeni Water	30 604	6 719 909	1 915 171
Mhlathuze Water	36 867	2 552 535	555 558
Total	67 471	9 272 444	2 470 729

	Total. Volumes (kl’000)	Tariff (R/kl)	Revenue (R’m)	Borrowing Limits	Staff
Umgeni Water (7 WSA)	549 091	8.02	4 528	R1 400m	1355
Mhlathuze Water (3 WSA)	125 777	7.51	642	R223 000	229

Umgeni Water covers a total of 8 water services authorities, namely: Ethekwini Metropolitan Municipality, Ilembe District Municipality, Umgungundlovu District Municipality, Ugu District Municipality, Msunduzi District Municipality, King Cetshwayo District Municipality and Harry Gwala

District Municipality. Reconfiguring and including Mhlathuze Water into UMGENI WATER means an increase in the area of operation of Umgeni as rural households in the northern part of KZN Province also become important clients of the entity.

Noting the areas highlighted in red in the maps above, it is clear that the two water management areas are in close proximity and therefore allowing for easy extension of boundary of UMGENI WATER. Nonetheless, some portions of both water boards still require reliable extension of services that are sustainable and reliable. Due to the proximity of the two water management areas, options may be explored in order to achieve integrated water services that entrench consolidation of technical and financial resources, skills and capacity, including the promotion of revenue collection. A move towards single water board as proposed will help achieve this objective.

Mhlathuze Water, since the construction of the Jozini bulk system on behalf of the Umkhanyakude District Municipality, has operated and maintained the system, serving 134 000 households. Umgeni Water has seven (7) customers (inclusive of uThukela DM but excl. King Cetshwayo DM) cover 44% of KZN geographical area and 72% of households as illustrated in Figure 10 below.

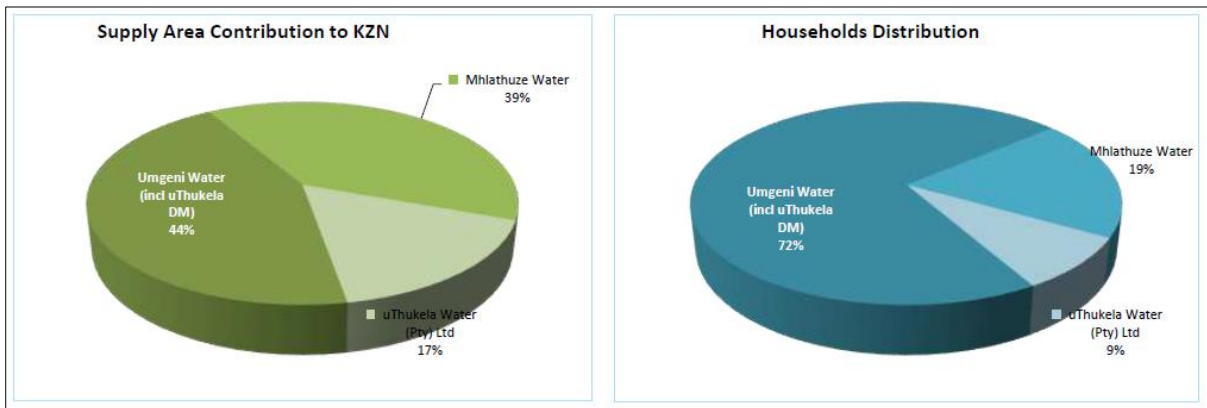


Figure 10: UMngeni Water distribution share in KZN

The clients overview for the Mhlathuze Water Board is summarised and illustrated in Figure 11 below.



Figure 11: Mhlathuze client overview showing status and condition of assets.

3.7 Un-serviced areas

Given the rate and percentage coverage of services, the Mhlathuze WB has embarked on a bulk infrastructure capital expansion programme detailed in *Figure 12* below.

Projected Statement of Capital Expenditure	Estimate 2020	Budget 2021	Budget 2022	Budget 2023	Budget 2024	Budget 2025	Total 2021 -2025
Year ending 30 June	R'000	R'000	R'000	R'000	R'000	R'000	R'000
Expansion	208,867	30,746	700	7,700	200	-	248,213
Rehabilitation	18,110	35,483	23,676	8,071	4,870	620	90,830
Equipment	2,750	19,050	5,200	5,000	5,000	5,000	42,000
Information technology communication	-	30,000	18,000	-	-	-	48,000
Augmentation & upgrade	4,565	126,004	148,498	109,509	-	-	388,576
Total Capital before Interest	234,292	241,283	196,074	130,280	10,070	5,620	817,619
Capitalised interest	8,094	15,293	27,210	28,408	3,935	-	82,940
Total Capital after Interest	242,386	256,576	223,284	158,688	14,005	5,620	900,559

Figure 12: Mhlathuze bulk infrastructure capital expansion programme highlights

This expansion programme is earmarked among other reasons, to reduce the number and extent of un-serviced areas within their jurisdiction. The planned expansion for UMngeni Water is equally aimed at addressing the un-serviced areas whilst keeping the current clients and serviced areas assured of quality service.

4 Governance and Institutional

Generally, Governance and Institutional Arrangements refer to a set of legislation, policies, structures, activities and/or actions that help manage water institutions and functions better therefore giving effect to sustainable water management and the intended vision. In this context it is the management of Water Boards as outlined in the Water Services Act, 107 of 1997, the water sector vision as outlined in a number strategy documents and other governance frameworks such as Corporate Governance Principles. The manner in which Water Boards are structured internally at Board level and Management level determine to a certain extent the success or failure of the institution. While there is a plethora of impacts leading to failure of some of the Water Boards, governance and management arrangements remain one of the main challenges impacting on their viability. The following water governance dimensions, in this context are considered important determinants for sustainable management of water boards:

Effectiveness: relates to the contribution and impact of Water Boards in the provision of bulk water services and other water management services. Therefore, meeting expectations of its clients and broadly the water vision.

Efficiency: relates to the contribution of Water Boards to maximise the benefits of sustainable water management and welfare at the least cost to society and contribution to economic development.

Trust and Engagement: relates to the contribution of Water Boards in building public confidence / trust in the service they provide and engagement of stakeholders through legitimate and effective structures.

4.1 Water Board Management and Governance Context

Water Boards do not exist or operate in a vacuum, but they exist within a regulated environment where there are reporting and accountability requirements. It is important that these are understood as they ensure the sustainable management and achievement of Water Boards objectives. The proposed reconfigured institution of Umgeni will operate within these arrangements to achieve administrative efficiency, bulk water and management services delivery within KZN.

The structure below indicates current governance and management arrangements, which govern Water Boards in KZN. A move towards a single Water Board in KZN will help improve management and governance efficiency where government structures and support institutions focus resources on supporting one single Water Board that address water challenges for the entire province ultimately.

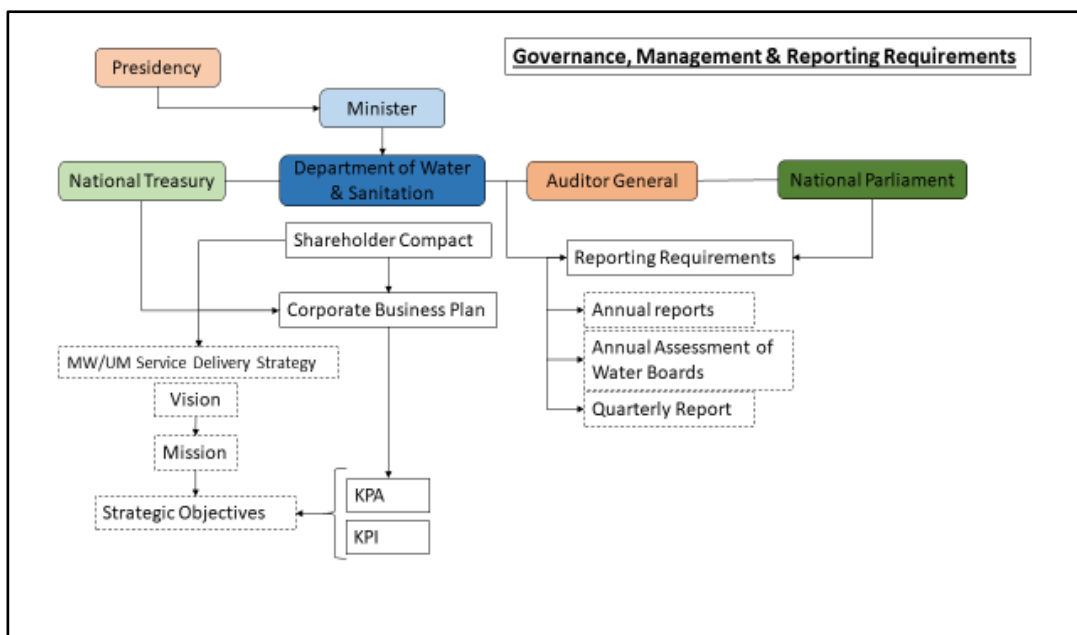


Figure 13: Governance, Management and Reporting Requirements

The arrangements indicated above are informed by various policies, legislation and strategies relevant to the implementation of water services and water resources.

4.2 Institutional Arrangements Context

The Water Boards as a bulk water services provider and varied water management services support, interact with a number of different institutions and water users. Through these interactions and functions, appropriate structures, contracts and arrangements are defined. These defined elements are the basis of sustainable delivery of water services by the Water Boards. The structure below gives an indication of high level and general institutional arrangements in the KZN water sector focusing mainly on Water Boards.

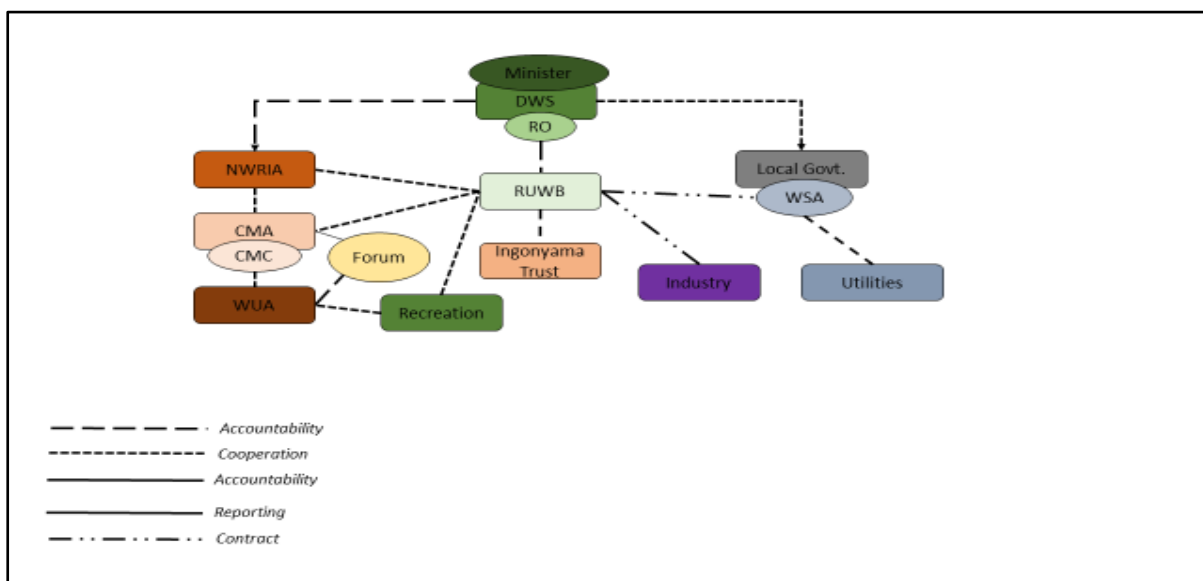


Figure 14: Emerging institutional arrangements for the RWU

4.3 Governance and Institutional Arrangement in Mhlathuze Water

Mhlathuze Water currently has a number of institutions that it interacts with as part of institutional arrangements. The expectations are that these arrangements will be kept and managed as part of the reconfigured Umgeni Water. As part of the reconfiguration process, the stakeholder engagement stream will address this part therefore making sure that all the existing institutional arrangements are kept and they continue to exist as part of ensuring sustainable water services provision within the emerging North Eastern Region of Umgeni Water.

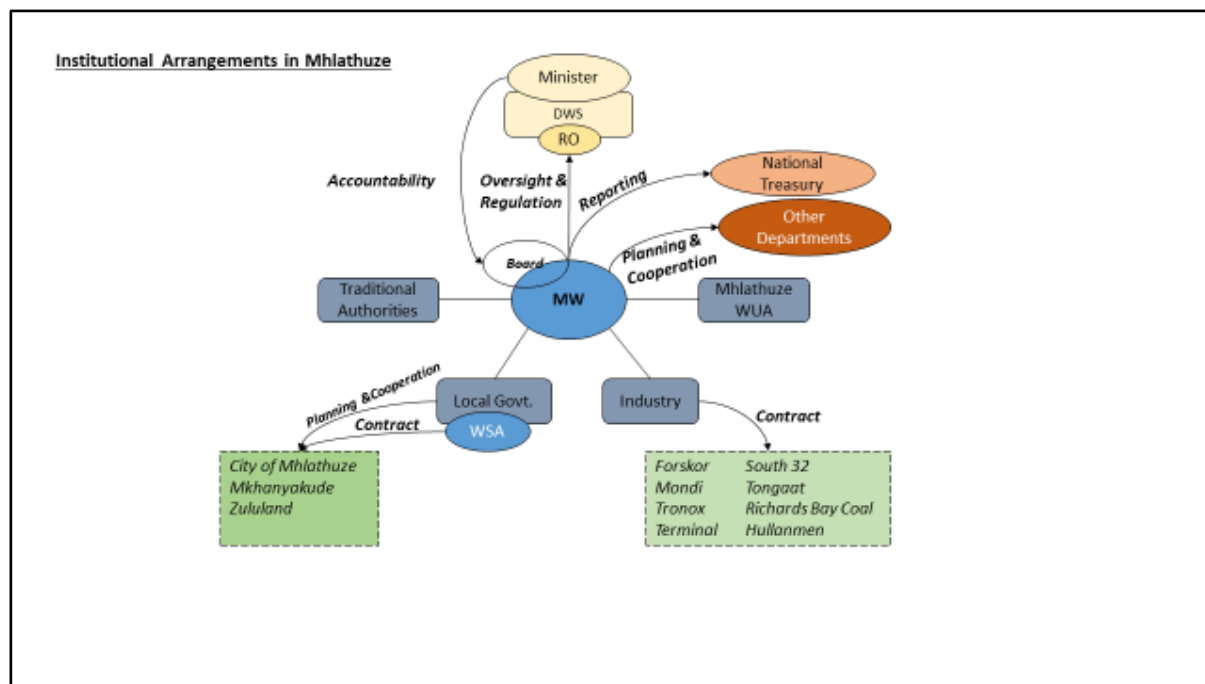


Figure 15: Current institutional arrangements in Mhlathuze

In terms of Board governance, the Minister had Mhlathuze Board term of office extended from the 5th of December 2022 until the completion of the reconfiguration process. The anticipated date of completion is April 2023. The current board has two main functions to assist with, i.e. the support for continued operations during the transitional period and support for the reconfiguration process until its completion. The board is central to the management arrangements proposed for the reconfiguration process.

4.4 Governance and Institutional Arrangements in Umgeni Water

The current institutional arrangements in Umgeni are centred on specific arrangements that are triggered by bulk water services provision and water services management functions. Secondly, they are triggered by integrated water management from a planning and joint strategy development perspective. The regulatory and oversight arrangements are standard. Umgeni further has arrangements with Ingonyama Trust Board (ITB) which addresses land use management in relation to developed water infrastructure. The structure below provides an indication of current institutional arrangements for Umgeni. It is important that these are enhanced in order to ensure integrated water management to the benefit of Umgeni Water Board.

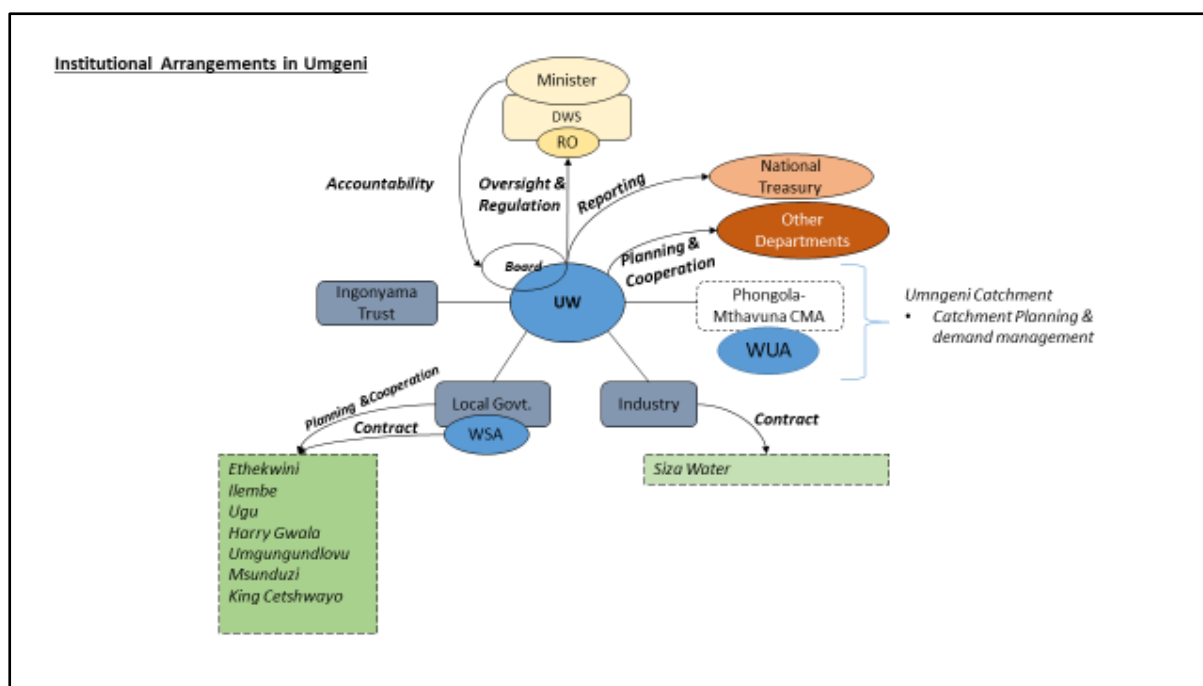


Figure 16: Umgeni Water Institutional and Governance arrangements

In terms of Board governance, Umgeni Water Board has a fully functional Governing Board. The term of office for the current board ends in April 2023. The current board has to drive continued operations during the transitional period and equally help implement reconfiguration process until its completion.

