

## **Report of the Auditor-General**

on a performance audit of entities that are connected with government employees and doing business with departments of the KwaZulu-Natal Provincial Administration

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**REPORT OF THE AUDITOR-GENERAL ON A PERFORMANCE AUDIT OF ENTITIES THAT ARE CONNECTED WITH GOVERNMENT EMPLOYEES AND DOING BUSINESS WITH DEPARTMENTS OF THE KWAZULU-NATAL PROVINCIAL ADMINISTRATION**

**1. EXECUTIVE SUMMARY**

- 1.1 The Auditor-General (AG) issued a report to Parliament in January 2006 on the approval for government employees to perform other remunerative work and the disclosure of financial interests by ministers, deputy ministers and senior managers. This report indicated that designated employees (senior managers) and certain ministers had failed to declare their interests and that the majority of government employees did not have approval to perform remunerative work outside their employment in government, as prescribed by the relevant legislation and regulations.
- 1.2 Based on the above, a transversal performance audit was conducted on government employee-related entities doing business with national and provincial departments.
- 1.3 During the audit specific emphasis was placed on the following:
  - 1.3.1 performance of remunerative work
  - 1.3.2 declaration of interest on standard bidding documentation (SBD)
  - 1.3.3 deviation from the supply chain management process
  - 1.3.4 non-compliance with value-added tax (VAT) legislation.
- 1.4 The audit revealed, *inter alia*, the following:
  - 1.4.1 The extent of business done by employee- or spouse-related companies in the KwaZulu-Natal Provincial Administration for the period 1 April 2005 to 31 March 2007 amounted to approximately R136 million. Although some of the departments are still determining whether employees who are directors or members of companies and close corporations (CCs) that did business with departments of the KwaZulu-Natal Provincial Administration had the necessary approval, the majority of employees did not have approval to perform other remunerative work.
  - 1.4.2 Some departments of the KwaZulu-Natal Provincial Administration had deviated from the supply chain management process without the necessary approval by awarding tenders to or accepting quotations from employee-related entities. This could be an indication of preferential treatment of such employee-related entities or of fraudulent activities in the adjudication of tenders or quotations.

- 1.5 Inconsistencies in rectifying the above shortcomings existed between departments. In some instances departments had proceeded with disciplinary action against employees, while others indicated that disciplinary steps could not be taken as employees had not been aware that they should have approval to perform other remunerative work. A consistent approach, which includes awareness, training, disciplining and legal action as well as the blacklisting of entities, should be encouraged.
- 1.6 In response to the findings of the Auditor-General of South Africa (AGSA) as included in the report of the AG to Parliament on a performance audit of entities that are connected with government employees and doing business with national departments [RP 242/2008], the Accountant-General, the Public Service Commission and the Department of Public Service and Administration (DPSA) indicated that the current legislation and regulations would be reviewed and consideration would be given to amending them, if necessary, to limit and avoid the shortcomings identified in this report.

## **2. PURPOSE AND CONTENT OF THE REPORT**

- 2.1 A performance audit was conducted of entities that are connected with government employees and doing business with departments of the KwaZulu-Natal Provincial Administration, as per section 188(4) of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), read in conjunction with sections 5(3) and 20(3) of the Public Audit Act, 2004 (Act No. 25 of 2004). The purpose of this report is to facilitate public accountability by bringing to the attention of the provincial legislature the findings of the performance audit.
- 2.2 Sufficient audit work was performed to provide substantiating audit evidence for the findings set out herein.
- 2.3 It is anticipated that this report, which reflects comments received from various departments, would give rise to corrective steps that would contribute constructively to the establishment and implementation of appropriate management measures and controls and, consequently, to improve value for money.
- 2.4 The responsibility for instituting these management measures rests with management. The primary objective of performance auditing is to confirm independently that these measures do exist and are effective, and to provide the executive and legislative bodies with findings and examples of the effects thereof by means of a structured reporting process.

## **3. AUDIT SCOPE**

- 3.1 This performance audit focused on the following aspects:
- 3.1.1 Employees of departments of the KwaZulu-Natal Provincial Administration who are

directors or members of companies and CCs where these companies and CCs did business with the departments where such employees work (annexure A refers).

