Guidance Note 3: Institutional Arrangements for Reforming Metro Trading Services

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TITLE:	GUIDANCE NOTE 3: INSTITUTIONAL ARRANGEMENTS FOR REFORMING METRO TRADING SERVICES
Purpose	To provide further guidance to metropolitan municipalities on institutional arrangements for turning around metro trading services.
Scope	The scope of the reform covers the water & sanitation, electricity & energy, and solid waste management services of metropolitan municipalities.
Phasing	Although the USDG framework in DORA 2024 only places the current focus on Water and Sanitation, as indicated in Annexure W1, reform is being extended to Electricity & Energy in 2025/26, and, in due course, Solid Waste management.
Target audience	Metro leadership and officials that are responsible for the management of trading services and shared services that support the delivery of the trading services (engineering, financial, and shared services such as billing & revenue, customer relations, human resources, etc.).
Must be read together with	• Division of Revenue Bill, 2024 (as published in GG No. 50099 on 8th February 2024); • Explanatory Memorandum, Annexure W1, p108 (Urban Settlements Development Grant), p121 (improving efficiency of urban utility services); • USDG framework, p231 (infrastructure financing reforms); • Schedule 4, Part B, p44 (USDG allocations); • Guidance Note #1: Metro preparations for the introduction of trading services infrastructure financing reforms (issued 1 April 2024); • Resource document A: Developing and implementing municipal water business turnaround strategies (issued 1 April 2024); • Updated mSCOA Specimen for parent, consolidated and Water & Sanitation AFS (issued 5 July 2024); and • Guidance Note #2: Process, Assessment Criteria and Timeframes (issued 7 August 2024).

1. Introduction

1.1 Trading services include the provision of electricity, water and sanitation, as well as solid waste management. The National Treasury has recognized the deteriorating state of infrastructure platforms that is driving the decline in the performance of trading services. This is evident in increased operational inefficiencies, declining service quality and reliability, declining cash revenues; and progressively lesser investments into the sector.

1.2 This decline is negatively affecting economic growth, and, in the case of cities, their financial sustainability which relies on cash revenues from well-performing trading services. To this end, the National Treasury has initiated reforms to reform trading services in metropolitan municipalities (category A municipalities) through performance-based financial incentives to reward good decisions and performance. These reforms seek to address not only operational inefficiencies but also structural impediments to the performance of trading services.

1.3 Conditions that will enable successful reform have been set out and communicated through the Division of Revenue Act, 2024, the release of Guidance Notes to support implementation of reform, and engagements with metros including through the City Budget Forum (CBF).

1.4 At its core, the reform acknowledges the need for institutional change to achieve better value from the considerable expenditure through grants and own sources of both capex and opex

on trading services. The conditions require institutional reforms that will enable and support the reform, aligned with the existing legislative and regulatory framework.

1.5 Guidance Note 3 (this document) outlines the enabling institutional arrangements for these conditions to be achieved. The intention is to provide metros with clarity on the required institutional arrangements, to avoid misinterpretation, and manage the necessary internal institutional reforms.

1.6 It was made clear in Guidance Note 2 (Section 4) that from a metro perspective the programme consists of compulsory and non-compulsory but incentivised parts:

- Trading services financial transparency requirements are compulsory: all metro municipalities will be required to provide separate comprehensive financial statements for their trading service, within their overall municipal statements. The requirements for this, including specimen financial statements, are being communicated separately;
- Access to the finance incentive is not compulsory, but is incentivised, based on metro performance against institutional and operational targets set in Council-approved **Trading Sector Reform Strategies (TSRS)** and its annexures (A, A1, A2, A3) that meet the required criteria; and
- The introduction over the medium term of the performance-based incentive USDG component for trading services is not intended or planned to disrupt baseline USDG allocations already committed to existing projects. It is specifically intended to reward metros who embark upon trading services reform as indicated here.

2. Background

2.1 National Treasury's Cities Support Programme has engaged the eight metropolitan municipalities to provide support to turn around or improve the performance of their trading services, creating viable entities that meet service delivery needs, raise capital funding from the market and generate financial surpluses to reinvest back in the service. International experience and interaction with metropolitan municipalities highlights five factors that are essential to achieve and sustain business reform. These are:

i. A single point of management accountability;
ii. A turnaround in cash revenue;
iii. A financial surplus;
iv. A clearly defined relationship between the service and the city; and
v. A fit-for-purpose organisational structure.

2.2 Metro municipalities seeking to access the performance-based incentive grant will need to provide a road map of institutional reforms setting out how these points will be achieved. This Guidance Note provides clarity on items i, iv and v:

- The creation of (v) a fit-for-purpose business unit underpinned by (i) a single point of management accountability for each service (see Section 3 below); and
- A (iv) clearly-defined financial relationship between the business unit and the metro, including financial transparency for the cost of running the business, and full autonomy on financial and management decisions.

2.3 The reform may require a business overhaul. It is acknowledged that achieving these conditions, including the transition toward implementation, require a clear pathway for the institutional changes to be mapped out and implemented. The purpose of this Guidance Note is to assist metropolitan municipalities in this transition.

3. Organisational Design: Single Point of Management Accountability

3.1 Reform strategies for trading services not only require the planning, budgeting and management of technical aspects, they also require the integration of the associated business aspects so that the technical, commercial and support functions are managed as a single

package. It is essential that trading services operate as businesses, given their nature and the role they play in income generation.

3.2 Treating a trading services as a business requires that a fit-for-purpose integrated institutional structure is in place to manage the business. It is this fit-for-purpose structure that must be arranged and managed through a single point of management accountability. This is necessary to ensure that all functions required to deliver the service (including the required support services) are effectively integrated and accounted for by a single individual who can be held accountable for the performance of the trading service.

3.3 The single point of management accountability (SPoMA) will be the head of the business, whether called Executive Director (ED), Head of Department (HOD) or Managing Director (MD) in the case of an entity.

3.4 To strengthen institutional accountability, the SPoMA must report directly to the Accounting Officer.

3.5 The SPoMA requires the management of the key features reflected in Figure 1 to be managed as a single integrated system, with the head of the business accountable for all aspects of the business. The areas to be directly managed by the single point of accountability are contained in the five grey boxes (Asset Creation; Asset maintenance and operations; Customer trust and satisation; Sound finances; Motivated people, systems and tools). The SPoMA needs to participate with the rest of the metro leadership in providing leadership, sound governance and supportive enabling environment without being directly and solely responsible (the blue boxes)) to optimise outcomes.

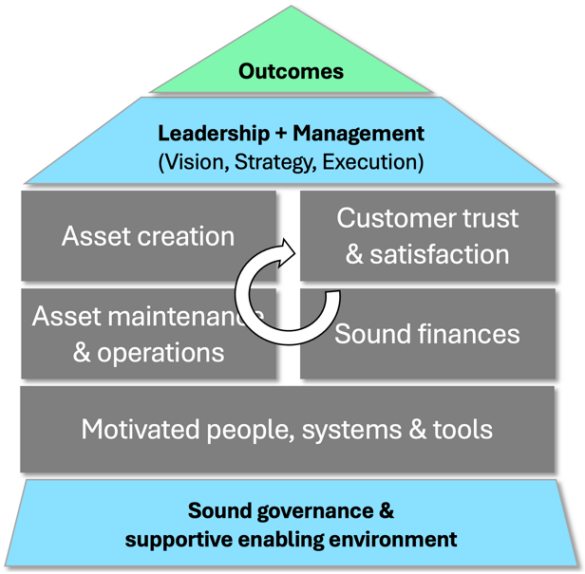

Figure 1: Seven-box framework for successful trading services.

3.6 The common practice in South African municipalities is that the lefthand-side of Figure 1 is managed separately from the righthand-side and the base of the grey boxes. In some cases, the righthand-side boxes are linked to the left through dotted-line reporting between corporate and the trading service.

3.7 MFMA delegations and sub-delegations by the City Manager and CFO can be used to achieve the implementation of the single point of management accountability.

Areas of consideration in establishing the SPoMA

3.8 Metro municipalities seeking to access the performance-based incentive grant should outline an institutional reform pathway to the creation of a single point of management accountability. The first step is for the organization to acknowledge that the service is not functioning at an optimum level. Indicators of this include:

i. Accountability is becomes difficult, with functions that underpin and support the trading service scattered throughout the organization, directly accountable to managers other than the head of the trading service business. This is clearly evident when something goes wrong, should the Accounting Officer need to call on more than one manager to craft a response;

ii. Both service reliability and service quality deteriorate over time without clear accountability for attending to progressive failure;

iii. The service is depends on corporate functions for critical operational decisions, most notably budget allocation and resource availability. Even where trading services businesses were once structured optimally, this has in some instances been eroded with centralisation of critical support services with no accountability to the head of the trading service business;

iv. Associated with this, the business is not effective in collecting cash given that they are not in control of the relationship with customers and consequently, the relationship between revenue and expenditure is broken; and

v. Inefficiencies are high and continue to grow without clear accountability on interventions to improve.