4.5 High Level Analysis and Proposed Positions for Consideration

The current board of Mhlathuze Water (MW) had its term of office coming to an end recently on the 3rd of December 2022. In terms of Governance, there should be no vacuum or lapse in terms of management roles played by the board. In order to address this issue. The Minister opted to extend the term of office for the current board of MW. The extension of term of office for MW was effective 5th December 2022 until end of April 2023, which is the anticipated date of completion of the reconfiguration process. Until end of April 2023, the current board of MW continues to provide strategic support as legislated. Secondly, it provides support to the reconfiguration process.

The current board of Umgeni Water (UW) has its term of office coming to an end in April 2023. The board currently continue to perform its governance and strategic leadership to the institution. The current board's term of office coincides with the anticipated date of completion of reconfiguration work, i.e. April 2023.

The implications of the above are that, both boards continue to serve on their roles and functions until April 2023. A new board in a newly reconfigured UW will lead the institution after April 2023.

4.5.1 Proposed Governing Board Arrangements

The ultimate goal for the Minister and DWS is to have a Single Water Board of UW whose boundary covers the areas of Dis-established MW by end of April 2023. Secondly, a new Board of a reconfigured UW must be in place by this time. Noting the latter, the following is therefore proposed:

- The process for appointment of new Board members of reconfigured UW should start in January 2023. Therefore, allowing the process to unfold fully as outlined in the water services act.

- Further to the prescripts outlined in the WSA, the appointed board members must also adhere to Corporate Governance principles, including the following amongst others,
 - Understanding of the fiduciary duties of board members;
 - Adherence to the code of ethics;
 - Good Board performance;
 - Effective control; and
 - Promotion of legitimacy of the board

All of the above must be part of the new Board Induction process.

It is proposed that the Minister intentionally considers retaining a combined 25% of the current board members in order to ascertain institutional memory in the new reconfigured UW Board of Governors.

The reconfiguration process leading to the completion date of end April 2023 comes with a number of challenges and strategic decisions that should be made from a governance perspective. It is therefore proposed that Joint Board Strategic Progress Appraisal be considered at identified and agreed intervals. This is a progress update to both boards on the progress as they support the reconfiguration process until its completion in April 2023

4.5.1.1 Reconfiguration Management Arrangements

Mhlathuze and Umgeni Water reconfiguration present a very unique yet challenging process in that it is a Due Diligence process but, it equally has its proposed options implemented simultaneously in order to meet the set time frame of April 2023. Based on this understanding. It therefore becomes imperative that an appropriate structure comprising of representative of both institutions is set up to drive the implementation process, particularly the action plans tied up to the set completion date. The Action Plan is attached as annexure in this report.

The structure below is a proposal for reconfiguration management arrangements into order to ensure that the set dates as well as the ultimate goal of establishment of a single water board is achieved in KZN. The objective of such a structure is to ensure that the implementation is structured and it is supported by both institutions. It will also ensure that all emerging issues during this process are dealt with efficiently and cooperatively.

Based on the above, a Joint Management Committee (JMC) is proposed. In principle, the function of the JMC is to implement the action plans and to ensure that every decision taken is implemented within the specified time in order to meet the set dates. The JMC will be composed of at least 2 members from each of the two institutions, one member from DWS and the TA. The JMC will report to both boards in association with the TA. The PSC will continue to provide strategic support and guidance to the process. The JMC will cease to exist or function when the new board of a reconfigured UW starts its term.

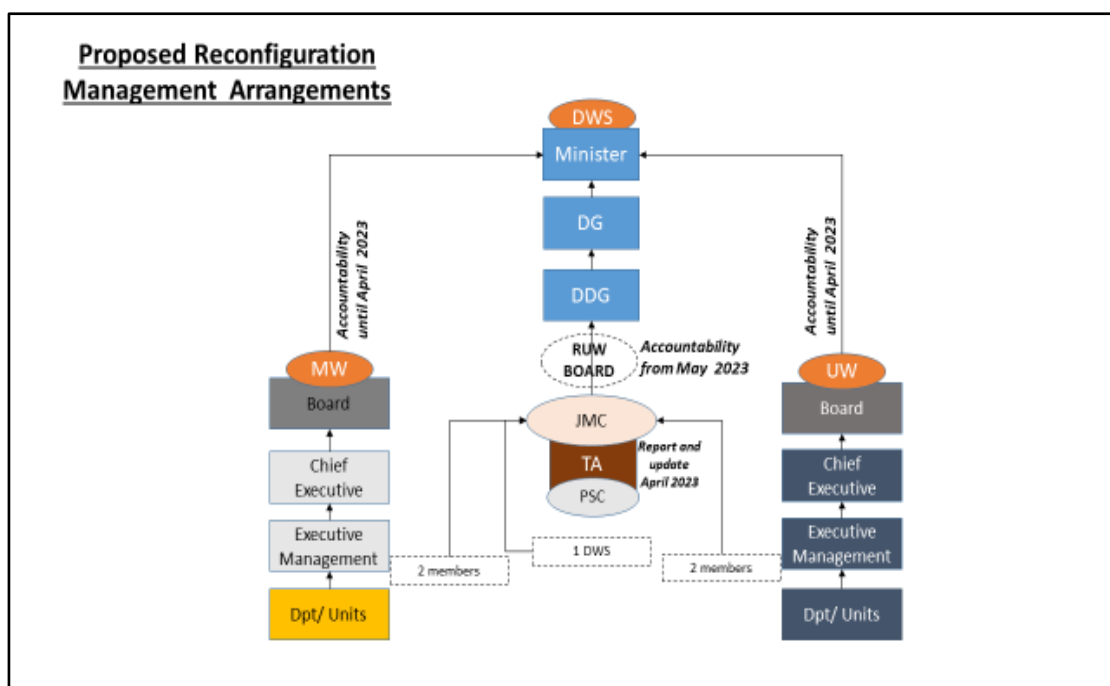


Figure 17: Reconfiguration management arrangements

4.5.1.2 Emerging Operating Business Model – Functional Structure

The emerging operating model structure begins to address the intended objective of a single water utility within KZN. There is an emerging distinct Regional Structure that addresses the North Eastern Region water services areas in KZN. In line with water resource management areas (WMA), it follows the current political boundaries. There is one current function by UW which, crosses the political boundary, i.e. in Gert Sibande District Municipality where the water board provides section 30 water management services. This is a laboratory services function.

In line with the reconfiguration process, this distinct regional structure should be a Ring-Fenced North Eastern Regional Structure under UW. It is proposed that it be an extension of UW operations servicing areas up until the KZN / Mpumalanga political border, with one exception of current Gert Sibande District arrangement for water management services in terms of section 30 of the WSA. The proposed Ring-fenced North Eastern Regional structure of UW should be effective from the date of transfer in line with the proposed project Action Plan. The organogram below provides a proposed high-level addition of the Ring-fenced North Eastern Regional Structure into the current structure of UW. The new board supported by the TA will address the emerging the positions, functions and HR and Labour issues. The principle is that all assets and liabilities move “voetstoots” to UW protected by section 197 of the LRA. The latter is clarified in detail by the HR section of this report.

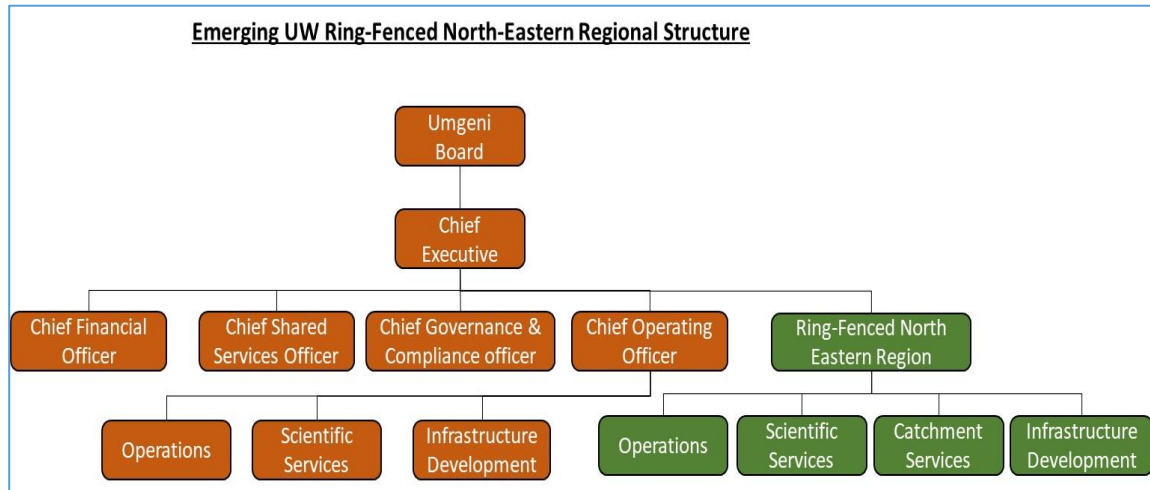


Figure 18: Umgeni Org structure with ring-fenced North Eastern Region

The emerging ring-fenced North Eastern Region operations carries with it, a lot of elements and responsibilities that make it imperative for UW Board of Governors and executive management to consider. The proposed structure is not about the levels of reporting or positions that exist either within Mhlathuze or Umgeni Water, rather it is about the strategic arrangement of functions in order to first, avoid water service delivery disruptions in areas previously serviced by Mhlathuze. Second, to enable, in the short term, the conclusion of the reconfiguration and hence the migration process. These include the reporting lines in terms of the structure and expected functions to be implemented. The following identified elements characterising this region makes it imperative that it be managed at an executive level:

- The region is identified as one of the key economic hubs meant to drive Economic Development in the KZN region and the country as a whole, therefore needing integrated and sustainable water management services as a cross-cutting feature to support this development vision.
- **National Spatial Development Framework** – the framework identifies the region as one of the key economic hub and investment area. It is further identified as a national resource production heartland, national eco-resource production regions and national Ocean and aquaculture production regions.
- **National Spatial Development Perspectives** – the framework identifies the region as an economic investment region to drive economic growth and help control migration and congestion into the key major cities by providing alternative employment centres.
- **Mega Projects** – currently the region houses one of the two Mega Housing development projects in KZN as guided by Breaking Ground Policy (BNG). The project entails development of housing development and development of business and industrial zones to complement the developed settlement areas. For this reason:
 - The region presents a very strong Waste Water Treatment element, as it services a number of industries discharging waste water. This is an important element that should be managed at a high level as its negative impact could have dire implications for the water resource Catchment Management Area. This waste water treatment strong element must be spread across UW operational areas.
 - The region is in a Water Management Area that is currently seeing a lot of changes in terms Catchment Management. There is currently a process to establish a Catchment Management

Agency (Phongola - Mthavuna CMA) as well as Mhlathuze WUA. Integrated Catchment Management Strategy development and planning makes it imperative that UW is represented in these processes. Secondly, noting the capacity and magnitude of the region, DWS and the CMA could consider delegation of some of catchment management functions as a business to the water board, therefore strengthening the Regional Water Utility function.

The sensitivity of some of these functions makes it imperative that it be managed at an executive level.

5 Finance

5.1 Business Overview

This chapter of the due diligence report covers the financial status quo for both Umgeni and Mhlathuze water boards.

5.1.1 Mhlathuze customers

uMhlathuze Water's revenue base is divided into three groups, namely:

- Industrial – contributing 56% of total revenue. This is a market made up largely of all commercial entities in the region. Included are business organisations such as Tronox, Fairbreeze Mine, Zulti South Mine and Richards Bay Minerals, among key industries.
- Public Entities – contributing 41% of total revenue. This includes all residential units within the municipal boundaries serviced by uMhlathuze Water as well as those serviced directly by each municipality.
- Other – 3%

There are also public entities such as:

- The City of uMhlathuze where Mhlathuze Water not only manages but also operates, maintains, and does its Treatment Works, and also supplies bulk distribution of their infrastructure;
- Thukela-Goedertrouw Transfer Scheme focusing on the operations and maintenance of the infrastructure;
- Richards Bay Minerals operation and quality monitoring of the five Water and Wastewater Package Plants at the Mining Ponds;
- Richards Bay Industrial Development Zone supplying them with water and maintenance of the infrastructure.
- Foskor, a producer of phosphates and phosphoric acid

In addition to providing bulk water services, Mhlathuze water has specific capacity and infrastructure to provide waste water treatment to the industries under its jurisdiction.

5.1.2 Umgeni Water Customers

Unlike Mhlathuze Water, Umgeni Water mainly supplies water to Municipalities. A total revenue contribution of 99.99% is generated from municipalities. The balance comes from other retail businesses. On the other hand, uMhlathuze Water focuses mostly on industrial organizations. Part of Umgeni's growth strategy is to increase their customer base and service offering. This reconfiguration will deliver precisely that, with the added advantage of diversifying the customer base which is set to stabilise revenues in turn. Umgeni customers include:

- Ethekewini metropolitan municipality
- Ilembe district municipality
- Ugu district municipality
- Harry Gwala district municipality
- Umgungundlovu district Municipality
- Umsunduzi Municipality
- King Cetshwayo Municipality

These customers cover almost 55% of the KZN Geographical area which is home to over 70% of households in Kwa-Zulu Natal.

5.1.3 Umgeni Water – Business Plan Analysis

Forecasts

- Forecasts suggest that 2020/21 net profit to be 18% lower than 2019/20 while the 2021/22 projections indicate a further 19% year on year net profit decrease.
- The financial plans were concluded based on a Board approved, tariff increase of 7% in 2021/22
- Debt covenants, set by the European Investment Bank, linked to operating profits and net profit indicate that the organisation will not breach the required covenant levels.
- In relation to the 2019/20 financial year, sales volumes for the 2020/21 financial period were projected to grow at a rate of 6.3% attributable to new volumes from KCDM.
- Current annual water demand is based on projected population growth. The current population growth rate stands at 1.06%.
- Post the reconfiguration of the two entities (Umgeni Water and uMhlathuze Water) forecast demand will vary as the two entities service two very distinct markets.

Cost Drivers

- The main cost drivers are Chemicals, Depreciation, Energy, Maintenance, Payroll and Raw Water

Cash Flow

- Maintaining positive operating cash flows is key to ensuring that Umgeni Water delivers on its mandate and remains a financially viable entity. In this respect, the reconfiguration will be of great value to Umgeni as it will stand to benefit from the Mhlathuze profits and cash flows.
- National Treasury debt covenants, linked to cash flow from operations, are not expected to be breached.

5.2 Umgeni Risks

Operations of Umgeni Water do not take place in a vacuum, so is the process to reconfigure the two entities. Stakeholders are key in this regard and consultations to inform and engage all interested parties is important. Concerns raised by customers and various stakeholders in some of the consultative processes include the following:

- Operating costs are too high
- Tariff increases are not substantiated adequately. The required tariff increases to support capital infrastructure requirements are a minimum of CPI plus 5.3%. Current expenditure increases are high and may not be adequately supported by the current regime of 7% price increases.
- There seems to be a consistent underspend of capex whilst there are continued year on year capex budget increases.
- Umgeni Water will have to defer some of the planned expenditure to allow for the affordability concerns raised from 2025/26 onward.
- To support repayment of debt raised for capital infrastructure expansion and the maintenance of operating costs Umgeni would have to consider applying a CPI plus 5,05% tariff increase methodology.

Umgeni Water has experienced challenges in the collection of amounts owed as customer debt. It is expected that the debtors' days will remain above 50 days for the foreseeable future.

5.3 Reconfigured entity – Value creation

5.3.1 Impact on water quantities

At the time of writing this report, the actual figures relating to water availability indicated that dams that supply Umgeni Water are filled to capacity. The table below illustrates a sample of the dams as at 02/02/2023. Although the current dam levels indicate a massive improvement on availability following good rainfall in the last two months. However, variable climate conditions together with frequent drought mean that it is not possible to generate a firm projection with regard to secure availability in the near future. Suffice to say that the incorporation of Mhlathuze Water into a single water board will add an estimated 9% capacity to the total water available to service the combined areas of service.

UMGENI DAMS	Dam Capacity	% Full	Overflow	Rainfall	Date
Mgeni System	952.88	102.02			02/02/2023
Spring Grove Dam	141.97	101.8	14.49	20.0	02/02/2023
Mearns Dam	6.18	120.79	0.69	5.0	02/02/2023
Midmar Dam	237.57	100.92	13.93	1.5	02/02/2023
Albert Falls Dam	295.51	102.2	28.9	0.8	02/02/2023
Nagle Dam	23.6	101.55	0.0	0.0	02/02/2023
Inanda Dam	248.05	102.63	0.32	0.0	02/02/2023
Henley Dam	1.1	107.22		2.4	02/02/2023
South Coast System	1.32	100.76			02/02/2023
Umzinto Dam	0.42	100.28			

Table 2: Dam levels in Umgeni

It is also important to note here that ground water sources have not been factored into for Mhlathuze above. However, figures obtained from the Mhlathuze Water website indicate that three dams sources of water namely: Hluhluwe, Goegertrouw and Pongolapoort dams are at 83%, 100% and 84% respectively. Based on the estimated abstraction capacities of the individual entities, the following combined quantities apply:

ENTITY	Abstraction m3/annum	Supply m3/annum
UMGENI	563.26	515.05
MHLATHUZE	49.37	49.37
COMBINED CAPACITY	612.62	564.42
Increased Capacity	8%	9%

Table 3: Impact of the combined water board on abstraction

As indicated in the table above, the increase in Bulk Water Supply Capacity of the New Water Board is expected to be 9% in total.

5.3.2 Organisational and systems

The reconfiguration presents opportunities for value creation across many business functions. These can be harnessed and utilised to enhance the financial performance of the reconfigured entity. The following are such identified areas of potential value creation:

- **Customers:** The re-configured entity will see Umgeni Water increase its industrial customer base as well as related revenue. This will also result in the reconfigured entity increasing its residential customer base amounting to 89% of total revenue. Although the increase is likely to be limited to its mandated geographical boundaries. In the mandated areas there may exist an opportunity to grow

revenues further by investigating the number and potential to expand to un-serviced as well as areas that are currently under-serviced.