- 3.1.2 Transactions by employees' spouses who are directors or members of companies and CCs that did business with departments where the husband/wife is employed (annexure B refers).
- 3.1.3 Employees of departments who are directors or members of companies and CCs where these companies and CCs did business with other departments of the KwaZulu-Natal Provincial Administration (annexure C refers).
- 3.2 The transactions included in this report cover the period 1 April 2005 to 31 March 2007.
- 3.3 The scope was limited to the procurement process up to approval of the payments. The scope also included determining whether employees who had an interest in the company or CC that rendered the service or supplied the goods to the department were involved in the procurement process.
- 3.4 The objective of the performance audit was to identify companies and CCs that are primarily profit driven and are transacting with departments. For this reason the following types of companies were excluded from the scope of the performance audit:
  - 3.4.1 Section 21 (not for profit) companies as defined in the Companies Act, 1973 (Act No. 61 of 1973) that was applicable up to April 2009. This act was subsequently replaced by the Companies Act, 2008 (Act No. 71 of 2008).
  - 3.4.2 Public entities listed under the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA).
  - 3.4.3 Companies where the employee is appointed as an independent contractor or board member in an executive capacity at a department. The reason is that in those cases the employee's details are loaded onto the Personnel and Salary System (Persal) for income tax purposes, and not because he/she is a permanent employee of the department.
  - 3.4.4 Employees who hold shares in listed companies.
- 3.5 The objectives of the procedures performed were the following:
  - 3.5.1 To identify the extent of employee-related entities that did business with departments of the KwaZulu-Natal Provincial Administration.
  - 3.5.2 To enhance transparency and adherence to relevant legislation.
  - 3.5.3 To identify and report on findings in the current processes and systems.

- 3.5.4 To possibly reduce the risk of corruption.

#### **4. SCOPE LIMITATION**

- 4.1 Due to cost implications and time constraints, transactions to be audited by the AGSA were selected on a sample basis. In most instances, transaction values in excess of R100 000 were selected as part of the sample to be audited.
- 4.2 The audit was seriously hampered as some payment and supporting documents of the procurement process were not furnished by the provincial departments of (i) Agriculture and Environmental Affairs; (ii) Education; and (iii) Health.
- 4.3 Due to time and cost constraints the departments were requested to investigate internally the transactions not included in the audit sample and to report the outcome of the internal investigation to the AGSA. The extent of transactions that the departments were requested to follow up on is reflected in annexures A and B. At the time of compiling this report, various departments were still in the process of investigating these transactions and therefore the outcomes of these investigations have not yet been communicated to the AGSA.
- 4.4 The scope of the performance audit did not include the verification of shares held in companies as this information is not available on the CIPRO database. Consequently, where an employee resigned as a director of a company, it was not possible to confirm whether the employee had sold his or her shares in the company unless this was discovered by chance. Therefore, a risk exists that employees might have resigned as directors from companies, but had not sold their shares in the companies. If the shareholding was not declared, or the employee had not requested permission to perform other remunerative work outside his/her employment at the department, it was not possible to identify employees who held shares in companies that conducted business with departments of the KwaZulu-Natal Provincial Administration.
- 4.5 Similarly, the procedures conducted in this performance audit will not reveal collusion between employees employed at a department and the company that did business with the department. This relates to employees who may be receiving another form of gratuity or emolument from the company that did business with the department.

#### **5. MODUS OPERANDI**

- 5.1 Performance audits are conducted in accordance with the internal guidelines for the planning, execution, reporting and follow-up of performance audits.
- 5.2 Computer-assisted audit techniques (CAATs) were used extensively to compile exception reports, while procedures were developed for following up on these exceptions. The

following databases were used in the compilation of exception reports during the performance audit:

- 5.2.1 Database of the Companies and Intellectual Property Registration Office (CIPRO) of directors of companies and members of CCs as at 31 January 2006. Actual dates of appointments and resignations were confirmed with CIPRO.
- 5.2.2 Persal payroll data for March 2006.
- 5.2.3 Consolidated Basic Accounting System (BAS) payment data for the period 1 April 2005 to 31 March 2007, unless stated otherwise. This file included accounts payable data for government departments on BAS during this period.
- 5.3 The draft management reports were issued for comments to the respective departments during the period May to mid August 2008. On 31 August 2008 the final management letters was issued requesting responses. Although responses were received as late as 6 November 2008, these did not deal with the details as per the findings and recommendations. The final comments on the management reports, which were provided through the Office of the Premier to the AGSA on 29 July 2009, were used in the compilation of this report.

## **6. OVERVIEW OF EMPLOYEE-RELATED COMPANIES AND CLOSE CORPORATIONS DOING BUSINESS WITH DEPARTMENTS OF THE KWAZULU-NATAL PROVINCIAL ADMINISTRATION**

- 6.1 During the performance audit a significant number of cases were identified where the employee had resigned as a director or member of the company or CC. This could possibly be attributed to the impact of the Report of the Auditor-General on the declarations of interest by ministers, deputy ministers and government employees that covered the 2004-05 financial year [RP 19/2006]. Where the employee had resigned before the transaction occurred, the information was omitted from the final summary. The following table is a summary of the number of employees, number of companies and/or CCs and amounts paid to companies or CCs that transacted with the departments. Refer to annexures A to C for detail.



