



Honourable V Smith
Chairperson
Standing Committee on the Auditor-General
Parliament of the Republic of South Africa
PO Box 15
Cape Town
8000

16 August 2017

Reference: SCoAG/PAA/implications/01

Dear Honourable Smith

Extent and key drivers of the financial implications posed by the Public Audit Amendment Bill, 2017

The above matter and our engagement scheduled for 25 August 2017 have reference.

The purpose of this letter is to confirm to the committee that adopting the Public Audit Amendment Bill, 2017 (Bill) will have financial implications for the state. The letter further provides an early estimate of the extent and key drivers of those financial implications.

Section 44(1) of the Constitution of the Republic of South Africa, 1996 confers the power on the National Assembly to pass legislation within certain functional areas. National Assembly rule 268 provides that the National Assembly may initiate and prepare legislation in terms of section 73(2) of the Constitution through its committees. The Standing Committee on the Auditor-General (Scoag), in its capacity as a committee of the National Assembly, intends to introduce certain amendments to the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) in compliance with the National Assembly Rules.

Rule 273 requires a committee to table a memorandum in the National Assembly. This memorandum is required to obtain the National Assembly's permission to initiate and prepare legislation and must contain the following prescribed content:

- Particulars of the proposed legislation
- The objects of the proposed legislation
- An indication as to whether the anticipated legislation will have financial implications for the state and, if so, the memorandum must give an account of those financial implications
- The views of the executive on the objects of the proposed legislation.

Cost estimate for mandatory referral mechanism

The Bill seeks an amendment of section 5 of the PAA by introducing a discretion for the Auditor-General to refer certain audit outcomes for further investigation by an appropriate organ of state. The Bill further seeks to strengthen the Auditor-General's

powers by providing for the authority to disallow any item of expenditure which is contrary to law and to surcharge the amount disallowed upon any person responsible for such expenditure. The power of disallowance and surcharge will extend to any sum not duly collected and any amount lost to the state as a result of negligence or misconduct.

The financial implications brought about by the referral system will include the cost for the investigation by an organ of state with an appropriate mandate, as well as direct and indirect costs for the Auditor-General of South Africa (AGSA).

Annual cost of investigations referred to other organs of state

The estimated cost of investigations referred to other organs of state will be approximately R20 million per annum for five cases of huge significance to the public interest and 10 smaller investigations. Table 1 provides a view of the potential, annual costs to be incurred by recipient organs of state.

Table 1

Description	Estimated price per unit	Unit	Cost
Top five referrals at R2 million per investigation	R2 000 000	5	R10 000 000
Additional 10 less prominent investigations at R1 million per investigation	R1 000 000	10	R10 000 000
Subtotal			R20 000 000*

*Note: It is important to note that the R20 million for investigations is subject to the results of further research on the cost for investigations into acts of financial impropriety. Note further that a portion of this cost is likely to be absorbed through efficient and effective procedures and preparatory work during the audit process.

Cost to capacitate an internal referral centre

The organisation will require dedicated capacity to facilitate the referral of matters for investigations to other organs of state. Such capacity should ideally be located in a separate centre that is strategically positioned. Table 2 reflects on the proposed structure of a referral centre to take care of the referral process, as well as the anticipated cost of such structure per annum.

Table 2

	Salary impact per employee	Head count	Salary impact
Senior manager	R1 166 911	1	R1 166 911
Manager	R891 391	1	R891 391
Audit supervisor	R380 867	1	R380 867
Subtotal			R2 439 169*

* The estimates have been prepared based on pay ranges applicable to chartered accountants. Figures will vary according to skills and qualifications.

Unbillable hours on the audit – consideration for referral

On completion of each audit, the engagement manager (usually in the position of senior manager) will be required to consider the relevant audit outcomes for possible referral. The organisation performs on average 950 audits per annum. At this stage, we aim to refer 15 cases for further investigation per year. An estimate of two hours will be spent to consider referral in approximately 935 audits per year, and 40 hours for the top 15 audits. Table 3 contains the annual cost estimate for the consideration of possible referral during the conclusion of all audits.

Table 3

	Average charge out rate	Hours	Cost
Engagement manager (top 15)	R1 751	600	R1 050 600
Engagement manager (935)	R1 751	1 870	R3 274 370
Sub-total			R4 324 970

Cost of the AGSA evaluation committee

An internal evaluation committee may be established. The main purpose of this committee will be to perform an initial evaluation of all audit outcomes identified by engagement managers for potential referral. The evaluation committee will be composed of a business executive, three senior managers (Audit Research and Development; Audit; Quality Control), and three product champions. Each member will potentially spend two hours per audit. Audits identified for possible referral are estimated at 100 audits per annum. Once the initial evaluation is completed, the top 15 audits will be taken forward to the referral committee for final decision.

Table 4 depicts the annual cost estimate for the internal evaluation committee.

Table 4

	Average charge out rate	Hours	Cost
Business executive	R2 825	200	R565 000
Senior manager (ARD) x1	R1 751	200	R350 200
Senior manager (Audit) x1	R1 751	200	R350 200
Senior manager (QC) x1	R1 751	200	R350 200
Product champions x3	R1 751	600	R1 050 600
Subtotal			R2 666 200

Cost of the AGSA referral committee

The organisation intends to establish a referral committee, which will be the final decision making body as far as referrals are concerned. The referral committee will be composed of internal and external members who will spend approximately 30 minutes per referral. Table 5 provides an annual cost estimate for the referral committee.

Table 5

	Average charge out rate	Hours	Cost
Auditor-general, Deputy auditor-general and executives (5-8 in total)	R2 825	60	R169 500
Independent members (2)	R2 876*	15	R43 140
Subtotal			R212 640

* Based on rates published for work conducted by specialists on behalf of the AGSA

Cost of external expertise

Audit outcomes considered for referral will vary in terms of complexity. The AGSA may on occasion source specialist skills and advisory services to assist the organisation with the referral function. Table 6 provides an estimate of the cost for the sourcing of specialist skills and advisory services.

Table 6

	Rate per hour	Hours	Cost
Specialists and advisors in various fields	R2 876*	1 500	R4 314 000
Subtotal			R4 314 000

* Based on rates published for work conducted by specialists on behalf of the AGSA

Section 36 of the PAA provides for the funding of activities of the AGSA through appropriations authorised by the Parliament. The extended powers sought through the Bill should ideally be funded through the mechanism of annual appropriations. These appropriations will be formally applied and accounted for as part of the Auditor-General's statutory reporting obligations.

The estimated cost to implement the strengthened powers of the Auditor-General through the Bill is estimated at R33 956 979 million per annum for the first three financial years following the commencement of the Bill (refer to table 7 below). This figure will be adjusted as the new processes mature over time.

Table 7

	Cost
1. Cost of investigations referred to other organs of state	R20 000 000
2. Cost to capacitate referral centre	R2 439 169
3. Unbillable hours on the audit – considerations for referral	R4 324 970
4. Cost of evaluation committee – sifting of possible referrals	R2 666 200
5. Referral committee – decision to refer	R212 640
6. Specialist and advisory services	R4 314 000
Total	R33 956 979*

This cost estimate intends to assist Scoag in its preparation of the explanatory memorandum required in terms of rule 273. A detailed business case, supported by appropriate benchmarks, will be prepared for purposes of seeking annual appropriations.

Yours sincerely



16/08/2017.

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