- **Services:** Seeing that the services offered by both entities are similar, their integration will not be cumbersome owing to these similarities. However, seamless integration will require significant capacity to support technical, administrative and governance functions and processes to adjust to the larger area of coverage.
- **Communication platforms:** Umgeni possesses strong communication platforms, including social media platforms, which has been identified as one of the weaknesses of Mhlathuze. The new entity will leverage on Umgeni's social infrastructure to support expanded service delivery initiatives.
- **Compliance:** Umgeni sets high standards in terms of compliance of systems and processes. Compliance issues have been reported as a key deficit in Mhlathuze internal controls. The reconfiguration process presents opportunities for improved efficiency and effectiveness of systems when properly managed.
- **Water loss management and metering:** As a result of a metering strategy focused on measuring critical nodes as well as accuracy in monitoring of meters, the non-revenue water is successfully maintained at 5%. It is believed these processes will likely increase revenue for the combined entity, with areas previously serviced by Mhlathuze also seeing similar metering and monitoring systems put in place.
- **Infrastructure projects:** Overall, 55% of target water infrastructure project milestones were met for Umgeni in FY2021. Both entities can benefit from an increased focus in Capex projects which will in turn ensure continued revenue generation for the re-configured entity, especially considering that already some water treatment plants are currently performing beyond the 85% utilisation target.

Although asset valuations and other infrastructure assessments are still pending, it is clear that there are tangible benefits in establishing a single water board.

5.4 Impact of reconfiguration on gross profit

5.4.1 Growth trends for the entities

Revenue growth is projected to be steady, yet slow. Recognising the impact of liabilities emanating from the Umgeni absorbing them as part of the transfer process. The table below illustrates the five-year projected growth together with the associated trends for both Umgeni Water and Mhlathuze Water.

UmgeniWater	HistoricalResults					ForecastPeriod				
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
IncomeStatement										
Revenueue	2,903,723	3,538,457	4,154,375	4,528,237	4,909,454	5,184,484	5,599,264	6,117,389	6,641,986	7,211,560
BulkWater	2,666,074	3,291,481	3,893,773	4,235,486	4,582,109	4,819,033	5,203,915	5,682,726	6,171,761	6,702,797
WasteWater	171,762	199,792	216,373	246,115	279,252	308,276	334,203	369,142	400,149	433,790
Section30	65,887	47,184	44,229	46,636	48,093	57,175	61,146	65,521	70,076	74,973
CostofGoodsSold(COGS)	1,191,532	1,363,161	1,492,278	1,788,513	1,966,084	2,110,724	2,377,848	2,569,141	2,775,936	3,004,774
BulkWater	1,051,352	1,231,220	1,327,444	1,613,705	1,796,945	1,883,511	2,130,485	2,305,207	2,494,302	2,704,078
WasteWater	96,523	105,274	139,004	148,109	141,845	192,683	206,147	220,204	235,289	251,580
Section30	43,657	26,667	25,830	26,699	27,294	34,530	41,216	43,730	46,345	49,116
GrossProfit	1,712,191	2,175,296	2,662,097	2,739,724	2,943,370	3,073,760	3,221,416	3,548,248	3,866,050	4,206,786

Table 4: Umgeni Water projections

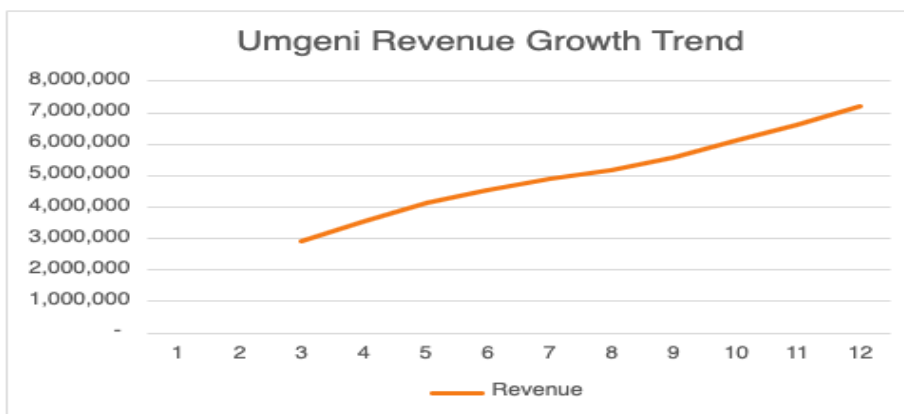


Figure 19: Umgeni water revenue projections

Mhlathuze Water	Historical Results					Forecast Period				
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Income Statement										
Revenue	538,996	712,643	664,047	643,514	643,089	873,882	852,709	911,828	943,921	972,286
Bulk Water	254,480	307,662	329,531	362,005	369,651	428,265	449,587	481,540	500,683	513,868
Waste Water	147,857	171,880	183,064	198,783	218,673	274,663	288,403	309,129	321,399	329,727
Section 30	136,659	233,101	151,452	82,726	54,765	170,954	114,719	121,159	121,839	128,691
Cost of Goods Sold (COGS)	232,441	309,411	240,763	250,898	227,747	416,794	394,688	412,642	422,417	437,715
Bulk Water	114,973	145,547	141,326	176,159	162,266	208,123	222,328	229,733	236,596	243,702
Waste Water	36,968	38,219	41,557	41,492	43,634	59,876	62,871	67,390	70,064	71,880
Section 30	80,500	125,645	57,880	33,247	21,847	148,795	109,489	115,519	115,757	122,133
Gross Profit	306,555	403,232	423,284	392,616	415,342	457,088	458,021	499,186	521,504	534,571

Table 5: Umhlathuze water growth projections

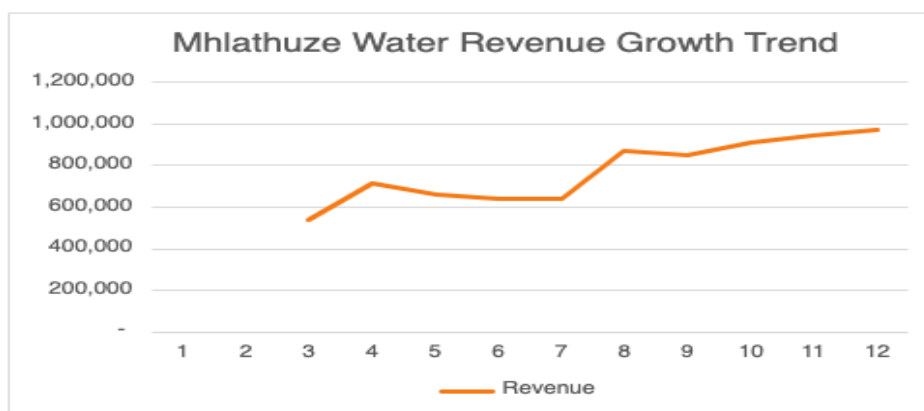


Figure 20: Umhlathuze water revenue growth trend

5.4.2 Gross Profit

With both Mhlathuze and Umgeni currently having high gross profit margins, the reconfigured entity is expected to yield high Gross Profits, starting at R3.5 billion and growing to R4.7 billion in 2027 in scenario 1 then R3.5 billion to R4.8 billion in scenario 2.

Revenue trends are expected to remain the same under the reconfiguration as with the Umgeni forecasts. As such, as long as the levels of costs of generating revenue remain consistent in the forecasts, the Gross Profit margins remain stable.

In both scenarios, the reconfigured entity reflects results that are profitable for the single water board when compared to the current scenario where Umgeni is a stand-alone entity. This confirms that from a

revenue generation perspective, the reconfiguration has a positive impact as the revenue and cost of revenue remains at historic levels after reconfiguration.

5.4.3 Gross Profit Margin

Umgeni’s forecast gross profit margins (GP%) start at 59.3% on 30 June 2023, ranging between 57.5% and 59.3% between the 2023 and 2027 forecast years. In scenario 1 of the reconfigured entity, GP% starting off at 58.3% on 30 June 2023, ranging between 57.0% and 58.3% between the 2023 and 2027 forecast years. In scenario 2 of the reconfigured entity, GP% starts off at 59.6% on 30 June 2023, ranging between 58.0% and 59.6% between the 2023 and 2027 forecast years.

The stability of this ratio under both scenarios confirms operations are not expected to deviate from normality on reconfiguration of the two entities. Under scenario 2 on the reconfigured entity is an improvement in the GP% by 0.3% to 0.5% each year throughout the forecast period. At such large numbers in revenue, the reconfiguration brings about positive change.

The comparative scenarios are illustrated in the diagrams that follow below.

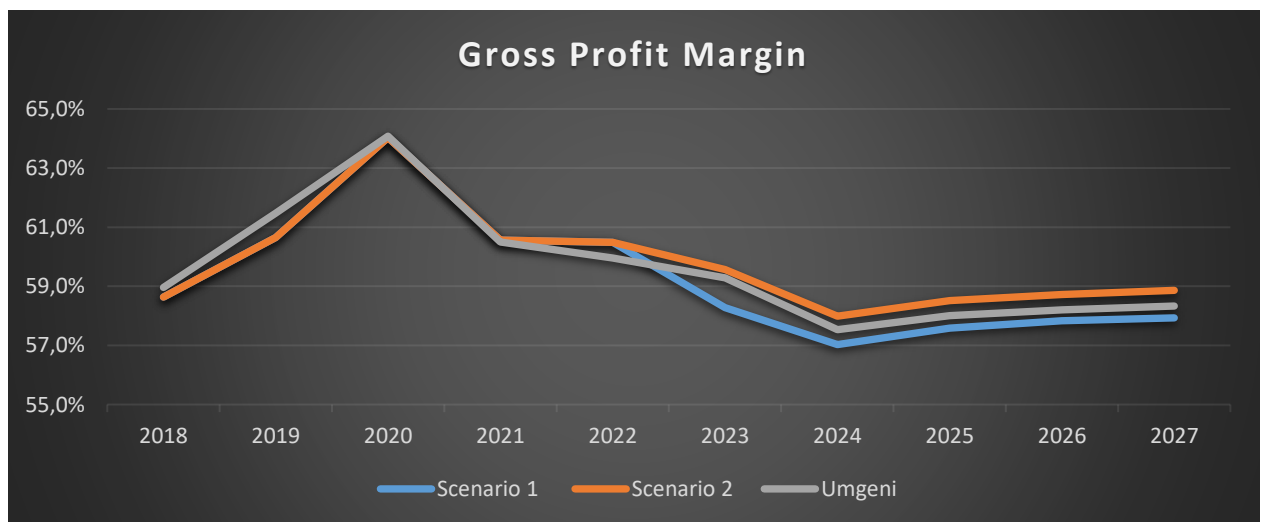
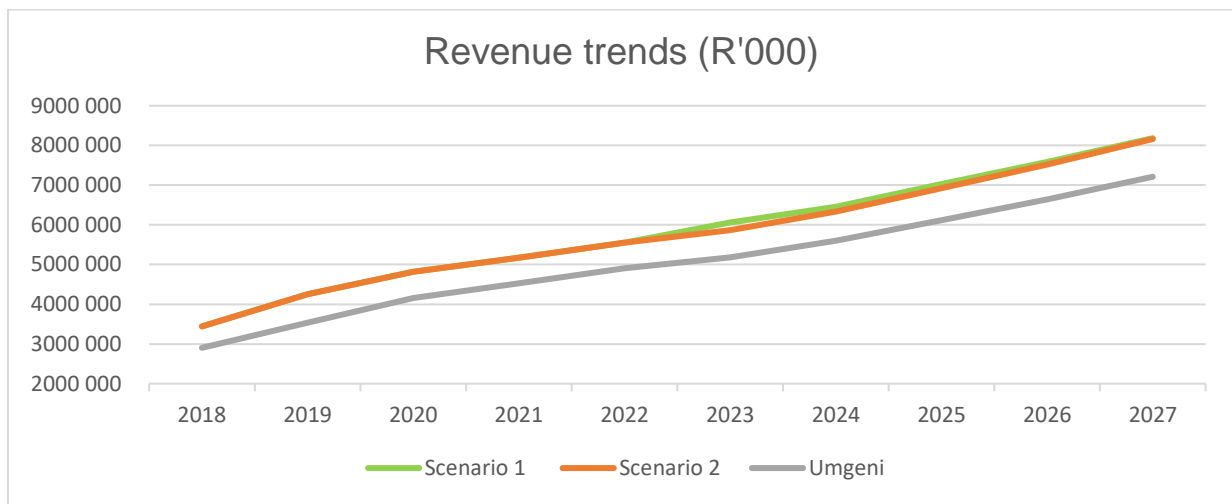


Figure 21: Projected GP margins – scenarios 1 and 2

5.5 Impact of reconfiguration on net profit

5.5.1 Net Profit

Umgeni has been profitable historically, with Net Profit percentages (NP%) ranging between 25% and 40%. The trend has however been declining with the lowest historical NP% seen in June 2022. Umgeni forecasts a decline in this profitability indicator by June 2023 with improvements from then going forward.

Reconfiguration is projected to maintain the same profitability trend as Umgeni realises Net profits projected to start off between R820 million and R980 million in June 2023 in both scenarios. Net profits are anticipated to grow throughout the forecast period ending in June 2023, peaking to levels between R1.8 and R2.1 billion in the financial year ending 30 June 2023.

A spike in operating expenditure and a dip in profitability is anticipated in the 2023 forecast year. This is due to the impact of writing off Mhlathuze's debtors after reconfiguration which reduces net profit by R110 million on 30 June 2023, with an average Net Profit percentage of 22% going forward. It is expected that sales estimated at around R434 million will be required to make up for these losses.

Profitability shows a positive forecast trend under both scenarios, as indicated by the profitability graph. Net profits are expected to increase by a 5-year average of between R120 million and R260 million as a result of the reconfiguration. Over and above the quantitative analysis, successful reconfiguration is expected to have a positive impact on both Umgeni and Mhlathuze as there are other benefits that have not been taken into account, for example, economies of scale which are expected reduce expenditure.

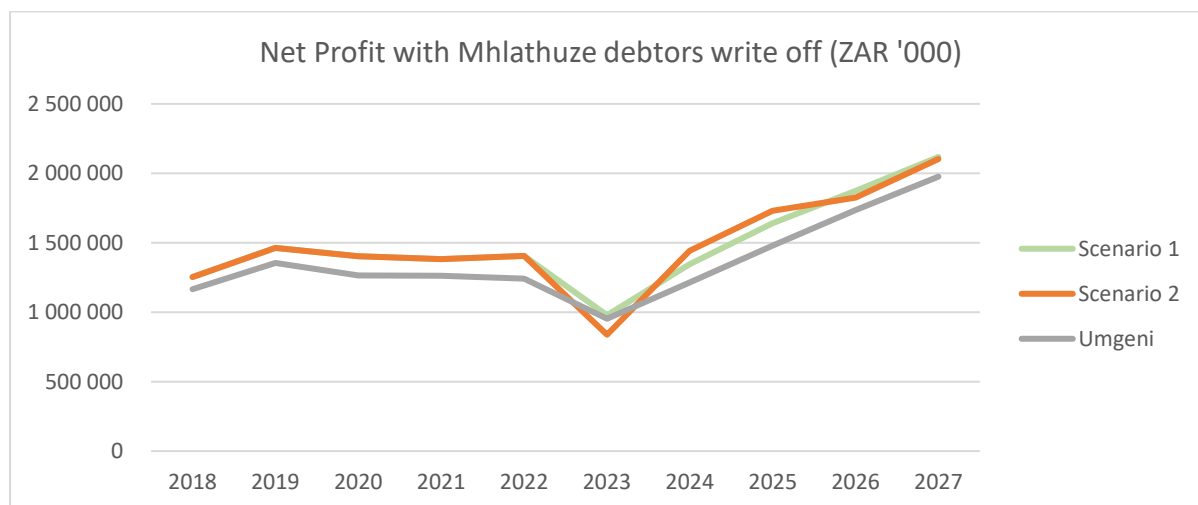


Figure 22: Net profit with debtors write off

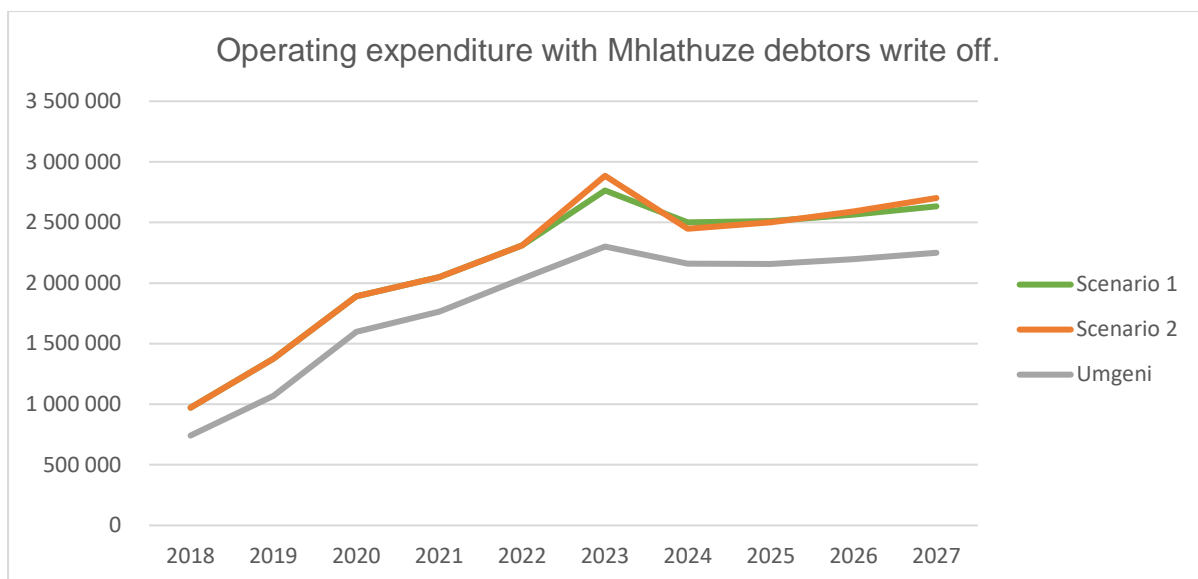


Figure 23: Comparative analysis of scenarios 1 and 2 – Operating expenditure and Net Profit

5.6 Impact of reconfiguration on balance sheet

5.6.1 Net Asset Value

Projections under Umgeni indicate that the entity anticipates continued growth with the entity's net asset value (NAV) projected to continue growing as they have done historically. Successful reconfiguration however, means that this trend is expected to continue. NAV is expected to increase at a relatively lower rate from 2023 due to the impact of writing off of Mhlathuze debtors at June 2023. Save for this, shareholder value is anticipated to continue growing as it has in the past.

Debt levels in the reconfigured entity only rise as much as the change in debt of Umgeni. No additional risk is introduced with the reconfiguration coming from Mhlathuze's side. Mhlathuze has not breached any covenants on their existing debt and has met all debt payments in the recent past. There is no indication of potential failure to settle any of the existing and projected debt.