Summary of employee-related companies and CCs doing business with departments of the provincial administration				
	Number of employees	Number of companies/CCs	Amount paid 01/04/2005 – 31/03/2007 R	Annexure
Employee-related companies and/or CCs doing business with own departments	308	349	25 897 217	A
Employees' spouse-related companies and/or CCs doing business with own departments	69	70	34 859 085	B
Employee-related companies and/or CCs doing business with other departments of the KwaZulu-Natal Provincial Administration	539	538	75 477 525	C

## 7. FINDINGS, RECOMMENDATIONS AND COMMENTS FROM DEPARTMENTS

### 7.1 Performance of remunerative work

Regulations with respect to the conduct of remunerative work by government employees differ in certain instances between departments of the KwaZulu-Natal Provincial Administration. Where relevant, these differences were taken into account.

#### 7.1.1 Regulations

- (a) Chapter VII, sections 30 and 31 of the Public Service Act of 1994 (Act No. 103 of 1994) (PSA) stipulates: *Unless it is otherwise provided for in his or her conditions of employment every officer and employee shall place the whole of his or her time at the disposal of the State. No officer or employee shall perform or engage himself or herself to perform remunerative work outside his/her employment in the public service, without permission granted by the relevant executing authority or officer authorised by the said authority. If an officer receives any remuneration, allowance or other reward, other than in accordance with this act, an amount equal to such remuneration received should be paid into the revenue account.*
- (b) Chapter 7, section 33 of the Employment of Educators Act, 1998 (Act No. 76 of 1998) states that *unless an Educator's conditions of service provide otherwise, an educator shall place such time as the Minister may determine at the disposal of the Employer; no educator shall without permission of the employer perform or undertake to perform remunerative work outside the educator's official duty or work.*
- (c) Paragraph 4.5.5 of the *Explanatory manual on the code of conduct for the public services* (a practical guide to ethical dilemmas in the workplace), discusses employees who undertake remunerative work outside their official employment

without approval and states that *employees are expected to place their undivided attention, time and skills at the disposal of the public service as employer. The nature and demands of the job in the public service are such that the interests of both the public service and community may be prejudiced by a public servant undertaking remunerative work outside official duties. It is therefore mandatory to obtain prior approval to perform remunerative work outside official hours.*

#### **7.1.2 Findings**

- (a) A total of 308 employees were identified who are directors or members of companies or CCs that did business with the provincial department where the employee is employed (annexure A refers). Apart from the Department of Agriculture and Environmental Affairs, which confirmed that its employees did not request approval to perform other remunerative work and was pursuing disciplinary action, proof of approval for employees to perform other remunerative work was not furnished. In various instances the departments were still determining whether employees had approval to perform remunerative work outside their official employment at the department. The total amount paid to these companies and CCs during the period under review was R25 897 217.
- (b) In addition, 539 employees were identified who are directors or members of companies or CCs that did business with other provincial departments (annexure C refers). Apart from the Department of Agriculture and Environmental Affairs, which confirmed that its employees did not request approval to perform other remunerative work and was pursuing legal action, proof of approval for employees to perform other remunerative work was not furnished. In various instances the departments were still determining whether employees had approval to perform remunerative work outside their official employment at the department. The total amount paid to these companies and CCs during the period under review was R75 477 525.
- (c) Furthermore, annexures A and C clearly indicate that employee-related companies and/or CCs did excessive business with their department and/or other provincial departments. The departments should therefore assess the impact of the employees' business transactions on their ability to effectively perform their respective duties within the department, especially when the amounts paid to these entities are taken into consideration.

#### **7.1.3 Recommendations by the AGSA**

- (a) As indicated in paragraph 7.1.2 (a) and (b) above employees did not request and received approval to perform other remunerative work. Therefore the relevant departments should take disciplinary action against employees whose companies or CCs did business with the departments of the KwaZulu-Natal Provincial

Administration and had not been granted approval to perform other remunerative work.

- (b) The departments should implement action plans to monitor the progress made with respect to disciplinary action taken against employees who had not applied for and granted approval to perform other remunerative work. The departments should also report back to the provincial legislature on the outcomes of the disciplinary actions and the action plans implemented.
- (c) The departments should monitor, on a yearly basis, the extent of business conducted by their employees. If the extent of business conducted by these entities is excessive and impacts on the employees' ability to perform their duties at the departments, the departments should consider withdrawing the approval granted. Approval to perform other remunerative work should not be granted if the approval would lead to work being performed for a government department.
- (d) The departments should implement and actively monitor the systems of control to manage the performance of other remunerative work by employees. This could include the annual issuing of letters to employees, informing them of the requirement to obtain approval to perform other remunerative work. Copies of the letters of approval should be either kept centrally or placed on the employees' files. Where possible, the completeness of certain aspects of the declarations should also be verified by, for example, conducting CIPRO searches to confirm the completeness of the declared directorships and memberships of companies and/or CCs.
- (e) Designated employees should be informed of the requirement that they should also request approval to perform other remunerative work. The fact that disclosure in the financial disclosure forms is not sufficient, should be emphasised.
- (f) