DRAFT

SARS

South African Revenue Service

SARS Operating Model review

December 2016

Context

- A 6-week diagnostic was conducted in February 2015 to review the SARS operating model, its strategy and its operational performance (the scope excluded IT). The findings were based on:
  - 7 tax and customs authorities benchmarked (incl. HMRC, ATO)
  - 50+ SARS Management interviews
  - 6 external stakeholders engaged (incl. SAIT, SAICA, ASISA)
  - 180+ survey responses from Senior Managers, Executives, General Executives and Chief Officers
  - SARS internal data and external reports (from OECD, World Bank, IMF and PWC)
- The diagnostic, strategic plan and operating model (down to level 3) were presented to the Minister of Finance as well as the SARS Advisory Board (diagnostic shared in April 2015)
- More detailed analyses were launched in June 2015 (incl. 20+ branch and border posts visits in Durban, ORTIA and Beitbridge) and led to the definition of the SARS transformation plan and priority initiatives
- Final diagnostic and implementation plan were validated by the SARS Steering Committee in October 2015
- Implementation was launched in Oct 2015

Executive summary

1. **The diagnostic** highlighted a number of areas for SARS to address:
   - Reduce the tax gap and focus on HNWI, SMME, Debt, Customs/Excise
   - Increase the level of goods control in customs
   - Improve taxpayer service levels and the efficiency of service channels
   - Increase the effectiveness of the SARS operating model
2. **The New Operating Model** was designed and implemented as a foundation of the SARS transformation
   - The SARS strategic plan was defined (incl. 4 must-win battles and 5 enablers)
   - The must-win battles and enablers were translated into design principles which included: increased focus on customs/excise, increased business unit accountability, definition of taxpayer segment strategies to pursue untapped revenue collection opportunities, balance between prevention and enforcement
   - International benchmarks helped define different operating model options
   - The operating model was recommended based on its adherence to the design principles
3. **The initial results of the SARS transformation were positive**
   - The achievement of the FY15/16 target showed a continued tax buoyancy with R1069.9B collected – 8.5% year on year growth vs 6% nominal GDP growth and ~0.7% real GDP growth). Also, SARS started (re-)building capabilities including SMME campaigns, tax inspection and debt equalization
   - The Customs "port of the future" implementation was initiated in Durban and led to improved goods control (<0.5% of undeclared cargo vs. 6% previously), an improved risk detection and intervention capability, and revised penalty guidelines
   - SARS is transitioning to the new operating model with most of the "hardware" changes implemented (organizational structure changes)

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❶ Diagnostic summary (1/4): **Tax collection**
Critical issues for SARS and South Africa identified

Tax	Customs/ excise
Service channels	Operating model

- **Past SA tax gap estimates** (from SARS and from Academic Studies) **show an opportunity to increase revenue collection by a potential 15%-23% (R135B-R210B). Total revenue collection has remained at ~26% of GDP since 2007** which could suggest no reduction in the tax gap *(p10-11)*
- A number of areas to increase tax collection were identified: SMMEs, HNWIs, debt collection and Large Corporates
  - **Stats SA and Finscope surveys indicate that between 1.5M and 2.5M SMMEs are unregistered and outside the tax net** *(p12)*
  - **New World Wealth study indicates that there are 12 times more HNWIs in South Africa than current SARS HNWI scope of ~400 individuals** *(p13)*
  - **Debt book was over R90B and has not been reduced significantly since 2009** *(p14)*
  - SARS interviews indicated that LBC did not have the tools, resources and capabilities to tackle BEPS
- A number of levers to address the tax gap were identified:
  - **OECD report indicates that SARS gains lower additional revenue (~R10-R17B loss) from verification/compliance checks than benchmarks** *(p15)*
  - There are **reasons to believe risk engine is not fully effective: 1.1M PIT cases are selected for compliance check but less than 2% of these are sent for full audit** *(p16)*
  - There is an opportunity to increase specialized resources dedicated to priority segments. For example, **SARS has 4 auditors dedicated to HNWIs within LBC** *(p17)*
  - SARS data shows that CIT, Trusts, & PAYE represent a low number of audits and that while 79% of audits are performed on PIT 84% of the assessment value comes from VAT *(p18)*
- Another set of levers were identified to reduce the debt book:
  - SARS data indicates that **~R2B refunds payed every year without equalizing with debt** *(p19)*
  - Data shows **disparity in debt collector performance as best quartile collectors complete x14 cases more than worst quartile** *(p20)*
  - SARS data shows 85% of LBC debt is disputed (R23B) and mostly suspended, preventing the application of the "pay now argue later" policy *(p21)*

1 Diagnostic summary (2/4): **Customs and Excise**
Critical issues for SARS and South Africa identified

Tax	Customs/ excise
Service channels	Operating model

- Findings show case for change for Customs and Excise:
  - **World bank ranks SARS customs efficiency 61st out of 143 benchmarks**. SARS Management interviews confirm significant improvement opportunity *(p22)*
  - Customs port visits (Durban, ORTIA, Beitbridge) and interviews indicate lack of controls, equipment and capacity for inspections *(p23)*
  - SARS data **indicates potential export mispricing with a net understatement of ~R1,5T from 2009-2013** *(p24)*
- Gaps at Durban, ORTIA and Beitbridge port indicate lack of control of goods:
  - An assessment of 10K containers in Durban shows that ~20% of containers are undeclared before ship arrival, ~6% of containers remain undeclared after 28 day limit (estimated 30K containers/year) while ~3% of containers are transported to be cleared at City Deep although SARS does not control road traffic *(p25)*
  - **There is a lack of Customs visibility in Durban port due to a wide port layout (30+ gates) and a lack of resources (2 Officers on the ground per shift)** *(p26)*
  - **Durban state-of-the-art scanner only has a 3% success rate and operates at 25% capacity** *(p27)*
  - Case selection at ORTIA currently has very limited access to cargo and passenger manifest data *(p29)*
- A number of other customs areas show potential for improvement:
  - The customs risk engine appears sub-optimal with 2% of declarations inspected for a ~13% hit rate. The **risk engine does not appear to be set up for continuous learning** (there is no systematic approach to develop entity-based risk rules, limited use of third party data, lack of integration of feedback loop and limited input from customs operations) *(p33)*
  - **SARS penalties appear ineffective and lower than other Customs authorities penalties:** there is only a R1K fine for failing to submit manifest, a R10K fine when avoiding container control, there is no policy/tracking of repeat offenders *(p34)*
  - Transparency International rates SARS corruption high (16% people of surveyed say they pay bribe – SARS interviews and data indicate high risk in customs) *(p35)*
- **Excise** inspections appear misallocated against revenue potential (e.g. there is only 3% of inspections that are performed on fuel although they contribute to 53% of revenue) *(p36)*. In addition, border post visits showed lack of integration between excise and custom controls.

1 Diagnostic summary (3/4): **Service Channels**
Critical issues for SARS and South Africa identified

Tax	Customs/ excise
Service channels	Operating model

- Data indicates that the level of service/ease experienced by taxpayers could be improved *(p37)*
  - **45% of e-filing is done by an agent in branch – many taxpayers visit branches multiple times and often for simple tasks (out of 6.2M branch queries, 40% require multiple time resolution)** *(p38)*
  - **SARS Connexion survey indicates 20% of branch employees are disengaged** which may be a barrier to high quality service *(p39)*
  - **PWC report indicates that SMEs take 25 days to comply with tax requirements** (vs 13 days in Australia) and SARS interviews indicate increase in administrative burden *(p40)*
- Service channel performance an efficiency show some gaps:
  - SARS data show **high variation in branch performance: on queue times best region is 4x better than worst** *(p41)*
  - SARS data indicates that Branch employee utilisation in off-peak season is 20-50% lower than in peak season *(p42)*
  - SARS interviews at branches report **outdated Service Channel IT system that impact service channel effectiveness** *(p43-44)*
- There are indications that SARS footprint could be optimized:
  - **SARS footprint coverage is higher than benchmarks**: there are 11.3 branches per million taxpayers in SA (if only active tax-payers are considered) against 7.6 branches per million taxpayers in the UK *(p45)*
  - **SARS is increasing its branch footprint. Other tax authorities such as HMRC are reducing their footprint** while increasing capillarity with tax kiosks and increase service through digital applications *(p46-47)*
  - Branch visits, interviews and project analysis indicate **suboptimal management of real estate** *(p48)*
- SARS data shows potential to increase levels of digitalization and redeploy branch staff:
  - There is an opportunity to potentially migrate ~4.7M transactions (~50%) out of branch into contact centre and digital channels *(p49)*
  - Reducing branch volume through automation and migration to other channels could free-up 425-850 staff for redeployment to priority areas *(p50)*

1 Diagnostic summary (4/4): **Operating model**
Critical issues for SARS and South Africa identified

Tax	Customs/ excise
Service channels	**Operating model**

- **Operating model shows potential for improvement:**
  - **Organisation structure shows unbalance with 9 main units reporting to the Commissioner but ~70% of employees under one unit (Operations)** *(p51)*
  - There appears to be unclear ownership and/or significant duplication of functions (customs, IT, Project Management, HR) *(p52)*
  - **Employees rank SARS relatively low in decision effectiveness**: strong on clarity but weak on structure, communication & roles *(p53)*
  - While **governance structures exist on paper, SARS Management interviews indicate that their effectiveness is poor** *(p54)*
- External stakeholders (The Banking Association SA, SAIT, Estate Agency Affairs Board) see **need for SARS to improve capabilities, decision speed and collaboration** *(p55)*
- Internal reports indicate issues in employee performance management: **30% of SARS employees are in the top performance tier vs. 5% in normal distribution, which makes it difficult to distinguish between high performers and others** *(p56)*
- Organization survey with 184 respondents shows that senior employees do not show high motivation and believe change at SARS is required:
  - **Only 25% of senior management would recommend SARS as a place to work** while **43% would actively discourage people from joining SARS** (strongest detractors are in HR function and CO/GE positions) *(p57-59)*
  - While employees think SARS is a relatively effective organisation there is a strong belief that change is required *(p60)*

1 Feb 2015 assessment summary: **next wave of transformation should be set up for SARS**

Mission & Vision

A modern and internationally respected revenue service, driven by highly skilled motivated and proud staff, delivering efficient and effective collection of all taxes due, protecting our borders and facilitating trade, providing simple and convenient interfaces to aid taxpayer compliance and effective pursuit and prosecution of deliberate evaders

KPIs

KPIs (e.g. tax gap, revenue collection, efficiency and effectiveness measures, taxpayer satisfaction (NPS), employee satisfaction (NPS))

Must-win battles

Ensure funding of SA through collection of all taxes due to the fiscus

- Ensure all activity in tax net
- Assess and tax full wealth of **HNWIs**
- Use available laws to limit **Large Corporates** tax avoidance and BEPS, with sophisticated detection and pursuit of avoidance/evasion
- Formalise **cash economy and unregistered SME activity**, incl. missing VAT
- Continue to improve int'l co-operation and information sharing
- Improve debt management collection

Collect customs tax due, whilst facilitating trade

- Modernize customs systems and data capability to support **revenue collection**
- Improve customs controls to tackle under-declaration of goods, reduce illicit trade and offer predictability to legit traders
- Link customs and company tax data to tackle fraud
- Capture excise opportunity

Develop high performing & efficient operations

- Improve capabilities and allocate resources to areas which will achieve highest impact vs objectives
- Increase overall **cost efficiency, employee productivity** and **optimize footprint**
- Improve **process effectiveness** (e.g. case selection, audit, verification, debt collection)

Provide fair, convenient and diligent service to aid taxpayer compliance

- Create convenient and cost-effective **channels** for servicing taxpayers
- **Educate taxpayers** on their obligations, and first assume honest intentions when dealing with them
- **Maximise transparency and fairness** through:
  - Fair treatment of all cases based on clear rules and procedures backed by governance
  - Zero corruption at all levels

Access additional revenue

- *In due course, use reach and infrastructure to deliver other govt services, e.g. delivery of social grants*
- *Use this to generate additional revenue or reduce fiscal spend*

Enablers

People & capability (attract and retain talent, develop skills, implement meritocracy, build leadership capabilities)

Operating model (incl. governance, decision rights, structure and processes)

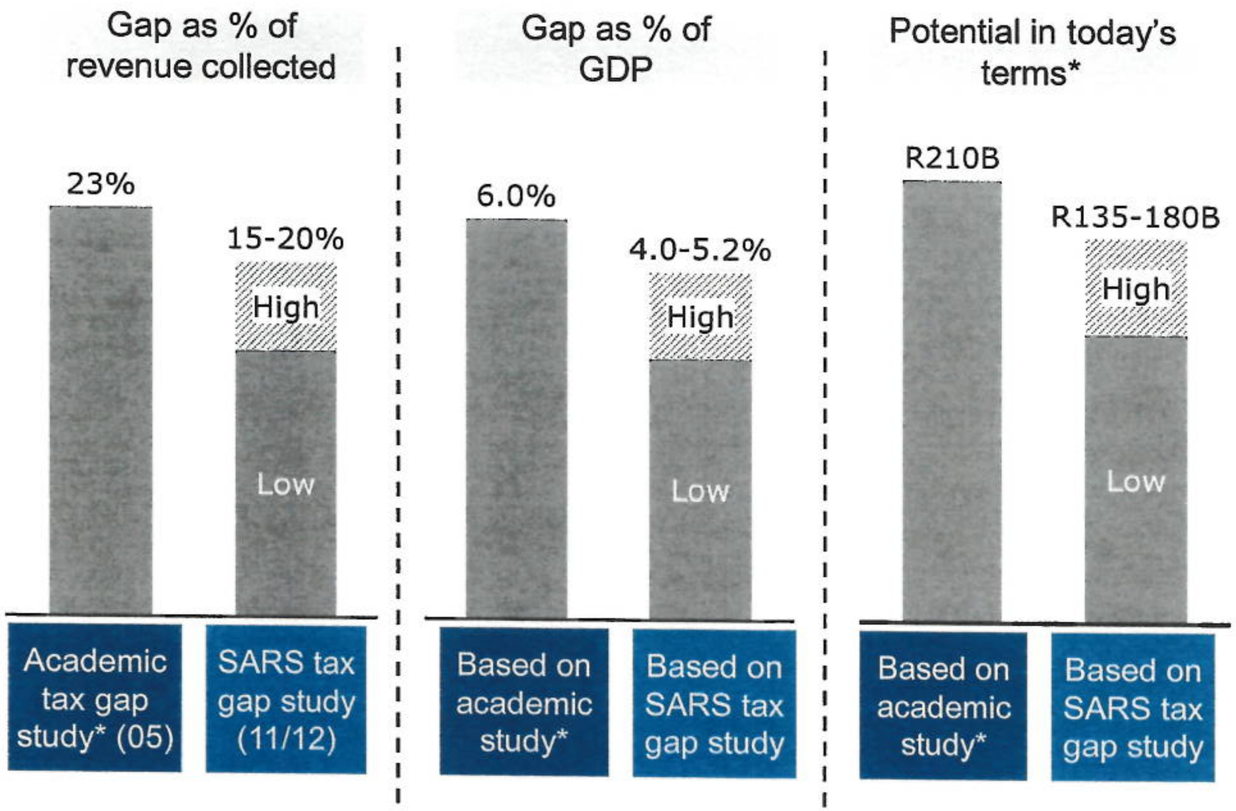
Tax intelligence (sophisticated data analytics capability, policy expertise, best practice understanding / development)

IT systems (designed to serve business needs)

Integration with other SA (eg. DHA, Police…) **and foreign** (other tax services) **institutions to share information**

Past SA tax gap estimates show 15%-23% additional revenue opportunity (R135B-R210B)

TAX GAP ESTIMATED AT 4-6% OF CURRENT GDP



THERE IS NO OFFICIAL VIEW

- **SARS does not have an official perspective on the SA tax gap** which impacts robustness of compliance measurement over time
- Few tax authorities publish tax gap estimates due to complexity and public controversy
- Last study commissioned by SARS in 2011/12 took 1.5 years and estimated 15-20% gap
- Tax collected today is 26% of GDP – estimates suggest 30-32% possible
- This would mean an extra R135-210B annually

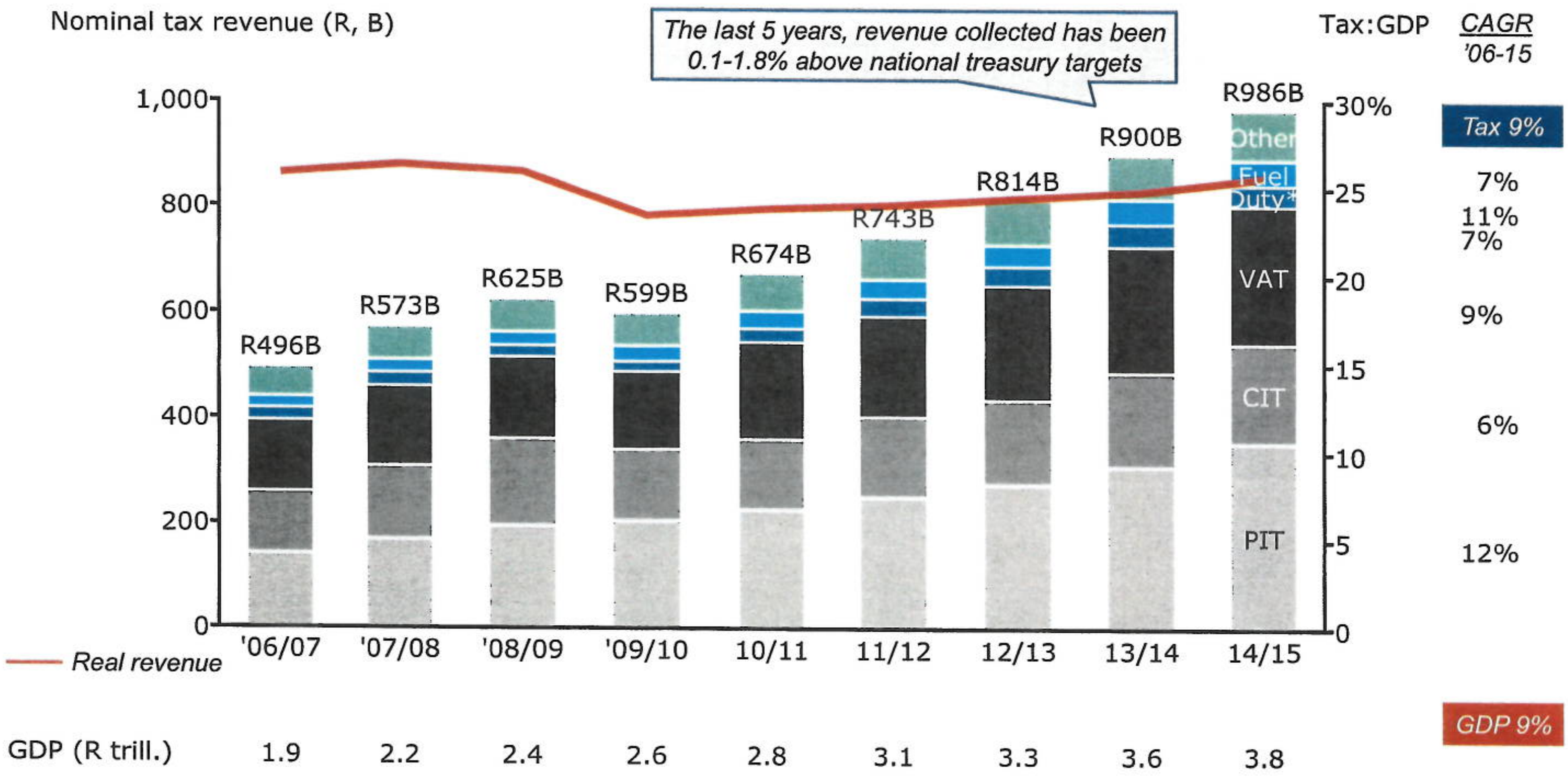
Note: *Tax collection opportunity calculated as % of 2013/14 R900B revenue, % GDP based on R3.45T in 2013;
Source: SARS modernization report 2011;* European Journal of Political Economy

1 The tax gap may be stable in South Africa as total revenue collection has remained at ~26% of GDP since 2007

Tax	Customs/ excise
Service channels	Operating model

Revenue collection

TAX POLICY CHANGES IMPACT RESULTS*



Note:*Tax changes include increase in CIT small business threshold from 35k to 65k in '06/07 and reduction of CIT from 29% to 28% in '08/09. Other changes were the increase of UIF contribution ceilings in '06 (11.7K), '07 (12.5K) and '12 (14.9K); Duty refers to all customs duty
Source: SARS Tax Statistics 2015; Statistics South Africa GDP 2014; Statistics South Africa CPI 2005-2014

SARS At Your Service

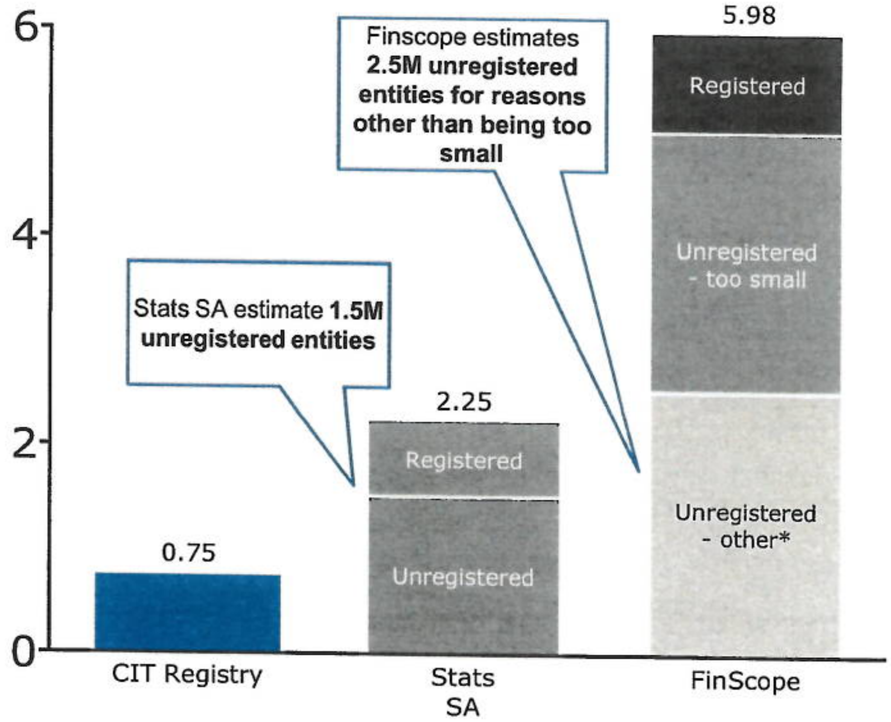
Stats SA and Finscope surveys indicate that between 1.5M and 2.5M SMMEs are unregistered and outside the tax net

Tax | Customs/ excise | Service channels | Operating model

SMMEs

NUMBER OF OPERATING SMMES VARIES BY STUDY SOURCE

SMME Entities in South Africa
(Count, Millions)



STUDIES INDICATE GAP MAY LARGELY BE DRIVEN BY INFORMAL/ CASH ECONOMY

- Informal economy valued at 5% of GDP (R120B)
- Number of businesses increased from 1.1M in 2009 to 1.5M in 2013
- Informal industries include: trading; construction; manufacturing and finance
- 9.6% of businesses had net profit above R72k p.a. and would be liable for tax

Notes/Sources: *SMME owners say reasons for not registering their business include lack of money or lack of understanding or high complexity
STATS SA Survey of employers and self-employed 2013 (1.5M + 0.75M); FinScope South Africa Small Business Survey 2010;
SARS Statistics 2014;

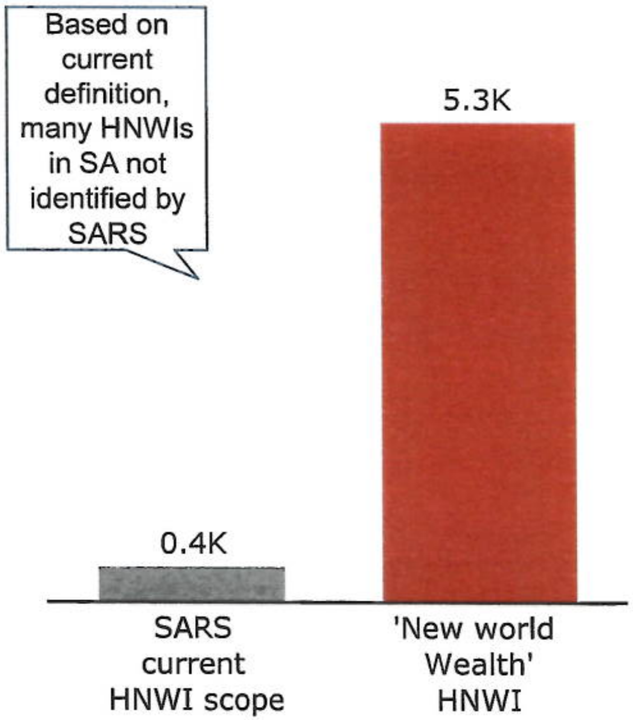
SARS focuses on only a fraction of HNWIs compared with New World Wealth estimates for South Africa

Tax | Customs/ excise | Service channels | Operating model

HNWIs

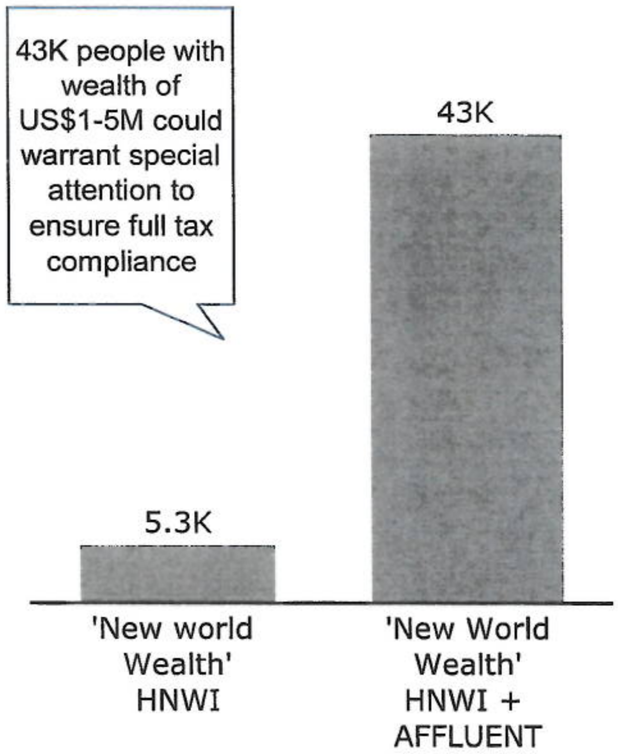
SARS DEFINITION ONLY INCLUDES A FRACTION OF HNWIs...

HNWI in South Africa



... AND FOCUS COULD BE EXPANDED TO MASS AFFLUENT SEGMENT

HNWI and affluent



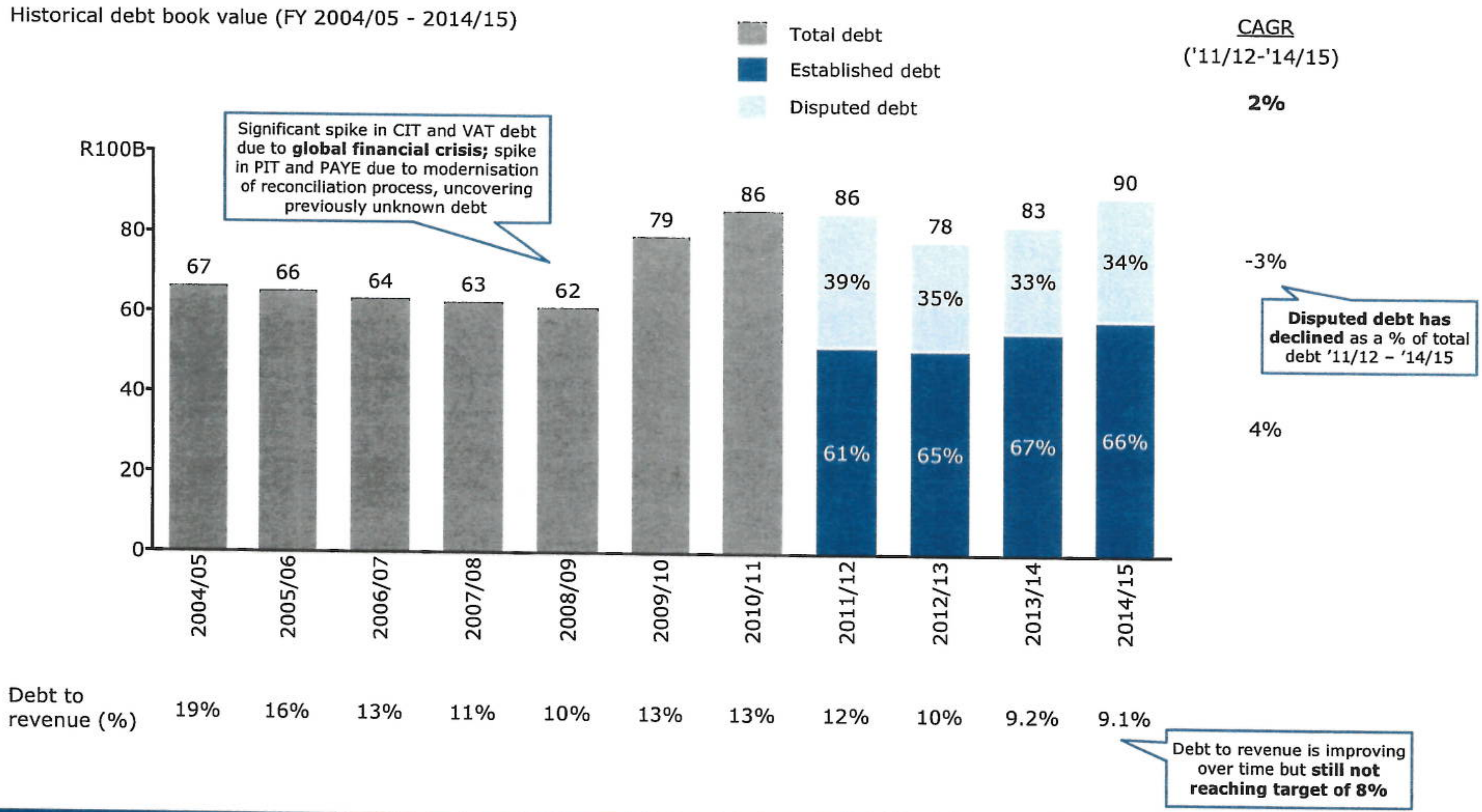
Note: SARS HNWIs income >R7M or gross wealth >R75M; aligned to New World Wealth definition of HNWIs with US$ net wealth >$5M (5.3K people) ; lower range based on SARS average income/HNWI; upper range based on wealth to earnings conversion multiple 1/6.5; 43K 'Low Tier' based on net wealth >US$1-5M

SARS At Your Service

Debt book has increased to ~R90B (FY 2014/15); debt decreasing as % of revenue but not yet at target 8%

Tax	Customs/ excise
Service channels	Operating model

Debt collection



Note: Disputed debt is under legal objection, appeal or in court and is uncollectable by SARS until resolved
Source: Daily Debt Summary FY 04/05 - FY 14/15

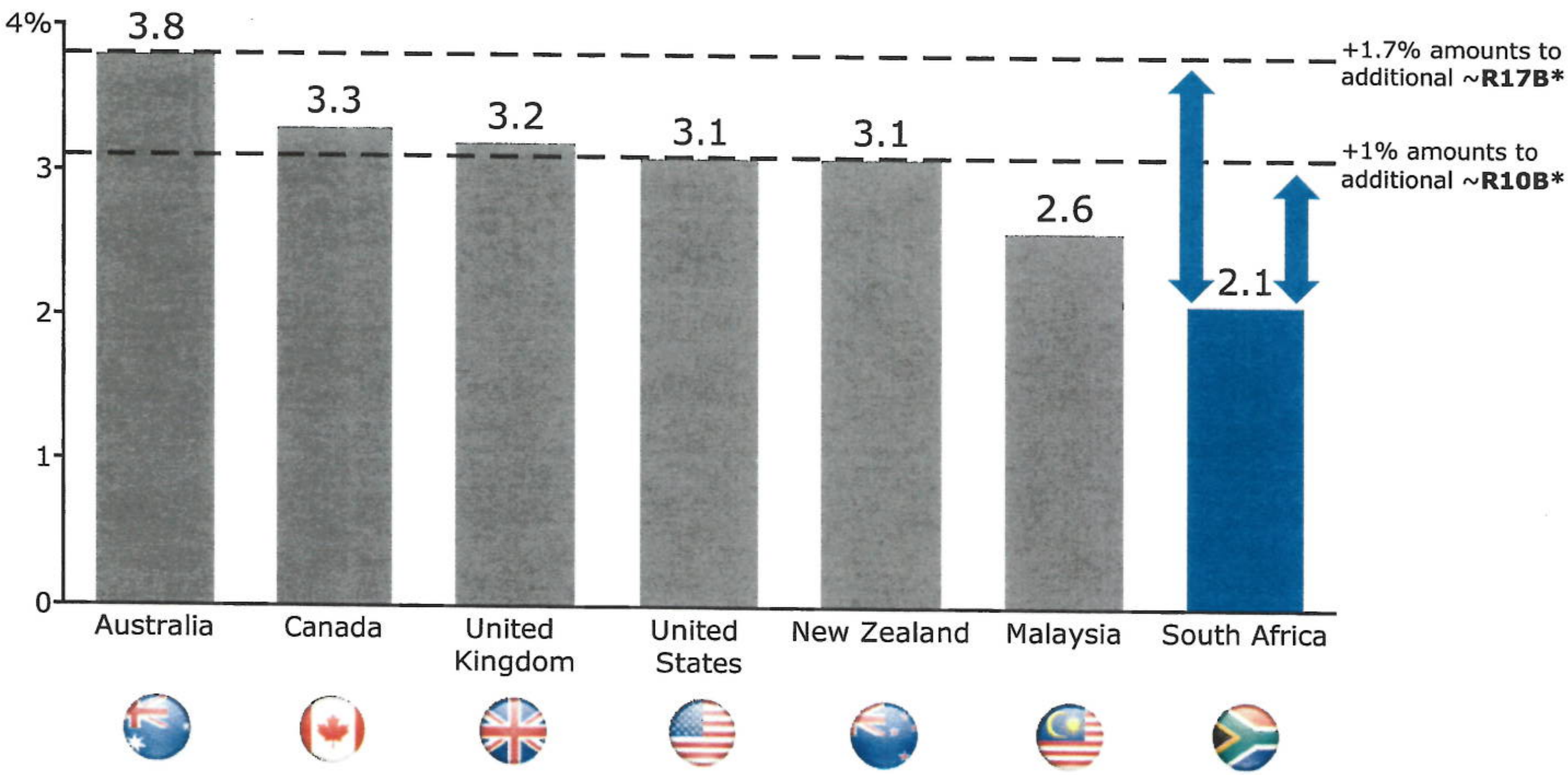
SARS At Your Service

OECD indicates that SARS gains lower additional revenue from verification/compliance checks (~R10-R17B loss)