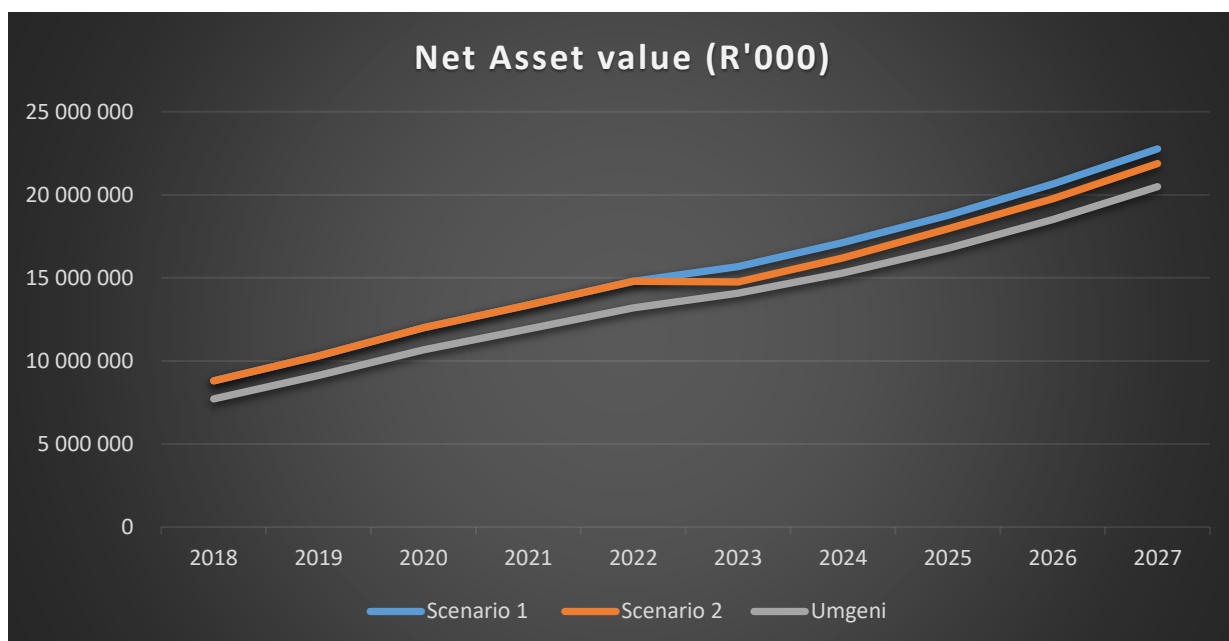


Figure 24: Net asset value comparative analysis – scenarios 1 and 2

5.6.2 Working Capital

The negative impact with the reconfiguration arises with the writing off of Mhlathuze debtors once the entity is disestablished. Over and above the impact on the profitability of the reconfigured entity in the June 2023 financial year, this also has the effect of significantly reducing working capital levels in 2023 thus reducing the current ratio. The impact of writing off debtors goes beyond 2023 and is the reason for the continued decline in the current ratio. Up to 2022, Umgeni has significant amounts of cash reserves invested but in the forecast periods, these investments see a decline from R5.7 billion to a projected R1.3 billion in June 2027. This is an impact filtering from the projected cash generating ability of Umgeni and not the impact of taking over functions from Mhlathuze.

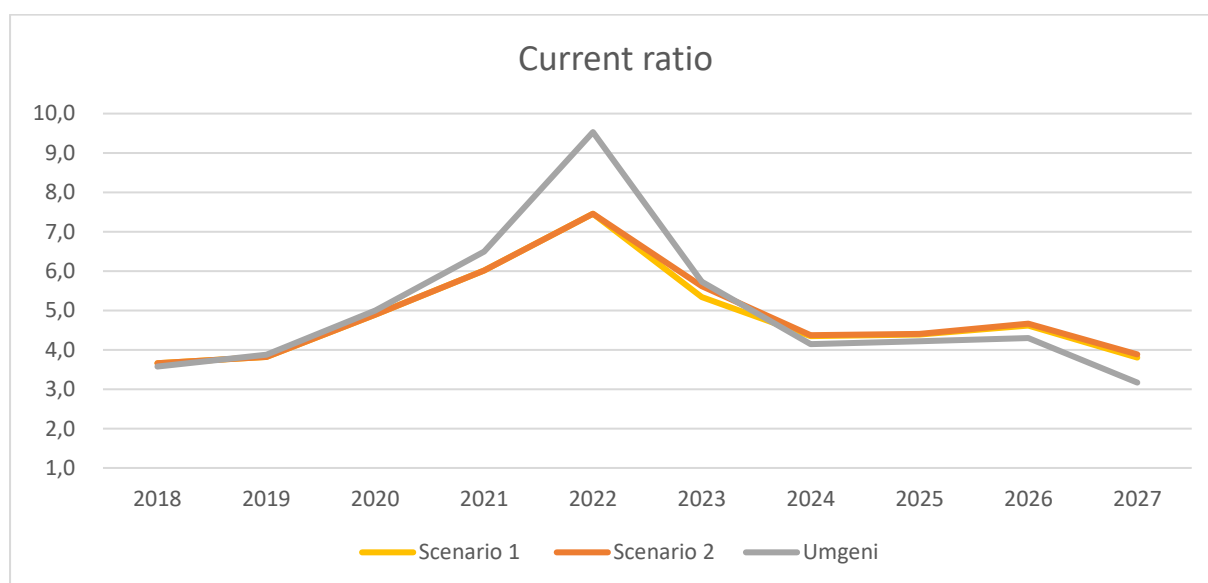


Figure 25: Current ratio

5.7 Impact of reconfiguration on cash flows

5.7.1 Cashflow

Reconfiguration results on the improvement of cashflows due to the increased profitability and anticipated improved working capital management. Writing off of Mhlathuze's debtors balance as at 30 June 2023 will create a dent in the cashflows of the combined entity. However, the entity will have sufficient resources to fund operations until a point when collection of the Mhlathuze's debtors improves (an estimated 45 to 55 days). The combined entity is anticipated to continue generating the bulk of their cash flows from operations, with minimum reliance on raising additional capital to sustain operations. Reconfiguration sees positive increases in cashflows generated from operations in both scenarios.

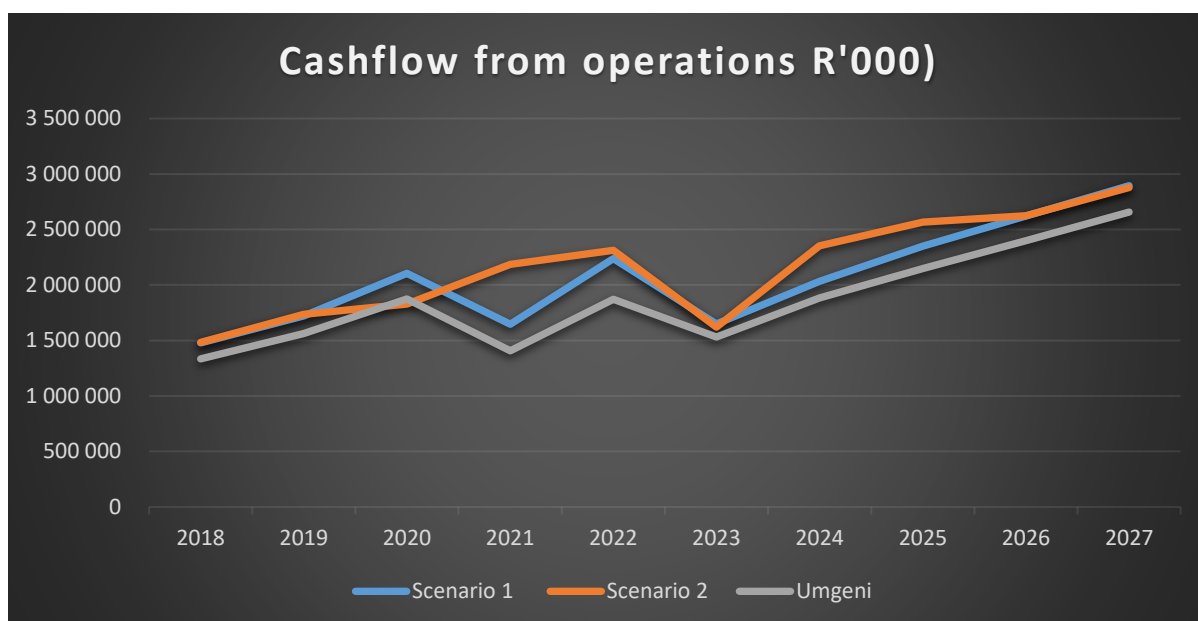


Figure 26: Cash flow from operations

5.7.2 Writing off of Mhlathuze debtors on reconfiguration

Assuming reconfiguration is finalised by 30 June 2023 and Mhlathuze's debtors balance at the time approximating R110 million is written off as irrecoverable, the funding gap created will result in the use of cash reserves and Umgeni's collected debtors to fill the funding gap created.

The reconfigured entity requires, on average between R180 million and R190 million per month to cover working capital needs. It will also be on average 40 to 50 days before collections on sales made in the 2024 financial year start flowing in. Average suppliers payment period in the reconfigured entity will be 130 to 140 days as at 30 June 2023. The reconfigured entity will need to ensure cash reserves are available to meet cash expenses (salaries) and working capital requirements for at least 130 to 140 days from the time the Mhlathuze debtors are written off as irrecoverable.

From our analysis of cash flows, the reconfigured entity will take at least 7 months settling creditors and paying cash expenses before the cash reserves are dried out. However, by the time the original cash reserves are dried out, more cash would have flowed in through collection of the 2024 revenue based on the average collection period of 40 to 50 days for debtors.

The reconfigured entity will comfortably survive the write off of Mhlathuze debtors on 30 June 2023 from a cashflow perspective.

5.8 Risks and Findings

5.8.1 General risks

The following risks and mitigation factors are worth mentioning here for the sake of completeness.

- Loss of stakeholder trust due to uncertainty of intentions and perceived outcome. **Mitigation:** Transparency through Involvement of stakeholders in every step of the reconfiguration process
- Customer dissatisfaction – a perception of raised tariffs has already left customers uneasy. There is a risk of dissatisfaction if this were to happen immediately post reconfiguration. **Mitigation:** If tariffs are to be raised, then a staggered approach could be better suited, perhaps commencing a year post reconfiguration.

- Disruption/compromise of quality of service, due to lack of experience in running the specific customer segments by Umgeni personnel. **Mitigation:** Retention of Mhlathuze personnel to ensure a smooth reconfiguration process
- An adaptation period may be required as employees get used to the new culture, processes and systems which may impact performance. **Mitigation:** Orientation processes by HR to ensure an expedited assimilation of staff
- Potential delay of existing/ upcoming projects as reconfiguration takes priority, including infrastructure maintenance plans. **Mitigation:** Have a post-reconfiguration maintenance plan before-hand that will be adhered to during and after the reconfiguration process to ensure continuity of plans

The list of risks is not exhaustive. While the above risks are identifiable immediately, some risks will emerge as the process to reconfigure is implemented.

5.8.2 Contingent liabilities

UMhlathuze Water like all institutions that contribute to the economy in the region has some liabilities that arise as result of unintended consequences. Unfortunately, some of these liabilities tend to be costly as illustrated in the table below.

Matter	Exposure
CCG JV : Contract payment dispute (it)	10 365 000.00
Rembu Construction CC - Contract no: mw/46/2019 (payment dispute - operations)	4 224 139.11
Mhlanga Incorporated (legal services)	2 269 935.50
South African Human Rights Commission ("SAHRC")	Not Yet Known
Sage (Pty) Ltd	-

Other matters that are not listed here, either have little or no financial impact or have a positive financial impact.

5.8.3 Short and Long-Term Interest Borrowings

Interest bearing borrowings include fixed term loan from Nedbank Limited and Rand Merchant bank maturing in June 2020 and November 2025 respectively. Long term interest borrowings declined from 2020 as the loan from Nedbank limited matured and was paid up on 30 June 2020. From 2021 to date, the figure on the account is the 15-year term loan from Rand Merchant bank with a balance of 36.5m as at 30 June 2022, which is in line with the repayment schedule agreement signed with the lender. The loan is repayable in bi-annual capital repayments in May and November with an average of 10.4 mil being paid each year.

5.8.4 Accounts receivable

The Accounts receivable balance is expected to remain constant at 19% of revenue for Mhlathuze, before decreasing to 13% despite the forecasted revenue growth. Umgeni accounts receivable balance is higher at 21%, expected to increase to 23%. The debtors' days for primary activities is 42 days for Mhlathuze, as opposed to 46 in the past years. On average Umgeni debtors pay in 97 days. This trend is expected to reduce to 84 days over the next 5 years. This will be influenced by the finalisation of all payment plans currently in place. It is also understood that the credit policy will be revised and operations will thus be

on a cash basis for non-contracted customers. The debt collection of Mhlathuze is therefore superior, and it can still be improved by solving the deadlock with non-paying debtors, specifically DWS. With little confidence in the collection of Mhlathuze debtors, a write off is being considered on reconfiguration. Bearing in mind the average collection periods for both Umgeni and Mhlathuze, our advice is that making extra collection endeavours might seem less enticing, yet both the workload and resources required are commonly found to be below what it takes to compensate for the writing off of the same balances.

5.8.5 Scenario analysis

This finance section of the DD assignment focused on the matters set out in the inception note presented at the commencement of the engagement. As such, it should be read in conjunction to the FDD report. Its scope is therefore limited to the analysis of the impact of the proposed reconfiguration on the finances of Umgeni Water.

Our analysis of the reconfigured entity has been based on two scenarios as described below:

1. **Scenario 1** of the reconfigured entity is where Umgeni and Mhlathuze's forecasts are combined throughout the forecast period. The assumption here is that given the strength of both entities, they both bring added value to ensure performance at a level planned in their business plan.
2. In **Scenario 2** of the reconfigured entity, the assumptions applied in the Umgeni business plan will be applied to the overall reconfigured entity.

The impact of writing off Mhlathuze debtors at the time of reconfiguration (currently assumed to be 30 June 2023) is assessed under both scenarios.

In the reconfigured entity, forecasts indicate that collection, on average will deteriorate from 70 to 80 days. In the event that the reconfigured entity decides to write-off Mhlathuze's debtors on reconfiguration, the following will be the impact on the reconfigured entity as at 30 June 2023;

- Debtors will be reduced by R110 million to R1.4 billion, thus creating a dent of just under 8% in Net Assets.
- Profits will be reduced by R110 million on the same date as a result of the write off and this will reduce shareholders' equity by 0.7% on 30 June 2023. To make up for a write off, the reconfigured entity will require making sales of approximately R430 million in order to achieve sufficient profit to off-set the write-off expense. The 5% to 6% revenue growth will suffice by generating more than the required sales levels to recover.
- The reconfigured entity will have enough cash reserves to run the business to a point where funds can be collected from the new revenue generated in the reconfigured entity.

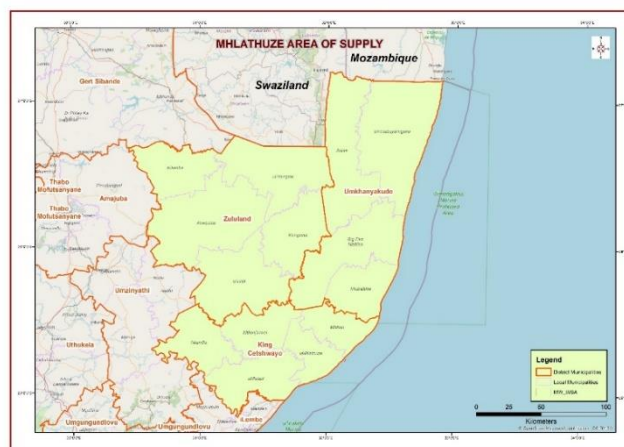
With debtors historically financing working capital, clearly the write-off creates pressure on the working capital for the reconfigured entity with cash and cash equivalents being heavily relied on to finance working capital needs for the 2024 financial year.

Tariff and revenue growth forecasts are based on past growth trends and management estimates. These numbers do not include expansion into underserved areas or a reduction of non-revenue water. The latter two being based on internal strategic and operational decisions. This will remain an opportunity for further revenue growth for the reconfigured entity.

6 Technical and GIS

6.1 Mhlathuze Water:

Mhlathuze Water forms part of the greater Usuthu to Mhlathuze catchment area. The primary catchment drains an area of approximately 56 231 km². However, only approximately 70 % (39 531 km²) of the Usuthu to Mhlathuze primary catchment area falls within the Pongola to Mtamvuna WMA (DWAf, 2004). The Usuthu to Mhlathuze primary catchment consists of several catchments which are mostly independent of each other. These are the Mhlathuze, Mfolozi, Mkuze, Pongola, Usutu and Lake Sibaya catchments. The average MAP across the Mfolozi catchment ranges from 600 mm in the inland areas to 1 300 mm along the coastal areas (DWS, 2003). Significant towns in the area are Richards Bay, Hluhluwe, St Lucia, Mkuze, Vryheid, Ulundi, Babanango, Nongoma and Mtubatuba. Major dams in the catchment include the Goedertrouw Dam, Klipfontein Dam, Bloemveld Dam, Grootgewacht Dam, Ulundi Blancing Weir, Vuna Dam, Volkwana Dam, and Mvunyana Dam.



Mhlathuze Water performance its own laboratory services, while also providing Scientific and Laboratory services to the following DM:

- Gert Sibande DM & WSA – which has a total of 7 Local Municipalities dependent on the services of Mhlathuze Water
- Umkhanyakude DM – Mhlathuze Water supports the Jozini Waste Treatment Plant.

Further, water services provided by Mhlathuze catchment extend to the Mhlathuze Local Municipality which is surrounded by the area serviced by Umgeni Water Board. In this regard, it is important to note that both Umgeni and Mhlathuze provide shared services to King Cetshwayo DM.

The main economic activity in the Usuthu to Mhlathuze catchment is manufacturing and mining from coal fields in and around Vryheid. The major activities are crop farming, cattle farming, game farming, sugar plantations and forestry. The importance of the manufacturing sector can be attributed to the railway infrastructure, mainly the harbour at Richards Bay (incorporating the world's largest coal export terminal), power supplies, and water availability. Key industries are pulp and paper manufacturing and aluminium smelting. Timber and sugar are critical raw materials. Agriculture is the largest water user in this catchment, predominantly for sugarcane, forestry, and Manufacturing (DWAf, 2004).