3.9 International experience informs possible business models for utilities enabled within the current legislative and regulatory framework in South Africa. Pathways towards achieving a sound business structure are shown in Figure 2.

3.10 Model 1 reflects the most common structure existing, where technical functions are disconnected from finance, commercial and corporate services. Transition to Model 2 is deemed most accessible, moving to an autonomous business unit within the municipality. Model 3 reflects a municipal-owned entity, which already exists in some metros, while model 4 is often implemented in successful international utilities.

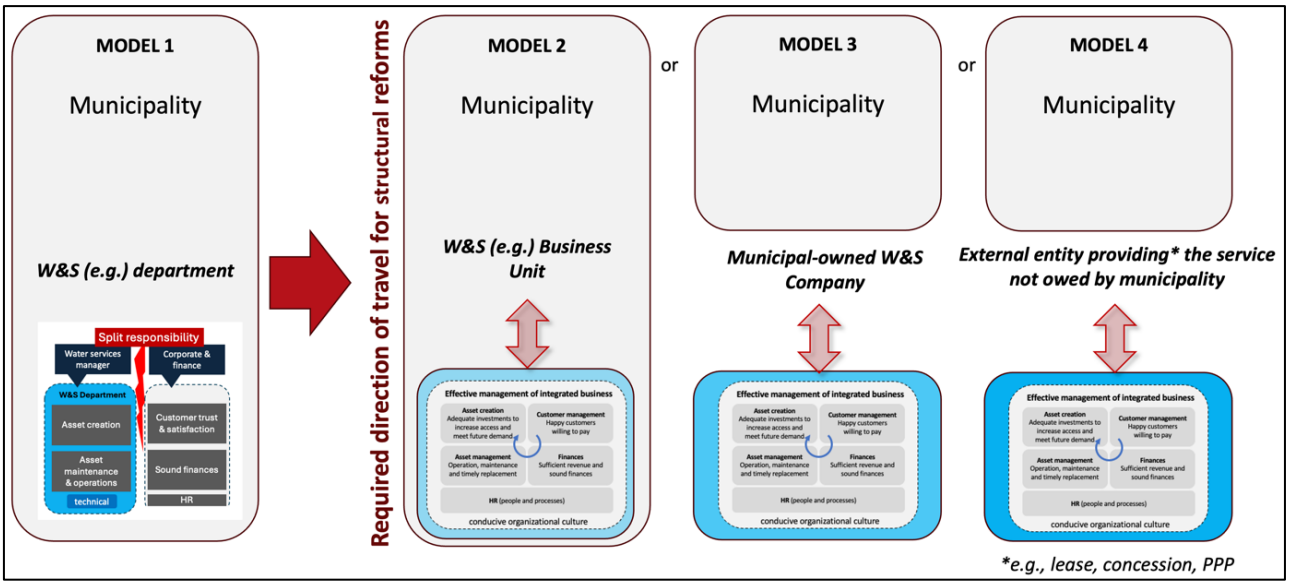

Figure 2: Direction of travel from department to managing trading service business.

3.11 Both a business unit within the city (historically in eThekwini), or a corporatised municipal entity (as exists in Johannesburg) must have responsibility for the technical, commercial and supporting aspects of providing the service which includes: Asset creation, Asset maintenance and operations, Finance, Human Resources, Supply Chain management, Customer services (including revenue management), Fleet management and IT.

3.12 For each devolved support service, the relevant corporate service retains its oversight and policy role. Should there be any infraction, this is to be taken up directly with the SPoMA. This

creates a positive tension between those responsible for operations and those responsible for oversight. Examples of how this approach would work includes:

Corporate HR	Business Unit HR
• Ensure compliance with Council HR policies and national regulations.	• Responsible for recruitment; • Attending disciplinary cases; • Payment of employees; • Management of employee pay and leave; and • Talent management and staff training, as well as organisational design.
Corporate IT, Fleet, Facilities	**Business Unit IT, Fleet, Facilities**
• Ensure compliance with all relevant policies and regulations, through effective oversight.	• Manage requirements within policy • Procure, allocate, maintain assets
Customer Services	
• A dedicated call centre that is closely linked to the back-office teams, as well as the business unit management, provides a responsive and effective level of customer service. Customer services staff from each trading service would also work from corporate customer services centres but be accountable to the trading service.	

Reporting Lines

3.13 A trading service business unit head must report directly to the Accounting Officer. In a number of metros, the trading service head currently reports through a general infrastructure-related executive to the Accounting Officer. Such a change in reporting line should not require overly onerous consultation. While the reporting level for subordinates will also change, the job content will remain similar to that existing, minimising the need for additional salary budgets.

3.14 Each of Water and Sanitation, Energy and Electricity, and Waste Management services will have their own business unit head (see section 3.3) with full responsibility and accountability over the business. This structure provides a clear boundary between sectoral issues that are always unique. It also enables proper oversight both at a political level and at a policy and regulatory level by the sector at a national level.

3.15 The fit-for-purpose structure may require either decentralising from the existing corporate structure or procuring services externally to enable proper functioning of the business. The reform is mindful that financial resources are limited and the intention is not to increase costs but rather improve efficiencies in application.

3.16 Where technical functions are disintegrated and spread across the organization, with the support functions located at a corporate level, the turnaround must design the process to create a business unit and rationalize all the disintegrated/ centralised technical and support services functions into the relevant trading service.

3.17 Where “independent” entities already exist, the necessary autonomy, sound governance and institutional form must be confirmed, and improvements made where required. If there is evidence of a lack of autonomy to function as legally established, the decision must be made to restore the necessary autonomy.

3.18 Figure 3 represents an example of an organogram that responds to the basic requirements for a single point of management accountability of a trading service operating either as business unit or municipal entity. The entire business reports to the Executive Director/ HOD/ MD who in turn reports to the Accounting Officer.

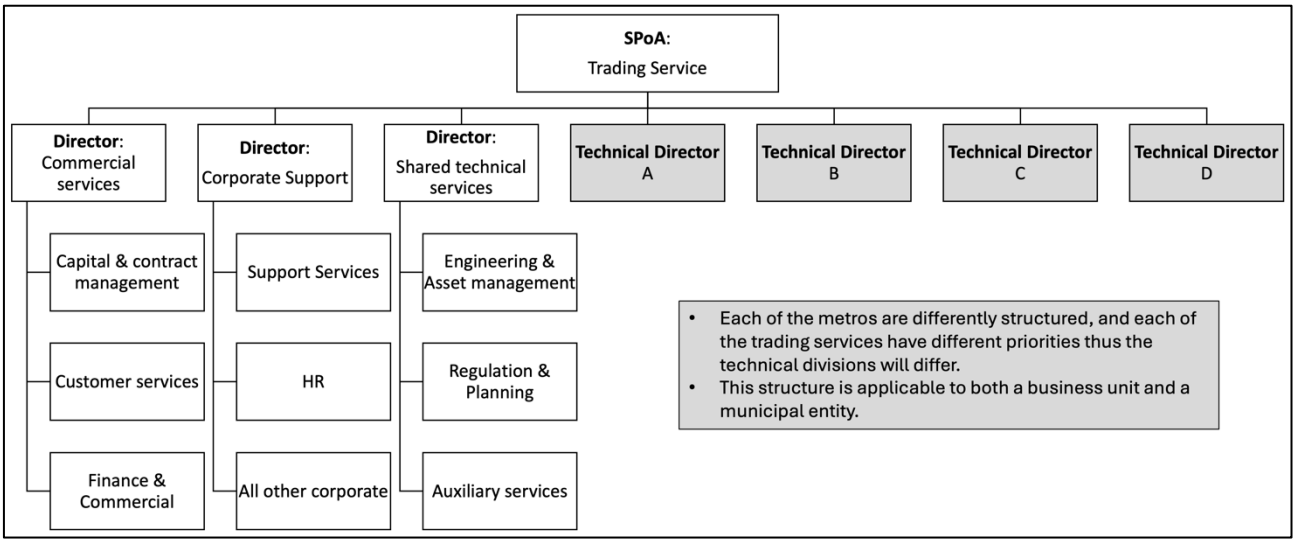

Figure 3: Indicative example organogram of a Trading Service.

3.19 An established norm is that a Water and Sanitation utility needs to have ±3 staff members for every 1,000 connections in each of water, and sanitation. This is if complete water and sanitation lifecycle functions are included. Similar norms for the other services have not been identified at this time.

4. Financial Transparency

4.1 The financial relationship between the trading services business unit and the metro as a whole must become clear and transparent, because that must be the basis for the performance expectations of all parties.

4.2 Full financial transparency will be achieved by implementing the *m*SCOA instructions issued separately. Updated *m*SCoA specimens for Parent, Consolidated and Water and Sanitation AFS for the 2023/23 year were circulated to metros on 4th July 2024, noting an intention to regulate such formats in future.

4.3 Future metro financial statements will at a minimum, report separate Trading Services AFS within consolidated metro AFS each year.

4.4 Auditing of the metro AFS will continue to be the responsibility of the Office of the Auditor General, which in due course will be asked to also audit the separate and consolidated AFS for each metro.

Implications of the implementation of the reform on the Budget and Treasury Office

4.5 Establishing the financial function within the trading service must allow and cater for the entire suite of required functions, including budgeting, reporting, the development of annual financial statements, management of accounts, revenue collection, and creditors.

4.6 The trading service must have a clear and transparent financial relationship with the administration with all transfers between them reported in a transparent manner.

4.7 Consolidation of accountability for each trading service will contribute to long-term financial sustainability. This gives the Council full ownership and oversight.

4.8 The Municipal Supply Chain Management (SCM) Regulations provides for the implementation of that SCM policy in municipalities and municipal entities. The SCM policy will apply to an autonomous trading services business unit, and adjudication decisions will remain with a centralised corporate Bid Adjudication Committee. However, both the Bid Specification and Bid Evaluation Committees must be located within the trading service.

4.9 The implementation of the single point of management accountability can be achieved through the use of delegations and sub-delegations by the City Manager and CFO.

4.10 The MFMA provides for delegation with clear oversight in Section 82 while Sections 80 and 81 provide for the functions of the CFO and describes what the CFO can decentralize in terms of the budgeting and cash flow management functions to the trading services as part of ensuring the single point of management accountability:

Extract from Section 5.2:

> **82.** (1) The chief financial officer of a municipality may sub-delegate any of the duties referred to in section 81(1)*(b)*, *(d)* and *(e)*—
>
> *(a)* to an official in the budget and treasury office;
>
> *(b)* to the holder of a specific post in that office; or
>
> *(c)* with the concurrence of the accounting officer, to—
>
> (i) any other official of the municipality; or
>
> (ii) any person contracted by the municipality for the work of the office.
>
> (2) If the chief financial officer sub-delegates any duties in terms of subsection (1) to a person who is not an employee of the municipality, the chief financial officer must be satisfied that effective systems and procedures are in place to ensure control and accountability.
>
> (3) A sub-delegation in terms of subsection (1)—
>
> *(a)* must be in writing;
>
> *(b)* is subject to such limitations or conditions as the chief financial officer may impose; and
>
> *(c)* does not divest the chief financial officer of the responsibility concerning the delegated duty.
>
> (4) The chief financial officer may confirm, vary or revoke any decision taken in consequence of a sub-delegation in terms of subsection (1), but no such variation or revocation of a decision may detract from any rights that may have accrued as a result of the decision.

4.11 The policies and oversight remains the responsibility of the the Budget and Treasury Office under the CFO. This creates a positive tension between those responsible for operations and those responsible for oversight with distribution of functions of (circumstances particular to each metro may result in minor differences):

Corporate Finance	Business Unit Finance
• Raising consolidated bills to customers; • Managing the corporate bank accounts, • Raising loans and undertaking investments; • Consolidating the financial statements of the trading services into the corporate municipal accounts at year-end; • Ensuring the devolved finance operation complies with corporate financial policies; and • Publishing full trading services AFS statements annually, and aggregated within metro AFS.	• Critical revenue value chain functions including meters and metering, and management / oversight of credit control; • Creditors payment; • The production of management accounts, • Engaging with internal and external audit queries; • Posting of entries into the accounts; • Maintaining assets registers, etc; and • Preparation and sign-off of trading service AFS.
Corporate SCM	**Business Unit SCM**
• Ensure compliance with all relevant policies and regulations, through effective oversight; and • Bid Adjudication committee (handling of reports from the trading service).	• Manage stores; • Procurement, (setting up and implementing the bid specification & bid evaluation committees for the trading service); and • The preparation of reports for consideration by the bid adjudication committee.

5. Sector Department Implications

5.1 To achieve the objectives of metro trading services reform, interaction with National Treasury, DCoG and the relevant national sector department will continue to ensure alignment and decide on any policy or regulatory changes that may be required.

COGTA: The Municipal Staff Regulations

5.2 The department of Cooperative Governance and Traditional Affairs published the Municipal Staff Regulations on 21 September 2021 in Government Gazette 45181, Notice 890.

5.3 It is not apparent that any of the metropolitan municipalities have aimed to comply with CoGTA 2021 Municipal Staff Regs as yet. The eight metropolitan municipalities vary greatly in both their macro- and micro structures.

5.4 Section 5.2 of the Municipal Staff regulations stipulate the number of layers and span of control for category A municipalities. It however does not directly speak against direct reporting to the Accounting Officer. In the interpretation of Section 5.2, many municipalities have grouped all trading services under Engineering/ Infrastructure/ Technical Services Departments. Having each trading service report directly to the Accounting Officer potentially means increasing the span of control (number of reports) to more than 8.

5.5 The proposals made in the trading services reform can however be fully accommodated in the regulations.

Extract from Section 5.2:

(2) The organisation design metrics with the four key dimensions of the organisation design as set out in the table below must be applied by a municipality when determining the staff establishment.

Dimension	Category A	Category B	Category C
Structural layers	• Six to Seven (6-7) layers	• Five to Seven (5-7) layers.	• Five to Six (5-6) layers.
Structural shape	• Strategic: 0.2 - 1% • Managerial/ Specialist: 1 - 20% • Operational: 80 - 90%	• Strategic: 1% • Managerial/ Specialist: 1% - 15% • Operational: 85% - 95%	• Strategic: 1% • Managerial: 5% - 15% • Specialist: 30% - 55% • Operational: 15% - 30%
Span of control	• Municipal Manager: 7 - 8 • Directors: 6 - 7	• Municipal Manager: 6 - 8 • Directors: 5 - 7	• Municipal Manager: 6 - 8 • Directors: 5 - 6
	• Divisional Managers: 5 – 6 • Managers: 5 – 6 • Supervisors: 9 - 15	• Divisional Managers: 5 – 6 • Managers: 5 – 6 • Supervisors: 9 – 15	• Divisional Managers: 4 – 5 • Managers: 4 – 5 • Supervisors: 9 – 12
Core to support employee ratio	• Core to support employee ratio of 70:30 • The ratio is based on actual headcount and not number of roles		

5.6 The unique role of trading services must be acknowledged in the structure guidelines. To ensure that trading services, as a basic priority for local government, is appropriately prioritsed, other directorates may need to be consolidated to limit the number of direct reports to the Accounting Officer to 8.