Tax	Customs/ excise
Service channels	Operating model

Case selection/audit

Additional tax revenue/Total revenue (%)

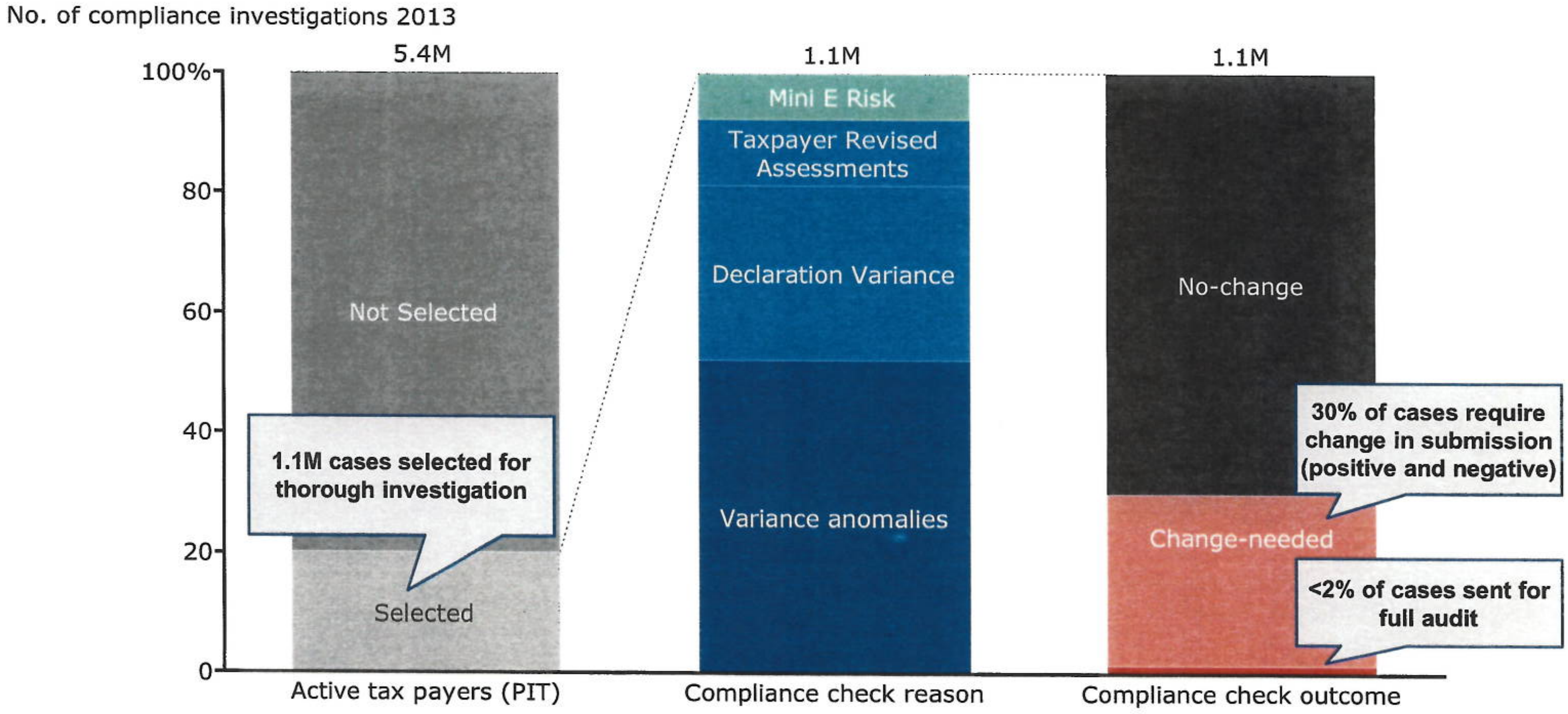


Note: *Based on FY 2014/15 SARS Revenue collections of R986.3B
OECD analysis based on verification activities which incl. tax audits, control & investigations determine by each different per country.
Source: OECD Tax Administration 2013

1 Risk engine not fully effective: 1.1M PIT cases selected for compliance check but less than 2% sent for full audit

Tax	Customs/ excise
Service channels	Operating model

Case selection/audit



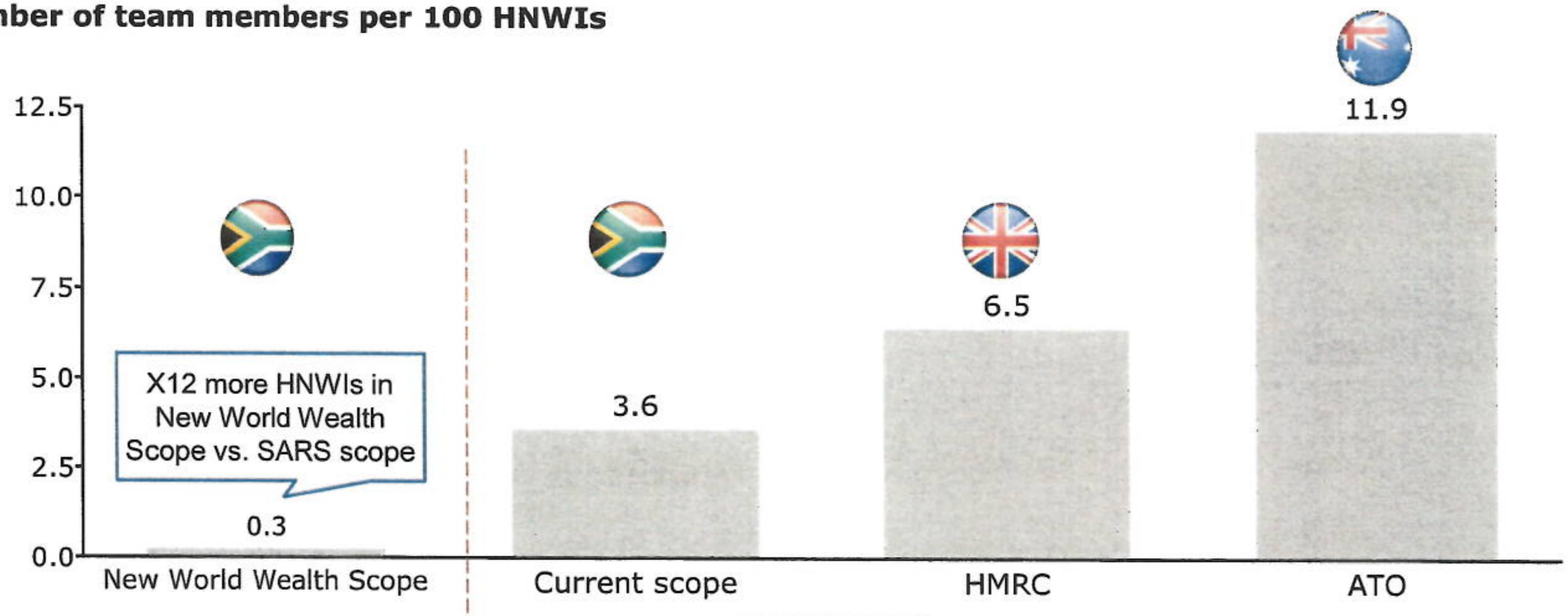
Note: Verification activities incl. tax audits, control & investigations but methodology is different per country.
Source: SARS PIT Risk Coverage Report 2015

1

Only 15 people and 4 dedicated auditors focus on HNWIs

HNWIs

Number of team members per 100 HNWIs



	New World Wealth Scope	Current scope	HMRC	ATO
Team	15	15	400	310
HNWIs	5,300	412	~6,200	~2,600*

Only 4 auditors

LBC only scope

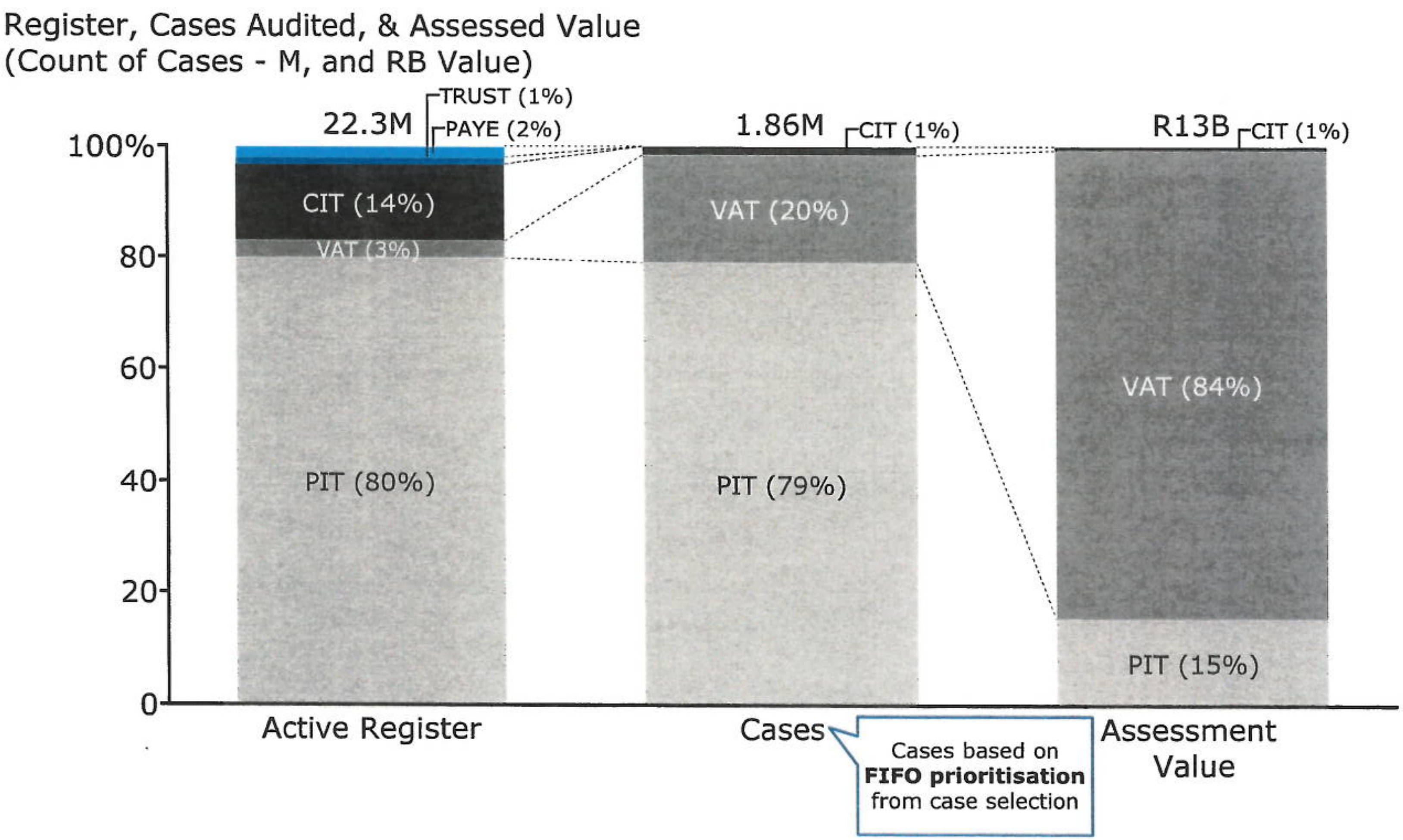
Even with current limited LBC scope, SARS staff-to-HNWI ratio is low vs. other countries; shortcoming would be amplified if HNWI scope increased to include wider definition

Note: (*) ~2,600 confirmed with an additional 3,700 who meet criteria but whose wealth estimate is to be confirmed (drop ratio to 4.9)
Source: SARS internal data; Managing Compliance of High Wealth Individuals – ATO; HMRC website

CIT, Trusts, & PAYE represent low number of audits; 79% of audits done on PIT while 84% of value comes from VAT

Tax	Customs/ excise
Service channels	Operating model

Verification audit



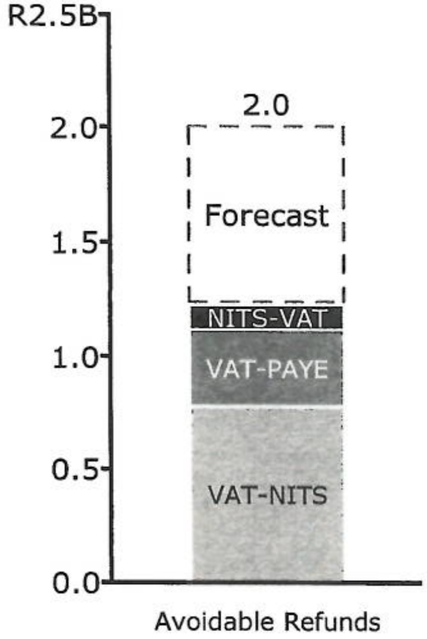
Tax | Customs/ excise | Service channels | Operating model

1 SARS data indicates that R2B refunds payed every year without equalizing with debt

Refunds / debt equalization

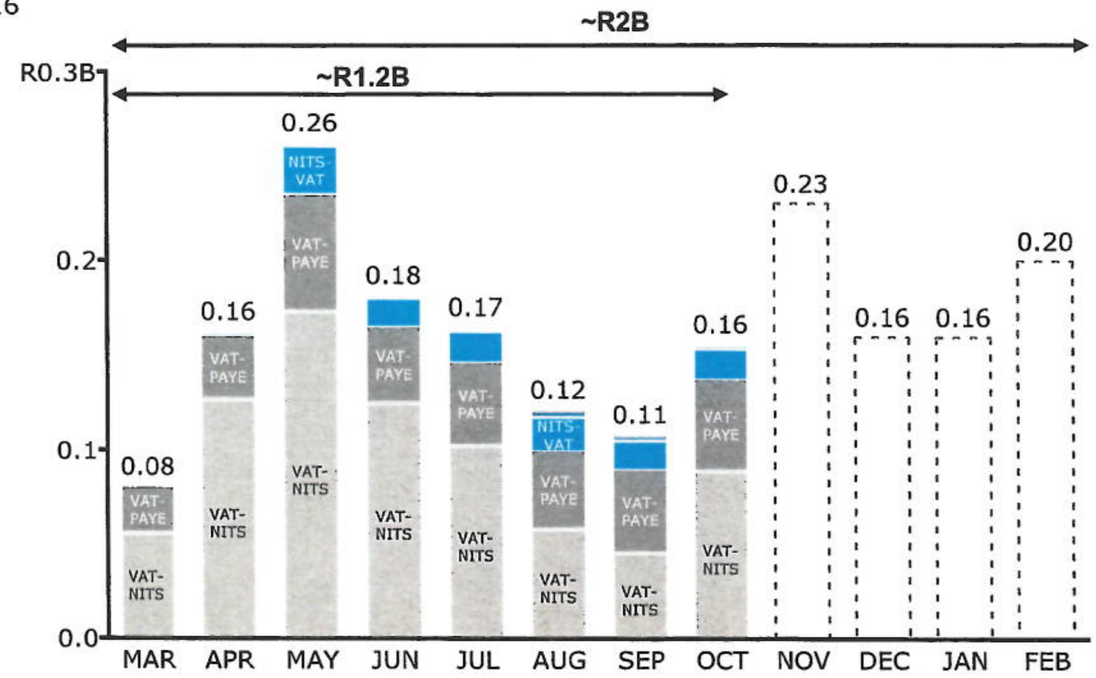
FORECAST IS R1.9B WORTH OF EQUALISATION OPPORTUNITIES

Avoidable refund breakdown YTD '15/16



VAT REFUNDS ARE 90% OF THE AVAILABLE OPPORTUNITY

Avoidable refunds by month by platform
FY 15/16



	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB
Total Refund	13.5	20.3	19.7	17.7	15.6	16.5	14.0	15.4	19.0	18.0	14.7	16.7
% Avoidable Refunds	0.6%	1.1%	1.5%	1.3%	0.8%	0.6%	0.6%	1.0%	1.2%	0.9%	1.1%	1.2%

Forecast

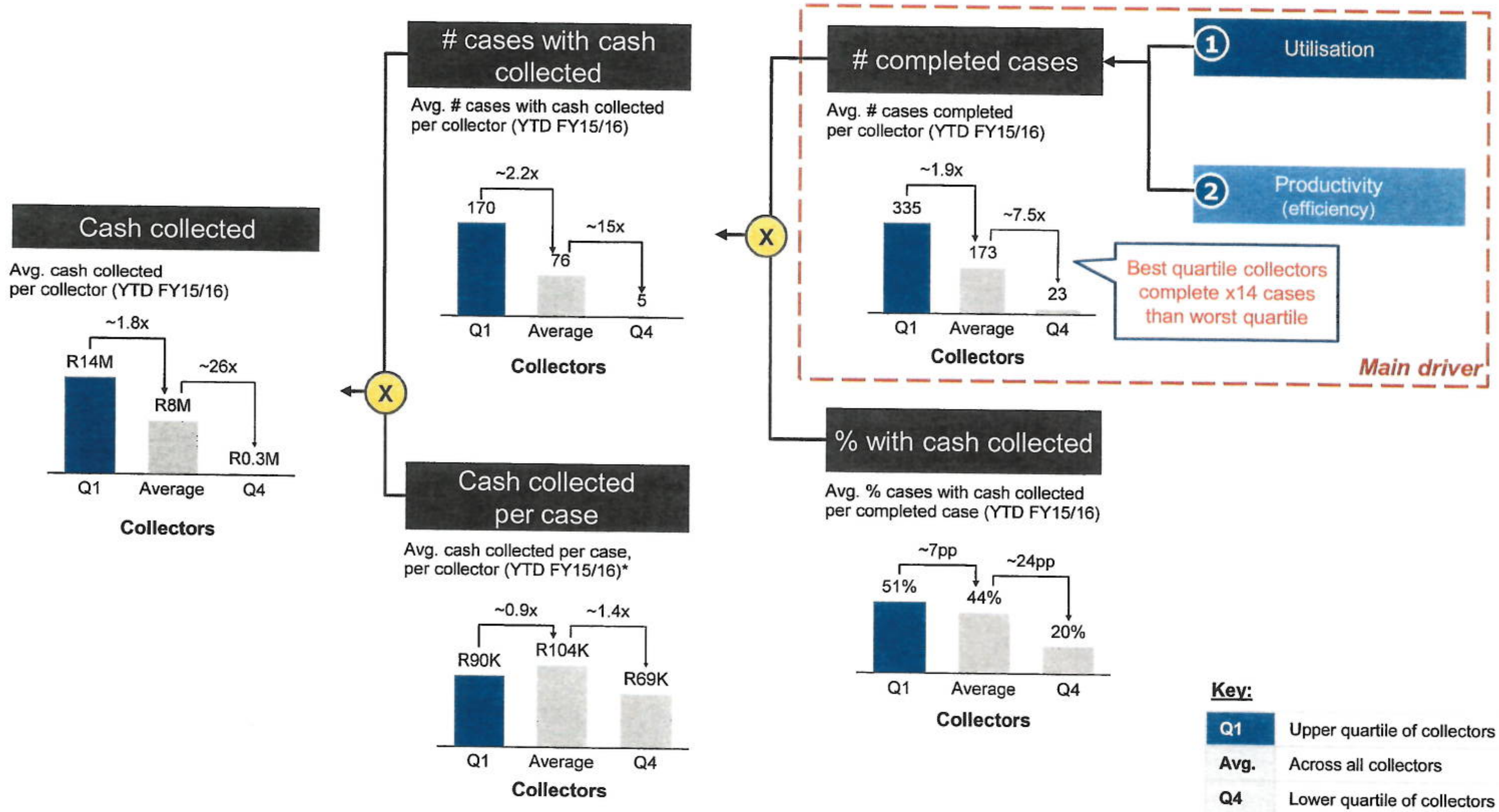
Notes: 1) 15/16 avoidable refunds YTD based on back calculation method, Avoidable refund = MIN(Refund, Debt) 3) Forecast based average monthly EQ opportunity + inflation assumption. 4) Data cleansed for disputed debt, unallocated payments and returns not received
Sources: 1) Monthly Credit and Debt Books (L Zinda, SARS 27/01), 2) Monthly refunds– SARS Internal Data L Zinda 27/01

SARS At Your Service

Disparity in debt collector performance as best quartile collectors complete x14 cases than worst quartile

Tax | Customs/excise | Service channels | Operating model

Debt collection



Note: (*) case value not accounted for; completed cases indicates that case has either been finalised (R0 outstanding balance) or has reached an outcome allowing it to move onto next stage in process; cash collected not only based on cases completed in period

Source: Collector performance data from G. Jacobs (14/01)

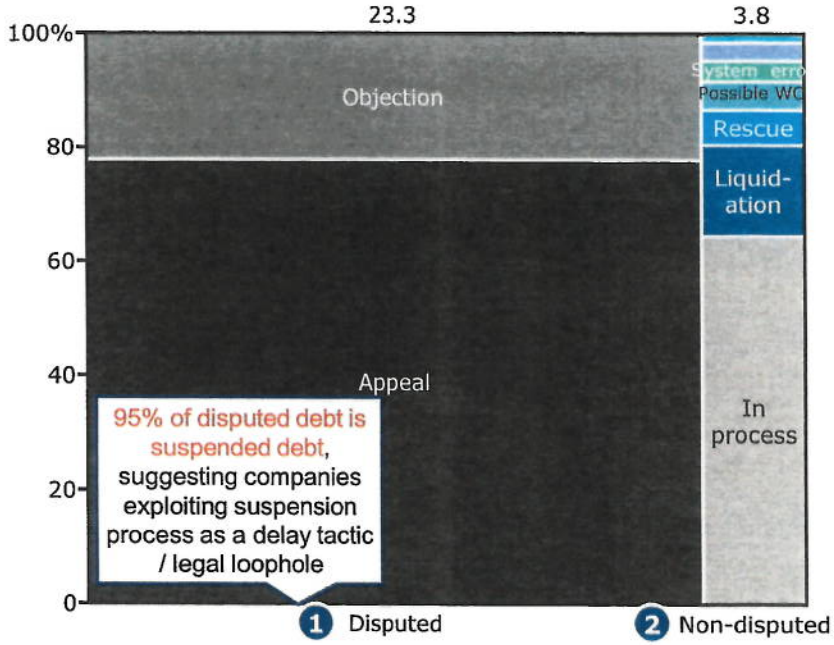
❶ 85% of LBC debt is disputed (R23B) and mostly suspended which prevents "pay now argue later" policy application

Tax | Customs/ excise | Service channels | Operating model

Debt collection

COMPOSITION OF LARGE BUSINESS DEBT BOOK

LBC debt balance, Aug 2015
(R billion)



# cases*	168	4,855

❶ **Disputed debt is 85%** of LBC debt book; key to **close any potential legal loopholes** associated with suspended debt

- **Suspended debt** is **95% value of disputed debt,** preventing application of "pay now argue later" policy to majority of cases
- **Only ~10%** of suspended debt value **collectable**

❷ **Critical to automate tracking and understand collectibility** of different categories of non-disputed debt

- **Non-disputed debt primarily tracked outside the system (on spreadsheets)** making it difficult to accurately track status
- **In-process debt (~65%)** represents debt backlog, requires processing and categorisation
- **Other non-disputed debt (~35%)** refers to processed debt that has been allocated to specialized processes

Note: * Number of cases excludes cases < R100 (3,638 cases with a total value of R24k); other includes SDL, div. tax; diesel, admin penalties
Source: CAM Debt Book decomposition

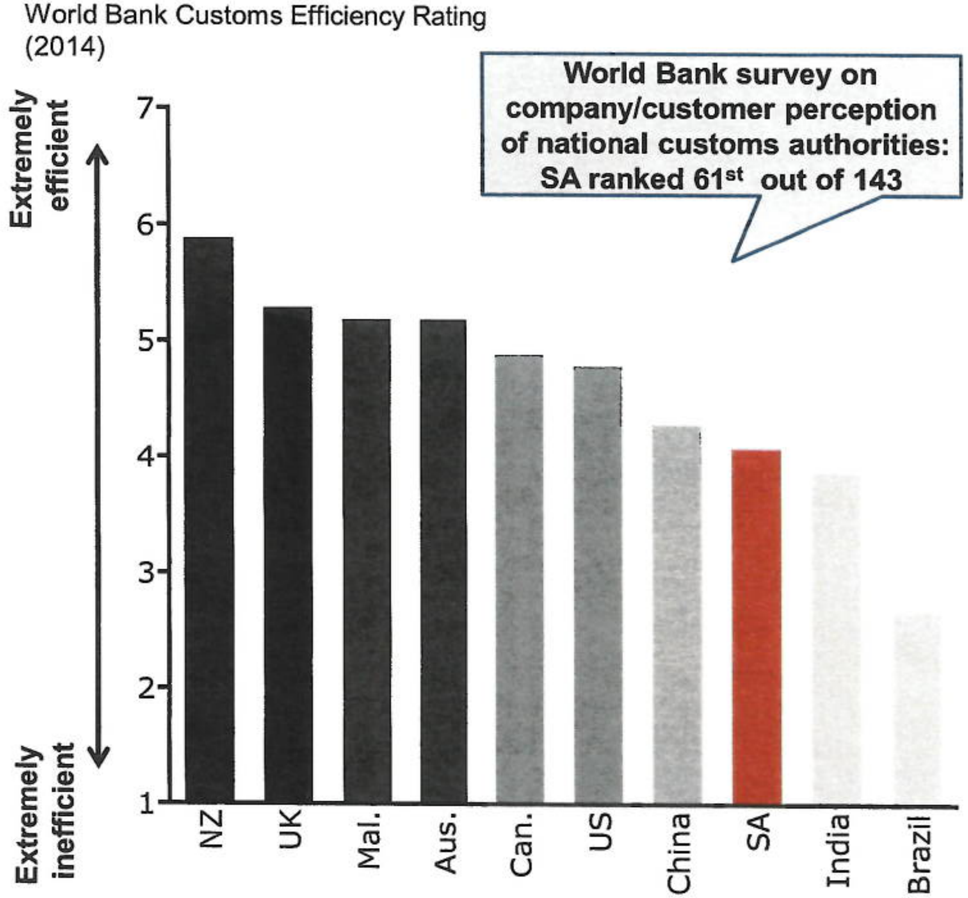
SARS At Your Service

1 World bank benchmarks and SARS interviews indicate significant efficiency improvement opportunity in Customs

Tax	Customs/ excise
Service channels	Operating model

Customs performance

WORLD BANK INDICATES CUSTOMS EFFICIENCY IMPROVEMENT



SUB-STANDARD CUSTOM SERVICE MAKES IMPORT/EXPORT PROCESS INEFFECTIVE

"We haven't yet figured out how to quickly process imports and we still get double-taxed when we export in Africa through South Africa"

Marketing director, Multinational company

"SARS bought a company called Interfront that was supposed to build a customs solution but they are still using multiple vendors for customs systems"

SARS Executive

"To be more effective, we urgently need to clarify roles and responsibilities in the organization, especially in customs."

SARS Executive

Source: World bank customs efficiency report; SARS interviews

SARS At Your Service

Customs port visits and interviews indicate lack of controls, equipment and capacity for inspections

Inspection

POOR CONTROLS AROUND INSPECTION PROCESS

DURBAN

- **No surveillance cameras** at most warehouses therefore inspectors 'unsupervised'
- **No supervision of goods leaving port** to the scanner or depot for inspection
- Industry experts used to test goods which may be a **conflict of interest** – companies testing are in competition with importers

DISCREPANCY OF EQUIPMENT & TECHNOLOGY ACROSS PORTS

ORTIA

- **ORTIA** inspectors record finding **on paper and use own cameras** while **Beitbridge have iPads**
- **No standardized tool** for Passenger Ops to give feedback to case selection
- Inspectors drive with Agents/Reps because of lack of (roadworthy) vehicles

LACK OF CAPACITY AND TOOLS FOR INSPECTIONS

BEITBRIDGE

- Inspection is **understaffed** therefore unable to meet 2 inspector per inspection protocol
- Management **do not have capacity** to supervise inspections to manage quality
- **No equipment to control value of excise (e.g. petrol)**

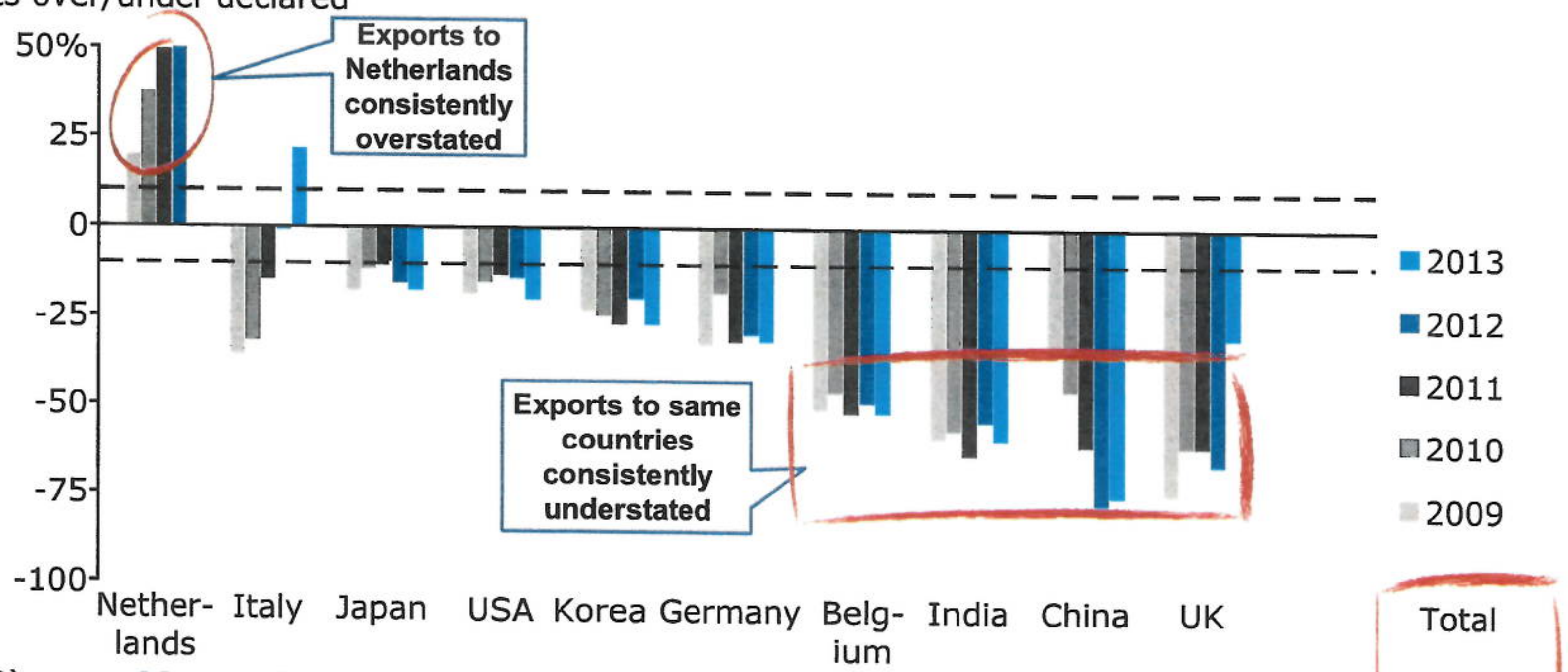
Source: Customs Interviews (2015), ORTIA, Durban Port & Beitbridge site visit (2015)

1 SARS data indicates potential significant trade mispricing– net understatement of ~R1,5T from 2009-2013

Tax | Customs/ excise | Service channels | Operating model

Trade mispricing

% Exports over/under declared



	Netherlands	Italy	Japan	USA	Korea	Germany	Belgium	India	China	UK	Total
Gap (R, B)	23	-12	-39	-55	-20	-73	-47	-175	-855	-232	-R1,49T