6.2 Mhlathuze Asset Base

Based on spatial information generated by the Garnet Ngubane team, data was added to Mhlathuze assets and imported into the GIS. The Fixed Asset Register was used to ascertain the total asset value. Based on all Active Assets, the table below captures the results:

Net book value as @ 31 October 2022	Insured Value	Replacement Cost
R958,360,282.13	R1,292,626,964.73	R1,370,211,727.83

The major contributors to the Total Net Asset Value are highlighted below, and the distribution of Asset Value (Based on Net Book Value) is indicated below:

- Nsezi Water Treatment Plant 39.80% (Excluding the current Augmentation Project)
- Weir Pump Station 25.23%
- Alkastrand Effluent 6.92%

Assets which were inspected during the Site Visit were determined based on the higher asset values. A major augmentation project is currently ongoing at the Nsezi water treatment plant.

6.3 Asset Verification

Site Visits were conducted. The itinerary started with a meeting at Mhlathuze Head Office in Richards Bay, followed by site visits to the following locations:

- Abstraction: Mhlathuze Weir
- Treatment Works: Nsezi Water Treatment Works (WTW)
- Nsezi WTW
- Nsezi WTW Augmentation Project.
- Water Transmission: Pipelines:
- Mondi Paper Inlet
- Effluent A-Line Buoyant
- Effluent B-Line (Dense)
- Surge Tower 2
- Effluent Discharge: Alkastrand Effluent Pumping Station.

Technical re-evaluations are still on the cards that will appraise and validate assets in order to support the finance workstream establish a comprehensive balance sheet for the new entity. This work must be done soon before the financial year end.

6.4 Asset Condition Assessment and Analysis:

Over and above visiting the major locations, the asset data was analysed in terms of general condition. The following criteria applies:

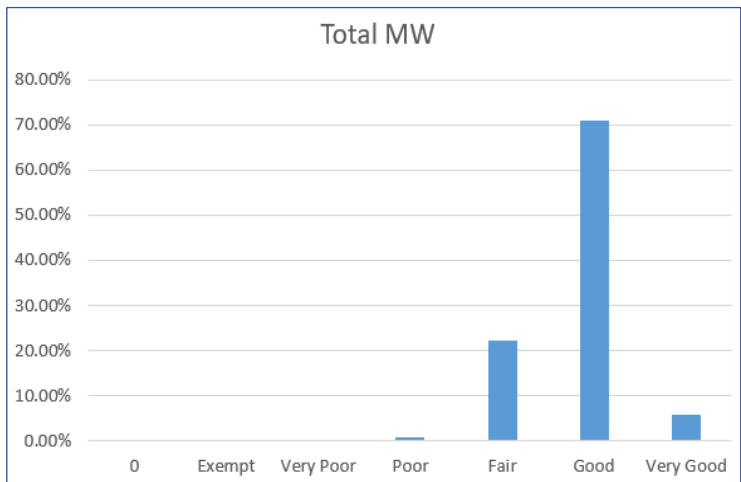
- Very Good
- Good
- Fair
- Poor
- Very Poor
- Exempt. It was found that extremely limited assets fell within this category. These were assets not considered in the evaluation.

It should be noted that the graphs below are on asset value. The percentages criteria are thus asset value percentages of total value within the condition criteria categories indicated above (ranging from Very to Very Poor).

6.4.1 Combined Condition of All Assets within Mhlathuze Water:

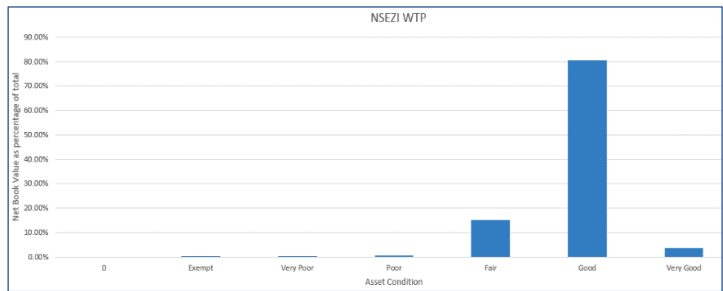
The general condition classification was performed on all assets within Mhlathuze Water. The assessment are positive in that most assets were found in a good condition, as indicated in the distribution below.

70% of assets within Mhlathuze Water fall within a condition classified as “Grade 2 – Good”. To clarify what Grade 2 mean, the International Infrastructure Management Manual – Version 3.0 is applied which provides the following definition of: “Acceptable physical condition but not designed to current standards or **showing minor wear**. Deterioration has minimal impact on asset performance. Minimal short-term failure risk but potential for deterioration or reduced performance in medium term (5 – 10 years). Only minor work required (if any)”. Considering the average age of the assets, minor wear is acceptable, but expenses might be incurred in the medium term to maintain original design performance levels. A further Evaluation was done on individual Locations for major assets below.



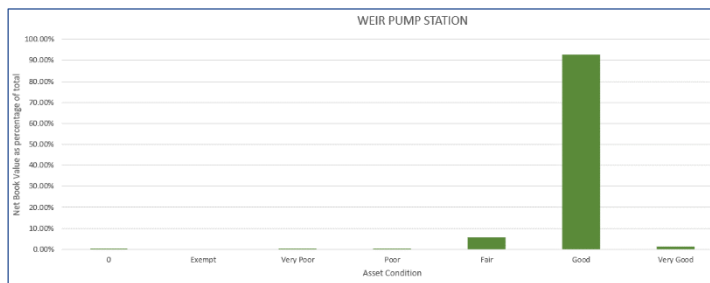
6.4.1.1 Condition of Nsezi Water Treatment Plant

The distribution with regards to general condition classification related to all assets within Nsezi Water Treatment Plant were found to be in a good condition, as indicated in the distribution below. More than 70% of the value of the assets are classified as ‘GOOD’



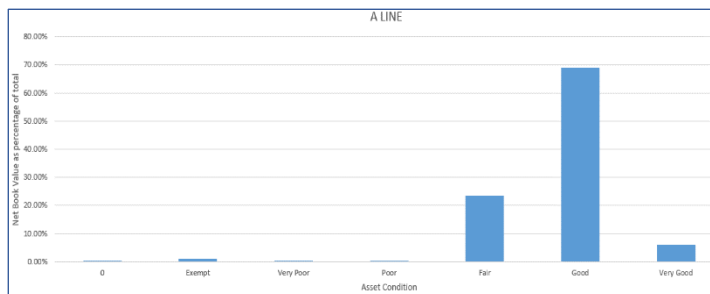
6.4.1.2 Condition of Weir Pump Station

The distribution with regards to general condition classification related to all assets within Weir Pump Station were found to be in a good condition, as indicated in the distribution below. More than 90% of the value of the assets are classified as ‘GOOD’



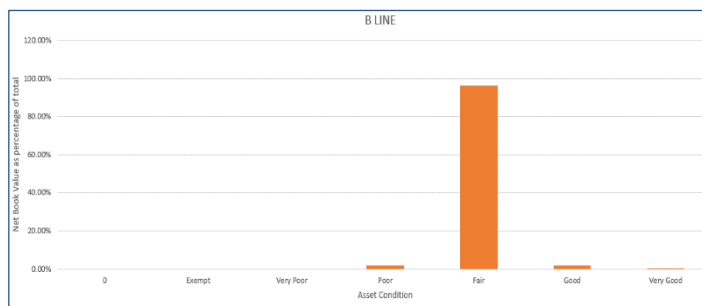
6.4.1.3 Condition of the A-Line at Alkastrand

The distribution with regards to general condition classification related to all assets within the A-Line were found to be in a good condition, as indicated in the distribution below. More than 60% of the value of the assets are classified as ‘GOOD’



6.4.1.4 Condition of the B-Line at Alkastrand

The distribution with regards to general condition classification related to all assets within the B-Line at Alkastrand were found to be in a good condition, as indicated in the distribution below. More than 90% of the value of the assets are classified as 'GOOD'



6.5 Bulk Raw Water Supply

The raw water to the Nsezi Water Treatment Works (NWTW) is sourced between the Mhlathuze River and Lake Nsezi. An additional licence (No B191/2/2050/1 dd. 01/04/2025) for water abstraction from the Tugela River at the Mandini Farm 10852 was issued by the then Department of Water Affairs and Forestry to Mhlathuze Water. The licence was issued for taking a maximum quantity of 47 300 000 m³/a. The licence further included the storage of 600 000m³. The licence is subject to a review period of 5 years. The current validity thus yet stands to be confirmed. This licence is yet to be utilised.

6.6 Bulk Waste Water Disposal

Mhlathuze Water owns and operates the biggest offshore wastewater disposal system in South Africa. Two pipelines extending four and five kilometres out to sea transfer wastewater from the industries in Richards Bay and its surrounding vicinities. Sludge removed during the treatment process at the Nsezi Water Treatment Plant and macerated sewage from the Mhlathuze Municipality is pumped into the two pipelines.

6.7 Other Agreements:

Jozini Regional Water Treatment Plant and Bulk Reticulation Network: Mhlathuze Water signed a tripartite agreement with uMkhanyakude District Municipality and DWS to implement the Jozini Bulk Water Supply Project in the District following the successful completion of the 40MI/day Jozini Water Works and regional bulk distribution system during 2017, Mhlathuze Water has been operating and maintaining this scheme on behalf of the Umkhanyakude District Municipality.

6.7.1 Maintenance

Early assessment of the situation is that maintenance at these major installations is predominantly done on a reactive basis. There seems to be insufficient scheduled preventative maintenance.

A CMMS (MAXIMO) has been implemented but is not fully functional. Maximo is arguably one of the industry standards and when fully implemented should provide more than adequate functionality for the needs of Mhlathuze's operations and maintenance requirements. Maximo also has seamless interface capabilities with most well-known ERP (Enterprise resource planning) or EMS (Enterprise management) systems such as SAP, Sage, etc.

6.7.2 Major Projects Ongoing:

A major augmentation project is currently ongoing at the Nsezi water treatment plant. The design capacity of the Nsezi Water Treatment Plant for flocculation / clarification system is currently 205MI/d and that of the dissolved air flotation / filtration system is 185MI/d.

The purpose of the project is to augment the plant to 260MI/d of clarified water, based on the 2020 requirements and predicted demands. From the 260MI/d of clarified water 25MI/d will be supplied to FOSKOR and the balance will further be treated by dissolved air flotation (DAF), rapid gravity

filtration and disinfection to achieve an excellent water quality to satisfy the requirements of MONDI and for potable water distribution.

6.8 Umgeni Water:

6.8.1 Supply Area

The Mvoti to Mzimkhulu primary water resource system drains an area of approximately 27 215 km² and consists of two large river systems (Mzimkhulu and Mkomazi). In addition two medium-sized river systems (Mgeni and Mvoti) and several smaller river systems (e.g. Mzumbo, Mdloti, Tongaat, Fafa, Lovu) (DWAf, 2003) also form part of the system. The major urban settlements in the catchment include Durban and Pietermaritzburg and are surrounded by both urban and informal settlements. There are several small towns of Bulwer, Impendle, Ixopo, Mkomazi, Craigieburn, Greytown and Magabheni which have small (yet potential growing) water requirements. The major dams in the primary water resource system include the Smithfield Dam, Impendle Dam, Ngwadini Dam, Temple Dam, Bulwer Dam, Midmar Dam, Albert Falls Dam, and Hazelmere Dam.

The KwaZulu-Natal Province comprises one (1) Metropolitan Municipality, ten (10) District Municipalities and forty-three (43) Local Municipalities. Fourteen (14) of these municipalities are Water Services Authorities (direct retail customers) as defined in the Water Services Act. In the prior period, Umgeni Water focused service delivery, and largely derived revenue from seven (7) customers:

- eThekweni Metropolitan Municipality
- iLembe District Municipality
- Ugu District Municipality
- Harry Gwala District Municipality
- uMgungundlovu District Municipality
- Msunduzi Municipality.

The Durban-Pinetown and Pietermaritzburg areas are the largest commercial centres in the primary water resource system. About 12% of the Gross Domestic Product (GDP) of South Africa originates from the Mvoti to Mzimkhulu catchment system. The main economic sectors in the water resources system include manufacturing which is the major economic activity, followed by trade, government, and finance. Most of the industrial development takes place in the Durban area, which has also become a major production and distribution centre for refined petroleum products. Some of the larger manufacturers include steel suppliers, the Toyota automotive plant, pulp and paper, as well as sugar mills (DWAf, 2004).

6.8.2 Umgeni Asset Evaluation and Condition Assessment:

The Fixed Asset Register dd. October 2022 was used with regards to the evaluation of the Asset Value Distribution. The 'Asset Class' has been used to group different classes of assets. These groupings have been evaluated and represented in graphs to display the Value Distribution attributed to the different Asset Classes. The main contributors to the Total Asset Value of Umgeni Water are listed below:

Asset Class	% of Total Asset Value
Pipelines	30%
Water Treatment Plant Assets	27%
Pumps and Associated Equipment	9%
Wastewater Treatment Plants	8%

Table 6: Assets and value

6.9 The Reconfigured Umgeni Water Board (including Mhlathuze Water service areas)

6.9.1 Impact on Water Quantities

To generate a broader, yet comprehensive perspective of a combined water services entity as envisaged in the gazette issued by the Honourable Minister, population development issues as indicated in the tables below are worth indicating here.

Catchment	Growth Scenarios	2020	2030	2040	2050
Mvoti to Mzimkhulu	High Growth Scenario	2 327 412	2 719 150	3 127 418	3 646 315
	Medium Growth Scenario	2 294 733	2 628 347	2 946 660	3 337 924
	Low Growth Scenario	2 172 249	2 322 614	2 436 389	2 580 442
Usuthu to Mhlathuze	High Growth Scenario	3 476 546	4 370 072	5 437 679	6 844 928
	Medium Growth Scenario	3 149 321	3 645 573	4 179 181	4 835 257
	Low Growth Scenario	2 861 013	3 053 711	3 233 197	3 451 894

Table 7: Population growth scenarios affecting water quantities of the proposed single entity

Contrasting the various population growth scenarios illustrated in the table above, the following shows impact of growth in population on water requirements.

Catchment	Growth Scenario	2020	2025	2030	2035	2040	2045	2050
Mvoti to Mzimkhulu System	High Growth Scenario (million m ³ /a)	97.95	109.09	120.16	131.87	144.00	158.15	174.87
	High Growth Scenario (Ml/d)	268.37	298.86	329.21	361.28	394.53	433.28	479.09
	Medium Growth Scenario (million m ³ /a)	92.97	99.79	105.92	111.91	117.89	124.73	132.50
	Medium Growth Scenario (Ml/d)	254.70	273.39	290.19	306.59	323.00	341.73	363.01
	Low Growth Scenario (million m ³ /a)	87.73	90.87	93.13	94.94	96.82	99.01	101.49
	Low Growth Scenario (Ml/d)	240.37	248.96	255.15	260.10	265.26	271.27	278.05
Usuthu to Mhlathuze System	High Growth Scenario (million m ³ /a)	220.85	253.61	288.49	324.16	367.81	382.10	488.71
	High Growth Scenario (Ml/d)	605.06	694.82	790.38	888.11	1007.71	1046.86	1338.93
	Medium Growth Scenario (million m ³ /a)	201.03	222.07	242.08	262.41	286.15	292.47	347.65
	Medium Growth Scenario (Ml/d)	550.76	608.40	663.23	718.94	783.97	801.29	952.46
	Low Growth Scenario (million m ³ /a)	182.16	192.92	203.36	213.23	224.37	226.79	251.55
	Low Growth Scenario (Ml/d)	499.06	528.55	557.14	584.18	614.70	621.35	689.18

Table 8: Water requirements per growth scenario

Although Thukela Water is not part of this reconfiguration process, it makes sense to present below a graph representing registered volumes of water in the three primary water boards in KZN. The integrated nature of water resources is critical and care needs to be taken to ensure that available resources are shared equitably based on identified needs. The graph gives a complete picture of the volumes of water registered in the interconnected geographic space called KZN. Clearly, Umgeni Water is the largest has the largest share as indicated in the graph below.

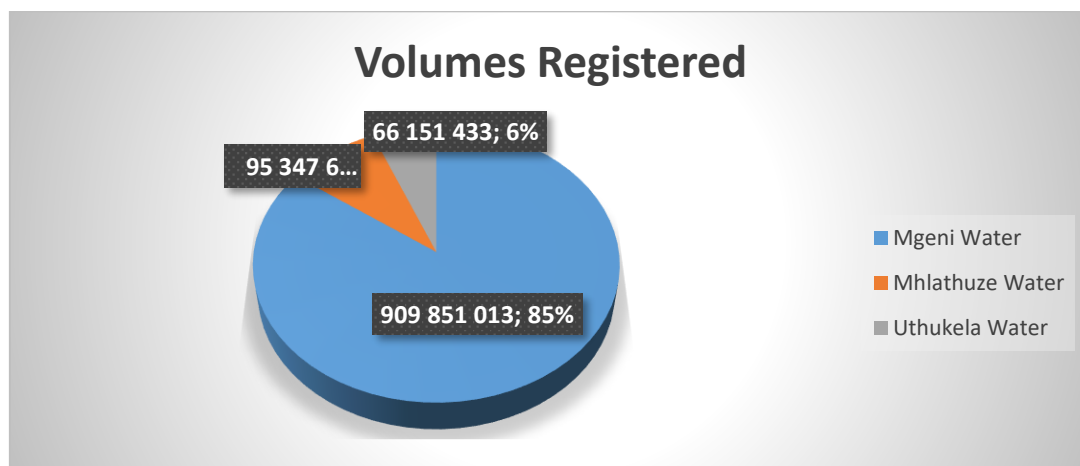


Figure 27: registered volumes in KZN

Based on the estimated capacities of the individual entities, the following combined quantities will apply:

ENTITY	Abstraction m ³ /annum	Supply m ³ /annum
UMGENI	563.26	515.05
MHLATHUZE	49.37	49.37
COMBINED CAPACITY	612.62	564.42
Increased Capacity	8%	9%

The increase in Bulk Water Supply Capacity of Umgeni Water a combined entity will be approximately 9% in total.

6.9.2 Impact on Asset Condition:

The distribution with regards to general condition classification related to all assets within Mhlathuze Water were found to be in a good condition. As defined by the International Infrastructure Management Manual – Version 3.0, more than 70% of the value of the assets are classified as ‘GOOD’. This implies that the assets are generally in an “Acceptable physical condition but not designed to current standards or showing minor wear”. Deterioration has minimal impact on asset performance. Minimal short-term failure risk but potential for deterioration or reduced performance in medium term (5 – 10 years). Only minor work required (if any). Based on the condition assessments done on both Mhlathuze and Umgeni, it is expected that a slight increase in maintenance cost will be incurred over the short term due to the implementation of the Preventative Maintenance Programme. Should this aspect however not be addressed, this could lead to breakdowns, service interruptions and increased cost over the medium term. The additional cost associated with implementation of the maintenance program is expected to be offset against a number of benefits as a result of improved and more effective Centralised Services.

6.9.3 Overall Impact

The reconfiguration of Umgeni Water and Mhlathuze Water to improve water services governance and institutional performance within the sector is achievable. The extension of the boundaries of Umgeni Water to include those that are currently under Mhlathuze Water to form a single Water Board and the disestablishment of Mhlathuze water could achieve the following as intended:

<p>Consolidation of financial resources, assets and skills for key water service infrastructure development.</p>	<p>This report addresses the identification, verification and high-level condition assessment of assets within both Umgeni and Mhlathuze Water. Synergies could be explored in terms of the following:</p> <ul style="list-style-type: none"> • Better governance and control by Umgeni Water. • Centralised Services could lead to better control over maintenance planning (CMMS) and execution, centralised spares holding, increased buying power by the larger combined entity, centralised management staff. • Increased training capability and capacity offered though Umgeni Water.
<p>Increase of water supply areas for Umgeni (Increased revenue);</p>	<p>Mhlathuze Water's main income stems from a number of large key industrial off-takers. If well managed these could provide a very good reliable source of stable income. The potential in Richards Bay for future expansion and industrial development is very good. This could also lead to large sources of increased revenue.</p>
<p>Assist with expanding access to un-serviced areas therefore improving water services delivery targets within the province; and</p>	<p>The Mhlathuze Water operations are predominantly centralised around Richards Bay. There are extensive un-serviced areas within Mhlathuze's footprint. With Umgeni Water's backing, economies of scale will apply and will enable better opportunities for improving bulk water distribution to un-serviced areas.</p>
<p>Institutional realignment objective of water management institutions. In this context, it is the ultimate establishment of a single Water Board or a Regional Water Utility (RWU).</p>	<p>From a technical perspective, realignment will lead to standardisation across all service levels</p>

Successfully achieving the above objectives is expected to facilitate the provision of universal and equitable access to reliable water supply and sanitation services.

7 Human Resources and Labour

7.1 Framework and Deliverables

The purpose and outputs of the HR Stream is to support the transfer of Mhlathuze Water as a going concern. In other words, the strategic fit of all technical skills can only be realised if functions and the necessary reporting arrangements are clear. Due to the sensitivity and the need to involve labour unions, this task is likely to take longer to conclude. This is despite strategic clarity with regard to the types of functions and the requisite skills required to implement the water service functions.

For the purpose of this analysis, the following framework has been adopted that provide a holistic view of the HR and Labour considerations relevant to the migration of staff.

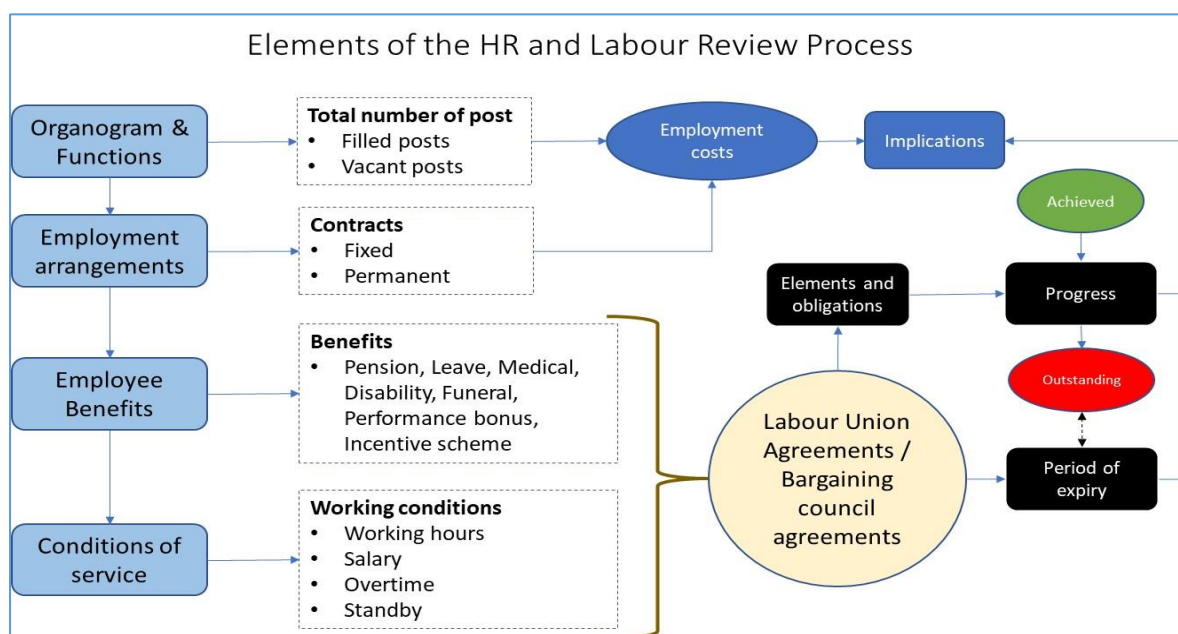


Figure 28: HR and Labour review framework

The left-hand side of the diagram shows the various areas of human resource management starting with the arrangement of functions and posts, the employment arrangements applicable within Mhlathuze, the actual benefits available to employees, and concludes with a brief overview of conditions of service. The second component is a review of the existing labour union arrangements that are currently active. Questions to consider include: what are the key elements and obligations, the expiry and /or time period of the agreements, progress on areas identified in the agreements as well as outstanding issues. The third component of the framework looks at the costs of employment with conditions of service and employment benefits in mind.

Finally, the framework considers the future implications arising as a result of current costs of employment together with outstanding issues that still require implementation in line with the agreements.

The sections below describe each element of the framework and presents the status quo (where we are – status quo). This is followed by a section detailing most pressing implications that are substantive and are likely to have material consequences to the receiving entity (Umgeni Water).

7.2 Mhlathuze Water Board

7.2.1 Legal context for transfer of staff with functions

The Labour Relations Act prescribes obligations to employers in terms of Section 197 with regard to the pending sale of a business as a going concern. In particular, on the transfer of contract of employment, Section 197 requires the transfer of contracts of employment where a business is sold as a going concern. This section safeguards employees by stating that unless otherwise agreed in terms of subsection (6), the new employer is automatically substituted in the place of the old employer in respect of all contracts of employment in existence immediately before the date of transfer. This means that all rights and obligations between Mhlathuze and its employees at the time of transfer remain in force as if they had been the rights and obligations between Umgeni and the transferred employee. Liability for unlawful acts by the old employer also passes to the new employer.

The implications of the sections cited above are that Umgeni Water should ensure that all processes relating to employee remuneration that are currently (if any) mooted within Mhlathuze, are put on hold. Postponing the resolution of the outstanding issues should not be construed to mean that such outstanding initiatives will be shelved forever, rather that Umgeni will first then align its systems to conclude such once employees have been transferred. In any event, Sections 197(2) indicates that a transfer does not interrupt an employee's continuity of service and an employee's contract of employment continues with the new employer as if with the old employer.

Similarly, Section 197 (3) requires that employee retain conditions of service and benefits that are substantively similar to those they enjoyed while employed by entity being sold. Moreover, employees may be transferred to a new pension or provident fund if the criteria in Section 14(1)(c) of the Pension Funds Act of 1956 are satisfied.

Section 197 is clear about what must be done in situations similar to the ones the two water boards are facing. Further details on the requirements of the section together with the relevant conclusions and implications are discussed in the comprehensive due diligence report, legal stream. Other human resource considerations relevant for the due diligence project that the report will expand on include requirements to consultation (Section 189(1), and prohibition against dismissals, and many others.

7.2.2 Functions and organogram

Primary activities of Mhlathuze Water include the provision of bulk water services through a bulk services agreement with a Water Service Authority. Secondary activities (WSA, Section 30), are also important and Mhlathuze Water ensures that these are budgeted for and managed in a way not to cause adverse effects to the provision of bulk water services as whole. Nonetheless, indications are that a form of cross subsidisation, even special social funding may be required to fund the expansion of infrastructure in order to achieve the objectives of reaching areas that are currently not currently serviced (rural areas under jurisdiction of Mhlathuze Water).

Secondary activities include the provision of bulk water services to a private institution (not deemed a WSA), the provision of retail services either to a WSA to directly to consumer, implementing agent agreements, management and operation of raw water infrastructure, and water quality testing when done for a third party.

The organisational structure is presented in the diagram below, while a summary of functions is provided in the table below.

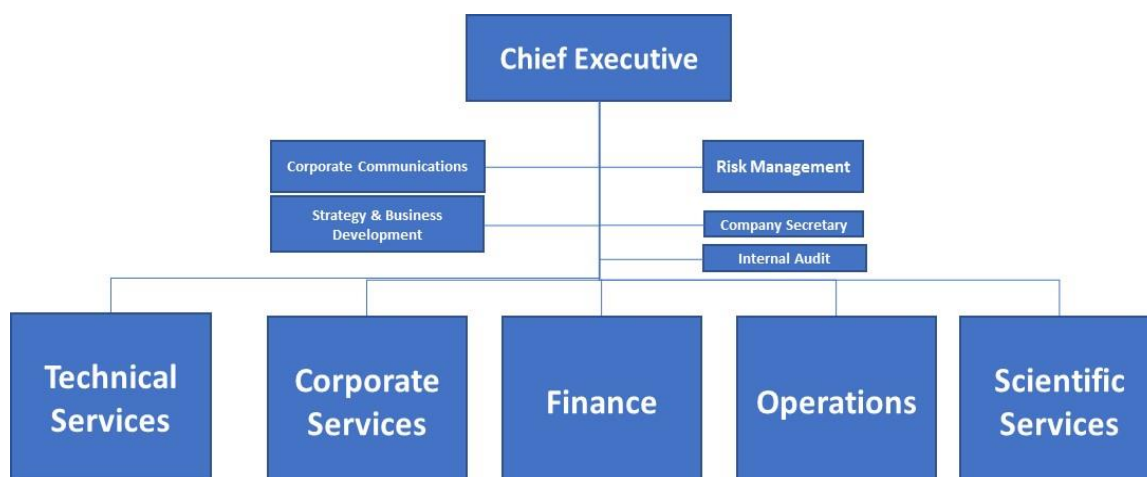


Figure 29: Mhlathuze functional organogram

Organisational Unit	Summary of functions	Comment
CEO Office	Overall oversight in ensuring the implementation of Mhlathuze Water strategic objectives through Strategy and Development, Risk Management, Internal Audit, Company Secretary, and Corporate Communications	Planning and strategic oversight
Corporate Services	Manages Information Technology, Human Resources operations, Training and Development, Employee Relations, Employee Wellness, Fleet Management, Document Management, Legal Services and the individual Employee Performance Management System.	Administrative and organisational systems and support
Finance Unit	Efficient and effective financial resources; financial planning and budgeting; financial structures; asset management; financial services; procurement; and financial risk management	Financial planning, compliance and risk management
Operations Unit	Ensure effective and uninterrupted water supply and waste water disposal systems to meet the needs of customers and minimise the impact on the environment	Operations and maintenance
Scientific Services	Provision of reliable and authentic laboratory, quality and environmental management services, SHEQ Systems and standards applied to water quality; waste water discharge permits; quality assurance; health and safety; environmental compliance	Standards and compliance
Technical Services	Design, optimise, install, and extend the required infrastructure to provide sustainable water and waste water services that meet the requirements of customers.	Infrastructure development, extension

Table 9: Summary of Mhlathuze functional arrangements

The organisational model of Mhlathuze is designed so as to cater for all the strategic and operational requirements associated with planning and implementation of water service activities. For this reason,

no changes are envisioned on the type of functions to be performed in the near future, save for the actual transfer into a single water board. Current water service functions performed by Mhlathuze will continue the same way as if the new entity is still the same.

7.2.3 Employment arrangements

The status of employees of Mhlathuze Water was analysed and the table below illustrates the contractual arrangement applicable. The table below indicates that 243 posts are filled. Of this, 195 employees are employed on a permanent contract bases at posts level A1 to D4, while 26 are employed on fixed contract bases. At the time of writing this report, the nature of contract arrangements for 17 Operations and Maintenance (O&M) employees was not confirmed. The expiry date of these O&M contracts and the contracts highlighted in yellow is not yet confirmed. The TA awaits information in this regard.

Mhlathuze Employees	Number of employees
Fixed Term Contracts - ending November and December 2022	2
Fixed Term Contracts – ending 2023 to 2027	17
O and M contracts	17
Fixed Term Contract - per month - ending by December 2022	2
Fixed Term Contract - per month - ending by 28 February 2022	3
Fixed Term Contract - per month - ending by 25 March 2023	1
Fixed Term Contract - per month - ending by 10 April 2023	1
Retirement November 2022	1
Retirement November 2023 to 2025	4
Permanent - A1 to D3	190
Permanent - D4	5
	243
Trainees	Number of Trainees
Interns	23
Artisan	2
Learners	4
	29

Table 10: Mhlathuze staff employment arrangements

The following can be observed from the table above.

- The Fixed Term Contract employees are impacted by the transfer process and the new employer is obliged to employ these employees on conditions on the whole not less favorable to the employees than those on which they were employed by the old employer. Nonetheless, a significant number of these contracts are about to expire. Include 17 O&M.
- The table above indicates that a number of employees are retiring or have contracts expiring at the end of this current year. This means that Mhlathuze has an opportunity to terminate in line with due process where such termination is necessary. Where contracts are expiring while the services of the employee are still desired, a due renewal process will then be performed as part of the new arrangements within Umgeni. Care needs to be taken that due and legal process are

observed in accordance with the law and the Umgeni Water policies and procedures (5 Mhlathuze employees).

- c. The transfer of the remaining 238 Mhlathuze employees are planned for transfer as of 01 January 2023. The normal transfer process of Mhlathuze functions as a going concern in terms of Section 197 must be observed.
- d. The Internship contracts are for a duration of 12 months (no information was provided on the end date of these contracts). The internship contracts require evaluation of the contractual obligations, and in terms of transferability from Mhlathuze to Umgeni. An evaluation shall be conducted on the contracts together with the feasibility to transfer.
- e. The type and nature of contract that artisans and learners entered was not provided. These 29 trainee's contracts will require evaluation in terms of duration and feasibility for transfer to Umgeni Water.
- f. Employees, employed on a permanent contract bases will be transferred accordingly in terms of Section 197.

7.2.4 Conditions of service

Employees of Mhlathuze Water enjoy several benefits that are clearly defined in terms of existing internal policies and procedures as well as prescribed labour union agreements. The most pertinent policies and procedures impacting on the conditions of service are briefly analysed below, mainly working hours and overtime, shift allowance, standby and responsibility allowance, leave as well as policy and system for job grading and remuneration.

Given the planned transfer of functions, assets and staff to join Umgeni Water, a few observations could be made that relate to HR policies in general. The first is that HR policies currently applicable within Mhlathuze Water will no longer apply. The reason for this is that Mhlathuze Water as an entity will cease to exist once disestablished. The second observation is that conditions of employment that will apply hence forth will be those currently applied by Umgeni Water. Save for the alignment of pertinent policies that are likely to have material impact on the receiving entity (Umgeni Water). Nonetheless, how a number of policies and procedures are implemented is a course for further consideration, especially where such are likely to have an impact on employee's salary and benefits, as per the requirements of s197 of the Labour Relations Act.

7.2.5 Policies impacting on conditions of service

Mhlathuze Water has numerous policies as required of an entity operating in a highly technical and specialised environment. The status of these policies has been confirmed and all are actively implemented by the utility. The purpose of this section is not to review and discuss all of them here, suffice to say that the following are critical to note to the extent that they have material implications for Umgeni Water, the receiving entity.

- **Working hours and overtime** – A review of procedures associated with this policy indicate that employees are fully engaged with work for a total of 20 hours each week. This means that overtime is in excess of 10 hours, which is remunerated at 1.75 times the salary of each employee concerned. However, it is not clear what the operational requirements are that each employee must satisfy, and whether the founding principles of the policy are aligned to operational requirements. Although a detailed review of a similar policy within Umgeni Water has not been conducted due to project time constraints, clearly a revision of working hours and overtime policies would be required to ensure that employment arrangements of the transferred staff are aligned to operational requirements. Key to this is the recognition of agreements reached, in particular, the Amanzi Bargaining Council agreements and other Minimum Service Agreement.

- **Shift allowance, standby duties, and responsibility allowance** – The operational requirements of Mhlathuze are such that continuity of service must be ensured. This, under limited resources, both financial and in terms of human capacity. For this reason, shift and standby allowances are a necessary solution to ensure round the clock service. This policy was assessed in the light of these reasons and the assessment indicates that shift and standby allowance is provided in addition to normal basic salary as necessary. However, the relationship between standby and overtime has not been established at the time of writing this report. In other words, how are these policies implemented, is standby applied independent of overtime, and what controls are in place to ensure there is less abuse of the system? For the purposes of alignment to Umgeni Water policies and systems, these questions will form part of the process to negotiate a transfer agreement between the two entities. The final analysis should consider the possible variances between allowances based on operational requirements, as well as alignment to Amanzi Bargaining Council agreements.
- **Leave** – All employees are entitled to leave in all its forms, including sick leave, study leave, family responsibility leave and general annual leave. The important point to make here is that how leave is administered, i.e., the implementation of procedures and related controls, may result in unintended costs to the employer. With this in mind, reviewing leave to generate a list of leave days owing to employees or by employees to the entity is critical. Any leave variances must be addressed or understood prior to the transfer process taking place. In this regard an agreement between the two utilities acknowledging leave variances that exist and putting a short-term process in place to address outstanding leave issues. In particular reconciliation of accumulated leave that is expected to be converted to cash pay-out.
- **Job grading and remuneration** - Mhlathuze Water utilises Paterson grading system, that evaluates jobs based on predefined criteria. It analyses the level of decision-making in job tasks and categorizes jobs into six groups that are graded and further categorised into two or three sub-grades depending on the levels of decision making required. Despite the existence of a job grading system, at the time of review, some posts still needed to be evaluated and graded accordingly. For the purposes of transfer, a smoothing process will be required should the grading and evaluation system utilised by Umgeni Water vary from the one currently used at Mhlathuze.

The above policies are likely to have an impact on costs of employment to the receiving entity

7.2.6 Employee benefits

Employees at Mhlathuze enjoy benefits ranging from Pension/ Provident Fund, Retirement Fund, Medical Aid, Smart Housing Plan Surety Agreement (FirstRand Bank Limited), Pension Backed Home Loan Suretyship (Alexander Forbes), as well as a long-term incentive scheme aimed at retain key senior personnel. Although further details relating to scale and extent of coverage (employees covered and grade levels), including how these benefits are applied are still being obtained, all the benefits listed here need to be considered as part of the transfer of Mhlathuze as a going concern. The transfer agreement between the two entities need to cater for the key elements that incorporate substantive benefits currently enjoyed by Mhlathuze employees.

The benefits are briefly described below.

- **Pension / Retirement Fund** – Both the provident and retirement funds are provided by Alexander Forbes. It is not immediately clear what the difference is between the two schemes, except to say that the Retirement Fund include a comprehensive offering as well as a provident fund section. Contributions are based on percentages between 65% and 82% of the total package for the determination of the pensionable earnings amount. Employees have flexibility in determining their contribution towards Provident Fund. The Employer contribution is then deducted from the

total monthly package. The general norm is that employees contribute 7.5%, while the employer contributes 17,5 % to the pension fund.

- **Long-term incentive scheme** – This is a long-term incentive (LTI) scheme policy aimed at retaining senior executives of Mhlathuze. The policy concerns itself with incentivising senior personnel to ensure organisational continuity through the retention of that mass of technical and managerial skills within the organisation. The required actions are not so much about the review of the incentive scheme as they are about the alignment of Mhlathuze employment contracts to similar policies within Umgeni Water. This should include the analysis of variances between incentives, including aligning such in line with Umgeni Water operational requirements.
- **Medical Aid Scheme** – Employees have a choice to belong to any medical aid fund. In this instance, Mhlathuze Water only facilitates a deduction to a limited number of Medical Schemes based on employee membership. The employer contribution is included as part of the cost to company package.
- **Housing benefits** – A combination of two housing schemes (loans) were mentioned that are provided two financial service providers. These are Smart Housing Plan Surety Agreement (FirstRand Bank Limited) and Pension Backed Home Loan Suretyship (Alexander Forbes). It is not immediately clear how the two schemes are applied and who is eligible to benefit from them.

7.2.7 Labour agreements

The South African Association of Water Utilities (SAAWU) is an association of water entities that sit at the Amanzi Bargaining Council to negotiate terms of employment and benefits on behalf of both Umgeni and Mhlathuze. At this bargaining council universal agreements are reached between employers (Umgeni and Mhlathuze) and the majority unions (UASA-The Union, SAMWU and NEHAWU). The scope of issues covered as part of the negotiation process includes all the elements (benefits and conditions of service) as briefly described above. Three agreements that have been reached were made available to the TA. Two agreements were reached in the previous financial years 2020/2021 and 2021/2022. The active period of these agreements seems to be 12 months from time of signing.

The salient features of the agreement dated for the financial period 2020/2021 covers the following elements:

- Salary increases of 6.5% on basic salary
- Housing allowance is proposed to reach a total sum of R2800 over a period of 3 years from date of signature. The agreement further differentiates between allowances below R2000 (which will see an increase of R300 per month), and allowances that are above R2000 (expected to see an increase of 220 per month for the same period).
- Annual leave which was expected to move to 25 days over a period of 3 years. Leave adjustment will be made consecutively for a period of three years (2019, 2020 and 2022) to reach the expected 25 days
- Other conditions of employment were deferred to a Task Team for further consideration and decisions.

In addition to an across-the-board salary increase of 5.5%, the 2021/2022 bargaining period saw an agreement reached covering a significant number of areas including the ones previously identified and referred to a Task Team. Key among these is a housing allowance that increased to R3000 a month, while standby and shift allowance saw an increase of 10% each on a basic salary. The standby allowance was capped at 14 days per period worked. Parental leave was agreed at 5 months fully paid for maternity and five days fully paid for paternity leave.

The recent agreement commenced in July 2022 and will end on 30 June 2023. This agreement proposes a salary increase of 6% across the board, as well as an increase in housing allowance to R3300 per month.

7.2.8 Job grading and remuneration

Mhlathuze Water utilizes Paterson grading system. The Paterson Job Grading System follows a method where jobs are evaluated based on predefined criteria. It analyses decision-making in job tasks and categorizes jobs into six groups that are graded and grouped into two to three sub-grades. At the time of writing this report, plans were afoot to grade jobs and update remuneration for specific employees. However, this has since been suspended pending the finalization of the DD process. Jobs will then be graded as part of the process to implement the transfer agreement between the two entities, once the transfer process has concluded.

7.3 Umgeni Water Board

7.3.1 Legal context for transfer of staff with functions

Umgeni Water is also subject to Section 197 as described above. The requirements are that all employees eligible for transfer must continue to enjoy benefits similar to those they are currently entitled to. The migration of staff must however, be subject to an agreement between the two entities.

7.3.2 Functions and organogram

The organogram for Umgeni Water macro-organogram is illustrated below and various functions are further tabulated in the table. What is clear in the organogram is that Infrastructure Development, Operations and Scientific services are part of the COO.

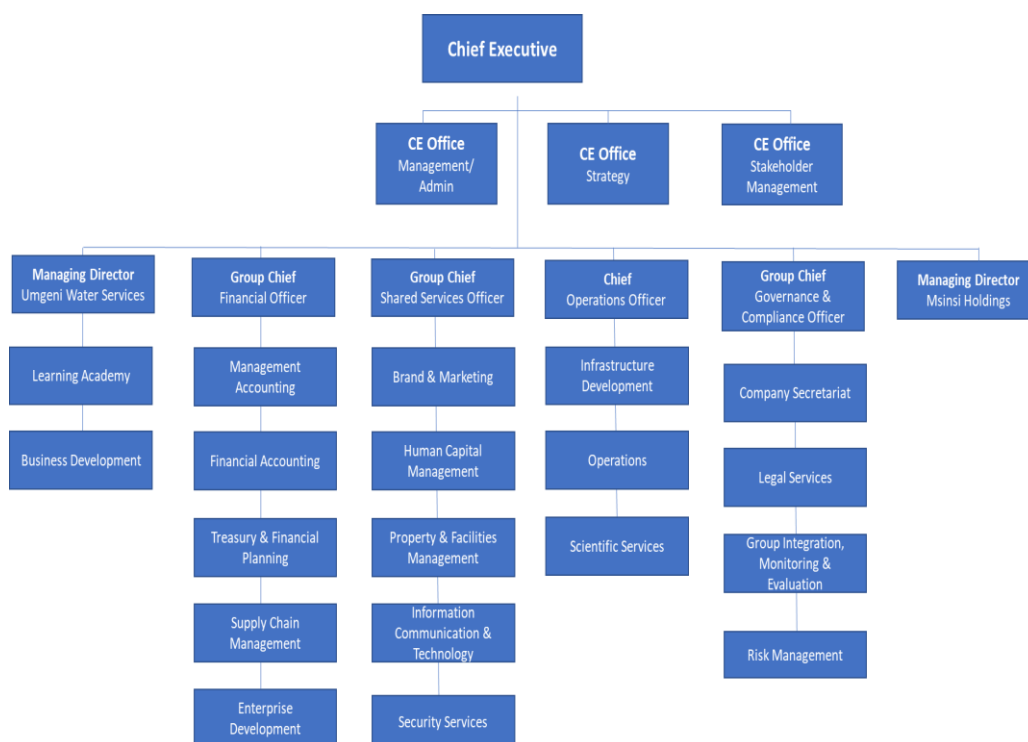


Figure 30: UMgeni functional organogram

The table below provide a high-level summary description of main functions illustrated in the diagram above.

Organisational Unit	Summary of functions	Comment
Office of the Chief Executive	Overall oversight in ensuring the development and implementation of Umgeni Water strategy and stakeholder engagement, Risk	Planning and strategic oversight

Organisational Unit	Summary of functions	Comment
	Management, Internal Audit, Company Secretary, and Corporate Communications	
Shared Services	Branding and Marketing, Human Capital management, Property and facilities management, security services, information communication & technology, Management, Legal Services and the individual Employee Performance Management System.	Administrative and organisational systems and support
Office of the Chief Finance	Efficient and effective management of financial resources; financial planning and budgeting; asset management; procurement, internal financial control systems, monitoring financial performance, financial services; procurement; and financial risk management, enterprise development.	Financial planning, compliance and risk management
Governance and compliance	Support to the board (company secretary), legal services, integration monitoring and evaluation, organisational risk management.	
CO Operations: Operations, Scientific and Infrastructure development services	Ensure effective and uninterrupted water supply and waste water disposal systems to meet the needs of customers and minimise the impact on the environment	Operations and maintenance
	Provision of reliable and authentic laboratory, quality and environmental management services, standards applied to water quality; waste water discharge permits; quality assurance; health and safety; environmental compliance	Standards and compliance
	Design, optimise, install, and extend the required infrastructure to provide sustainable water and waste water services that meet the requirements of customers.	Infrastructure development, expansion

Table 11: Summary of functions

The COO function in the structure above is interesting as it combines all three technical functions (infrastructure development, scientific services, and operations). This represents a slight variation in the arrangements of functions, one which is likely to demand further scrutiny at the time when the functions are integrated into the Umgeni. Another variation is the Governance and Compliance unit that performs company secretary functions as well as legal services and organisational risk management.

7.3.3 Employment arrangements

While a list indicating the type of employment arrangements currently used to manage the relationship between employer and employees was not made available, the macro structure indicates three managerial positions where staff are employed on an acting basis:

- Chief Executive Officer,
- Shared Services, as well as Brand & Marketing, and Human Capital Management
- Management Accounting

Further assessment of the employment arrangements applicable within Umgeni is planned for the next phase of this project.

7.4 Conditions of service

Employees of Umgeni Water enjoy benefits that are clearly defined in terms of existing internal policies and procedures as well as active labour union agreements. Given the fact that both Umgeni and Mhlathuze are part of the same collective agreements, it is not necessary to repeat the various policies that are likely to impact on conditions of service here. Suffice to mention that the most pertinent policies and procedures impacting on the conditions of service are mainly working hours and overtime, shift allowance, standby and responsibility allowance, pension and retirement, leave as well as policy and system for job grading and remuneration among others.

7.4.1 Employment benefits

Employer contributions vary slightly between Mhlathuze Water and Umgeni Water. Employer pension fund contribution at Umgeni constitutes 16.32%, while employee contribute 8% of their basic salary. Umgeni Water medical aid membership is compulsory, and the employer contributes 100% on the Primary Plan and 75% on alternate plans. Pertinent issues on medical schemes are summarised below.

- Umgeni Water has two Medical Aid Schemes i.e., Bonitas and Discovery Health.
- Membership of Medical Aid is compulsory.
- Except in the case of a married person already covered by their spouse's medical aid.
- Umgeni Water contributes 100% on Primary Plan.
- Employer contributes an average of 75% and the employee contributes 25% on other options.

With regard to Provident /Pension fund, the following can be observed:

- Employer contributes 16.32 % towards the Fund and the employee contributes 8% of basic salary per month.
- Group Life - Employees have the option of choosing 2x or 4x annual salary to be paid in the event of death.
- Spouses Benefit - 2 x annual salary in the event of spouse's death up to a maximum of R450 000.00.
- Dreaded Disease Benefit – 2x (to a maximum of R550 000.00) of annual salary.
- Employees are covered for Accidental Bodily Injury, Death, Permanent and Temporary Disability.

Additional benefits applicable at Umgeni Water include: Disability Benefit, at 100% of basic salary for two years and thereafter the benefit will reduce to 75% without allowances. Funeral Benefit for fixed term employees is provided for a premium of R27.98 per month, as well as optional benefits.

7.4.2 Labour agreements

Mhlathuze Water, as well as Umgeni Water are members of the South African Association of Water Utilities (SAAWU). Agreements reached at this council apply to all entities as employers as well as the majority unions (UASA-The Union, SAMWU and NEHAWU).

The summary contents of agreements presented under the analysis of Mhlathuze applies to Umgeni Water as well. Although preliminary assessment indicates that Umgeni seen some has progress in terms of implementation of the collective agreements. It is expected that an agreement to transfer staff will build on the collective agreements reached at the Amanzi Bargaining Council. For this reason, this process should be smooth, since both entities are signatories of such agreements.

7.4.3 Job grading and remuneration

Umgeni Water utilises the Peromnes grading system, the Peromnes system identifies and measures levels of job complexity from a number of perspectives and is specifically designed to give equal weight to all types and all levels of positions.

7.5 Summary of Findings

7.5.1 Employment arrangement

Given the planned transfer of functions, assets and staff to Umgeni Water, a few observations could be made that relate to HR policies in general. The first is that HR policies currently applicable within Mhlathuze Water will no longer apply. The reason for this is that Mhlathuze Water as an entity will cease to exist once disestablished. The second observation is that conditions of employment that will apply hence forth will be those currently applied by Umgeni Water. Nonetheless, how policies and procedures are implemented is a course for further consideration, especially where such are likely to have an impact on employee's salary and benefits, as per the requirements of s197 of the Labour Relations Act.

The various human resources and labour elements considered in this assignment are summarised in the table below. Where possible comments are made indicating how variances that have been observed could be resolved.

Key elements	UMgeni Water	Mhlathuze Water	Comment
Organogram and functions	Primary and secondary functions aligned to requirements in terms of Water Services Act; Significant revenue base to expand services	Primary and secondary functions aligned to requirements in terms of Water Services Act; Reach of services limited – infrastructure require expansion	Residential for Mhlathuze base largely rural and require access to water and sanitation, Umgeni is largely urban with a small rural portion. Functions and capacity could easily integrate. Mhlathuze strong on waste water collection and disposal.
Senior Posts	Acting CE, Shares Services, Brand and Marketing Management, Human Capital Management and Management Accounting	Acting CE and CFO	Reconfiguration provides an opportunity to resolve vacant posts, Proposed regional perspective provides opportunity to refocus Mhlathuze (senior posts) including CE and CFO posts
Employment arrangements	Further analysis of Umgeni employment arrangements required.	Combination of permanent and fixed term contracts, Fixed term contracts mainly at senior level	Mhlathuze - Some fixed term contracts to expire. Capacity requirements within Umgeni needs assessment to facilitate absorption of staff from Mhlathuze. Employment arrangements could recognise Mhlathuze as a region of Umgeni Water with a Regional Mgr and CFO.
Employment benefits	Superior benefits, including disability,	Benefits will improve as a	Common benefits include: Pension & Retirement Fund, Housing

Key elements	UMgeni Water	Mhlathuze Water	Comment
	spouse / family benefit and a 100% compulsory medical aid scheme.	result of reconfiguration.	Allowance, Medical Aid Scheme. Significant variances exist with Umgeni showing better benefits – these will be explored as part of the planning process for the migration.
Conditions of service	Common conditions of service	Common conditions of service	Seemingly, there are variances with regard to working hours, overtime, shift allowance, and standby policies that will require smoothing.
Labour Union Agreements – SAAWU Bargaining Council	Subject to water sector collective agreements.	Subject to water sector collective agreements.	Not clear if Umgeni and Mhlathuze have equally implemented agreements reached so far. Benefits and conditions of service applicable seem to vary – perhaps due to size and scope of activities.

Sub-section 7.5.2 below expands on some of the salient features observed during the due diligence assessment.

7.5.2 Policies impacting on conditions of service

Policies that have been analysed are all grounded on the collective agreements that have been reached between SAAWU and labour unions. This means that the alignment of the contracts of employment of employees that are transferred to Umgeni Water is expected to be smooth. However, care needs to be taken to ensure that section 197 of the Labour Relations Act is applied. Key conditions of service that should form part of the negotiation to agree on the terms of transfer between the two entities include among others:

- Leave and leave administration
- Shift, standby and overtime work
- Nightshift policy
- Incentive scheme policies
- Housing allowance
- Medical aide and Pension/ Retirement fund

7.5.3 Employment benefits

The preliminary assessment of both Umgeni and Mhlathuze water indicate that employees eligible for transfer are going to enjoy additional benefits that they did not have access to previously. The impact of the transfer on employees is expected to be negligible. Except for areas where Mhlathuze may not have implemented parts of the collective agreements mentioned in 7.5.2 above.

7.5.3.1 Job grading and remuneration systems

Most likely, posts that are transferred to Umgeni will have to undergo a job analysis and grading process to ensure that placements are aligned to the existing systems within Umgeni. A conversion table exists that will be applied to all posts to ensure parity across Umgeni, including aligning Mhlathuze posts to the existing systems in Umgeni.

OCCUPATIONAL LEVELS	Paterson Classic (levels)	Paterson Modern (bands)	Hay Units (points)	Peromnes (points)	Task (levels)
Top Management/ Executives	F+1 – F+5	G Band	3581-7160	1++	
	F1 – F5	F Lower-F Upper	1801-3580	1 to 1+	23-26
Senior Management	E1-E5	E Lower-E Upper	735-1800	4-2	18-22
Professionally Qualified & experienced specialists/mid-management	D1-D5	D Lower-D Upper	371-734	7-4	14-18
Skilled Technical & Academically Qualified/ Junior Management/ Supervisors/Supervisors/Superintendents	C1-C5	C Lower-C Upper	192-370	11-7	9-13
Semi-Skilled & discretionary decision-making	B1-B5	B Lower-B Upper	85-191	15-11	4-8
Unskilled & defined decision-making	A1-A3	A	54-84	19-16	1-3

Umgeni Water remuneration structure encompasses grade 2 and 3 on a total cost to company salary scale and the grade 4 to 16 on a remuneration system of base pay plus benefits and allowances. Base pay is generically defined as the amount of income an employee receives before benefits, bonuses, taxes, deductions, and other modifications. Umgeni Water remuneration practices are structured for grade 7 to 16 in terms of base pay.

Mhlathuze grade salary scales are up to a grade E2 (grade 3), whereas Umgeni Water scales extend to Grade 2 (E4/ E5). Mhlathuze salary scales are based on total cost to company wherein the medical aid employer's contribution is included in the cost to company and Provident Fund contributions are calculated based on percentages from 65%; 70%; 75%; and 82% of the total cost to company. The employee selects the percentage for pensionable earnings. Employer contribution to pension/ provident fund is deducted from total cost to company to quantify the cash salary and the cash salary is utilized for calculation of other allowances such as overtime.

A comparative table is presented below that indicates salary structures of the two entities.

Umgeni TCTC and Mhlathuze TCTC												
Umgeni Grade	Mhlathuze Grade	Minimum Mhlathuze	80 % Umgeni	Lower Guide Mhlathuze	90 % Umgeni	Reference Salary Mhlathuze	Midpoint Umgeni	Upper Guide Mhlathuze	110 % Umgeni	Maximum Mhlathuze	120 % Umgeni	Max Umgeni
2	E5		2889892		3251128		3612364		3973601		4334837	4768321
	E4											
3	E3		2167419		2438346		2709273		2980201		3251128	3576241
	E2	1735822		1952799		2169777		2386755		2603733		
3(a)			1908419		2146971		2385523		2624076		2862628	3148891
Base Pay Umgeni / Mhlathuze TCTC												
Grade	Mhlathuze Grade	Mhlathuze min	80% Umgeni	Mhlathuze Lower	90% Umgeni	Mhlathuze Reference Salary	Midpoint Umgeni	Mhlathuze Upper	110% Umgeni	Mhlathuze Max	120% Umgeni	Max Umgeni
4	E1	1512070		1701079		1890088		2079097		2268106		
4	D5	1210749	933909	1362093	1050648	1513436	1167386	1664780	1284125	1816123	1400864	1540950
5	D4	1074355		1208649		1342943		1477238		1611532		
5	D3	1092132	770161	1228649	866431	1501682	962701	1501682	1058971	1638197	1155241	1270765
6	D2	933318	587249	1049984	660655	1283312	734062	1283312	807468	1399978	880874	968961
7	D1	761432		856611		1046968		1046968		1142147		
7	C5	629343	436147	708010	490665	865346	545184	865346	599702	944015	654221	719643
8	C4	530549	385323	596869	433489	729505	481654	719505	529819	795823	577985	635783
9	C3	431754	320272	485724	360306	593663	400340	593663	440374	647632	480408	528449
10	C2	362820	281299	408172	316462	498878	351624	498878	386787	544230	421949	464144
11	C1	308868	231410	347477	260336	424694	289263	424694	318189	463302	347115	381827
12	B5	257525		289175		321907		354097		386287		
12	B4	226543	178298	254860	200585	283178	222872	311496	245159	339814	267447	294191
13	B3	191864	137974	215848	155220	239831	172467	263814	189714	287797	206961	227657
14	B2	170689	123027	192025	138406	213360	153784	234697	169163	256033	184540,965	202995

The table above compares a few of the available job grading systems, as well indicate the number of points that each would produce based on the assessment done on each job specification. Although the two entities are using two different job grading systems, the resulting job grade would easily be converted to the system applicable within Umgeni.

- Grades vary and there is not a direct correlation across Paterson and Peromnes;
- Mhlathuze grade salary scales are up to a grade E2 (Grade 3), whereas Umgeni Water scales extend to Grade 2 (E4/ E5); and
- Umgeni Water salary scales at a Grade 2 and 3 are based on a total cost to company and from 5 to 16 are based on base pay plus benefits. Mhlathuze salary scales are based on total cost to company wherein the medical aid employer's contribution is included in the cost to company. Employer contribution to pension/ provident fund is deducted from total cost to company to quantify the cash salary and the cash salary is utilised for calculation of allowances, overtime.

The two entities (Umgeni Water and Mhlathuze) conduct salary reviews in July of each year.

8 Legal and Regulatory

8.1 Introduction

The Legal Stream is a cross cutting function in the reconfiguration process, providing advice and having an opinion on findings and implications in all work streams. It addresses the legal implications emanating from the activities of the various streams. The role of the legal function in the reconfiguration process is three-fold, viz. litigations and their implications in the reconfiguration process, the existing contracts and their conditions, in particular, the extent to which the receiving entity will be materially affected, lastly the associated reconfiguration processes that require legal support, e.g., the Asset Inventory and Asset Transfer Process.

The legal review and implications can be established at three levels, viz, the legalities around the decision to reconfigure the two Water Boards, i.e., the Ministers powers, actions and process. The second level relates to the legalities around the Ministers due regard for interests of consumers and creditors. Lastly, it is the legalities around agreements at the institutions' operational level across the identified pillars (see approach to the DD assignment).

Using the approach to this due diligence process, the subsection that follows explores some of the key components that, once addressed, are likely to ensure legal compliance of this process. It must be noted here that most of the actions required in terms of the law have been taken thus far. Save for some areas which could not be dealt with owing to time constraints. However, the action plan contained in the executive summary to this report identifies focus areas that still require urgent attention in the next two to three months prior to the actual amalgamation of the two water boards.

8.2 Areas that require legal compliance

With respect to the compliance requirements, the legal context means that the following principles are adhered to during and after the reconfiguration process.

- **Stakeholder Engagement:** All identified and categorised stakeholders shall be engaged at the appropriate level in line with the functional impact they have on the water management function. In this instance, the Minister is not only required to consult at the provincial, and water service authority levels, rather that due regard must also be given to consumers and creditors alike who are affected by the proposed reconfiguration and disestablishment of a water board.
- **Immovable Assets:** With the authority from the Minister of Finance, an asset inventory shall be developed for all immovable assets of the institution that is earmarked for disestablishment. Compliance with the relevant legal requirements in this instance mean that the directive of the Minister of Water and Sanitation to transfer assets must align to and lend itself to approval by the Minister of Finance in terms of the PFMA. Even so, the legalities pertaining to assets go as far as due compliance with the Land Reform Act to facilitate registration of such assets with the Deeds Office. The action plan specifically identifies steps to followed to ensure compliance with the aforesaid legal requirements.
 - All immovable assets for transfer shall be subject to re-evaluation before being added into the balance sheet of the re-configured institution.
 - All immovable assets shall be subject to registration with the Deeds Office for transfer into the re-configured institution. Legal requirements here demand that the Land Reform Act and the related regulations are followed.
 - All immovable assets shall be transferred “voetstoots” into the re-configured institution.
- **HR and Labour:** All transfers must be subject to Section 197 of the labour relations Act. The existing collective agreements should form the bases of any future agreement relating to the transfer of staff to the new entity. The chapter on human resources and labour contained in this due diligence report sets out some of the key elements that relate working conditions, including employment benefits as

described in the most recent collective agreements and operationalised in specific policies defined by the two entities. Negotiation and agreement with the labour unions along with contractual arrangements with relevant staff to be transferred are pending issues as we write this report. Nevertheless, labour union issues together with the relevant agreements are paramount to the success of this assignment.

- **Existing Contracts:** All existing contracts including water supply contracts are to be subject to assessment/engagement with parties for transferability into the re-configured institution. The need for legal compliance arises due to the expected financial implications along with possible liabilities to Umhlathuze and the receiving entity. In this regard, questions abound around transferability of water service contracts, and if transferable, what are the legalities that must be complied with? The summary table on litigations, agreements and contracts below starts to answer some of these questions.
- **Financial Arrangements:** All creditors and debtors shall be informed of pending institutional re-configuration for their input and decision making moving forward. The requirement to engage stakeholders on the matter together with the requirement to develop amicable arrangements to address contractual issues, are integrally linked to this financial arrangement's requirement.
- **Technical and Infrastructure:** The transfer of the vast infrastructural assets presents financial implications to the receiving entity. The type of assets, age, size and capacity, including general functionality must be understood prior to the actual transfer. Valuations need to be done and confirmed along with the necessary registration of assets before end of June 2023 to enable updating of Umgeni books at the end of the financial year.
- **Governance and Institutional Arrangements:** Compliance issues arise as a result of the expected expiry of the term of office of the two management boards. The newly reconfigured institution will need a board to continue performing governance functions.

The sections below, provide some of the existing litigation and contracts in both institutions, then the implications for the reconfiguration process.

8.3 Summary of legal implications

8.3.1 Ministerial prerogative to disestablish

As indicated above, the first level of legal compliance with regard to the disestablishment process is the requirement to comply with Section 28 of the WSA. Section 28 of the Water Services Act 108 of 1997 ("The Water Services Act") regulates the process to be followed and/or requirements to be met when establishing and disestablishing Water Boards. Section 28 (1) gives the Minister of Water and Sanitation powers to establish and disestablish Water Boards.

Section 28 (2) states that the Minister may only establish and disestablish water boards after consultation with every Province concerned, the water board concerned, if in existence and every water services authority having jurisdiction in the service area or proposed service area. The Minister, on 23 August 2022 consulted the Water Services Authorities together with the Province thereby fulfilling two of the three consultations required by this section. In relation to the consultation with the Water Boards, the Honourable Minister, has engaged the Umgeni Water board to solicit their support and for the board to approve the appointment of the Transaction Advisor to conduct the due diligence process. However, it is not clear if the Honourable Minister has consulted the board on Mhlathuze in a formal manner. However, if the said consultation has not been attended to, the Minister should avail himself for same and the requisite arrangements should be prioritised.

In addition to the above, the Minister issued a notice in the Government Gazette on 3 November 2022 in relation to the envisaged reconfiguration in terms of which stakeholders were given 60 days to comment.

Section 28 (3) states that the Minister must, when disestablishing a Water Board, have regard to the interests of consumers and creditors. A Transaction Advisory Team was appointed and is currently finalising a due diligence process which is aimed at, inter alia, considering implications the reconfiguration will have on the existing arrangements and/or relationships with the creditors and consumers.

Important to note here with regard to the above consultative processes are the following:

- It is common knowledge that the Department of Water and Sanitation (through its senior officials) has been busy with numerous consultations across the areas of jurisdiction under the two water boards. The transaction advisor is however, not privy to the outcomes of some of the processes.
- The process to consult and engage stakeholders has only begun. More still needs to be done, in particular with regard to consulting with large industrial consumers on the Mhlathuze side. From a strategic perspective, these are potential funders of projects to expand water services to improve access to rural areas,

8.3.2 Valuation and registration of assets

The initial assessment of all assets of Mhlathuze has been conducted. However, the valuation process still remains that is currently included as part of the action plan (see Executive summary to the due diligence report). The balance sheet of the receiving entity will need to be updated accordingly. For that happen, proper valuation of assets needs to take place, along with the necessary registration of assets (as assets of the new entity) with the relevant authorities. These aspects have legal implications in terms of the PFMA and the Land Reform Act as well as internal systems and controls of the receiving entity. All actions and processes to conclude this element of the transfer process must be completed prior to actual transfer taking place.

8.3.3 Human Resources and Labour

To the extent that labour unions have formed part of a number of meetings during the status quo assessment phase leading to the due diligence report, labour unions have been consulted. If anything, just to make them aware that the process of reconfiguring the two entities is in motion. Having said that however, more needs to be done to openly engage labour in the water services sector. In particular to start discussions on specific labour issues, the collective agreements and the extent to which these have seen progress (or if there are outstanding issues that require attention prior to the actual transfer), arrangements and agreements on the process to transfer staff to the new entity. The staff migration process needs to be informed by labour, in particular with regard to substantive issues in terms of Section 197 of the Labour Relation Act. The action plan identifies key steps to be taken in this regard.

8.3.4 Existing contracts and agreements

The table below (8.3.5) provides a summary of assessments that have been performed so far with regard to understanding the legal implications of the various contracts that inform Mhlathuze' relationship with its critical clients.

8.3.5 Litigations, agreements and contracts

Customer agreements.

No.	Clients Name & Type of Service	Comment
1.	uMgungundlovu District Municipality for Howick Waste Water Treatment to operate and maintain the facilities.	The validity and enforceability of the contract will not be affected by the reconfiguration process.

No.	Clients Name & Type of Service	Comment
	<p>Effective as of the 1st of July 2009 for a period of 5 years until 30 June 2015.</p> <p>Another Bulk water Supply Agreement was concluded, effective as of the 1st of June 2014 for a period of 20 years until the 30th of June 2034.</p> <p>1st Addendum for the transfer of UW's employees as a going concern to the Municipality, should the municipality decide to take over the operations and management of the plant before the contract expires, was effective as of the 20th of February 2015, to remain valid for the duration of the main agreement.</p> <p>2nd Addendum, concluded on the 8th of July 2015, to remain valid for the duration of the main agreement whereby;</p> <ul style="list-style-type: none"> - Section 5.4.2 of the main agreement was deleted <i>"augmentation or up-grading or increasing the design capacity of the Bulk Waste Water Works"</i> - Section 10 of the main agreement was amended to add 3 subsections: <ul style="list-style-type: none"> - <i>"10/1 UW shall provide an expenditure programme ..."</i> - <i>"10.2 UW shall bear the costs...."</i> - <i>"10.3 In the event that the contract is terminated before UW has not fully recovered the capital investment made.....The Municipality shall pay UMgeni Water....."</i> 	<p>The agreement will therefore, post reconfiguration remain valid and enforceable.</p> <p>Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.</p>
2.	<p>uMgungundlovu District Municipality for Umkhambathini Waste Water</p> <p>Effective as of the 1st of July 2014 for a duration of 20 years until 30 June 2034</p> <p>Cessionary Agreement between Umgungundlovu Municipality (Cedent) and Umngeni Water (Cessionary) wherein cedent cedes cessionary rights, title and interest in and to payments or monies due by the cedent to Preben Naidoo & Associates Effective as of 17th of February 2010 until the project is concluded. (The Agreement was concluded on the 24th of August 2014.)</p>	<p>The validity and enforceability of the contract will not be affected by the reconfiguration process.</p> <p>The agreement will therefore, post reconfiguration remain valid and enforceable.</p> <p>Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.</p>
3.	<p>uMgungundlovu District Municipality for Mpophomeni Waste Water for the construction, upgrade, operating and maintenance for Mpophomeni</p> <p>Effective as of the 1st of July 2014 for a period of 20 years until the 30th of June 2034</p> <p>Addendum to amend main agreement and further instruct Umngeni Water to construct the sewer trunk main supply sewage to the Treatment Plant and the monthly management fee will be calculated in accordance with paragraph 9 of the main agreement.</p>	<p>The validity and enforceability of the contract will not be affected by any material change in the ownership structure of Mhlathuze Water</p> <p>The agreement will therefore, post reconfiguration remain valid and enforceable.</p> <p>Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.</p>
4.	<p>uMgungundlovu District Municipality for N3 Hilton Corridor Waste Water Treatment</p> <p>Effective on the 1st of July 2017 for a duration of 20 years expiring on 30 June 2037</p>	<p>The validity and enforceability of the contract will not be affected by any material change in the ownership structure of Mhlathuze Water</p> <p>The agreement will therefore, post reconfiguration remain valid and enforceable.</p>

No.	Clients Name & Type of Service	Comment
		Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.
5.	uMgungundlovu District Municipality for Bulk Water Supply Effective as of the 10th of April 2006 for a duration of 20 years until the 9th of April 2036	The validity and enforceability of the contract will not be affected by any material change in the ownership structure of Mhlathuze Water The agreement will therefore, post reconfiguration remain valid and enforceable. Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.
6.	Uthukela District Municipality for Bulk Water Supply Effective as of the 27th of November 2017 for a duration of 20 years until the 26th of November 2037	The validity and enforceability of the contract will not be affected by any material change in the ownership structure of Mhlathuze Water The agreement will therefore, post reconfiguration remain valid and enforceable. Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.
7.	King Cetshwayo District Municipality for Bulk Water Supply Effective as of the 29 th of June 2020 for a duration of 20 years until the 28 th June 2035	The validity and enforceability of the contract will not be affected by any material change in the ownership structure of Mhlathuze Water The agreement will therefore, post reconfiguration remain valid and enforceable. Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.
8.	Dolphin Coast for Bulk Water Supply Effective as of the 5th of July 2000 for a duration of 30 years until the 4th of July 2030	The validity and enforceability of the contract will not be affected by any material change in the ownership structure of Mhlathuze Water The agreement will therefore, post reconfiguration remain valid and enforceable. Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.
9.	Msunduzi Local Municipality for Bulk Water Supply	The validity and enforceability of the contract will not be affected by any

No.	Clients Name & Type of Service	Comment
	Effective as of the 13th of December 2012 for an initial period of 10 calendar years extendable at the end of the initial period as agreed by the parties in writing	material change in the ownership structure of Mhlathuze Water The agreement will therefore, post reconfiguration remain valid and enforceable. Umgeni Water may terminate the agreement on condition that all termination steps are aligned with the provisions of the main agreement or contract.

LICENSING AGREEMENTS	
<p>Software License concluded with Altron TMT (Pty) Ltd</p> <p>Non-exclusive, Non-transferable License to use and operate the Software and the Documentation for the License Term and at the Site Initial commencement date 01/07/18-30/06/19</p> <p>Perpetual License With automatic renewal for successive one-year periods</p>	<p>Termination of the agreement does not automatically terminate any schedule still in effect</p> <p>A written proposal needs to be sent to Bytes in the event of change management</p>
<p>Annexure A to the Software Maintenance Agreement Concluded on 01/07/2022</p> <p>Supply of Labware's Laboratory Information Management System Software- Support during normal office hours from 08h00 to 17h00 on regular business days Contract No. MHL2013/001</p>	<p>Main Software agreement and proof of payment of annual fees not available</p>
SERVITUDE AGREEMENTS	
<p>RBM requires servitudes as well as general right of access over the Landowner's Property, which</p>	<p>Agreements are not dated</p>
<p>Richard Bay Titanium (Pty) Ltd servitudes are to be used for the purposes of a mine</p>	<p>Traversing Right Agreement Signed by RBM and RBT on 10/06/15</p> <p>Compensation Agreement (Rental for Temporary construction areas is R602,00 per square meter per month)</p>

LICENSING AGREEMENTS	
	<p>Amendment to Servitude Agreement (For the pumphouse servitude R37500)</p> <p>Signed on</p> <p>07/12/16</p>

9. Conclusion and Way Forward

The key objective of the assignment is to do a Due Diligence in order to fairly consider in detail, the implications of reconfiguration of the two Water boards of Umgeni and Mhlathuze using the business value chain as inputs to test viability, impact, implications, position and options moving forward.

The discussions in the chapters above are a reflection of current status of the institutions, the impact, implications and recommendations moving forward. These are however, subject to further refinement through detailed stakeholder engagement as per provisions of the water services act. This report should serve as the basis for engagement and decision making including confirmation of a critical path implementation plan.

While the above is indicated, there are certain elements that should be considered as essential moving forward to the next activities of this process:

- Time allocated to finalise the process - The unpacking of the of some of the issues in this report dictate that there be allocation of sufficient time to fully engage, consider, discuss and conclude the critical inputs of this process. The initial review process was void of this consideration.
- Information gathering and sharing – The success of this process equally depends on the ease of availability and sharing of information.