5.7 An example of a structure that meets the span of control requirement is shown in Figure 4.

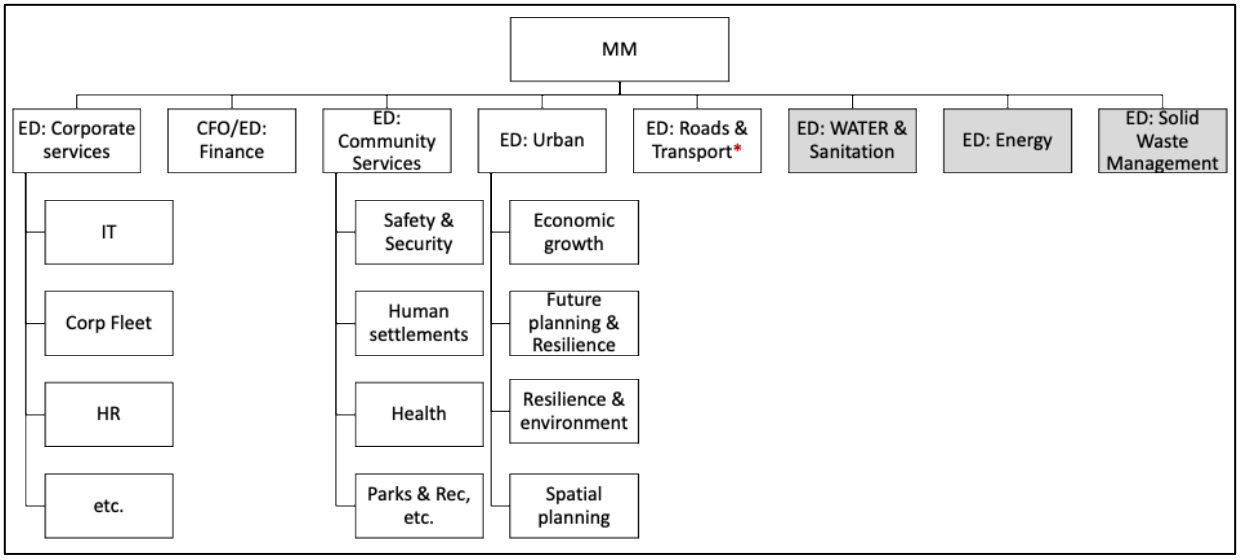

Figure 4: Example of macro-structure with trading services as Business Units[1].

5.8 If a municipality is unable to resolve its structure in alignment with the regulations, the process for deviation must be followed.

Extract from Section 5.1:

> (4) A municipality may, in exceptional circumstances and upon good cause shown, and in consultation with the relevant MEC for local government, deviate from the requirements of sub-regulation (1) and (3) after considering the following factors:
>
> *(a)* The category or type of the municipality;
>
> *(b)* the duties and functions of the municipality;
>
> *(c)* the gross income, the area of jurisdiction and the nature of the settlement within the municipality;
>
> *(d)* the financial capacity of the municipality, with the wage and salary bill not exceeding financial ratios and norms as set out in terms of Municipal Finance Management Act.
>
> *(e)* the need for the promotion of equality and uniform norms and standards.

DWS: Water Services Ammendment Bill

5.9 In November 2023, the Department of Water and Sanitation issued an amendment Bill to the Water Services Act.

5.10 The amendments makes provision for the transfer of the Water Service Providers (WSPs) functions to an independent entity if a municipality (Water Service Authority, WSA) does not meet the required service levels. By implication, this means that a WSA can lose its provider license if its WSP is not meeting service-level standards. This is a critical and timely sectoral regulatory intervention bolstering efforts towards the reform.

5.11 Given that the failures in trading services are largely a result of governance and structural problems, the amendment Bill would effectively result in the creation of a business unit-type structure with a single point of accountability. Therefore, the intentions of the DWS's

[1] Note Executive Director is used here to indicate the trading services SPoMA reporting to the Accounting Officer

Amendment Bill and those of the National Treasury's directives are aligned, giving impetus to the reforms.

5.12 The Guidance Note will be updated should legislative or regulatory changes in other sectors require clarification for implementation of the SPoMA in a specific trading service.

6. Conclusions: Next Steps

6.1 Metro municipalities seeking to access the performance-based incentive grant will need to ensure that each of their three trading services are configured into viable businesses, likely in the form of a business unit or a municipal entity. A fit-for-purpose organisational design must consider the 7-box model for successful trading services (Figure 1).

6.2 This reform may require appropriate delegations and sub-delegations by the municipal manager and/ or CFO; it may require shifting staff from corporate to the trading services units, or in other cases, it may necessitate hiring new staff to the support services. Should internal capacity be insufficient to implement reform, a management contract can be a mechanism to aid and accelerate change. The devolution/ decentralisation of relevant functions to the trading services should come with clear separation of duties, reporting lines and oversight over the delegated functions by corporate. A fit-for-purpose engagement process must be accommodated as part of the reform.

6.3 Each trading service must allow and cater for the entire suite of financial functions, have a clear deliniation of responsibilities and accountabilities for shared services; and have clear financial relationships with the administration, with all transfers between them reported in a transparent manner.

6.4 Specific to the Water Services Ammendment Bill, implementation of the reform must to refer to the directive from the Water Services Amendment Bill of 17 November 2023.

6.5 Additional Guidance notes will be issued as the MTS programme and Finance Incentive are further developed.

6.6 Metros requiring further information or support in relation to the contents of this Guidance Note should direct their enquiries to:

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