Need to assess chapter level (product and industry) to understand drivers

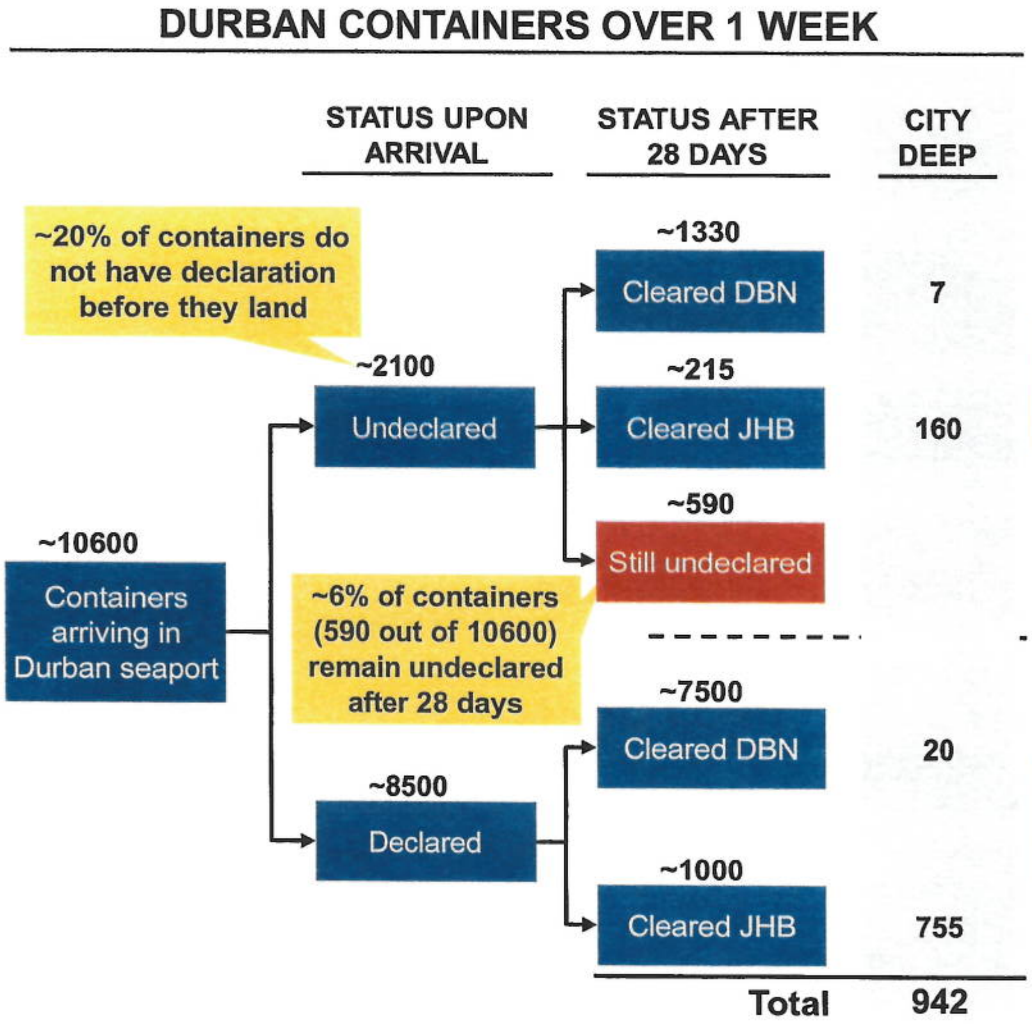
Note: % Over/Under declared calculated as follows= (Export value at SA border-Export value at foreign border)/Export value at foreign border
Assumption: Export value at foreign border is correct
Source: SARS 80 20 Export and Import

SARS At Your Service

Data gaps identified in monitoring goods: ~6% of containers landing at Durban remain undeclared after 28 days

Tax	Customs/ excise
Service channels	Operating model

Import control



DATA TEST 26 OCT - 2 NOV 2015

FINDINGS:

1 **Goods Control**

- Declarations not tied back to goods that arrived
  - ~6% of goods uncleared
- Potential leakage of goods en-route to depots
  - ~20% of goods are undeclared before arrival
  - Within these, ~10% cleared outside Durban; highest risk are those traveling by road
- Potential leakage en-route to City Deep
  - ~10% destined for City Deep
  - ~60% travel by rail

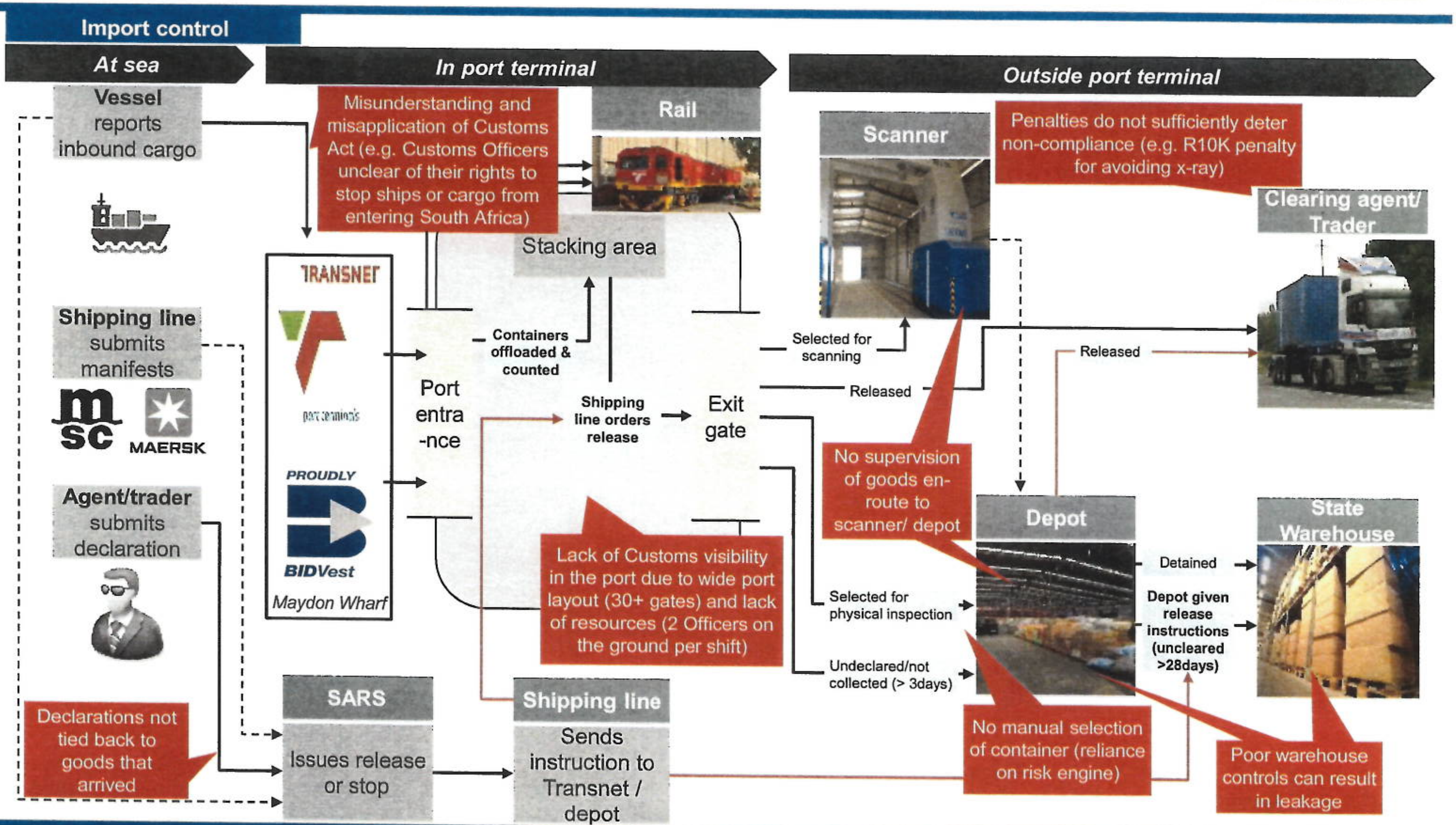
2 **Case Selection**

- >80% of declarations are released by the system, as these are deemed low risk
  - Traditionally low hit rate (~13%) on inspections
- Penalties not viewed as deterrent as they are too low

Note: Goods manifested for JHB/PTA can be cleared in DBN; Place of clearance does not necessarily have to be Port of Entry
Source: Navis data, 26 Oct- 02 Nov 2015

A number of gaps at Durban seaport indicate lack of full control of goods

Tax	Customs/ excise
Service channels	Operating model



Note: This process only depicts containerised cargo.
BLNS = Botswana, Lesotho, Namibia, South Africa

Key: Not happening consistently/ at all — Shipping line releases

1 Durban state-of-the-art scanner only has 3% success rate and operates at 25% capacity

Tax	Customs/ excise
Service channels	Operating model

Goods control

SCANNER CAN BE EFFECTIVE IN DETECTING GOODS NOT DECLARED…

DURBAN EXAMPLE

…HOWEVER ONLY 3% SUCCESS RATE RECORDED

- **No supervision of goods** before scan:
  - **Trader informed of scan**; shipping line responsible to transport goods to scanner
  - **Seal is only surety** against tampering
  - Only **R10k penalty if scan missed** with no follow-up action
- Scanner is **under-utilized**:
  - Only 20 scans per day vs. potential of 80; main **constraints** are **staff & processing time**
  - Scans **purely based on risk engine**
  - **No manual/random scans** because scanner not in normal flow on goods

Scanners only in Durban, Cape Town and Beitbridge

Note: Success rate self-reported by Scanner team
Source: Durban Sea port scan team and site visit (23 July 2015)

1 ORTIA: Several risks and leakage opportunities exist across goods types at ORTIA

Tax	Customs/ excise
Service channels	Operating model

	CARGO/MAIL CENTRE	PASSENGER
Limited data visibility on goods entering limits targeting	• **Poor data availability from airlines** and other stakeholders - No view on all goods entering and leaving (up to 20%[1] of manifested Cargo not declared) - Un-scheduled flights land without Customs knowledge (~1% flights) - Manifest is not in an appropriate format • **No tracking or securing cargo undeclared >14 days** • **Ineffective SAPO mail centre systems**: tariffs are outdated, no Customs visibility and no risk engine	• **Poor data availability from airlines** and other stakeholders - No view on all passengers entering - Lack of information about passengers for targeting **(Electronic manifests only received from SAA; ~40% of pax[2])** - Data formats are unusable • **No risk engine exists** (SCS selection accounts for <0.5% of inspections) • **Limited feedback between SCS and Ops** - **No feedback for 70% of submitted targets** in 2015/16 FY
Limited ability to physically react to identified risks	• Opportunities exist for **leakage of goods** - **Un-manifested cargo removed** en route to or in shed/facility and **thefts in sheds** - **Goods removed/tampered** with by OGAs - **Detained goods removed** from virtual state warehouse - High risk for **illicit cargo to be smuggled within** mail • **Poor surveillance** across process	• **No central identification point** (chance of missing passengers in green channel) - **36% of pax were not successfully identified** in 2015/16 FY • **Lack of full visibility** of passenger and baggage movements (incl. unclaimed baggage) • **Limited random inspections** to refine SCS risk approach
Lack of enablers to exert Goods Control	• **Poor alignment** with **stakeholders** (e.g. airlines) **& OGAs** (e.g. SAPS) • **No system/interface in place** to provide single end-to-end view of movement of goods • **Penalties do not deter non-compliance** e.g. supplying false documents leading to underpayment of duties – **25% of underpayment; minimum R1500** • **Enforcement approach** not consistently applied or targeted to prevent **repeat offenders**	• Lack of **staff capacity** to perform targeting, identification and inspections (~200-400 Int'l Pax per Ops member per hour) • Commercial goods process is **sub-optimal (e.g. system does not enable efficient processing**)

Note: (1) (2) includes pax and crew (2) SAA manifest recon (1 month)
Source: API System (M. de Beer, 18th May 2016); PNR targeting database (K.Loncey, 04/2015-03/2016); Revision 5 of SARS customs intervention list

ORTIA: Currently there is limited access to cargo and passenger manifest data

Tax	Customs/ excise
Service channels	Operating model

SUMMARY: AIRLINE DATA ACCESS

Airline	Passenger flight volume (%)	Current Passenger Manifest Access	Future Passenger Manifest Access	Cargo Import tonnage volume (%)	Current Cargo Import Manifest Access	Future Cargo Import Manifest Access
SAA	41%	✓	✓	20%	✓	✔
Emirates	8%	✗	✓	13%	✓	✔
Etihad	Unavailable	✗	✓	4%	✓	✔
Ethiopia Airways	3%	✗	✓	4%	✓	✔
British Airways	7%	✗	✓	Unavailable	✗	✔
Air France	3%	✗	✓		✓	✔
Qatar	3%	✗	✓	24%	✓	✔
Other Swissport*	N/A	N/A	✓		✓	✔
Courier Flights	N/A	N/A	✓	4%	✓	✔
Other Operators	34%	✗	✓	33%	✓	✔

STEPS TO INCREASE ACCESS

Passenger

- Engage Airline Association and send letters to airlines to specify data requirements

Cargo

- Work with IT team to gain live access to MPR database
- Engage Airline Association to get permission from airlines to use IVS data
- Enforce manifest submission to MPR through penalties if airlines do not comply

Legend:

✔ Received electronically - usable format**

✓ Received electronically – not usable format**

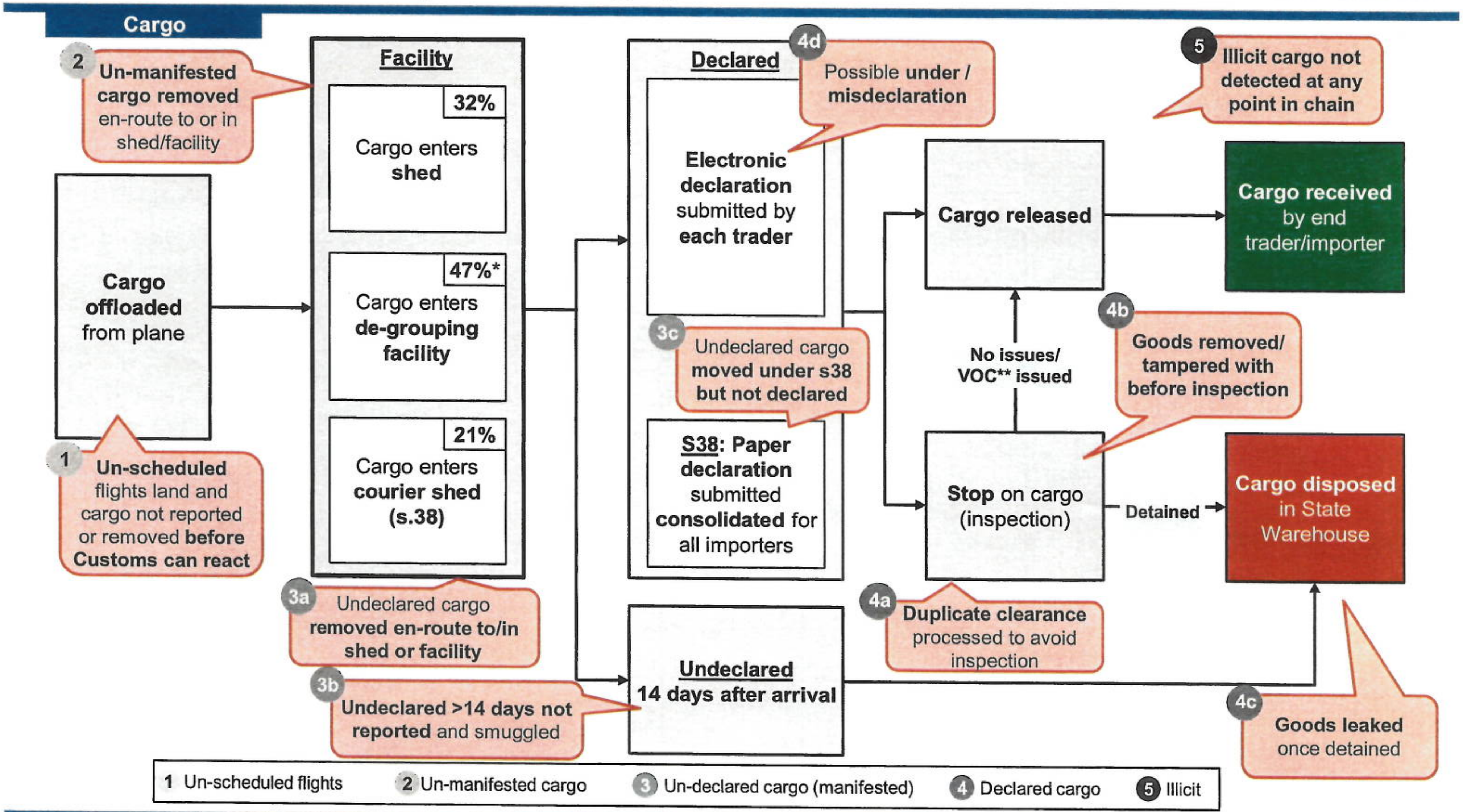
✗ Not received electronically

Increased data accessibility will enhance data visibility and targeting accuracy

Note: *Swissport incl. Airfrance, KLM, Qatar, KenyaAir; **Usable for Command Centre workflow tool
Source: Cargo data; Menzies, AFS,SAA, Swissport and ACSA ('15); PAX data; API System (M. de Beer, 18th May 2016)

ORTIA: Airline and courier shed goods control process highlights the 5 key control gaps that must be addressed

Tax	Customs/ excise
Service channels	Operating model



Note: *De-grouping facility % based on SAA manifests that had description "Consol"; **VOC – voucher of correction (to adjust initial declaration); Process exclude Mail Centre process and transit cargo

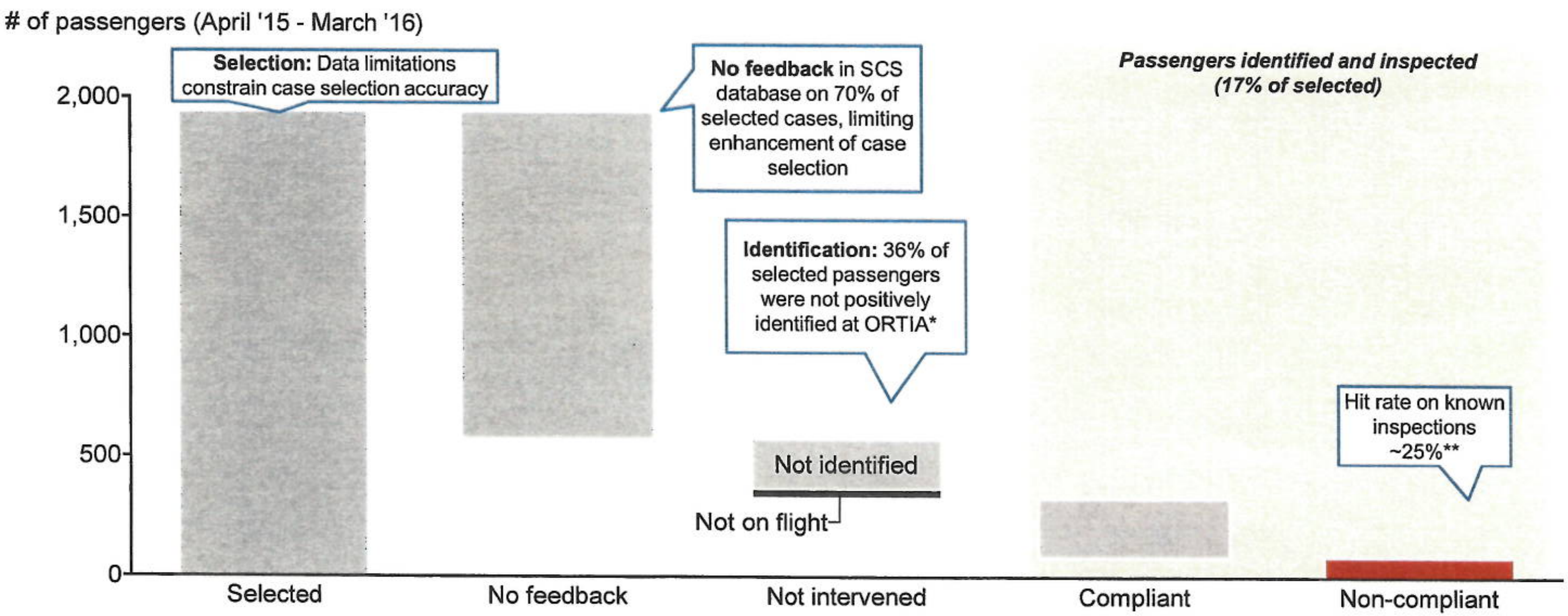
Source: SAA Manifests (Jan 2016); Site visit (April 2016)

SARS At Your Service

1 ORTIA: Number of passengers intercepted with unwanted goods can be increased through improved risk profiling

Tax	Customs/ excise
Service channels	Operating model

Passenger



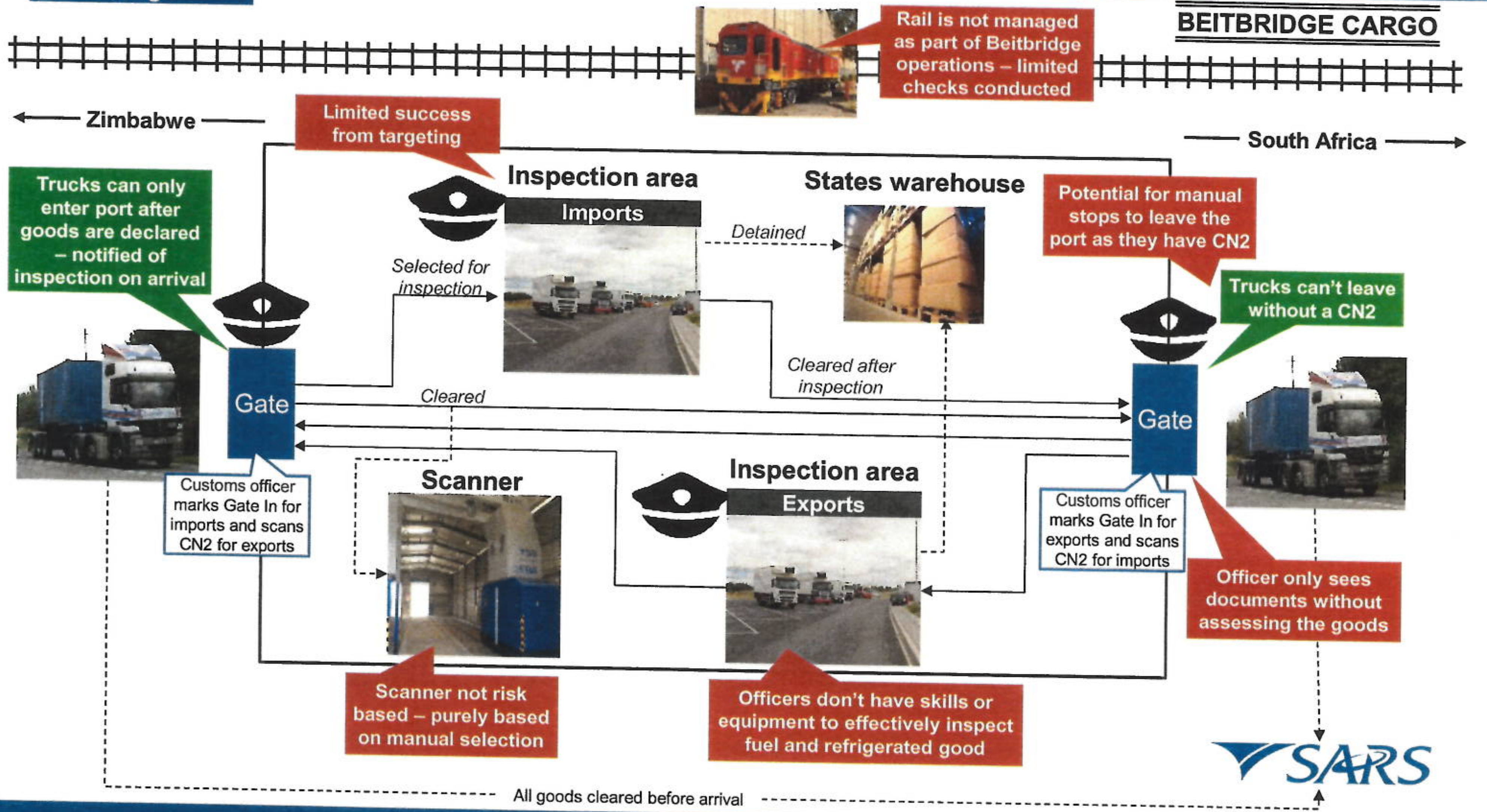
Increasing data access and developing central ID point can significantly increase passenger busts

Note: *% Not identified = # not identified / (# selected - # no feedback); **Hit rate = # non-compliant / (# selected - # no feedback - # not intervened)
Source: PNR targeting database (K.Loncey, 04/2015-03/2016)

1 Beitbridge: good oversight of goods movement at port, however targeting/inspection quality are potential issues

Tax	Customs/ excise
Service channels	Operating model

Cargo



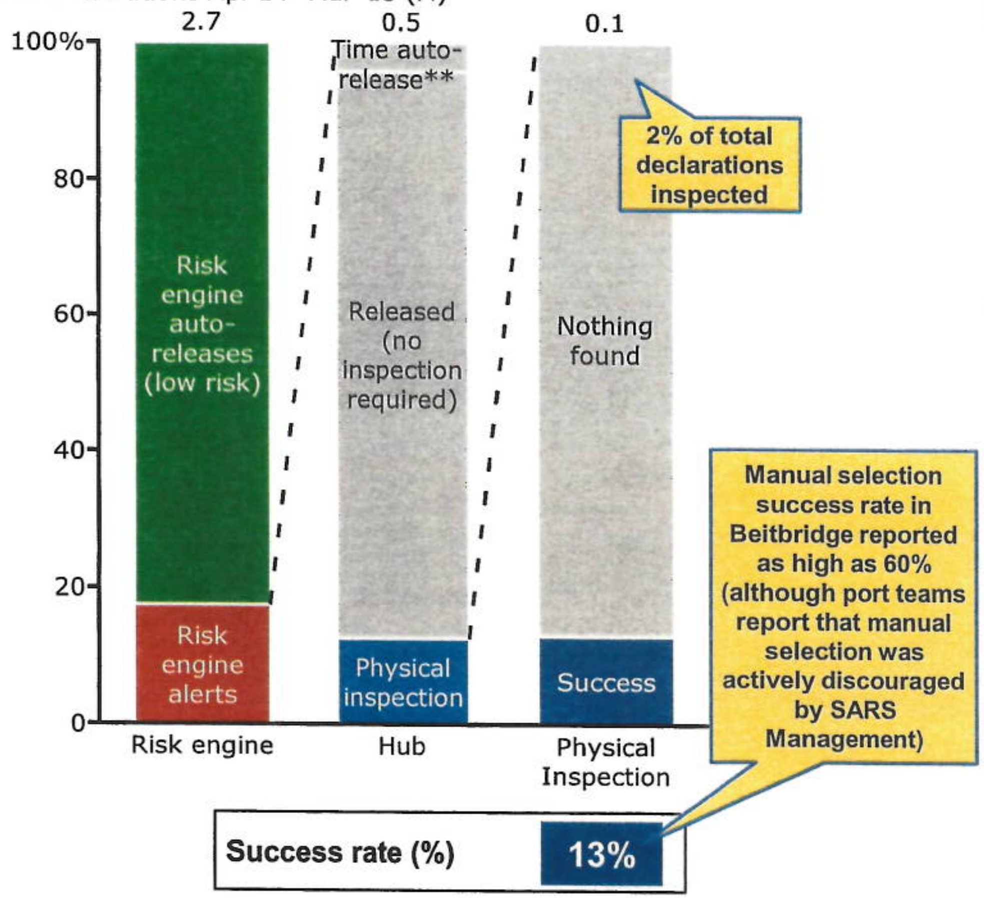
Risk Engine appears sub-optimal: 2% of declarations inspected with ~13% hit rate; engine not learning effectively

Tax | Customs/ excise | Service channels | Operating model

Customs case selection

2% OF DECLARATIONS ARE INSPECTED – SUCCESS RATE OF 13% VS ~60% FOR MANUALLY SELECTED*

No. of declarations Apr'14- Mar '15 (M)



RISK ENGINE USES LIMITED THIRD PARTY DATA, AND DOES NOT APPEAR TO LEARN EFFECTIVELY

- **Engine model and methodology:** No systematic approach to develop entity-based risk rules
  - Entity non-compliance is tracked on an ad hoc basis by different regions separately, with limited analysis on behaviours displayed
- **Third Party Data:** Limited use of third party data
  - Engine does not verify against 3rd party data e.g. payment records, export declaration from country of origin, etc.
- **Feedback loop:** Engine does not learn
  - No feedback loop from documentary inspection, Physical inspection, and PCA to refine risk rules
  - Tracking of manual selection cases not facilitated by service manager
- **Governance of engine:**
  - Limited input from Customs operations
  - No systematic approach to making changes

Note: *Manual selections based on working group estimate. Success defined as a case where there was a financial outcome from Customs interventions (i.e. a Voucher of Correction was issued). **Time based auto-releases (4 hours) figure close to 0 due to close monitoring.
Source: Customs Monthly Report from SCS (2015); Site visit to Beitbridge July 2015

SARS Customs penalties weak compared to other Customs authorities; ineffective in deterring non-compliant behaviour

Tax | **Customs/ excise** | Service channels | Operating model

Consequence Management

EXAMPLE

Penalties often **overturned** due to operational **errors**

		SOUTH AFRICA (SARS)	UNITED STATES
Failure to report cargo	**Manifest not submitted**	• Min/Max: R1,000	• Min: $5K (first time) • Max: **$10K (2nd time) or forfeiture** (severe situation)
	Goods on vessel not captured on manifest **(excess cargo)**	• Min/Max: No fine	• Min: $10K • Max: **value** of merchandise
	Discovery of **drugs/ restricted goods inside un-manifested cargo**	• Min/Max: No fine	• Min: **$500/oz** of drug (e.g. marijuana) • Max: **$1000/oz** of drug (e.g. cocaine) *Fine charged to shipping line*
	Attempt to **import goods without declaration** or missing scan	• Min: R5000; Max: value of the goods • Missing scan: R10 000	• Min/Max: **value** of the goods
Misrepresentation	**Fraudulent** (voluntary or intentional)	• Min: **25%** of underpayment • Max: **50%** of underpayment / value of goods*	• Min: **5 to 8x** underpayment • Max: **value** of goods *If no loss due to error fine = 50-80% dutiable value*
	Gross Negligence (had actual knowledge or acted in wanton disregard)	• Min: **25%** of underpayment • Max: **50%** of underpayment / value of goods*	• Min: **2.5 to 4x** underpayment • Max: **4x** underpayment *If no loss due to error fine = 25-40%*
	Negligence (fails to exercise reasonable care)	• Min/Max: **10%** of underpayment	• Min: **0.5 to 2x** underpayment • Max: **2x** underpayment *If no loss due to error fine = 5-20% dutiable value*

Penalties tiered based on occurrence

Penalties a significant cost for trader

Some rulings are publically reported

Notes: Misrepresentation includes classification and valuation errors etc. *Max penalty will depend on violation
Source: Durban site visits and management interviews; Expert calls with former employees from benchmark tax authorities

SARS At Your Service

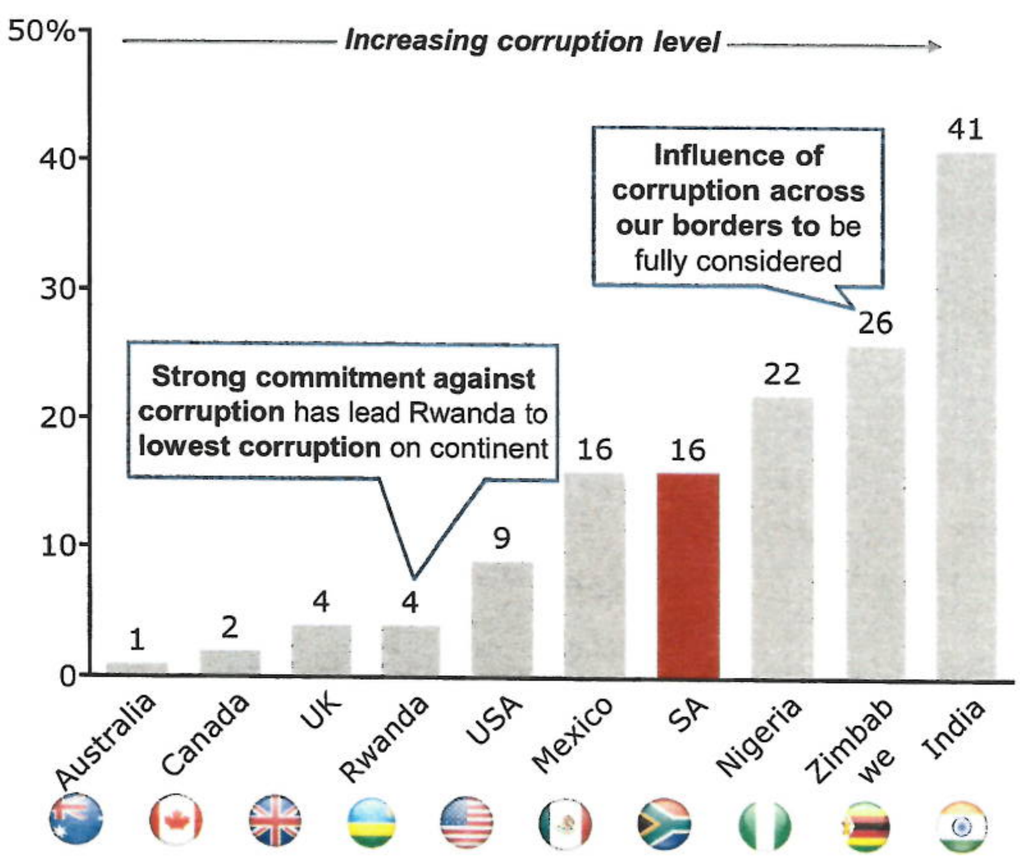
Transparency International rates SARS corruption high (high risk in customs)

Tax	Customs/ excise
Service channels	Operating model

Corruption

SARS BETTER THAN DEVELOPING PEERS BUT PERFORMING POORLY AGAINST BENCHMARKS

People who have paid a bribe to the revenue authority (%)



SARS DOES NOT HAVE STRONG VIEW ON RISK AREAS FOR CORRUPTION

- Use of manual systems and **lack of corruption reporting** have resulted in **limited data**
- Enforcement teams **target key areas** skewing the little data that exists
- Customs has **high risk of corruption** due to
  - Numerous **manual processes**
  - Level of trader **interaction**
  - Officials have **discretion** at some ports (e.g. manual inspections at land borders)
  - Lack of **physical control** at ports

Process issues (e.g. exports controls) present opportunities for corruption

Note: Survey posed question "Have you or anyone in your household paid a bribe to one of these eight (public) services in the last 12 months?" where respondent had interacted with that public agency in past 12 months
Source: Transparency International Global Corruption Barometer (2013); Transparency International Corruption in Tax & Customs Authorities (2014)

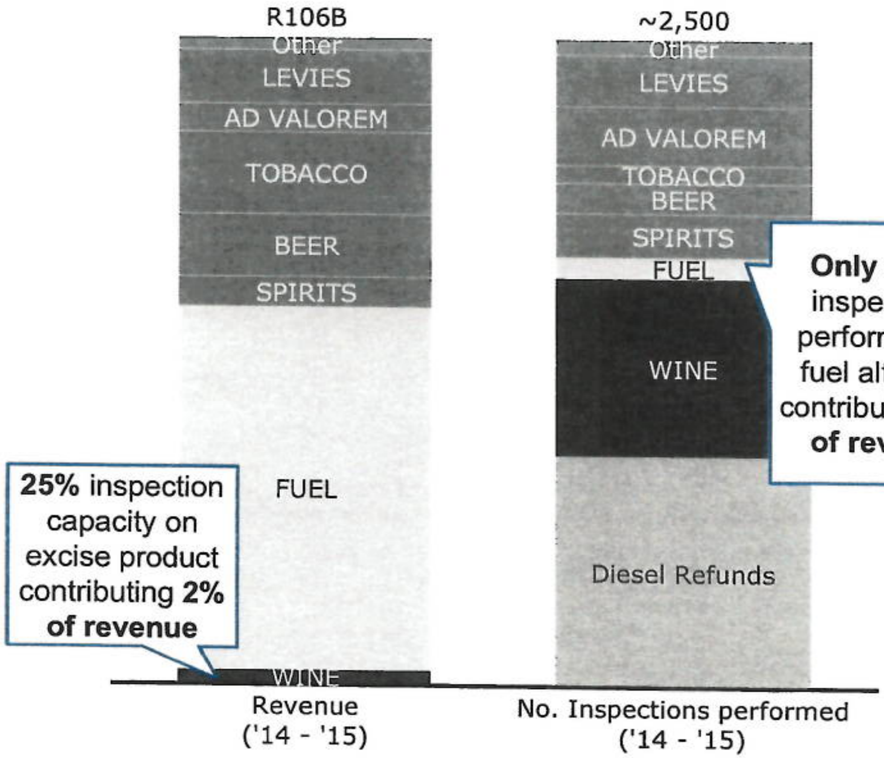
SARS At Your Service

Excise inspections appear misallocated against revenue potential – SARS interviews indicate lack of control

Excise

LOCAL: INSPECTION COVERAGE NOT LINKED TO REVENUE COLLECTED

Inspections and revenue by products ('14-'15)



EXPORT: FRAUD POSSIBLE DUE TO MANUAL SYSTEM AND POOR CONTROL OF EXPORTS

Duplicate refunds

- **Export declaration used multiple times**
- **Paper-based process** means team unable to check same refund already claimed

Ghost exports

- Customs risk engine **not focused on Excisable goods** so trades unlikely to be caught
- **Poor physical port control** increases risk

Round Tripping

- **Truck exits border and full truck returns** but trader claims as export
- **Lack of tools** to test e.g. scanners at all borders

Note: Data from Jul '14- Jun '15; "Other" Excise tax type includes: Ad valorem, Plastic bags, Air departure, Incandescent light bulb, CO2 tax - motor vehicle emissions, Universal Service Fund and Diamond Levy. Coverage calculated on basis of %inspections - % revenue contribution per product
Source: SARS Excise Collection Figures; National Monthly Inspection Report 2015; Interviews with excise teams (Incl. Durban seaport)

Taxpayer experience varies significantly depending on the type of interaction and channel

Tax	Customs/ excise
Service channels	Operating model

Taxpayer experience

	Registration	Filing	Declaration	Payment & refunds	Enforcement/ Border protection
Description	• Ongoing expansion of tax register with adult citizens (new and backlog)	• Automated system generates partially completed forms for PIT from employee records & other data sources	• Filings assessed in an efficient and accurate manner	• Tax payers able to make arrangements / online payments and receive a response instantly (SMS, email)	• Targeted enforcement approach, fed both by checks on returns submitted, and proactive identification of high risk situations
Positive experiences	+ Call centre exceed **first call resolution target of 82%** + Branches have **short queue time** in low season (avg 18min)	+ PIT **eFiling ~10mins** for taxpayer to submit + **90% taxpayers declare they would use online (Help-you-e-File) tool** again	+ Quick turnaround on returns - **4hrs (avg) for PIT**; 11hrs for CIT	+ **96%** of refunds paid to taxpayers now made **electronically**	+ **# of disputes dropped from 3K to 2K** in 2014 + **99% of customs bills** declared **electronically**
Negative experiences	− **Long queue during tax season (avg. 36mins)** − **Multiple visits** required for complex and sometimes simple queries	− **Increase of 5% in branch visits*** despite e-filing uptake	− **Tax Clearance Certificate require online & branch interactions**	− **Long refund turnaround** (31.7 days for VAT) − Taxpayer **unable to get advice** from call centre (no access to systems)	− Taxpayers still perceive **process as inefficient or unfair** − **Little real time update** on what is happening if delays / investigations

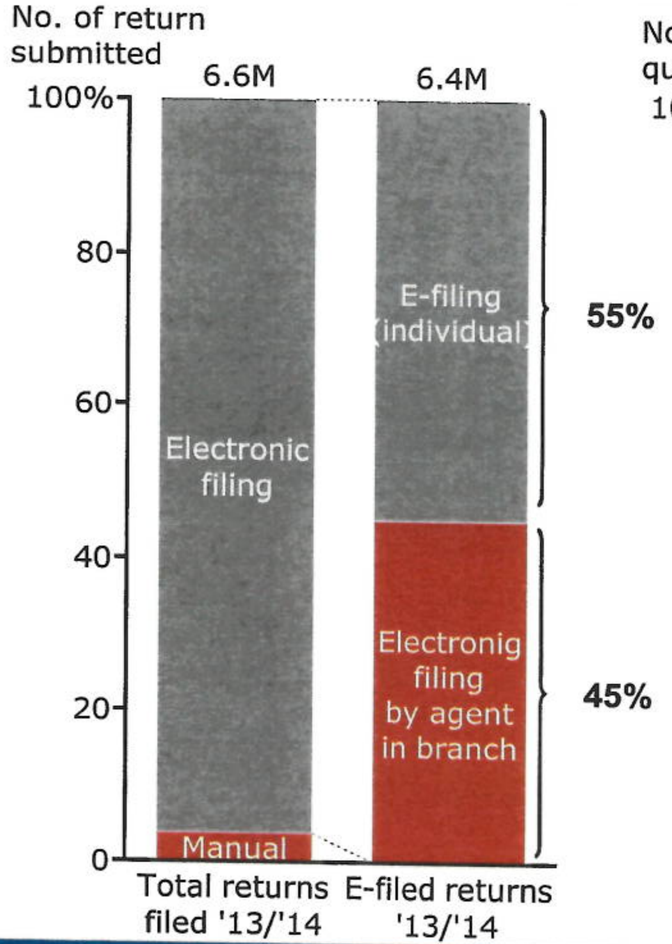
Note: *Potentially driven by branch footprint; 36mins queue time based on national average, June and July
Source: Industry research; SARS interviews; Branch visits; Annual report 2014

45% of e-filing is done by an agent in branch – many taxpayers visit branches multiple times (incl. simple tasks)

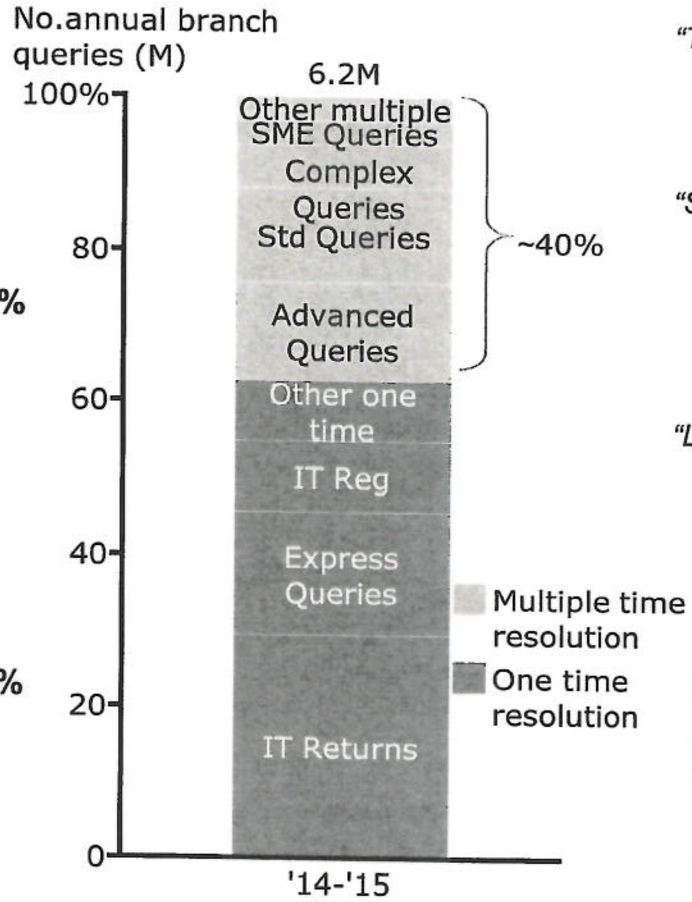
Tax | Customs/excise | Service channels | Operating model

E-filing

HALF OF E-FILED RETURNS SUBMITTED BY BRANCH AGENTS



6.2M INTERACTIONS OCCURRED IN BRANCHES LAST YEAR



TAXPAYERS VISIT BRANCHES UNNECESSARILY

"Taxpayers should be able to print tax clearance certificates at home. All we do is print it for them."

SARS Branch Employee

"SMEs avoid doing registrations themselves and send employees to register for tax before they begin work. This floods branches with unnecessary visits"

SARS Executive

"Lack of fraud prevention technology prevents call centre agents from helping taxpayers with certain queries. These taxpayers then have to go to the branch."

SARS Executive

- Many people visiting to file (large volume concentrated in few months), while there are alternative channels
- A number of people do not need to file at all – they file either because of a lack of understanding or to try to get a refund

Notes: Return numbers for PIT, CIT & VAT; Branch queries based on total ticketed interactions from Jan 2014 to Jan 2015
Source: SARS Statistics 2014; SARS internal HC Data; SARS PIT Risk Audit Report; Performance Overview (Pretoria CBD Branch) 2015

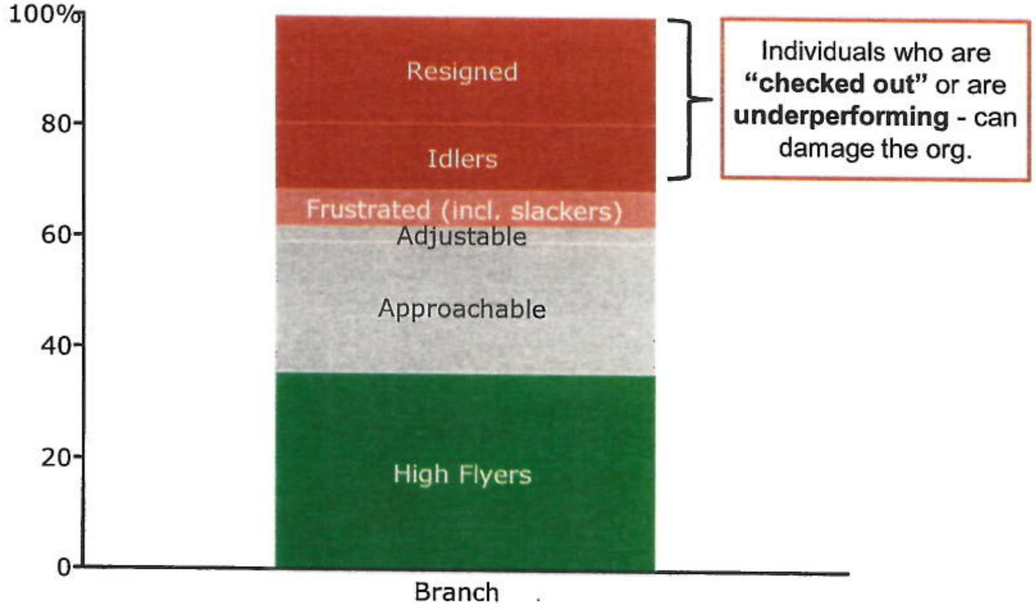
1 SARS survey indicates 20% of branch employees are disengaged which may be a barrier to improved service

Tax	Customs/ excise
Service channels	Operating model

Service performance

~20% OF BRANCH EMPLOYEES ARE DISENGAGED - POTENTIALLY DAMAGING TO SERVICE AND SARS REPUTATION

Breakdown of employee engagement levels



	Branch
Engagement level (%)	67
# FTE's	2,091

EMPLOYEES ARE POSITIVE ABOUT..

- **Sense of achievement and job satisfaction**
- SARS viewed as **dependable employer of choice**
- Belief in the **fairness of processes**

EMPLOYEES SHOW FRUSTRATION OVER...

- **Ambiguity in role** and responsibilities between agents and consultants
- **Lack of clear change management** drives feelings of disengagement
- **Misalignment with unions** (e.g., automation) increases resistance to changing how people work
- **Lack of user-friendliness** of service manager system
- **Back-end processes disempower** agents

Note: 60% participation rate for Branch Ops; 61% across SARS; overall employee base n=7091
Source: Connexion Survey (Branch and overall), 2015

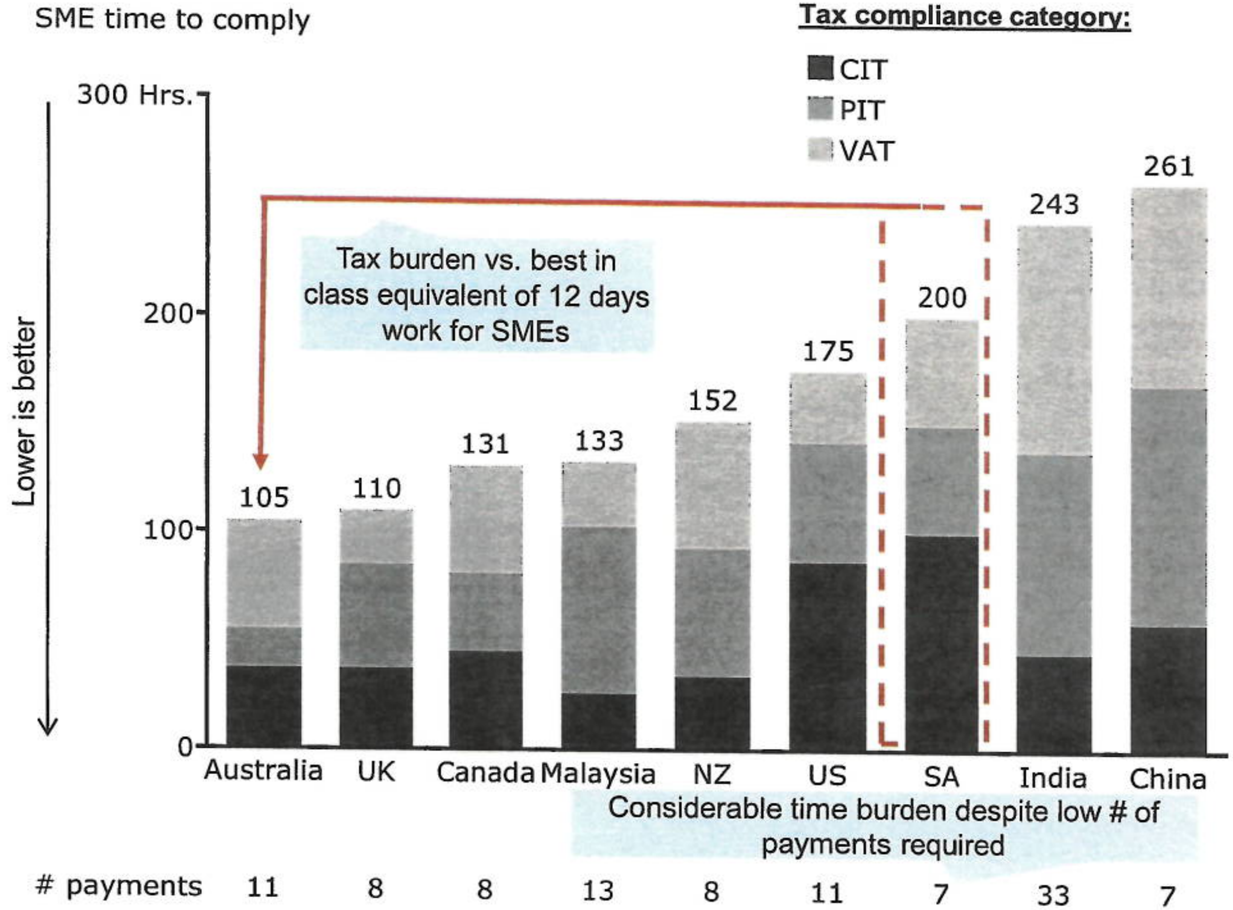
SARS At Your Service

PWC indicates SMEs take 25 days to comply with tax requirements – administrative burden could be increasing

Tax	Customs/ excise
Service channels	Operating model

Registration/filing

SME TIME TO COMPLY



SARS INTERVIEWS INDICATE SME BURDEN IS INCREASING

- **2003-2013: SARS made corporate tax process easier** with e-filing, single monthly payroll returns, and fewer document requirements
- **Since 2013: compliance demands increased** with enhanced disclosure and account reconciliation forms (65% of SMEs file via practitioners due to complexity)
- **Going forward: new tax policies may increase burden further** incl. dividends tax, carbon tax, and non-resident rules

Note: Time to comply based on medium sized domestic enterprises; Labour tax include any mandatory contributions/taxes on behalf of employees; days based on 8 hours
Source: PWC Paying taxes reports 2014/15;

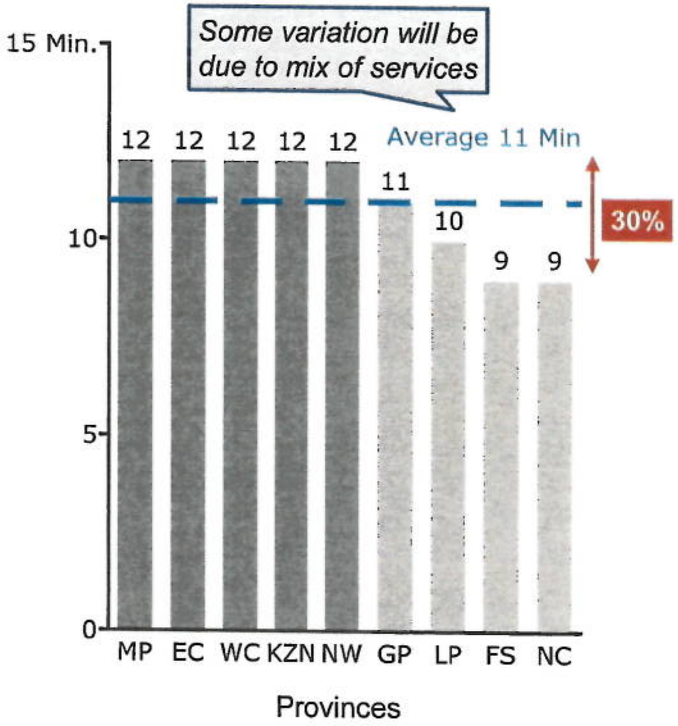
1 SARS data show high variation in branch performance: best region queue times is 4x better than worst

Tax	Customs/ excise
Service channels	Operating model

Service performance

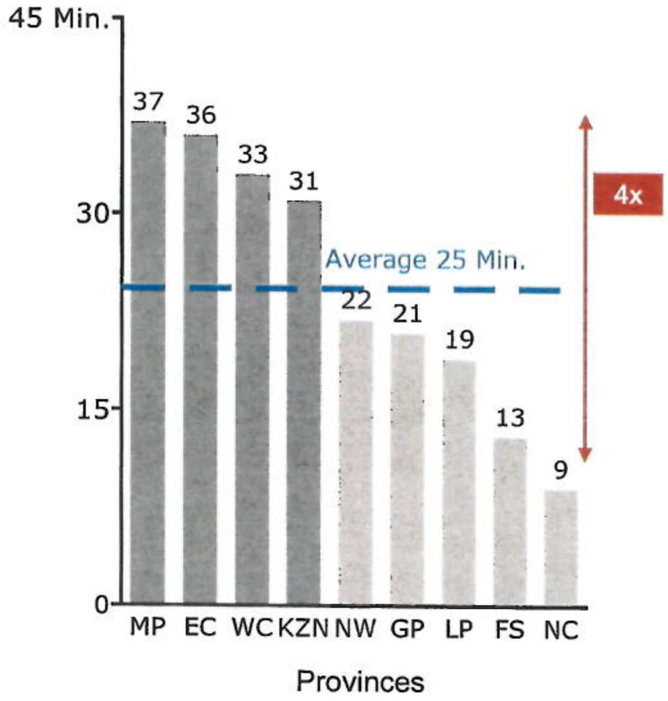
SERVICE TIME IS SIMILAR – 30% PERFORMANCE RANGE

Average service time



QUEUE TIME HIGHLY VARIED – BEST REGION 4X BETTER THAN WORST

Average queue time



Note: Activity data based on 12 month form Jan to Dec 2014; FTEs 2014
Source: SARS BQMS reports; SARS HR Data

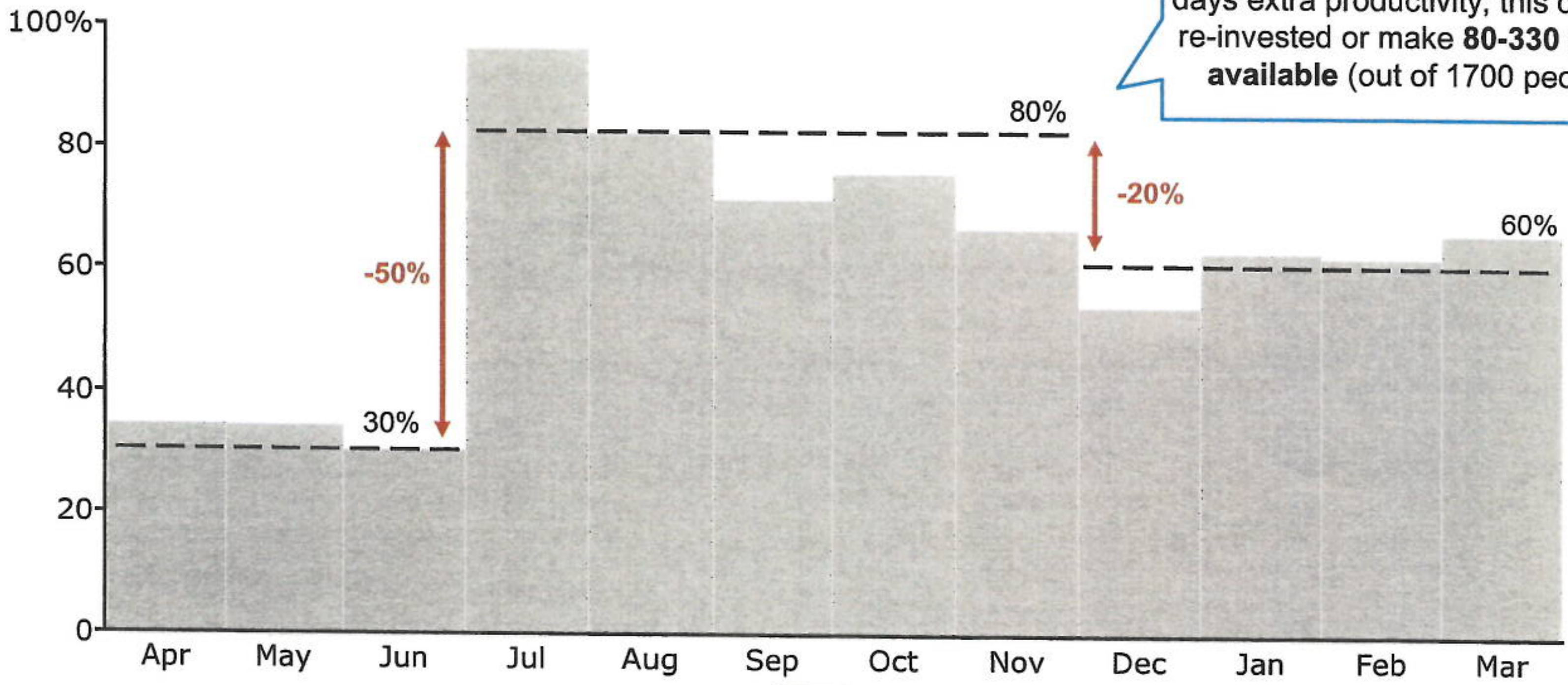
SARS At Your Service

1 SARS data indicates that Branch employee utilisation in off-peak season is 20-50% lower than in peak season

Tax	Customs/ excise
Service channels	Operating model

Service performance

Utilisation of FTE's for Branch (%)
(available time adjusted for leave)



Raising utilisation in low months to 60-80% is equivalent to 20-80K days extra productivity; this could be re-invested or make **80-330 people available** (out of 1700 people)*

There is an opportunity to improve the efficiency in which branch employees are used throughout the year

Note: Headcount for FTE's worked on productive employees; # days=20 per month; utilisation based on productive mins & available time less leave;;
*Add'l 10M minute in productive time from increase to 60% utilisation; Add'l ~40M minutes in productive time from increase to 80% utilisation; # resources made avl based on hrs increase in utilisation and avg 8hr work day and 240 day work year
Source: Branch utilisation data (based on ABM data)

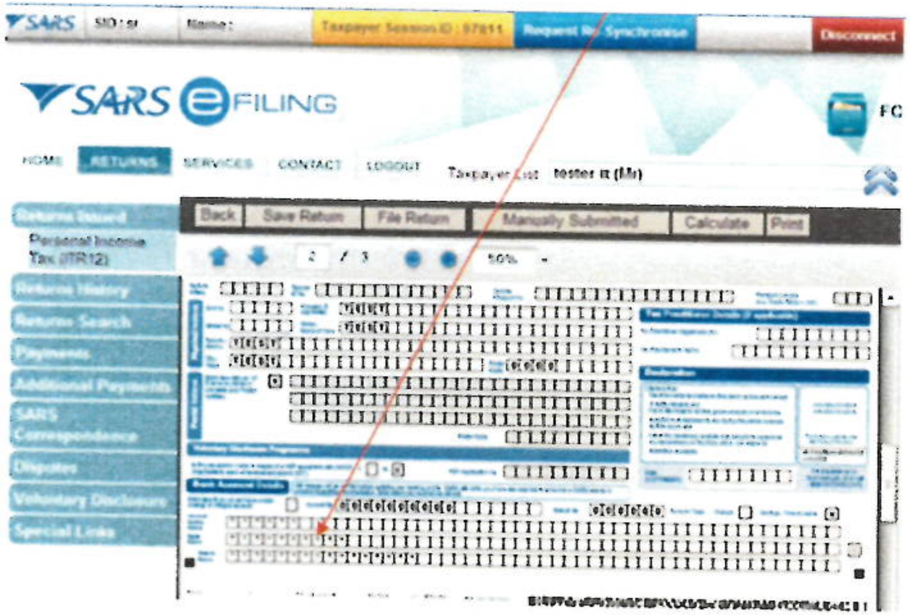
SARS At Your Service

Tax | Customs/ excise | Service channels | Operating model

1 SARS interviews report outdated Service Channel IT system that impact service channel effectiveness (1/2)

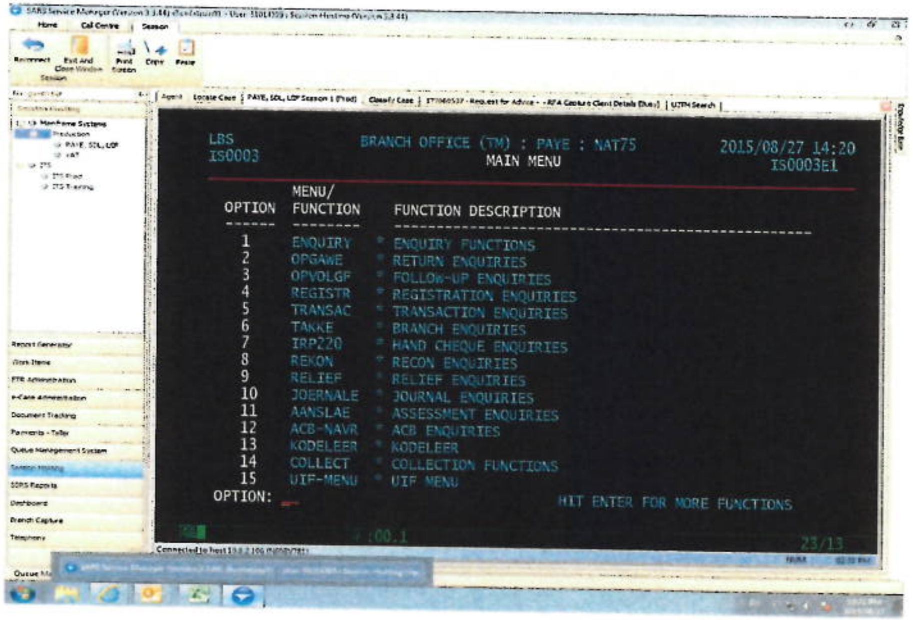
Service performance

RECENTLY LAUNCHED TAXPAYER INTERFACES ARE NOT USER FRIENDLY…



- **Navigation** for newer users is **difficult**
  - Buttons not well laid out
  - Long pop up messages are displayed
- **Language** used is **complicated** e.g. s6quin instead of foreign tax credits

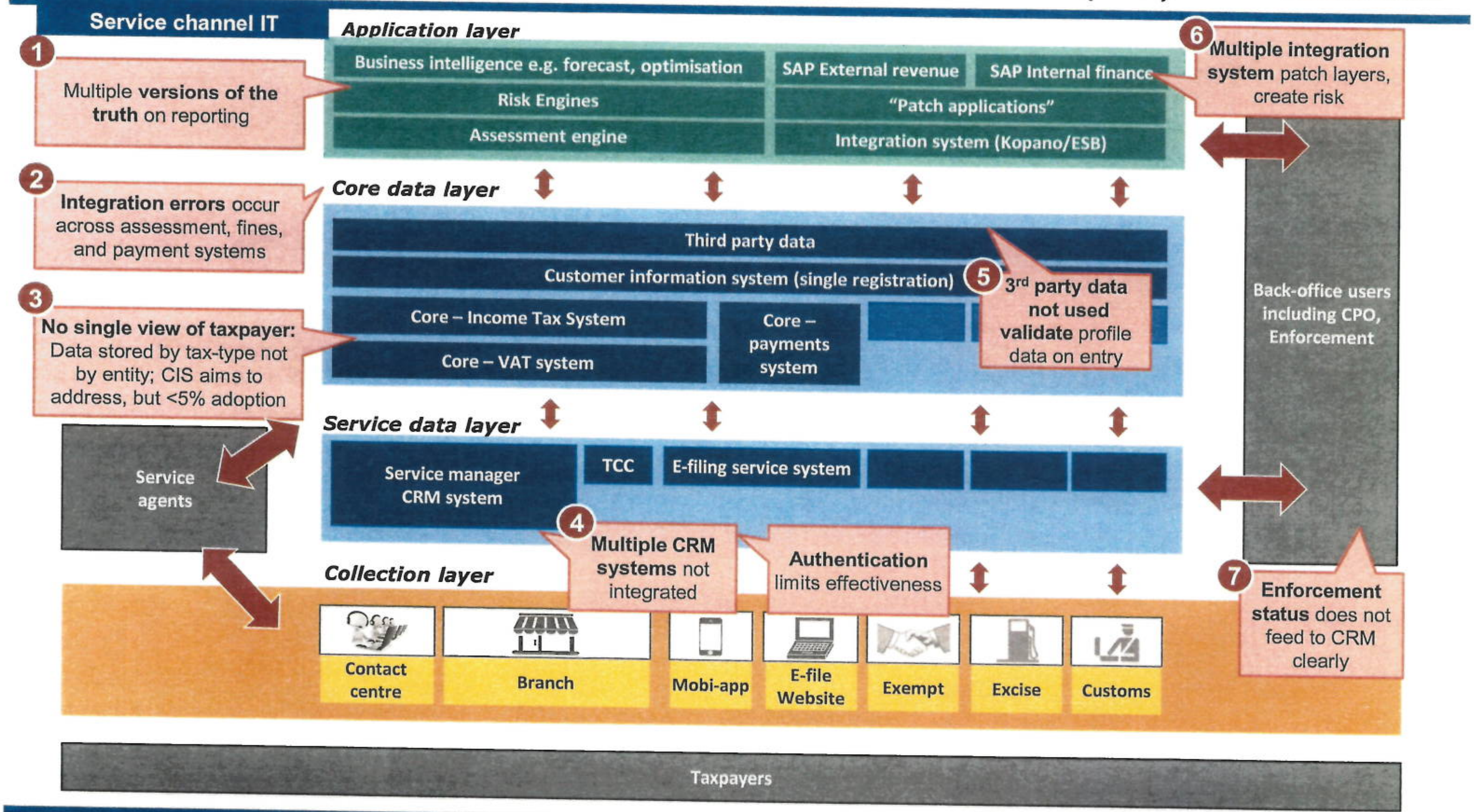
… AND OUTDATED CRM AND CORE SYSTEMS DO NOT SUPPORT SERVICE AT BRANCHES



- Multiple CRM systems are **not well integrated increasing complexity and chance of error**
- **Lack of instructions/ prompts** on systems leads to **inconsistent classification**
- **No single view** of taxpayer as data is stored by tax-type

Source: Management interviews

1 SARS interviews report outdated Service Channel IT system that impact service channel effectiveness (2/2)



Source: SARS Enterprise Business Enablement interviews

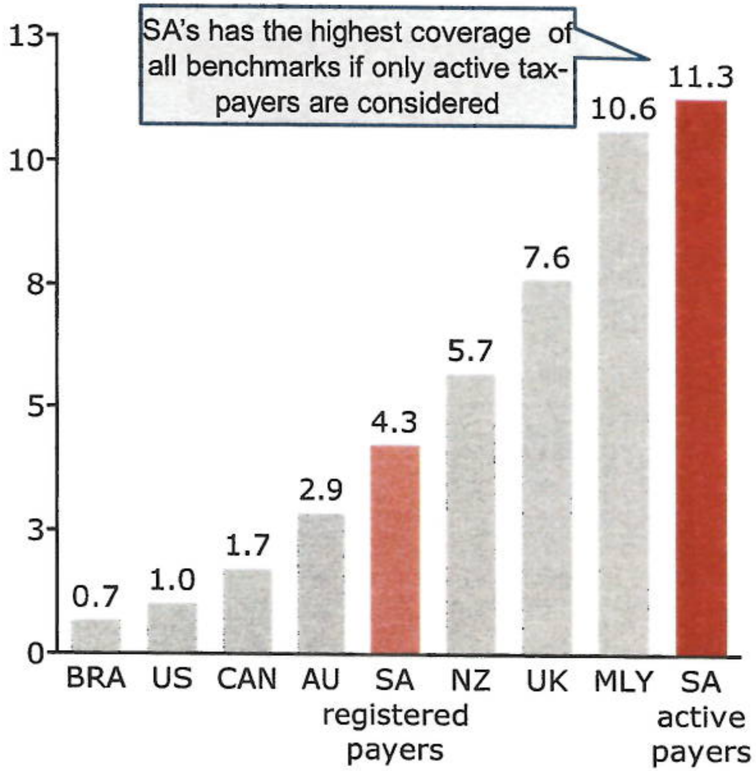
SARS footprint coverage is higher than benchmarks – SARS branch OPEX in some provinces appears high

Tax	Customs/ excise
Service channels	Operating model

Service channels

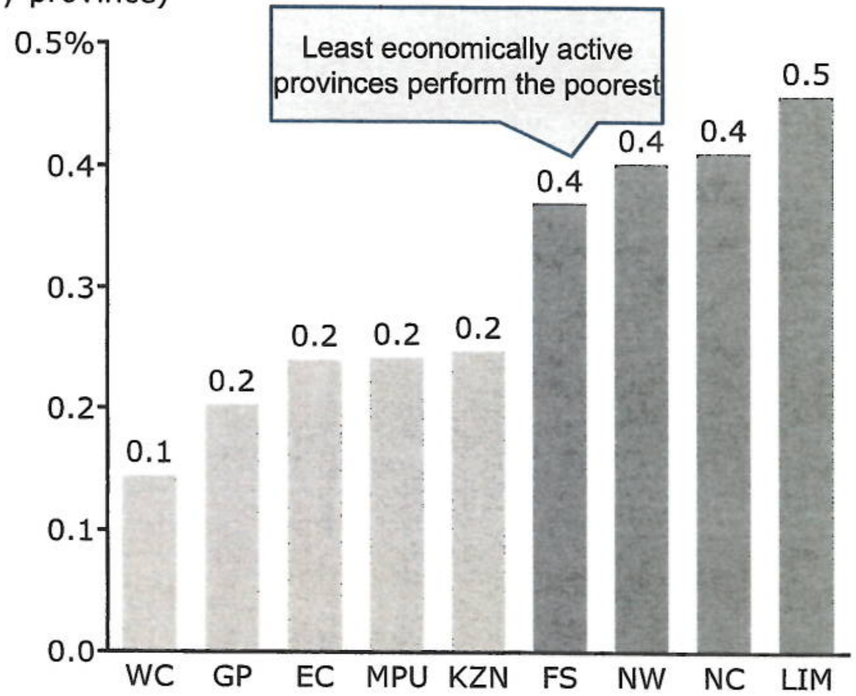
OWING TO NATIONAL DIFFERENCES, THERE IS NO NORM FOR TAXPAYERS/ # BRANCHES

#Branches/ Million tax payers



WITHIN SA PROVINCES HAVE WIDE RANGING COST PERFORMANCE

Province branch OPEX/ income ratio (by province)



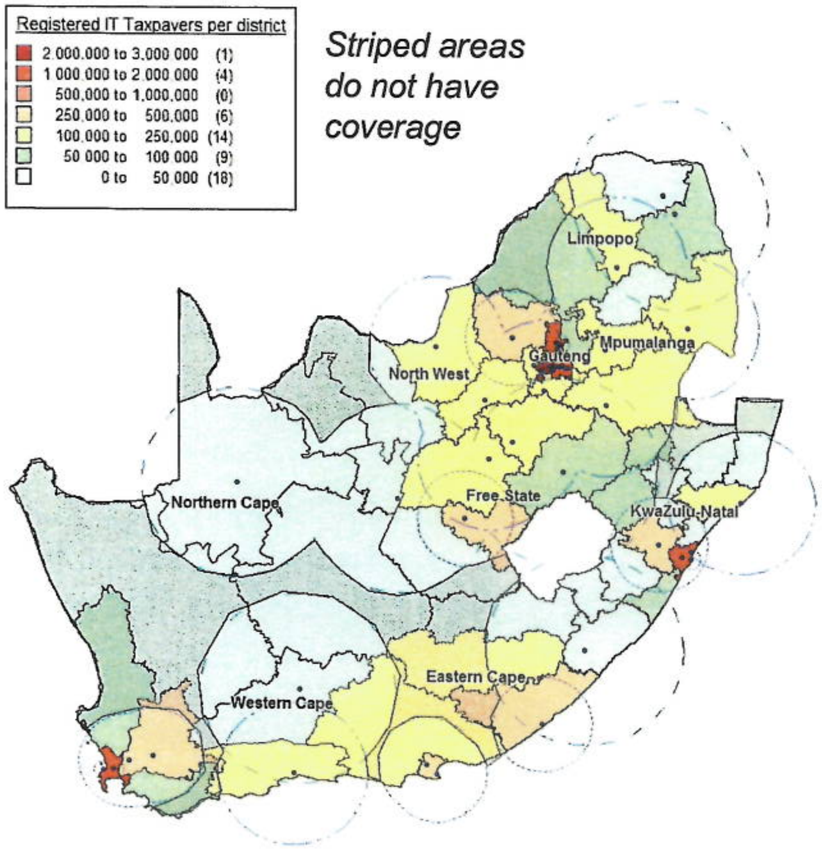
	WC	GP	EC	MPU	KZN	FS	NW	NC	LIM
Taxable income (R, B)	183	503	85	64	147	46	51	21	51

Note: SARS employee & taxpayer numbers based on 2013-2014 data; Income & VAT taxpayers only; Cost to income considers PIT assessed revenue per province and operating expenditure by branches in that province
Source: SARS Statistics 2014, OECD Tax Administration 2013

Extension of SARS branch footprint is planned

Tax	Customs/ excise
Service channels	Operating model

TODAY, BRANCH NETWORK COVERS MOST TAXPAYERS



THERE ARE MANY OPTIONS TO IMPROVE BRANCHES AND/OR OTHER CHANNELS

1 **New branches are being built**	• 4 branches approved for construction over next 2 years: Springbok, Lephalale, Queenstown, Vredendal
2 **Areas for potential branches have been identified**	• GIS project identified 2 possible new sites, & 5 existing excise sites that have potential to be co-located incl. Tzaneen, Ulundi, Langebaan, Stellenbosch
3 **More MTUs and kiosk sites have been suggested**	• 31 possible sites identified for Mobile Tax Units, co-locations, and potential kiosks
4 **Contact centre and engagement want more resources**	• Conversations with engagement team and contact centre team highlight common request for more resources
5 **Various initiatives to improve contact centre and digital**	• More than 10 modernisation initiatives proposed to improve contact centre, digital, and branch processes

Approach needed to prioritise investments across channels

Note: at this stage the study sourced only identifies potential sites, no formal proposals are in place; other options include Newcastle, Potchefstroom
Source: Preliminary GIS study conducted by EBE branch review team

1 Benchmarks show movement away from "bricks and mortar" branches while increasing capillarity

Tax	Customs/ excise
Service channels	Operating model

USA: TAXPAYER ASSISTANCE CENTRES

- IRS Taxpayer Assistance Centres (TAC) are **used for personal tax help** when the returns cannot be handled online or through the call centre

- TAC's **do not accept bookings** and will only assist with matters that cannot be handled online and via a call centre

UNITED KINGDOM: LEVERAGING CO-LOCATION

- UK has **moved away from physical branches** and towards online payments

- Physical infrastructure has **leveraged co-location with banks and Post Office** to file tax returns,, track refunds and make payments

- Additionally, should you require personal assistance, HMRC has **linked with specific organisations** such as TaxAid to assist with tax returns

INDIA: KIOSKS & MOBILE BRANCHES

- Indian Income Tax Dept. set up special **'tax kiosks' in residential areas, large office complexes** to assist in the filing of tax returns and tracking refunds during tax filing season

- Tax kiosks usually **stationed at one location for 1-2 days**, manned by **trained Tax Return Prepares (TRPS)** who help the taxpayers in filing returns.

Source: Economic Times India; IRS.gov; gov.uk; India PR Wire

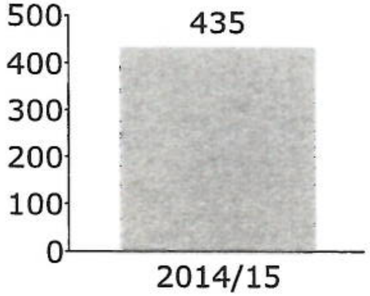
❶ Branch visits, interviews and project analysis indicate suboptimal real estate management

Tax	Customs/ excise
Service channels	Operating model

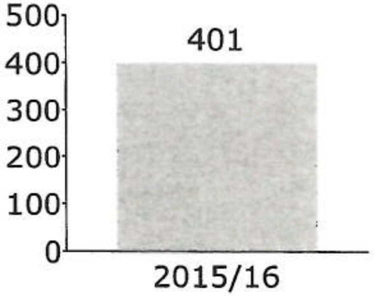
Real estate

SUBSTANTIAL SPEND ON PROPERTY AND PROPERTY RELATED PROJECTS

Land & Buildings Lease Expense (R M)



Property Related PMO Initiatives (R M)



SPACE UTILIZATION EXAMPLE – RANDBURG BRANCH

ANECDOTAL EVIDENCE OF BRANCH VISITS AND PROJECT ANALYSIS

- **Apparent lack of budget control** (high costs and budget overruns)
  - **On branch/warehouse upgrades/fitting** – (e.g. increase in Bloemfontein upgrade budget from R14M to R22M)
  - **On land and buildings acquisition** (e.g. R3M piece of land purchased in Upington)
- **Apparent lack of asset management** (*"an expiring lease resulted in SARS purchasing the property due to inability to vacate on time"*)
- Large areas of **unutilised or under-utilised space** in branches and offices

Opportunity to migrate ~4.7M transactions (~50%) out of branch into contact centre and digital channels

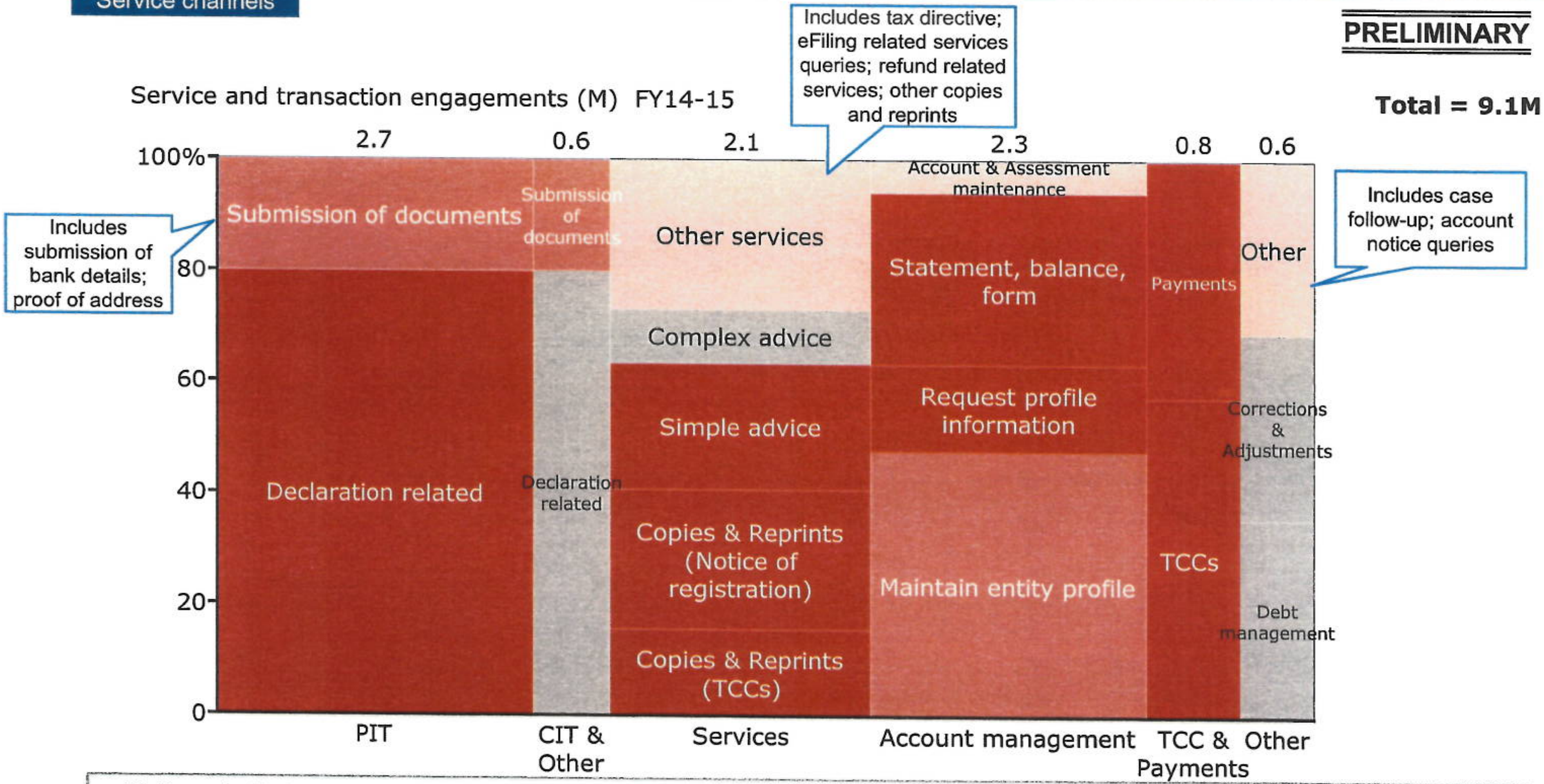
Tax	Customs/ excise
Service channels	Operating model

Service channels

PRELIMINARY

Service and transaction engagements (M) FY14-15

Total = 9.1M



% Opportunity to migrate activity	<20% migration	20-30% migration	30-50% opportunity	>50% opportunity

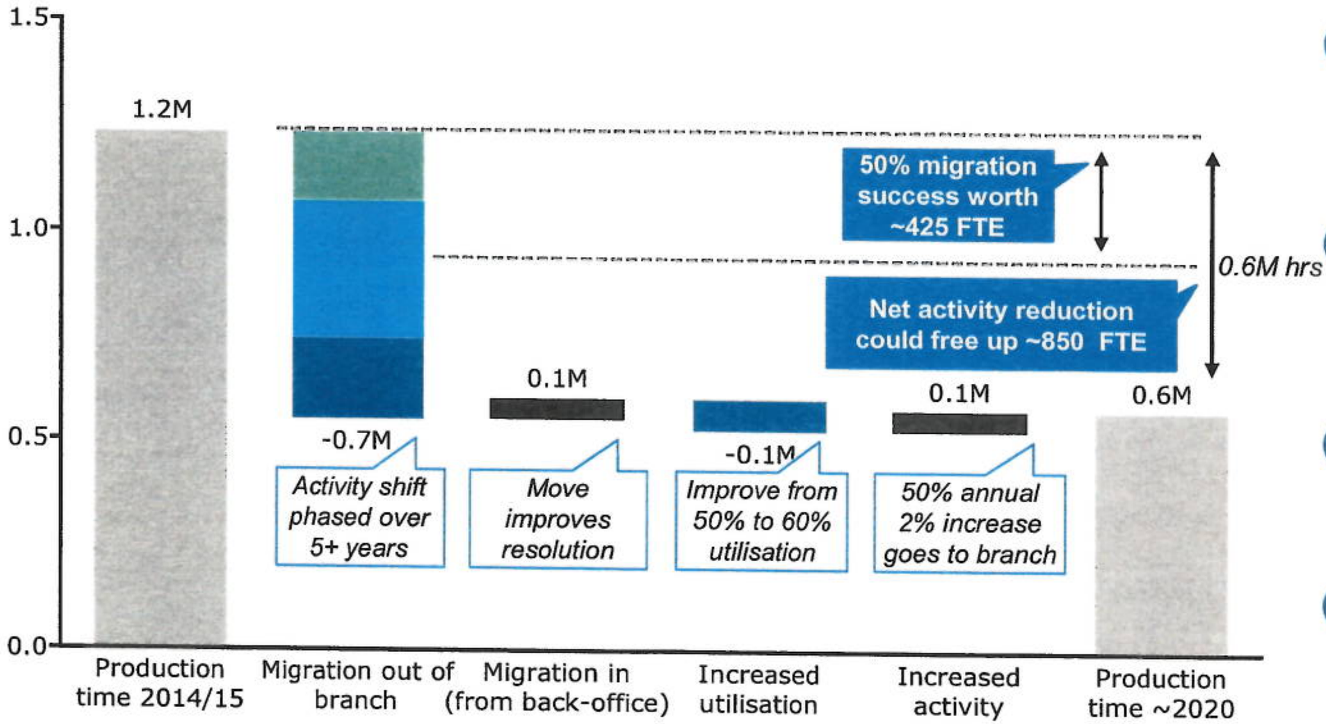
Reducing branch volume through automation and migration to other channels could free-up 425-850 staff

Tax	Customs/ excise
Service channels	Operating model

Service channels

PRELIMINARY

Branch annual production time, Hours (M)



	Production time 2014/15	Migration out of branch	Migration in (from back-office)	Increased utilisation	Increased activity	Production time ~2020
Transactions (M)	9.1M	5.0M	0.1M		0.3M	~4.6M
FTE equivalent	**1,656**	(920)	60	(54)	60	**802**

When migration can begin: Near term 0 -1.5years | Medium term 1.5-3 years | Long term 3-5 years | Largely remain

PRODUCTIVITY GAINS COULD BE RE-INVESTED

1. **Redirect** staff activity towards other activities in branch operations e.g. Education, registration
2. **Re-allocate** staff across other service channels (e.g, contact centre)
3. **Redeployment** to assist with shortfalls in other areas e.g. customs capacity
4. **Attrition** of staff overtime to lower cost base

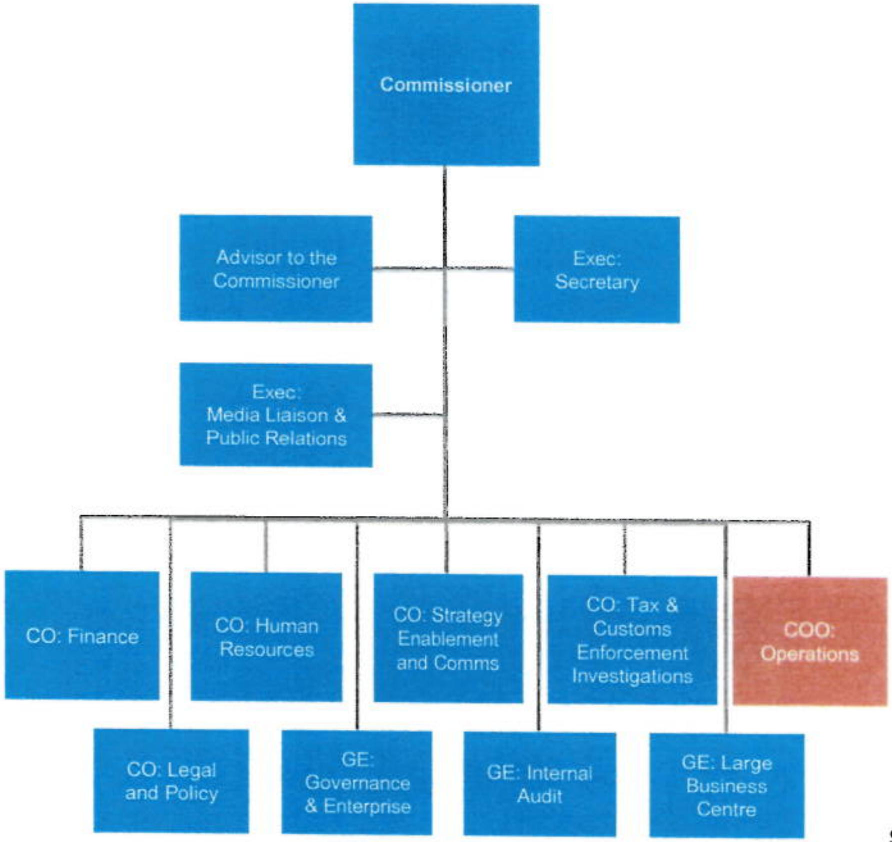
Deployment strategy to be determined based on needs and impact on employees

Note: Time for case completion based on EBE data- different for each query type; FTE numbers adjusted to account for 1656 HC; Increased activity based on 2% growth in activity across channels; increased utilisation time adjusted by growth in activity; Production mins from SSM cases adjusted to account for BQMS queue times
Source: FTE utilisation data, SSM volume data (EBE); Branch SSM service production times (EBE)

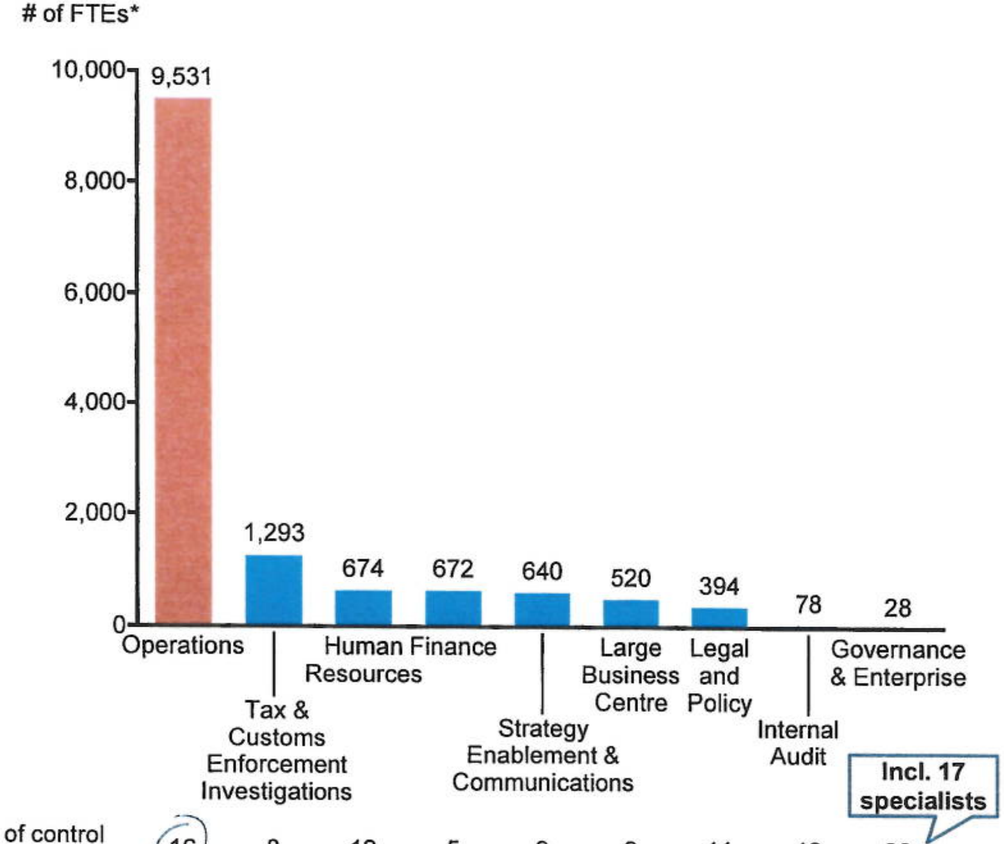
1 Organisation is unbalanced with ~70% of employees concentrated in operations

Operating model

SARS CURRENTLY HAS 9 MAIN UNITS REPORTING TO THE COMMISSIONER...



...BUT 70% OF STAFF IS CONCENTRATED IN OPERATIONS



	Operations	Tax & Customs Enforcement Investigations	Human Resources	Finance	Strategy Enablement & Communications	Large Business Centre	Legal and Policy	Internal Audit	Governance & Enterprise
Span of control (# of direct reports)	16	8	12	5	9	9	11	12	23
# of layers	8	7	6	6	7	6	6	5	4

Note: *# of FTEs excludes Advisor to the Commissioner, Media Liaison & Public relations and Secretary employees; Excludes physical protection; FTE's Exclude Temps and Vacancies
Source: SARS HR file

1 Functions in SARS are fragmented/duplicated with unclear accountability to a single person for results achievement

Tax	Customs/ excise
Service channels	Operating model

Operating model

INSIGHTS FROM EXECUTIVE INTERVIEWS

Significant IT duplication in operations

Unclear ownership of customs

Lack of strong enterprise risk function

Commissioner

Operations
- GE: Programme Management
- GE: Processing
- GE: Branch Ops
- GE: Contact Centres
- GE: Debt
- GE: Chief Information Officer
- GE: Case Selection
- GE: Modern. Strat. & Design
- COO Officer Manager
- Exec: HR Bus. Partnering
- GE: Customs Trade
- GE: Serv. Esc & Supp
- GE: Compliance
- GE: Business Systems
- GE: Border Man. Chair BCOCC

Internal Audit
- SM: Internal Audit
- SM: Audit
- Manager: Quality Assurance
- SM: Info Integr.

Governance & Enterprise
- SS: Stakeholder Management
- EA
- SS: Media Liaison
- Manager: Governance Risk
- SS: Programme Management
- Manager: Secretariat

Finance
- GE: Finance
- GE: Revenue Plan. Analysis and Report.
- Exec: Procurement
- Exec: Financial Own Accounts
- GE: Corporate Legal Services
- GE: Facilities and Properties

Tax & Customs Enforcement Investigations
- GE: Enforcement Investigations
- GE: Audit
- COO (ATAF)
- Exec: Business Resources Services
- Exec: International Relations

Human Resources
- Exec: Employee Relations
- Exec: Learning & Development
- Exec: Advisory
- Exec: Bus. Resources
- Exec: HR Bus. Partnering
- Exec: Remuneration and Benefits
- Exec: HR Planning

Strategy And Communications
- GE: Anti Corruption & Security
- GE: Enterprise Bus. Enablement
- GE: Strategic Planning & Risk
- GE: Instit. Enablement & Integr.
- Exec: Programme Management
- Exec: Business Resources Services
- Exec: Marketing & Communications
- Exec: Office of the Commissioner

Legal and Policy
- GE: Legal Delivery Support
- GE: Interpretation & Rulings
- GE: Product Oversight
- GE: Legislative R & D
- GE: Dispute Resolution
- SS: Legal
- Manager: Div. Plan. Monitor. & Reporting

Large Business Centre
- Exec: Risk & Intelligence
- SM: Client Account Management
- Exec: Audit
- SM: Div. Plan. Mon. & Reporting
- Exec: Bus. Resources
- Manager: Governance Risk
- Exec: Specialist Support
- Exec: Taxpayer Interface Officer
- Office Manager

Segmentation of taxpayers between LBC and Operations results in some taxpayers slipping through the cracks (HNWIs and Medium sized Corporates)

- IT
- Service Channels
- Case Selection
- Audit
- Research & Analytics
- Communication
- Debt

Source: Executive Interviews; SARS internal documents

Employees rank SARS low in decision effectiveness: strong on clarity, weak on structure, communication & roles

Tax	Customs/ excise
Service channels	Operating model

Organisation survey

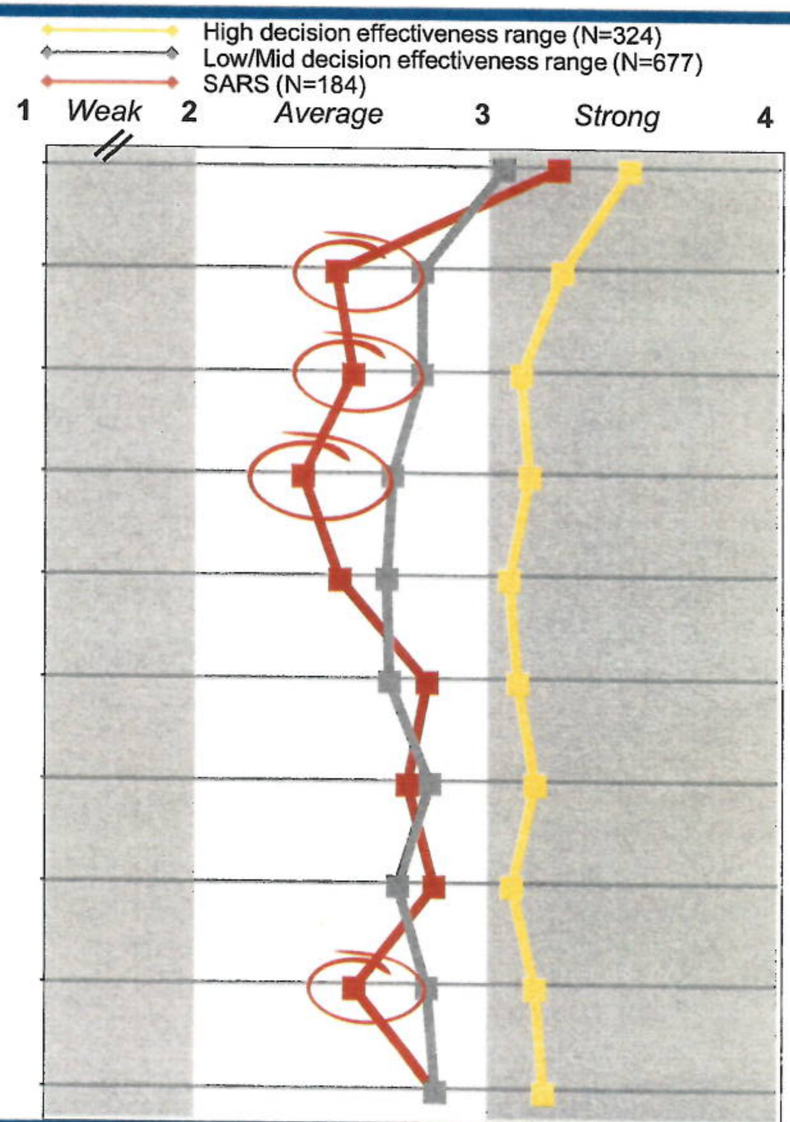
Clarity & Alignment
- **Clarity** on what drives value
- Communication and **alignment**

Roles & Structure
- Clear **roles** for critical decisions
- **Structure** that enables key decisions

Processes & Information
- Effective decision **processes**
- Right **information**, right form, right time

People & Perform-ance
- Right **people** in the right jobs - will and skill
- **Performance**-linked objectives/incentives

Leadership & Culture
- Cohesive **leadership**
- Winning **culture**



Source: Decision and org effectiveness database (Jan 2013) n=1001, SARS diagnostic survey (N=184)

❶ While governance structures exist on paper, SARS interviews indicate that their effectiveness is poor

Tax	Customs/ excise
Service channels	**Operating model**

Governance

NUMEROUS GOVERNANCE COMMITTEES ON PAPER…

Enterprise

- **Audit** — Resp: External; Freq: Quarterly
- **Human resource** — Resp. External; Freq: Quarterly
- **Commissioner**
  - **EXCO** — Resp: Commissioner; Freq: Bi-Monthly

Group

- **Operations MANCO** — Resp: COO; Freq: Weekly
- **Compliance risk** — Resp: Deputy Commissioner*; Freq: Twice weekly
- **General Anti-Avoidance Rule** — Resp: Chief LAPD; Freq: Monthly
- **Debt Committee** — Resp tier 3: Group Executive; Resp tier 4: CFO
- **Procurement** — Resp: CFO; Freq: Monthly
- **Enterprise risk** — Resp: Deputy Commissioner*; Freq: Quarterly
- **People** — Resp. Chief HR; Freq: Bi-Monthly
- **National Appeals**** — Resp. Chief LAPD; Freq: Monthly
- **Legal function**

Legend: Multiple concerns raised by execs — Compliance risk, Procurement; Some concern raised — EXCO, Enterprise risk, People, National Appeals

…HOWEVER STRONG VIEW THAT THEIR EFFECTIVENESS IS POOR

*"We have **lots on paper** (committees, clear rules of engagement, etc.) but **not enough enforcement of these principles**. We need a stronger compliance/audit function and a Board."*

SARS, Executive

*"**Delegation of authority does exist on paper, however it is not really used.**"*

SARS, Executive

*"The **compliance risk committee** is an excellent example of something that **looks good on paper, but is really not functioning**. It is a shame as this is such an important committee."*

SARS, Executive

*"**Meetings aren't happening,** they discuss other things, and **do not focus on their responsibilities.** People in the organisation are left to do what they want."*

SARS, Executive

Note: MANCO – Management committee, Several sub MANCO's i.e. Customs, Customs, LAPD, Finance, Human resources
Source: SARS Internal documents; Executive Interviews

1 External stakeholders see need for SARS to improve capabilities, decision speed and collaboration

Tax	Customs/ excise
Service channels	**Operating model**

Stakeholder feedback

NON EXHAUSTIVE

Collaboration

*"It is also imperative that the assessors, auditors and account maintenance divisions within SARS **improve their communication within SARS in relation to client information which has already been received but not shared with the other divisions**."*

The Banking Association of South Africa

*"We **recommend face to face meeting with the Commissioner** to discuss pressing and urgent matters"*

Estate Affairs Agency Board

"Generally, simplifying tax laws, reducing administrative costs on taxpayers **and allowing ample time to implement changes should be paramount in SARS way of doing things**."

Association For Savings And Investments SA

Capability

*"SAIT recommends that a **list of specialists in different tax types be made available to resolve complex tax issues** which cannot be resolved by the Call Centre or the Branch Offices."*

South African Institute of Tax Practitioners

Speed

*"Some **urgent issues which are crucial to banks can be outstanding for more than two years**."*

The Banking association South Africa

*"SARS **should review the decision making levels (red tape) in query resolution because it creates inefficiencies in the SARS operating model**."*

South African Institute of Tax Practitioners

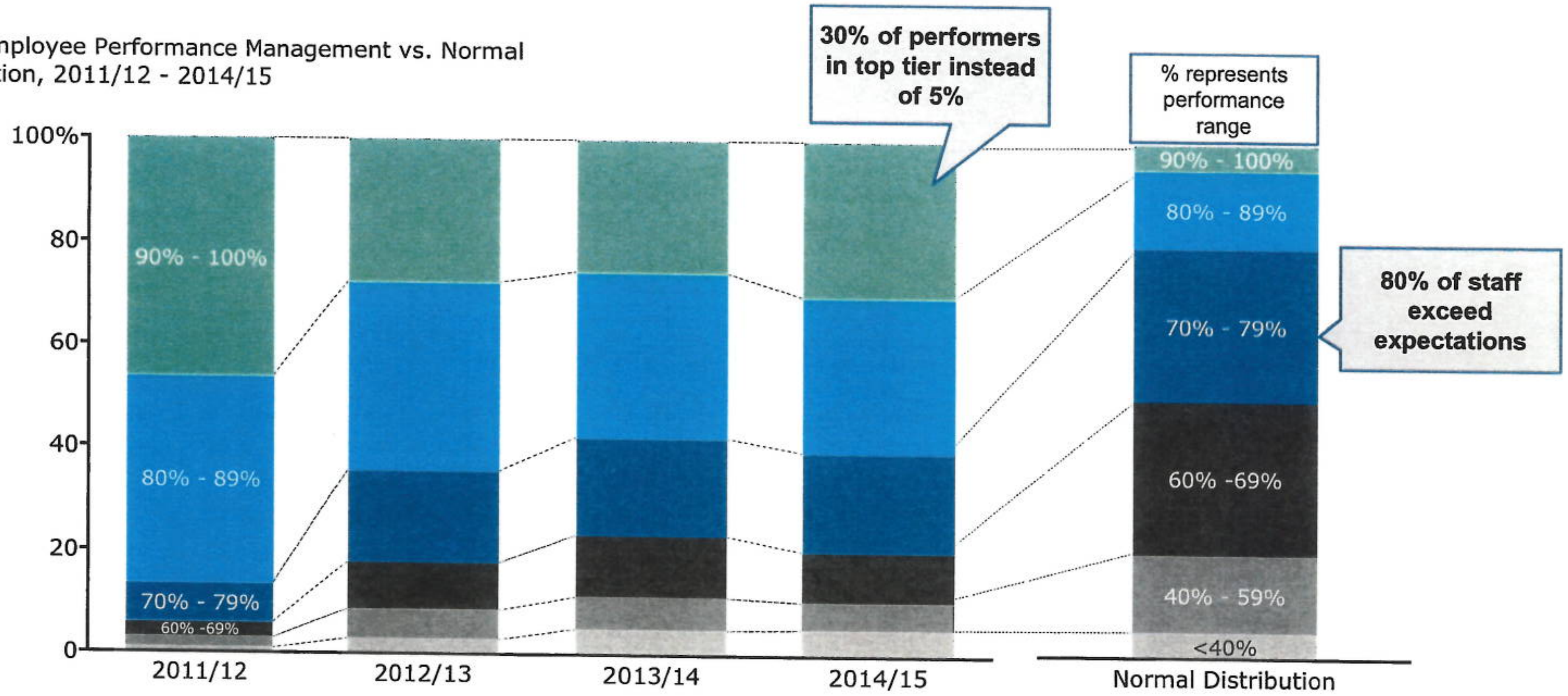
Source: External Stakeholder input – January/February 2015

Internal reports indicate that 30% of SARS employees are in the top performance tier vs. 5% in normal distribution

Tax	Customs/ excise
Service channels	Operating model

Performance Management

SARS Employee Performance Management vs. Normal Distribution, 2011/12 - 2014/15



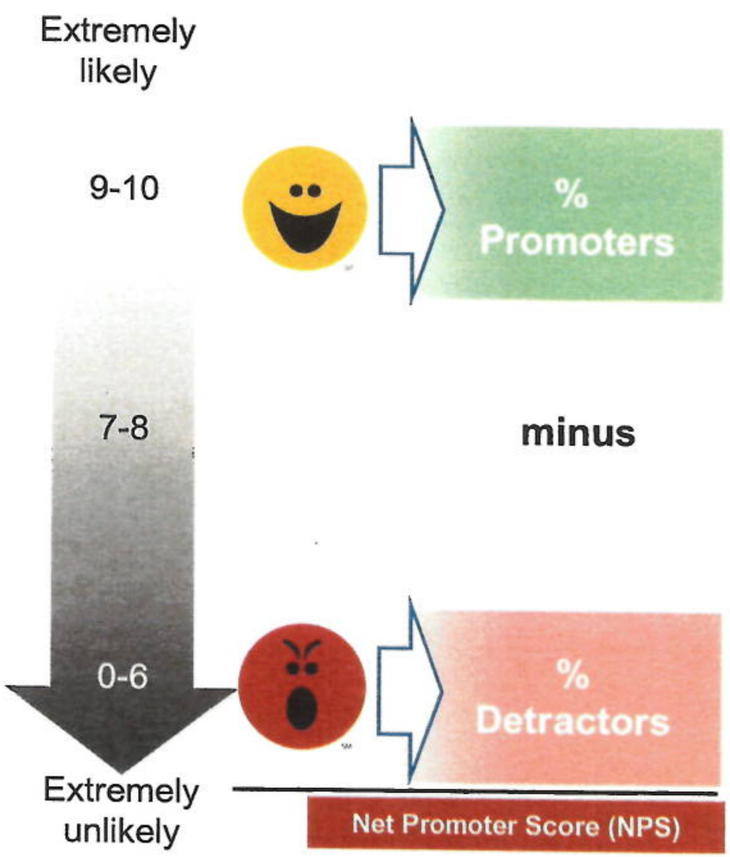
1 25% of employees would recommend SARS as a place to work - 43% would discourage people from joining SARS

Tax	Customs/ excise
Service channels	Operating model

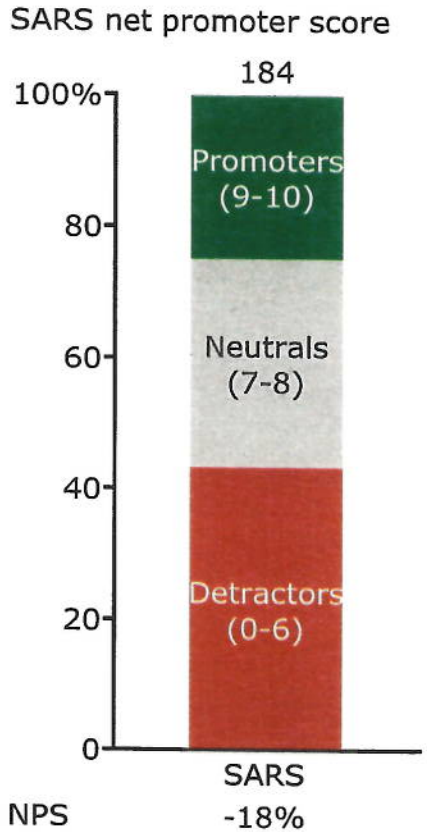
Organisation survey

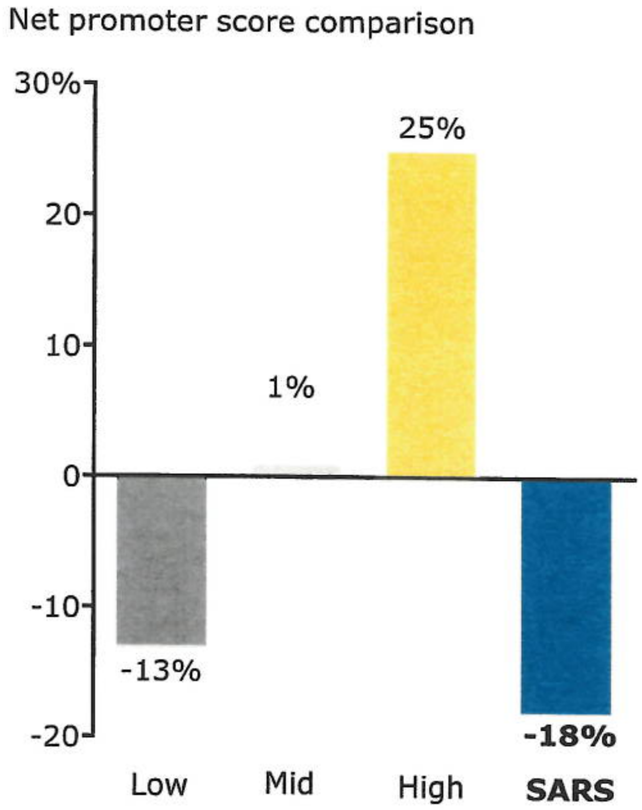
FEBRUARY 2015

NET PROMOTER SCORE (NPS) CALCULATION



HOW LIKELY WOULD YOU BE TO RECOMMEND SARS AS A PLACE TO WORK TO A FRIEND OR RELATIVE?





❶ Finance most likely to recommend SARS, while HR and Legal are the least likely; LBC is most contrasted entity

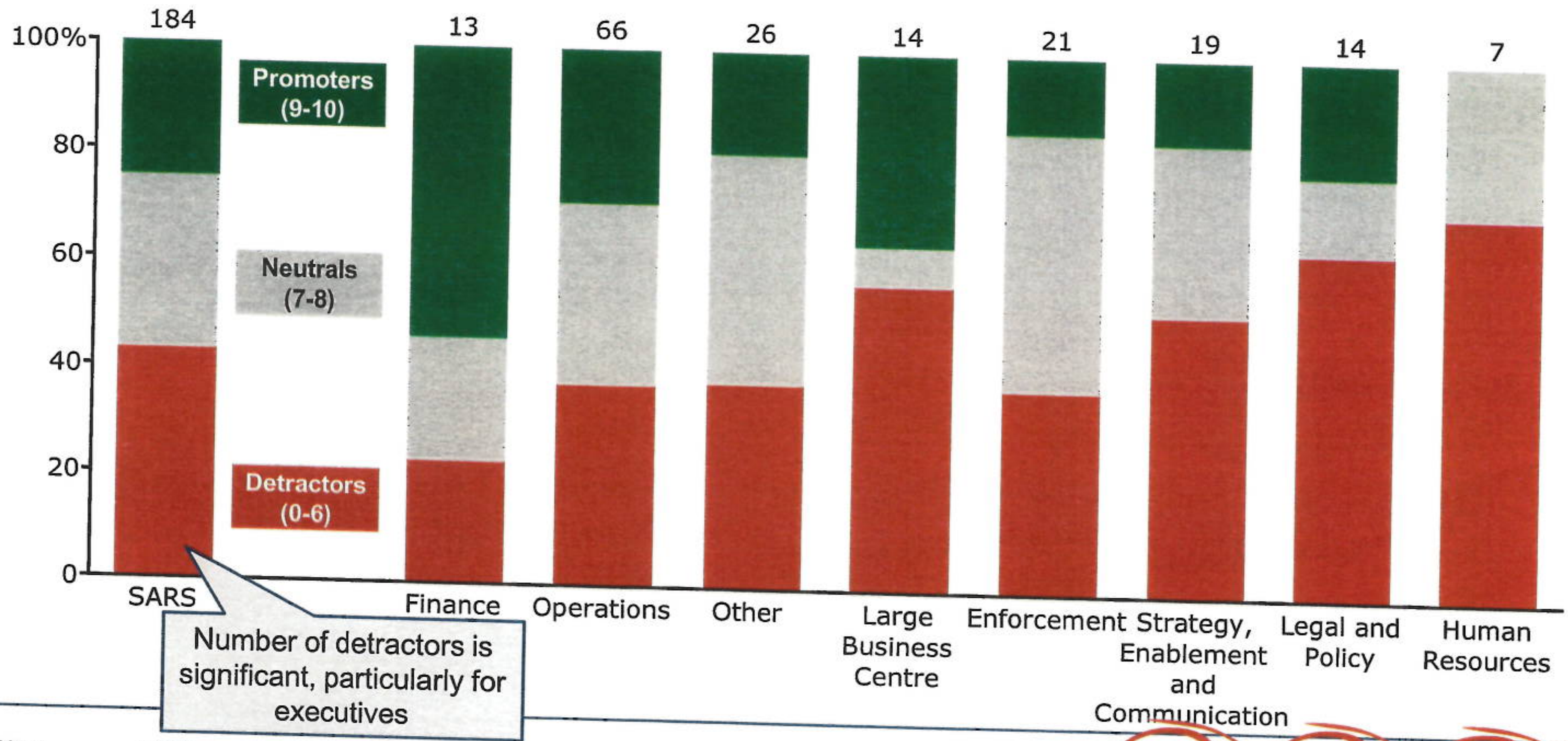
Tax	Customs/ excise
Service channels	Operating model

Organisation survey

How likely would you be to recommend SARS as a place to work for a friend or colleague?

FEBRUARY 2015

SARS net promoter score



NPS	-18%	31%	-9%	-19%	-21%	-24%	-40%	-43%	-71%

Source: SARS diagnostic survey (N=184 – February 2015)

Chief Officers and Group Executives are least likely to recommend organisation to friend or colleague

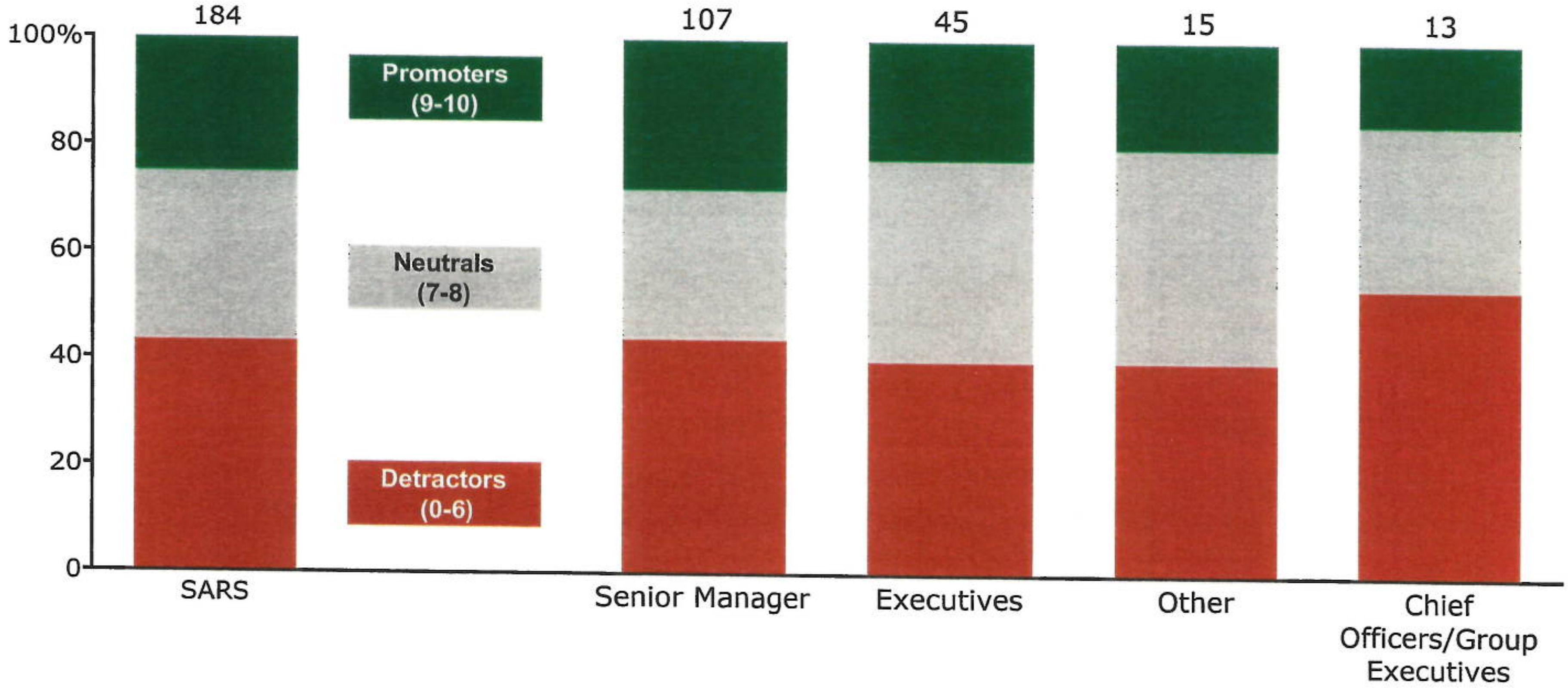
Tax	Customs/ excise
Service channels	Operating model

Organisation survey

FEBRUARY 2015

How likely would you be to recommend SARS as a place to work for a friend or colleague?

SARS net promoter score



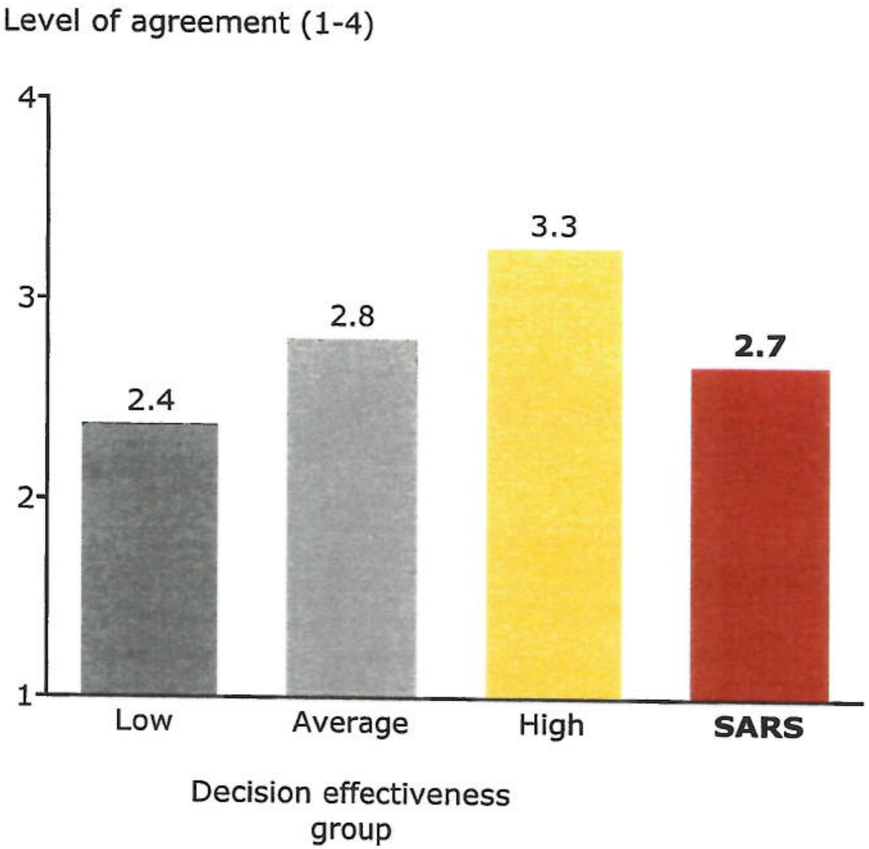
NPS	-18%	-16%	-18%	-20%	-38%

❶ While employees think SARS is a relatively effective organisation there is a strong belief that change is required

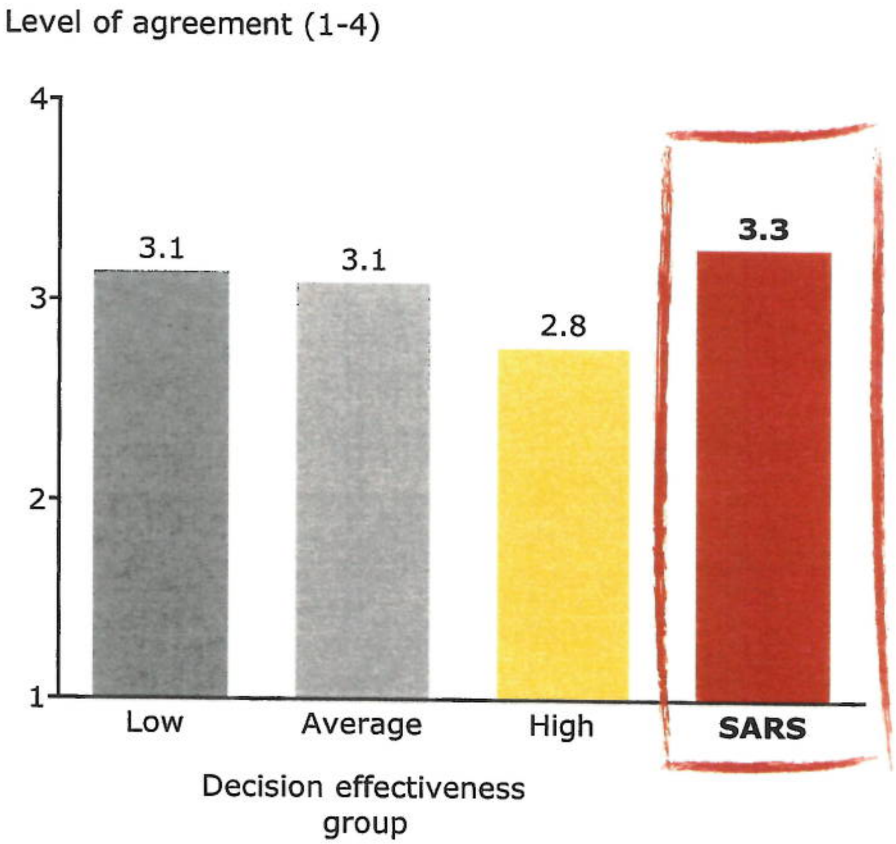
Tax	Customs/ excise
Service channels	Operating model

Case for change

ALL THINGS CONSIDERED, WE HAVE A HIGHLY EFFECTIVE ORGANISATION



OUR ORGANISATION NEEDS TO CHANGE SIGNIFICANTLY TO BE SUCCESSFUL IN THE NEXT 5 YEARS



Source: Decision and org effectiveness database (Jan 2013) n=1001, SARS diagnostic survey (N=184)

Executive summary

1 The diagnostic highlighted a number of areas for SARS to address:

- Reduce the tax gap and focus on HNWI, SMME, Debt, Customs/Excise
- Increase the level of goods control in customs
- Improve taxpayer service levels and the efficiency of service channels
- Increase the effectiveness of the SARS operating model

2 The New Operating Model was designed and implemented as a foundation of the SARS transformation

- The SARS strategic plan was defined (incl. 4 must-win battles and 5 enablers)
- The must-win battles and enablers were translated into design principles which included: increased focus on customs/excise, increased business unit accountability, definition of taxpayer segment strategies to pursue untapped revenue collection opportunities, balance between prevention and enforcement
- International benchmarks helped define different operating model options
- The operating model was recommended based on its adherence to the design principles

3 The initial results of the SARS transformation were positive

- The achievement of the FY15/16 target showed a continued tax buoyancy with R1069.9B collected – 8.5% year on year growth vs 6% nominal GDP growth and ~0.7% real GDP growth). Also, SARS started (re-)building capabilities including SMME campaigns, tax inspection and debt equalization
- The Customs "port of the future" implementation was initiated in Durban and led to improved goods control (<0.5% of undeclared cargo vs. 6% previously), an improved risk detection and intervention capability, and revised penalty guidelines
- SARS is transitioning to the new operating model with most of the "hardware" changes implemented (organizational structure changes)

A structured approach was followed to make operating model choices

Ensure feedback loop to manage consistency

Define **vision** and articulate **must-win battles / enablers**

- Overarching focus and purpose of organization based on:
  - Mandate
  - Legislation requirements
  - Trends
  - Benchmarked tax authority visions
  - Organization DNA
- **Must-win battles**: most critical outcomes targeted
- **Enablers**: major changes that will support required outcomes

Establish **design principles**

- Design parameters based on must-win battles and enablers
- Design principles inform decisions to be made on
  - Organisation
  - Governance
  - Processes

Make operating model choices

- Options informed by benchmarks best practices on:
  - Structure
  - Governance and decision rights
- Preferred option(s) to be assessed based on design principles

Preparation for change

- Preparation consideration for change

2 Must-win battles and enablers translated into a clear set of **design principles** (1/2)

Design Principles

	IMPERATIVES	DESIGN PRINCIPLES
Must-win battles	Vision	• **Ensure vision and strategy drives operating model design**
	Ensure funding of SA through collection of all taxes due to the fiscus	• Ensure **balanced focus between compliance and revenue collection**, including **pursuit of untapped tax collection potential** (e.g. small debt, VAT, excise, large corporates, HNWIs)
	Collect customs tax due, whilst facilitating trade	• Ensure **sufficient focus on customs and excise** for both to be effective
	Develop high performing & efficient operations	• Ensure **resources** (human & financial) **allocated to deliver critical objectives** • **Balance need for customised service to taxpayer** (front-end service; back-end functions) **with efficient industrialisation** (standard processes in the middle) • **Customer channel** (branches, contact centres, etc.) **approach and footprint should deliver good service to taxpayers whilst improving operational efficiency and reducing cost** • Ensure there is an accountable person for **end to end process & taxpayer view**
	Provide fair, convenient and diligent service to aid taxpayer compliance and develop good standing with the public	• Increase **ease of interaction for taxpayers** through channel integration and process streamlining • **Balance prevention and enforcement**, treating taxpayers as well-intentioned until proven otherwise, and ensuring sufficient education • Ensure **robust and functioning governance mechanisms, with appropriate separation of duties and checks & balances**, to guarantee fairness of treatment

Source: SARS homepage; Medium Term Expenditure framework for 15/16-17/18; Executive interviews

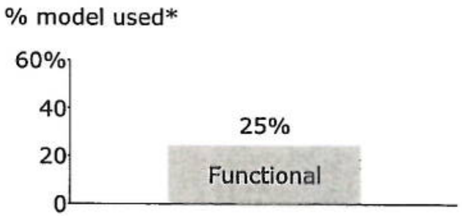
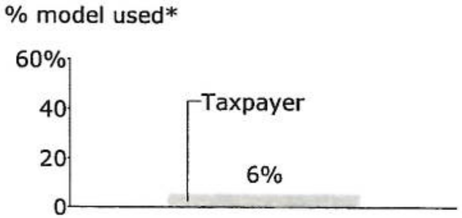
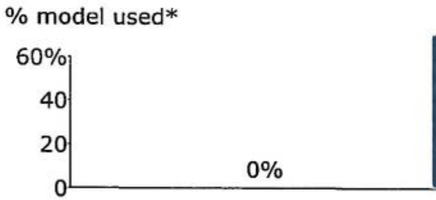
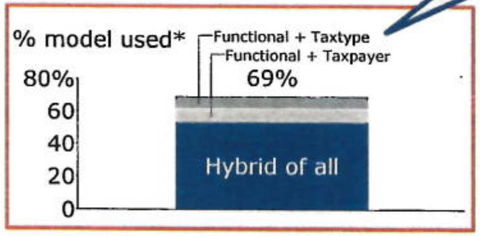
2 Must-win battles and enablers translated into a clear set of **design principles** (2/2)

Design principles

Enablers – IMPERATIVES	DESIGN PRINCIPLES
Operating model	• **Ensure balanced structure**, without excessive concentration of power • **Ensure that the responsibility of function will lie where accountability lies** & is clearly assigned only to one place • Cluster together functions with similar specialization or capability requirements and/or high interdependence, whilst **minimising complexity, fragmentation & duplication** • Ensure **priority** in design **for client facing & delivery functions** vs enabling & support functions • **Ensure decision-making** occurs at the appropriate level, as close to the front line as possible, and enable **agility to respond to changes in taxpayer behaviour & government mandate**
IT systems	• **Business needs drive technology choices**, not the other way around
People & capability	• **Deepen employees' pride** to enable a better functioning organisation and **drive commitment and accountability** • Deliver **continuous professional development to build capabilities for all staff** supported by meaningful appraisal & appreciation/recognition & rewards • Simplify and standardize repetitive tasks (automating where possible) **and focus specialized capabilities on value adding activities which require them**
Integration with SA & foreign institutions to share info	• Enable **effective engagement and collaboration with other institutions and government bodies**
Tax intelligence	• Enable **sophisticated data analytics**, development of **policy expertise** and application of **best practice**

2 Tax authorities are organised around a few main models – most of them have some form of hybrid organisation

Structure

MODEL	PRO'S	CON'S	USAGE	EXAMPLES*
Process Organising around key processes (Registrations, Processing, enforcement etc.)	• Increases standardisation across tax types, enabling factory approach which releases economies of scale	• Limited ability to deal well with complex taxpayers e.g. large corporates		Brazil, Malaysia, Canada, Turkey
Taxpayer Organising around taxpayer type (Individuals, HNWI, SME & lager corporates)	• Ensures customised approach toward each taxpayer and specialised in-house capability for compliance per taxpayer	• Increases duplication of functions & increases cost & complexity		USA, Ireland, France
Tax type Organising around tax type (PIT, CIT, VAT, PAYE etc.)	• Increases level of in-house specialisation per tax type	• Increases duplication of functions & causes multiple contact points for taxpayer		
Hybrid Organising around a mix of above mentioned (PIT, processing & Large corporates etc.)	• Captures benefits from each model - Ability to leverage customisation for certain aspects with industrialised approach for others • Enables tailoring to specific needs/ functions and strategy	• Can lead to increased complexity		Australia, UK, Sweden, New Zealand

OECD *indicates* that functional is the primary dimension in many hybrid organisations

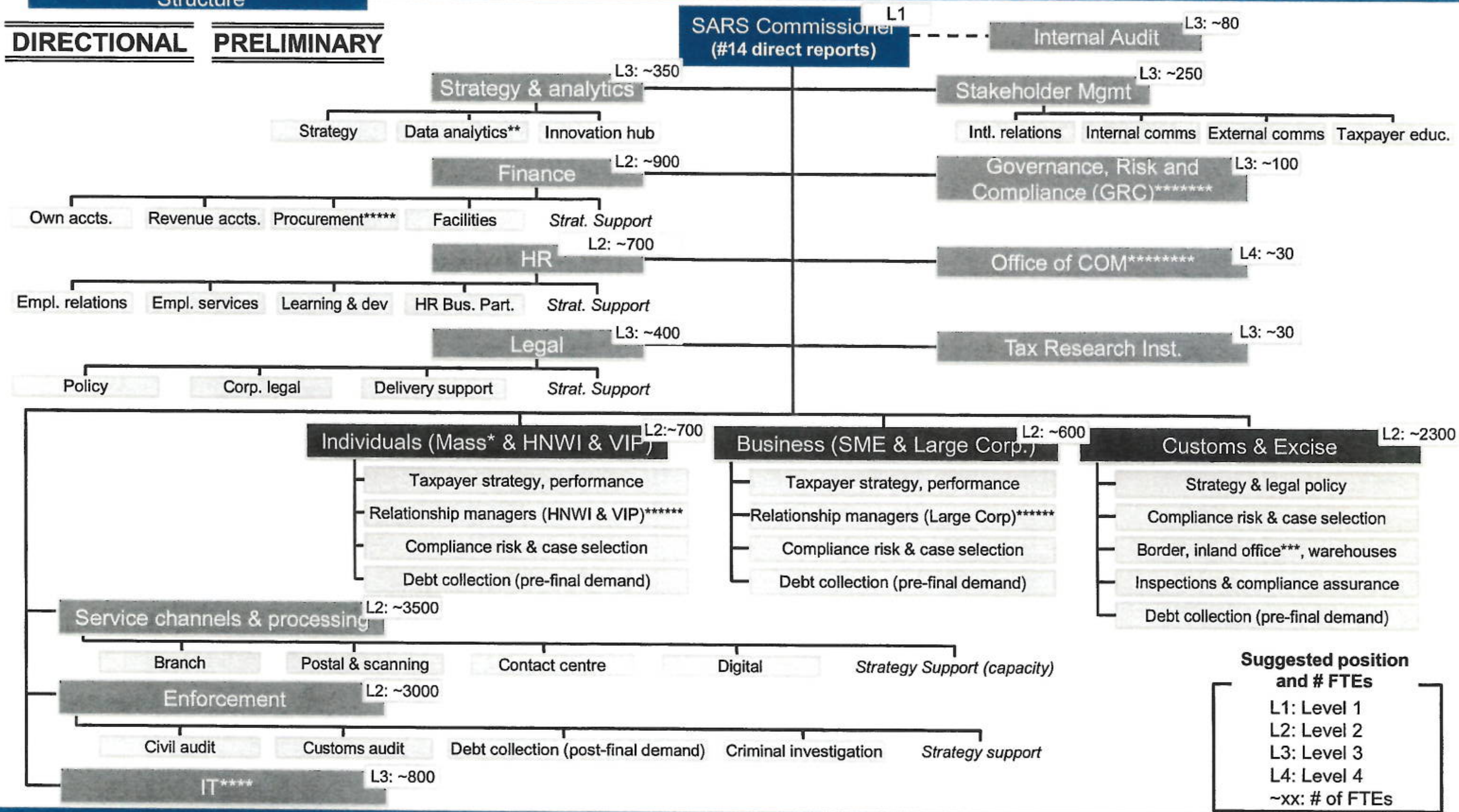
*Primary model determined using OECD Tax Administration 2013, according to survey of 52 countries – difficult to compare to organisational charts; Source: OECD Tax Administration 2013

SARS At Your Service

2

Operating Model options considered: example 1

Structure



*Including estates **Including risk engine ***Including other customs channels ****To be defined by Gartner team; *****Includes other supply chain ******Includes organisational complaints management responsibility;*******Includes Fraud Investigations ********Only included VIP security, regular office security under facilities

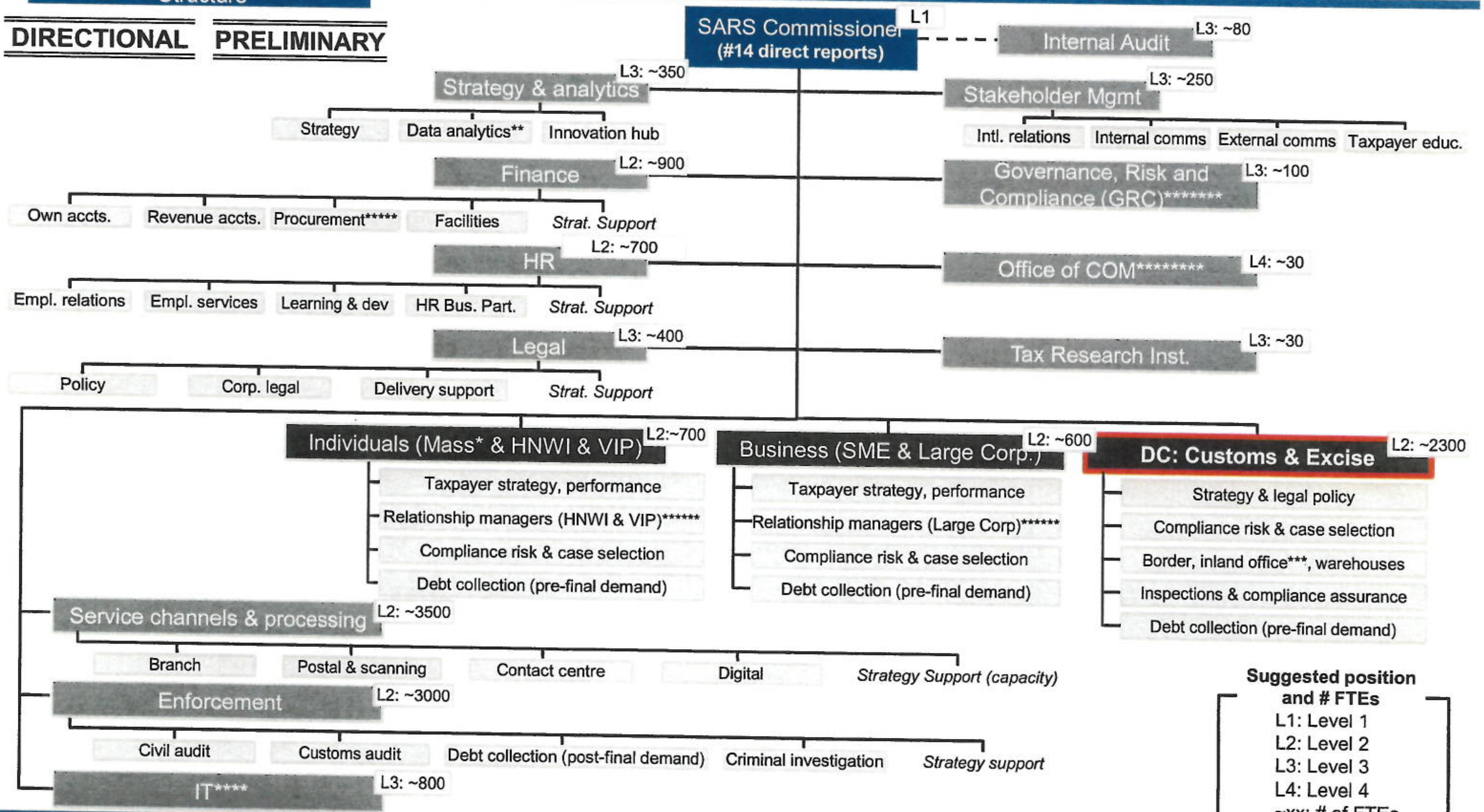
Note: Estimation on sizing based on mapping of previous organisation to new suggested organisation, no reductions or additions have been made

SARS At Your Service

Operating Model options considered: example 2

Structure

DIRECTIONAL **PRELIMINARY**

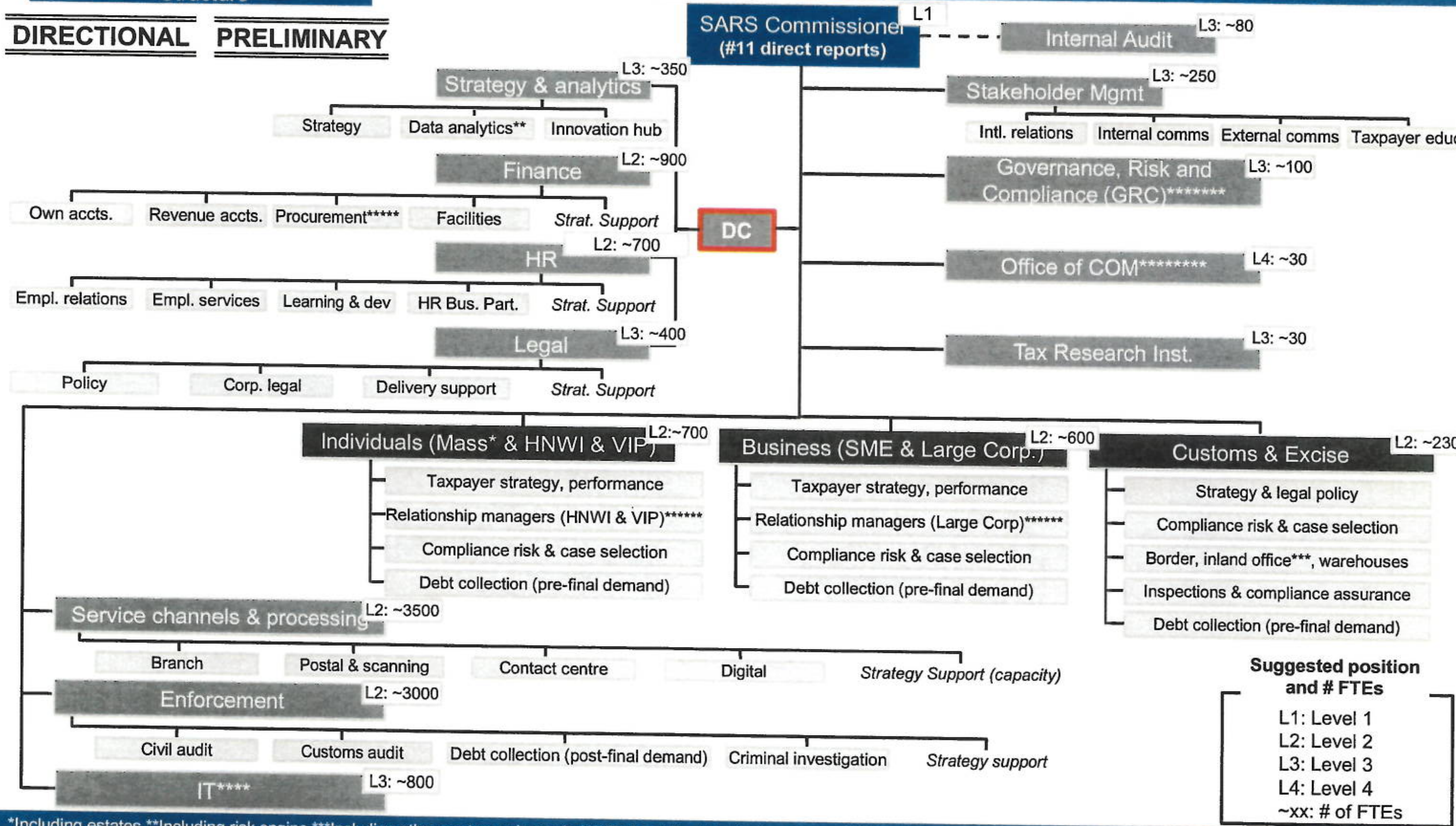


*Including estates **Including risk engine ***Including other customs channels ****To be defined by Gartner team; *****Includes other supply chain *******Includes organisational complaints management responsibility;*******Includes Fraud Investigations ********Only included VIP security, regular office security under facilities
Note: Estimation on sizing based on mapping of previous organisation to new suggested organisation, no reductions or additions have been made

2

Operating Model options considered: example 3

Structure



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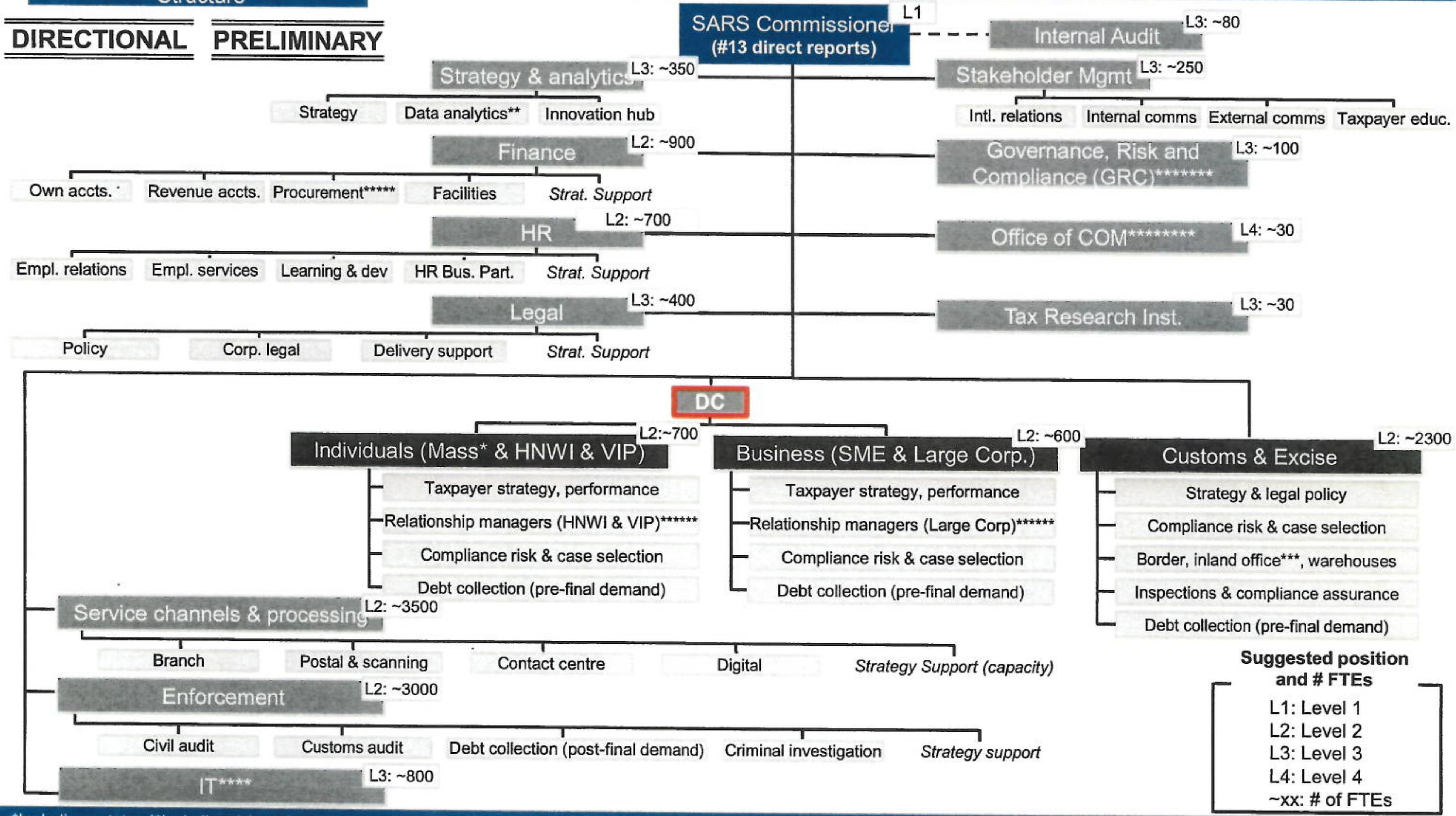
Note: Estimation on sizing based on mapping of previous organisation to new suggested organisation, no reductions or additions have been made

SARS At Your Service

2

Operating Model options considered: example 4

Structure



*Including estates **Including risk engine ***Including other customs channels ****To be defined by Gartner team; *****Includes other supply chain *******Includes organisational complaints management responsibility;*******Includes Fraud Investigations ********Only included VIP security, regular office security under facilities
Note: Estimation on sizing based on mapping of previous organisation to new suggested organisation, no reductions or additions have been made

SARS At Your Service

2 **Final Operating Model:** Key organisation design principles and business model

KEY DESIGN PRINCIPLES

- Balance structures, cluster together similar functions and increase focus on governance
- Simplify structures (minimise complexity, fragmentation and duplication) and focus on high-value opportunities
- Collect all taxes due by focusing on untapped collection potential
- Increase focus on Customs & Excise
- Balance minimal disruption with achieving the optimal structure and maintain focus on core operations
- Delayer structure (reduce the number of managerial-level roles, unfunded vacancies and acting managerial positions)
- No downsizing within the structure

BUSINESS MODEL (N-1 UNITS)

Tax and Customs & Excise business units to drive SARS strategic agenda...	Tax – Business and Individual	Customs and Excise	
Enabled by Digital Information Services and Technology and Enforcement functions...	Digital Information Services and Technology	Enforcement	
And supported by corporate support functions...	Finance	Human Capital and Development	Legal Counsel
	Strategy and Communications	Internal Audit	Tax, Customs and Excise Institute

2

Final Operating Model: Overview of new organisation structure

Commissioner

GE: Internal Audit
- Fraud Investigations
- Assurance
- Specialized Audit (IA)
- Technical Audit

GE: Tax, Customs & Excise Institute
- SARS Institute of Learning
- Trade & Industry Statistics
- Policy Research
- Macroeconomic Research
- Operational Research
- Research Support

CO: Business and Individual Tax
- Tax Compliance Risk & Case Selection
- Taxpayer Strategy (large corporates, HNWI, SMMEs, etc.)
- Branch
- Direct Channel
- Relationship Management (large corporates, HNWI)
- Tax Debt Collection (Pre Final Demand)
- Tax Operational Centre of Excellence

CO: Customs & Excise
- C&E Strategy & Legal Policy
- C&E Compliance Risk & Case Selection
- C&E Processing
- C&E Operational Centre of Excellence
- C&E Debt Collection (Pre-Final Demand)
- Customs Investigations
- Customs Branch

CO: Enforcement
- Investigative Audit
- Debt collection (Post-Final Demand)
- Criminal investigation
- Compliance Audit
- Excise Audit
- Customs Audit (Investigative)
- Divisional Planning & Monitoring 2

CO: Digital Information Services & Technology
- Business Solutions
- Service Delivery
- Strategy & Architecture

CO: Human Capital and Development
- Learning & Development
- Employment Relations
- Remuneration & Employee Services
- HR business Partners 1 & 2
- Division Planning & Monitoring 5

CO: Strategy and Communications
- Strategy Development & Analytics
- Partnership Dev & Communications
- Governance & Risk
- Office of the COM

CO: Finance
- Own accounts
- Revenue accounts
- Procurement
- Facilities
- Account Maintenance
- Division Planning & Monitoring 6

CO: Legal Counsel
- Delivery Support & Dispute Resolution
- Corporate Legal
- Legislative R & D
- Legal Advisory
- Division Planning & Monitoring 3

Business unit functions | Enabling functions | Corporate support functions

Executive summary

1 **The diagnostic** highlighted a number of areas for SARS to address:

- Reduce the tax gap and focus on HNWI, SMME, Debt, Customs/Excise
- Increase the level of goods control in customs
- Improve taxpayer service levels and the efficiency of service channels
- Increase the effectiveness of the SARS operating model

2 **The New Operating Model** was designed and implemented as a foundation of the SARS transformation

- The SARS strategic plan was defined (incl. 4 must-win battles and 5 enablers)
- The must-win battles and enablers were translated into design principles which included: increased focus on customs/excise, increased business unit accountability, definition of taxpayer segment strategies to pursue untapped revenue collection opportunities, balance between prevention and enforcement
- International benchmarks helped define different operating model options
- The operating model was recommended based on its adherence to the design principles

3 **The initial results of the SARS transformation were positive**

- The achievement of the FY15/16 target showed a continued tax buoyancy with R1069.9B collected – 8.5% year on year growth vs 6% nominal GDP growth and ~0.7% real GDP growth). Also, SARS started (re-)building capabilities including SMME campaigns, tax inspection and debt equalization
- The Customs "port of the future" implementation was initiated in Durban and led to improved goods control (<0.5% of undeclared cargo vs. 6% previously), an improved risk detection and intervention capability, and revised penalty guidelines
- SARS is transitioning to the new operating model with most of the "hardware" changes implemented (organizational structure changes)

3

SARS Transformation: Overview of transformation initiatives

FOR DISCUSSION

Customer journey

Registration → Filing & Declaration → Payment & refunds → Case selection & assessment → Enforcement / Border protection

BAIT

Tax

- SMME audit & cash economy reduction
- Large Corporates incl. BEPS control
- HNWIs profiling & VDP campaign
- Debt collection prioritisation
- Register integrity & classification
- Case selection effectiveness
- Penalty management & application
- Third party data including Trusts

Service Channels

- Digital volume migration (e.g. TCCs)
- Customer-centric operations (incl. NPS)
- Workforce efficiency
- Network of the future

Customs & Excise

- Customs control from origin to depot
- Case selection approach & rules
- Penalty policy & application
- Enforcement strategy including tactical team
- Trade facilitation/Preferred trader
- Excise coverage / inspection

Enforcement

- Debt collection prioritisation
- Audit coverage/quality (incl. Trusts)

Transversal activities

DIST
Strategy & Comms
HCD
Finance
Legal
Tax institute

- People
- IT strategy
- "Big" decisions
- Sourcing
- Application
- Transformation delivery
- Tax Gap Levers
- Relationships
- Communication
- Digital and big data
- Business model
- Capability gaps
- Org transition / design
- People strategies (capacity, capability, talent mgmt)
- Organisation Culture
- HR policy
- Procurement
- Facilities
- Government regulations
- SARS Policy
- Tax Gap Assessment
- Tax & Customs training

External stakeholders

Taxpayers

Travellers & traders

Banks

Associations

FNB

Tax authorities

Government

HM Revenue & Customs

Policy & Regulations

Assets

Data Sources and architecture

Delivery
Enabling
Support

3

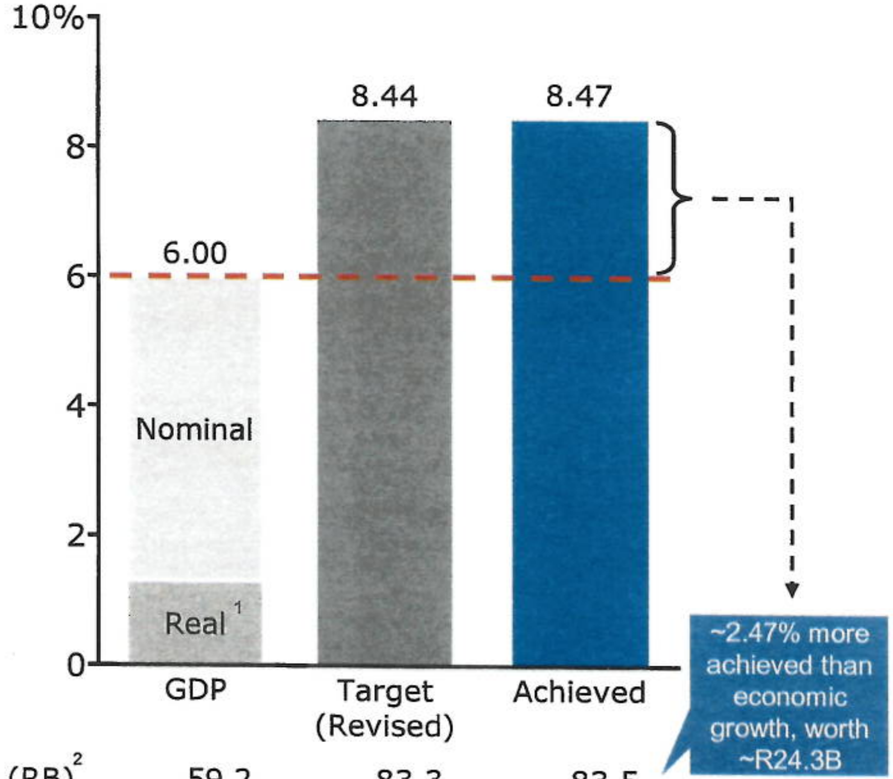
SARS Transformation: Results to date

Tax	• Met revenue target with R1069.9B collected – 8.5% year on year growth vs 6% nominal GDP growth • Piloted and **rolled out debt prioritization** approach resulting in **+R50M additional cash collected in ~2 months vs same period last year** • **Initiated enhanced debt equalisation approach** that will ensure equalisation of debt across all tax types; **projected to generate additional ~R1B-R2B / year** • **Kicked-off consistent pre-debt sms campaign** leading to +R50M cash collected through auto-contact channels vs same period last year • **Designed and launched new targeted SMME capability** aimed at increasing compliance in high risk industries; **in 6 weeks** since campaign launch, **+130 business inspected and R15M-R20M of value identified**
Customs	• Implemented **new Command Centre and Port team** to give SARS greater control over imports at the Durban seaport, resulting in **100% tracking** of all containers entering the port vs ~6-8% visibility gap previously • Introduced **new methodology** to determine entity risk resulting in a **consolidated list of high risk Agents and Traders** across all modalities and regions nationally; plan to incorporate learnings into Risk Engine • Conducted **special operations at Durban Seaport and City Deep simultaneously** (Operation Sunlight); generated 56 hits (pre-finalisation) and identified **key learnings** for the goods control & case selection processes • Case Selection and Goods Control initiatives could realise **~R2B of value** for SARS per year
Overall transfor-mation	• Implemented New Operating Model; Rebalanced the organisation to ensure **greater allocation of accountability across units** and allow for more **optimised spans of control** • Streamlined the organization by **reducing the number of managerial-level roles by 143, eliminating ~200 unfunded vacancies and reduced number of acting managerial positions by 130** • Reduced the number of **enterprise-level governance committees from 23 to 11** and allocated decision rights to appropriate levels within the organisation • Launched implementation of Balanced Scorecard to **communicate SARS' strategy throughout the organization** and align its activities towards the attainment thereof

③ Meeting the revenue target is a tremendous accomplishment given the state of the economy and overall context for SARS

8.5% GROWTH IN REVENUE ACHIEVED EXCEEDS GROWTH IN THE ECONOMY

Revenue growth achieved vs. GDP and target (2015-16)



	GDP	Target (Revised)	Achieved
Y-o-Y2 (RB)[2]	59.2	83.3	83.5
Revenue (RB)[3]	1,045.6	1,069.7	1,069.9

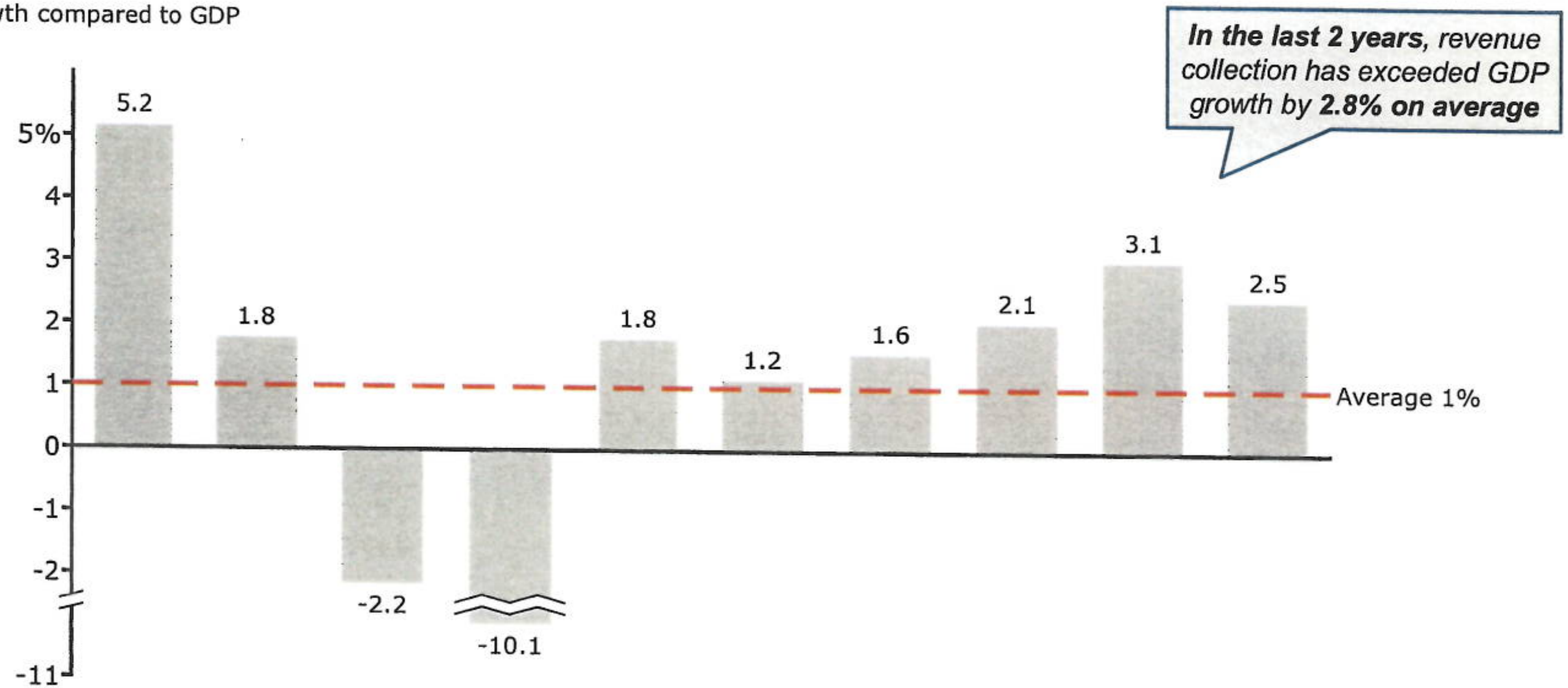
TRANSFORMATION INITIATIVES CONTRIBUTED TO TARGET ACHIEVEMENT

1. **Debt collection** – prioritized highly collectable debt and used **debt equalization** to claw back funds (combined worth ~R800M)
2. **SMMEs** – build and launched new SMME campaign capability (worth R100M to-date)
3. **Customs** – goods control reduced import container declaration gap from ~6.8 to ~2%; case selection and inspection capabilities built

Note: Nominal GDP growth for FY15/16 at 6.0%; [1]Real GDP growth in 2015 was 1.3% (estimated at 0.7% in 2016); [2]SARS revenue growth vs. 2014/15 base of R986.4Bn; [3]Total revenue based on growth rate
Source: SARS revenue data; RSA Treasury *National Budget Review* 2006-2016; BMI

FY14/15 and 15/16 revenue collection outperformed nominal GDP growth at the 2nd and 3rd highest levels in the last 10 years

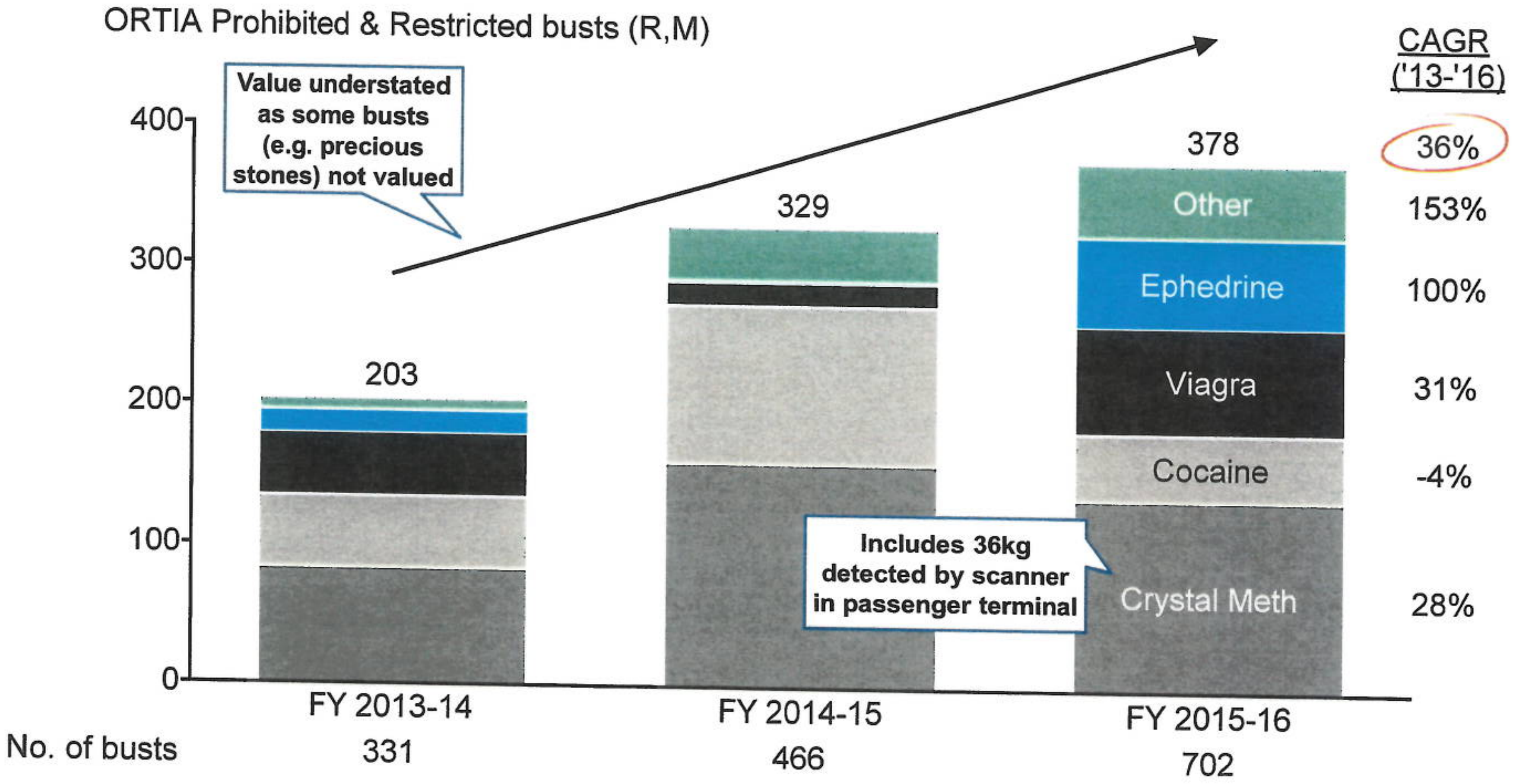
Revenue growth compared to GDP



	'06/07	'07/08	'08/09	'09/10	'10/11	'11/12	'12/13	'13/14	'14/15	'15/16
GDP growth (nominal)	13.6%	13.8%	11.3%	5.9%	10.8%	9.0%	8.0%	8.5%	6.5%	6.0%
Revenue growth	18.8%	15.6%	9.1%	-4.2%	12.6%	10.2%	9.6%	10.6%	9.6%	8.5%

Note: In FY06/07-FY08/09 Treasury reports real GDP growth and GDP inflation, summed for nominal GDP growth
Source: SARS Tax Statistics 2015; RSA Treasury *National Budget Review* 2006-2016

Bust value has increased by ~35% over past 3 years



Rise in busts potentially due to increased trafficking as well as ORTIA initiatives*

Notes: *Initiatives include new structures &increased focus on Mail Centre
Source: ORTIA busts database (FY'13/14-FY'15/16)

3 "Port of the Future" vision developed and implementation initiated in Durban

PRELIMINARY

Outcomes	**Fully account for all goods entering and leaving the country**	**Effectively assess risk and manage compliance through segmentation model**	**Accurately detect non-compliance**	**Effectively follow-through on consequences**	**Customer centric operations**	**Critical Enabler: Highly effective and professional people**
KPIs	% Manifest acquittal within 5 days of landing	% consistently compliant traders	% Hit rate	% compliance, & % cases completed within xx days	Compliant trader satisfaction	% adherence to career plan
Building blocks	• Automated data matching for full picture of goods movement • Electronic manifest acquittal of all goods • Dedicated team (Command Centre) with oversight over all goods through which all enforcement activity is coordinated • Coordination with key stakeholders to act on suspicious goods	• Segmentation model which accurately differentiates traders by compliance level • Advanced coordinated audit system/process to verify compliance • Highly effective risk targeting technology and profilers to target from the Command Centre built through: - Third party data (e.g. declarations from other countries) - End-to-end view of process with feedback loop	• All enforcement actions within port before goods leave port gate: - Logistics owned by Customs - Inspections conducted in port - Detentions and undeclared goods held in port - Gate management system to control Customs authorized entry into the port • Coordinated enforcement action emanating from Command Centre • Specialized skills at the front line	• Develop effective consequence guideline: - Harsh negative consequences for non-compliance - Incentives for compliant trade • Develop end-to-end management process to create accountability through the chain (incl. debt and criminal cases) • Enable staff to issue correct consequences with training and systems	• Enforce adherence to service levels by incorporating into scorecard • Adequately train employees to be customer centric with specialized training programs • Increase visibility of customer complaints and develop feedback loop	• Recruit the best people for the job • Improve the quality of induction training in line with best practice (incl. specialist training) • Develop effective career planning for all roles • Develop tailored training programs for each level and monitor attendance (part of scorecard)

Enablers

Organization and Organizational enablers (org structure to support new operating model with associated KPIs and incentives)

IT/systems to support operating model

Complete alignment with key stakeholders

3

SARS Transformation: Results to date - Tax

- Met revenue target with R1069.9B collected – 8.5% year on year growth vs 6% nominal GDP growth
  - Piloted and **rolled out debt prioritization** approach resulting in **+R50M additional cash collected in ~2 months vs same period last year**
  - **Initiated enhanced debt equalisation approach** that will ensure equalisation of debt across all tax types; **projected to generate additional ~R1B-R2B / year**
  - **Kicked-off consistent pre-debt sms campaign** leading to +R50M cash collected through auto-contact channels vs same period last year
- Defined strategy to improve collection in high priority areas (SMMEs, HNWI, debt equalization)
- **Designed and launched new targeted SMME capability** aimed at increasing compliance in high risk industries; **in 6 weeks** since campaign launch, **+130 business inspected and R15M-R20M of value identified**
- **Built new HNWI risk profiling capability** based on building **web of assets**

3

SARS Transformation: Results to date - Customs

- Implemented **new Command Centre and Port team** to give SARS greater control over imports at the Durban seaport, resulting in **100% tracking** of all containers entering the port vs ~6-8% visibility gap previously
- Introduced entity-based risk assessment into the Risk Engine using a **consolidated list of high risk Agents and Traders** across all modalities and regions nationally; Risk Committees set up to provide feedback into risk engine based on inspection findings
- Conducted **special operations at Durban Seaport and City Deep simultaneously** (Operation Sunlight); generated 56 hits (pre-finalisation) and identified **key learnings** for the goods control & case selection processes
- All penalty amounts reviewed to be closer in line to benchmarks, and **new penalties introduced** e.g. Missing container scan
- Case Selection and Goods Control initiatives could realise **~R2B of value** for SARS per year

3

SARS Transformation: Results to date – Overall transformation

- Implemented New Operating Model; Rebalanced the organisation to ensure **greater allocation of accountability across units** and allow for more **optimised spans of control**

- Streamlined the organization by **reducing the number of managerial-level roles by 143, eliminating ~200 unfunded vacancies and reduced number of acting managerial positions by 130**

- Reduced the number of **enterprise-level governance committees from 23 to 11** and allocated decision rights to appropriate levels within the organisation

- Launched implementation of Balanced Scorecard to **communicate SARS' strategy throughout the organization** and align its activities towards the attainment thereof

Back-up

Phase 1 diagnostic scope: 33 interviews, 4 Experts, 184 respondents to org survey, 6 external stakeholders & 7 countries benchmarked

PRIMARY RESEARCH

Interviews (n=33)

- Thomas Moyane: Commissioner
- Jonas Makwakwa, Acting CO: Operations
- Elizabeth Kumalo, CO: Human Resources
- Gene Ravele, CO: Enforcement
- Kosie Louw, CO: Legal & Policy
- Matsobane Matlwa, CO: Finance
- Brian Kgomo, GE: Internal Audit
- Thinux Marx, GE: Compliance Audit
- Sunita Manik, GE: Large Business Centre
- Mark Kingon, GE: Service
- Jeanneé Padiachy, GE: Processing
- Firdous Sallie, GE: Contact Centres
- Makungu Mthebule, Acting CO: Strategy
- Vusi Ngqulana, GE: Debt Management
- Erick Smith, Acting GE: Corporate Legal
- Giorgio Radesich, GE: Governance
- Randall Carolissen, GE Revenue Planning
- Babs Naidoo, Comms. and Marketing
- Chris Madima, Debt Management
- Dan Zulu, GE Branch Operations
- Eugene Wessels, Tax & Customs Register
- Mpho Mashaba, Customs & Excise
- Naresh Ramsumair, Shared Services
- Thabelo Malovhele, Case Selection
- Ramesh Jinabhai, Governance and Risk
- Ronald Makomva, Enforcement
- Sipho Bavuma, Legal
- Luther Lebelo, Human Capital
- Jacques Meyer, Case Selection
- Brenda Hore, EBE
- John Cruickshank, Trade Statistics
- Mogogodi Dioka, Procurement

External Experts (n=4)

- Representative, Swedish Tax authority
- Former Deputy Assistant Commissioner Canada Revenue Agency
- Former Director Performance Improvement, HM Revenue and Customs
- HMRC Strategic Policy and Technical BU

Survey Sample (n=184)

- Chief Officers; n = 2
- Group Executives; n = 11
- Executives; n = 45
- Senior Managers; n = 108
- Other; n= 18

External stakeholders (n=6)

- South African Institute of Tax Practitioners
- Association For Savings And Investments SA
- General Council Of The Bar Of South Africa
- Estate Affairs Agency Board
- The Banking Association of South Africa
- South African Institute of Chartered Accountants

SECONDARY RESEARCH

Benchmarks (not exhaustive)

- Organisational structure comparisons from Australia, Brazil, Canada, Malaysia, New Zealand, UK and US
- Operational performance benchmarks from leading tax authorities, including UK and Australia
- Select case studies on operational improvements including UK and Australia

External documents (not exhaustive)

- OECD Tax Administration 2013 comparative study
- OECD statistics database and supporting reports
- PWC Paying Taxes 2015 compliance report
- Worldbank Tax modernisation case studies
- IMF revenue administration toolkit
- National tax authority resources incl. UK, Australia
- Statistical resources: Worldbank, EIU, Datamonitor

SARS documents (not exhaustive)

- SARS Annual reports (2009,10,11,12,13,14)
- SARS Strategic documents and Statistics report
- SARS modernisation program (Randall Carolissen)
- SARS data on revenue, labour, cost, and operations
- National Development plan 2030
- SARS Compliance Program

12.7 DEBT MANAGEMENT AND FUNDING REQUIREMENTS

12.7.1 Introduction

Based on the debt maturity profile and cumulative debt curve, the following key issues have been identified and are taken into account in terms of creating the short, medium and long-term funding strategy:

1. **Capital structure**
   A key principle to managing the outstanding debt is to target the optimum capital structure of 70 % fixed and 30 % floating so as to minimise volatility of both the tariff and income statement.

2. **Asset/liability matching**
   A further key principle to managing Umgeni Water's debt is to match the maturity dates and quantum of debt outstanding in any year to the free cash generated by operations after servicing interest and operational expenditure. There still exists a mismatch between liabilities and free cash. This needs to be pro-actively managed on an ongoing basis.

3. **Optimal Debt Level**
   The key driver in determining the optimal level of debt for Umgeni Water was the ability to service debt given the cashflows generated after capital expenditure. A best-case scenario is that for every R1 of debt to be repaid, there is R1.40 of operational cash flow after capital expenditure to fund the repayment.

4. **Redemption portfolio**
   Having debt with large bullet repayments, such as the UG65 bond, exposes Umgeni Water to forward starting interest rate and refinancing risk. These risks can be eliminated through redemption portfolio management.

12.7.2 Funding Strategy

Table 12-23: Funding requirements (2009/10 to 2014/15)

FUNDING REQUIREMENTS	Short term (R m)			Medium Term (R m)		Long Term (R m)
Financial Year	F10	F11	F12	F13	F14	F15
Operational Cashflows	768	682	658	700	774	821
Capex (Escalated)	(557)	(816)	(712)	(509)	(497)	(494)
Net Operating Cashflow (shortfall) after Capex	211	(134)	(54)	191	277	328
Refinance - Capital (existing Debt)	(1,182)	(113)	(119)	(121)	(108)	(112)
UG21	600	-	-	-	-	-
EIB*		238	95	(17)	20	(19)
Refinance - Finance costs (existing Debt)	(8)	(20)	(24)	(24)	(11)	10
UG21	-	(64)	(64)	(64)	(64)	(64)
EIB		(7)	(21)	(29)	(27)	(29)
Funding Requirements	(379)	(101)	(186)	(65)	86	113
Redemption Portfolio - UG65	640	-				
Redemption Portfolio - New bond						
Redemption Portfolio – Interest						
Net Annual Incremental Funding Requirement	262	(101)	(186)	(65)	86	113
Net (Funding) Investing requirements						
Opening Balance Call Investments	370	632	531	345	280	367
Closing Balance	632	531	345	280	367	480

* European Investment Bank

Short term funding strategy: FY10 to FY12

- During F'10 a Three Billion Rand Domestic Medium Term Note programme was established allowing for short term paper and longer dated debt such as bonds to be issued with relative ease.
- The incremental funding requirement in F'11 and F'12 will be adequately covered from the call investments on hand, which were primarily derived from the funds obtained on the R 600 million UG21 bond issued in F'10 and R 400 million funding will be obtained from the proposed European Investment Bank (EIB) loan.
- All surplus cash is to be invested in short term financial assets (three to six-month term deposits).
- The net investing (funding) portion excludes the R 200 million liquidity buffer as reflected in the balance sheet.

Medium-term: FY13 to FY15

The medium term funding requirements indicate that Umgeni Water will not require additional borrowings above the EIB drawdown in F'14 and that it holds sufficient funds to cover any incremental funding.

Table 12-24: Funding requirements (2009/10 to 2014/15)

FUNDING REQUIREMENTS	Rand (millions) L/Term	L/Term	L/Term	L/Term	L/Term	L/Term
Financial Year	F15	F16	F17	F18	F19	F20
Operational Cashflows	821	876	976	1,054	1,131	1,210
Capex (Escalated)	(494)	(1,167)	(1,233)	(942)	(781)	(1,482)
Net Operating and Capex cash flow	**328**	**(291)**	**(256)**	**112**	**350**	**(272)**
Refinance - Capital (existing Debt)	(112)	(118)	(117)	(220)	(260)	(4)
UG21	-	-	-	-	-	-
EIB*	(19)	(19)	(19)	(19)	(19)	(19)
Refinance - Finance costs (existing Debt)	10	(5)	(50)	(85)	86	(90)
UG21	(64)	(64)	(64)	(64)	(64)	(64)
EIB	(29)	(27)	(26)	(24)	(22)	(21)
Funding Requirements	**113**	**(524)**	**(532)**	**(300)**	**71**	**(470)**
Redemption Portfolio - UG65						
Redemption Portfolio - New bond			(48)	(155)	(195)	398
Redemption Portfolio – Interest						43
Net Incremental Funding Requirement p.a.	**113**	**(524)**	**(580)**	**(455)**	**(124)**	**(29)**
Net (Funding) Investing requirements						
Opening Balance Call investments	367	480	(45)	(625)	(1,080)	(1,204)
Closing Balance	480	(45)	(625)	(1,080)	(1,204)	(1,233)

* European Investment Bank

Long-term: FY15 onwards

The current projections reflect that Umgeni Water will in the long term require additional long term funding to provide for its next phase of high capital expenditure.

12.7.3 Terms and Conditions on which money is borrowed

The terms and conditions on which money is borrowed differ according to loan agreements and bond issues. Bank committed facilities offered can be for a full twelve months or for a specified seasonal period. This committed facility would attract a facility fee on any unutilised balances during the agreed period only. Accessing the uncommitted facility will be subject to Umgeni Water giving the relevant banks at least forty eight hours notice in order that the bank may obtain the necessary credit approval to make the funds available to Umgeni Water.

A summary of the various funding facilities that Umgeni Water currently has and major conditions relating to those facilities are as per **Table 12-25.**

12.7.3.1 Bank Funding

Table 12-25: Bank Funding Facilities

Bank	Type of facility	Committed	Uncommitted
FNB	Working capital facility	R100 million	
RMB	Multipurpose Treasury Facility		R100 million
Standard Bank	General banking facility	R50 million	
Investec	General credit facility		R50 million
ABSA	Overnight facility	R65 million	
	Bridging facility	R300 million	
Nedbank	General banking facility		R 49,9 million

First National Bank

Instruments available under the short-term direct facility are:

- Overdraft – prime less 1% up to R10 million, thereafter prime;
- Corporate term loans – negotiable rate;
- Bankers acceptances (Acceptance credits) – negotiable rate;
- Promissory Notes – negotiable rate;
- Offshore Finance – negotiable rate; and
- Call loans – negotiable rate.

Standard Bank

Instruments available under the general short-term bank facility are:

- Overdraft – prime;
- Call loans – negotiable rates;
- Short-term loans – negotiable rates;
- Revolving acceptance credit facility and foreign currency finance facility;
- Offshore trade and working capital loans; and
- Other instruments – as offered by the bank.

Investec Bank

Instruments available under the general credit facility are:

- Bank call facility – negotiable rates;
- Foreign financing facility – negotiable rates; and
- Foreign exchange dealing facility – negotiable rates.

ABSA Bank

Instruments available under the general credit facility are:

- Bank call facility – negotiable rates; and
- Call bonds – negotiable rates.

12.7.3.2 Annuity Loans

Terms, conditions and maturity are specific to each loan agreement. The most significant loans and the balances as at 30 June 2010 (forecast) are: loan 71, which is the DBSA fifteen-year loan at, R 547million; and loan 73, which is the DBSA ten-year loan, at R 243 million.

12.7.3.3 Capital Market Bonds

Domestic Medium Term Note (DMTN) Programme

The DMTN Programme was established to fund long term capital expenditure requirements and to fund short term working capital requirements. The DMTN Programme was completed and signed off on 25 November 2009.

Under this DMTN Programme, Umgeni Water may from time to time issue unsecured or secured registered notes of any kind, in an aggregate outstanding nominal amount which will not exceed R 3 billion.

Notes may comprise without limitation:

- Fixed rate, floating rate, mixed rate, zero coupon notes or a combination of such foregoing notes or any other type of notes determined by Umgeni Water and the relevant dealers.

Interest rate

The interest rate will be determined at the time of issuance of notes and will be specified in the Applicable Pricing Supplement.

Maturity

The Notes are not subject to any minimum or maximum maturity.

Issuance of UG21 bond under the DMTN Programme

On 02 March 2010, after a very successful road show, Umgeni Water issued a R 600 million unsecured fixed rate bond, the UG21, at an interest rate of 10.70 %, under the DMTN Programme.

The UG21 falls due on 02 March 2021 and interest payments are due on 02 March and 02 September each year.

The UG21 was oversubscribed at the time of issuance.

12.7.3.4 Development Funding Institutions

Proposed European Investment Bank (EIB) Loan

The due diligence for Umgeni Water was completed during 2009 and the Board of the EIB, in principle, approved the R 400 million twenty-year loan, on the 7 December 2009. The Contract Agreement is still being finalised.

12.8 PROPOSED BORROWINGS

12.8.1 Borrowings Domestic and Foreign

Short-term borrowings consist mainly of the portion of long term debt falling due within one year. In F'09, there is a significant increase in the short-term borrowings due to the UG65 bond redemption in the following year (F'10).

Table 12-26: Proposed total borrowings

DATE OF BORROWING	TOTAL GROSS BORROWING	TOTAL PORTION IN RANDS					
		LONG TERM			SHORT TERM		
	Actual	Actual			Actual Total Short term	Short-term portion of long term debt	Short-term borrowings
2007/2008	2,078,337,303	1,976,783,560	-	-	101,553,743	101,553,743	-
2008/2009	1,978,904,300	917,448,873	-	-	1,061,320,091	1,061,320,091	-
	Projected	Projected	Proposed	Total	Projected	Projected	Projected
2009/2010	1,517,584,209	800,302,212	600,000,000	1,400,302,212	117,281,997	117,281,997	-
2010/2011	1,637,885,541	1,265,365,376	237,583,329	1,502,948,705	134,936,836	134,936,836	-
2011/2012	1,609,974,821	1,359,768,753	107,026,116	1,466,794,869	143,179,952	143,179,952	-
2012/2013	1,466,794,869	1,336,427,700	-	1,336,427,700	130,367,169	130,367,169	-
2013/2014	1,373,668,255	1,205,071,336	37,240,555	1,242,311,891	131,356,364	131,356,364	-
2014/2015	1,242,311,891	1,105,044,774	-	1,105,044,774	137,267,117	137,267,117	-

Table 12-27: Borrowing programme in Rands - Foreign

DATE OF BORROWING	TOTAL GROSS BORROWING	FOREIGN PORTION IN RANDS					
		LONG TERM			SHORT TERM		
	Actual	Actual			Actual Total Short term	Short-term portion of long term debt	Short-term borrowings
2007/2008	-	-	-	-	-	-	-
2008/2009	-	-	-	-	-	-	-
	Projected	Projected	Proposed	Total	Projected	Projected	Projected
2009/2010		-	-	-	-	-	-
2010/2011	237,583,329	-	225,704,163	225,704,163	11,879,166	11,879,166	-
2011/2012	344,609,451	225,704,163	101,674,816	327,378,979	17,230,472	17,230,472	-
2012/2013	364,619,532	310,148,506	35,378,527	345,527,034	19,092,499	19,092,499	-
2013/2014	345,527,034	326,434,535	-	326,434,535	19,092,499	19,092,499	-
2014/2015	326,434,535	307,342,036	-	307,342,036	19,092,499	19,092,499	-

* The loans are denominated in South African Rands and thus there is no currency risk

Table 12-28: Borrowing programme – Domestic

DATE OF BORROWING	TOTAL GROSS BORROWING	DOMESTIC PORTION IN RANDS					
		LONG TERM			SHORT TERM		
	Actual	Actual			Actual Total Short term	Short-term portion of long term debt	Short-term borrowings
2007/2008	2,078,337,303	1,976,783,560	-	-	101,553,743	101,553,743	-
2008/2009	1,978,768,965	917,448,873	-	-	1,061,320,091	1,061,320,091	-
	Projected	Projected	Proposed	Total	Projected	Projected	Projected
2009/2010	1,517,584,209	800,302,212	600,000,000	1,400,302,212	117,281,997	117,281,997	-
2010/2011	1,400,302,212	1,265,365,376	11,879,167	1,277,244,543	123,057,670	123,057,670	-
2011/2012	1,265,365,370	1,134,064,590	5,351,300	1,139,415,890	125,949,480	125,949,480	-
2012/2013	1,102,175,336	1,026,279,194	35,378,527	990,900,666	111,274,670	111,274,670	-
2013/2014	1,028,141,221	878,636,801	37,240,555	915,877,356	112,263,865	112,263,865	-
2014/2015	915,877,356	797,702,738	-	797,702,738	118,174,618	118,174,618	-

12.8.2 Maturity Profile of Debt

The maturity profile (**Table 12-29**) indicates the short and long term borrowings.

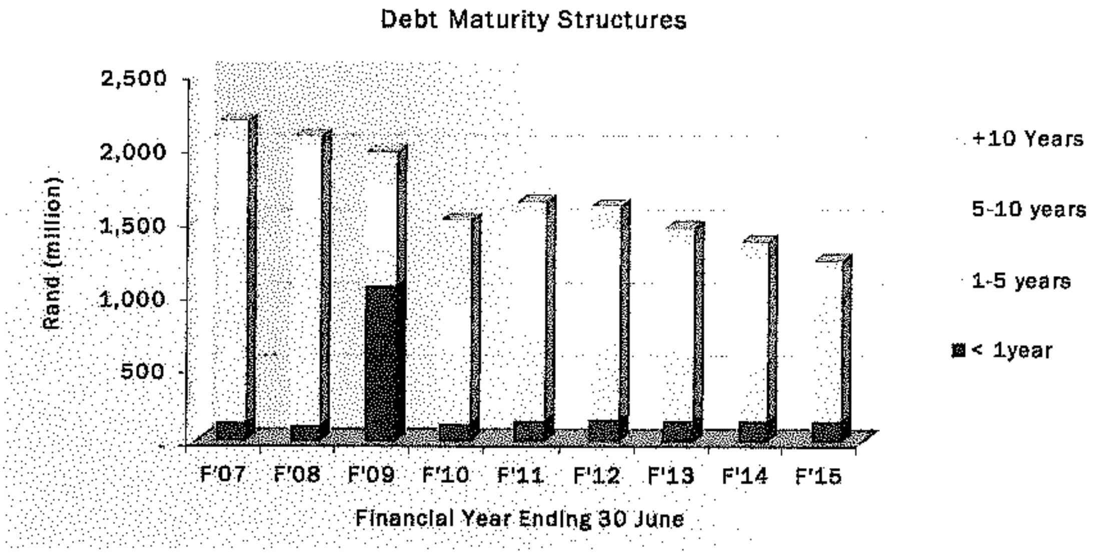
Table 12-29: Maturity profile of debt (Balance Sheet)

Maturity Profiles - Investment and Debt								
Investment maturity structure (R'm)	F'08	F'09	F'10	F'11	F'12	F'13	F'14	F'15
< 1year	501	1,213	860	759	573	508	595	708
	53%	98%	98%	98%	98%	99%	100%	100%
1-5 years	440	22	19	14	10	5	-	-
	47%	2%	2%	2%	2%	1%	0%	0%
5-10 years	-	-	-	-	-	-	-	-
	0%	0%	0%	0%	0%	0%	0%	0%
+10 Years	-	-	-	-	-	-	-	-
	0%	0%	0%	0%	0%	0%	0%	0%
Total Investments	941	1,236	878	773	583	513	595	708
Debt maturity structure (R'm)	F'08	F'09	F'10	F'11	F'12	F'13	F'14	F'15
< 1year	102	1,061	117	135	143	130	131	137
	5%	54%	8%	8%	9%	9%	10%	11%
1-5 years	1,433	275	533	593	534	525	417	903
	69%	14%	35%	36%	33%	36%	30%	73%
5-10 years	470	417	267	834	769	704	700	119
	23%	21%	57%	51%	48%	48%	51%	10%
+10 Years	74	226	600	76	164	107	126	83
	4%	11%	0%	5%	10%	7%	9%	7%
Total Borrowings	2,079	1,979	1,517	1,638	1,610	1,466	1,374	1,243
Net Borrowings	1,137	743	639	865	1,027	953	779	535
Long - term debt (>1 year)	1,977	918	1,400	1,503	1,467	1,336	1,243	1,106
Movement	-4.0%	-53.6%	52.5%	7.4%	-2.4%	-8.9%	-7.0%	-11.0%
Short - term debt (<1 year)	102	1,061	117	135	143	130	131	137
Movement	-15.6%	945.1%	-88.9%	15.1%	6.1%	-8.9%	0.8%	4.5%

Table 12-30: Fixed versus Floating Debt

Fixed vs Floating		F'08	F'09	F'10	F'11	F'12	F'13	F'14	F'15
Fixed	Rand	1,561,507,126	1,503,543,294	1,067,585,477	1,237,886,809	1,259,976,089	1,166,658,979	1,123,532,367	1,042,176,003
	%	74.1%	75.0%	70.3%	75.6%	78.3%	79.5%	81.8%	83.9%
Floating	Rand	564,222,400	500,000,000	450,000,000	400,000,000	350,000,000	300,000,000	250,000,000	200,000,000
	%	25.9%	25.0%	29.7%	24.4%	21.7%	20.5%	18.2%	16.1%
Total	Rand	2,125,729,526	2,003,543,294	1,517,585,477	1,637,886,809	1,609,976,089	1,466,658,979	1,373,532,367	1,242,176,003

Figure 12-7: Debt Maturity structure



12.8.3 Analysis of Funding Against Approved Borrowing Limits

In preparing the funding strategy, cognisance was taken of the level of gross debt against the unconditional borrowing limit set by the Department of Water Affairs and National Treasury which is R 2,800 million for F'10 and R 1,800 million for F'11.

Figure 12-8: Analysis of funding against approved borrowing limits

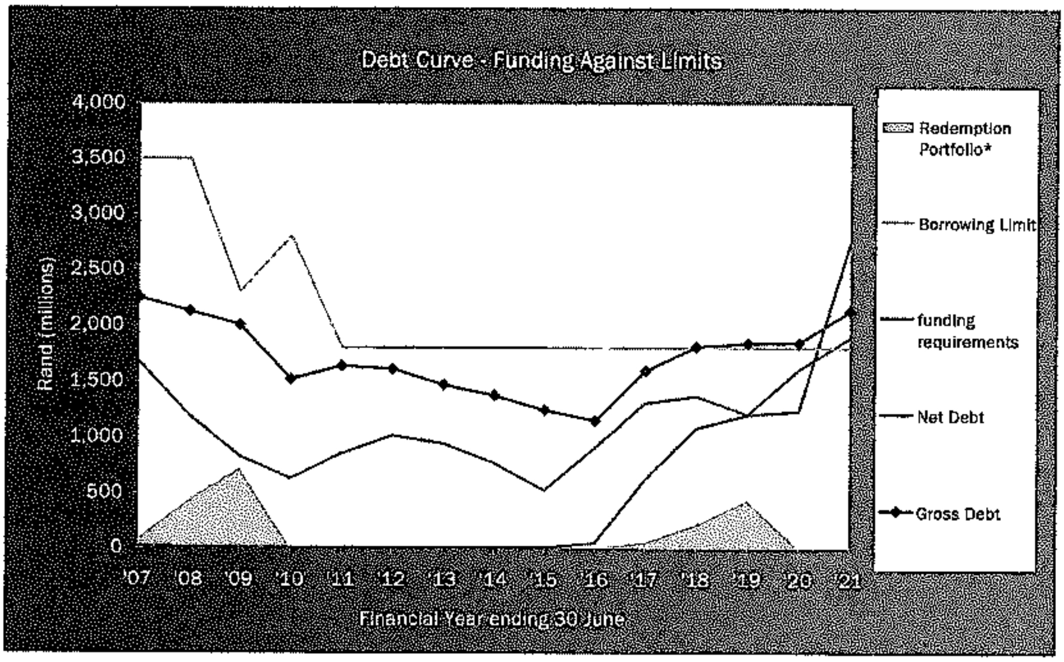


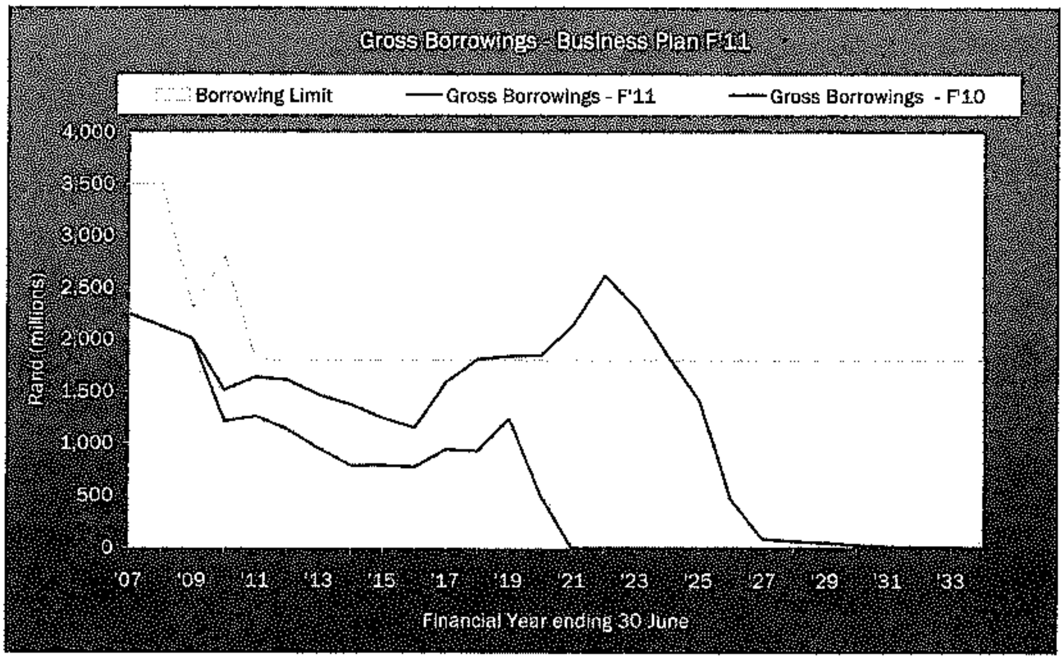
Table 12-31: Gross Borrowings (R'm)

Borrowing Limit	F10	F11	F12	F13	F14	F15	F16	F17
Gross Borrowings	1,518	1,638	1,610	1,467	1,374	1,242	1,150	1,594
At Peak	973							
Contingencies	25	164	161	147	137	124	115	159
TOTAL GROSS BORROWINGS	2,515	1,802	1,771	1,613	1,511	1,367	1,265	1,753
Approved borrowing Limit	2,800	1,800						
(Over) Under utilisation	285	(2)	29	187	289	433	535	47

The borrowing limits of R 2,800 million and R 1,800 million were approved by National Treasury as per the approval letter dated 15 December 2009.

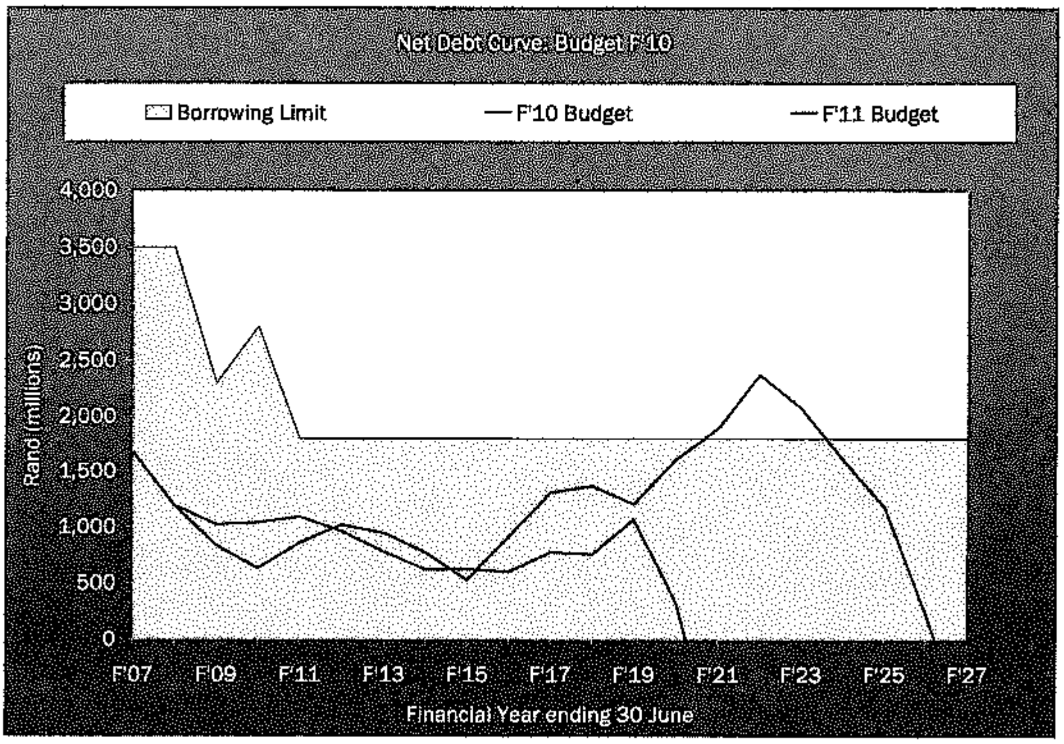
12.8.4 Debt Curve

Figure 12-9: Comparison of gross Debt Budget F'10 to Budget F'11



The shift in long-term borrowings arises primarily from the reduction in volumes sales and the thirty-year increase in Capex.

Figure 12-10: Comparison of net Debt Budget F'10 to Budget F'11



12.9 FINANCIAL RISK

Umgeni Water assumes a low risk tolerance approach to risk. The three risks described in the sections that follow have been identified as specific treasury risks and are managed proactively to ensure their timely mitigation.

12.9.1 Sustainable Tariff

An unsustainable tariff will affect Umgeni Water's ability to fund future capital expenditure programmes and undertake operational expansion. This risk impacts on the organisation's ability to deliver on its financial strategies, namely, **'Contribute to an Affordable Tariff'**.

Mitigation approach

Umgeni Water monitors and reports on cashflow funding requirements and maintains optimal debt levels, has a transparent and formalised tariff policy, together with a robust tariff model. The organisation undertakes water demand planning, liaises with stakeholders to obtain commitment to the capital expenditure programme and subsequently undertakes project evaluation to assess sustainability of the programme.

12.9.2 Liquidity Risk

Liquidity risk will result in Umgeni Water being unable to raise sufficient funds in the required currency and at the correct time to meet its financial obligations. This will impact on the organisation's ability to achieve its financial strategies, namely, **'Enhance Shareholder Value'**.

Mitigation approach

To mitigate liquidity risk, Umgeni Water has:

- **Short-term funding facilities** to meet ongoing cash requirements for which facility options are in place with four banks (FNB, Standard, ABSA, Nedbank);
- **A Domestic Medium Note (DMTN) Programme** has been established allowing for longer dated debt such as bonds to be issued with relative ease;
- **Provided for a R 200 million cash buffer investment** to cater for delayed payments by its customers;
- **A redemption strategy framework**, which provides guidelines for managing the risks associated with refinancing large debt maturities (such as the UG65 bond). The build-up in the redemption portfolio over a three-year period is: 10 % of the capital redemption value three years before maturity, 40 % two years before maturity, 75 % a year before maturity, and the balance of 25 % is funded during the year of maturity; and
- **Borrowing limits approved by National Treasury**, which are currently: R 2,800 million for F'10, and R 1,800million for F'11.

12.9.3 Credit Risk

Credit risk concentration will result in Umgeni Water being exposed to counter-party failure. This has the potential to impact on the organisation's ability to '**Maintain an Optimal Debt Level**, amongst its other strategies.

Mitigation approach

Umgeni Water will:

- According to its Investment Policy, mitigate credit risk by conducting transactions only with counter parties and issuers who satisfy soundly based and acceptable assessment processes, and only after formal limits have been set. In addition, same-day settlement limits will be set wherever possible and/or strict settlement procedures set and adhered to, and
- Continue monitoring of the credit quality of counterparties.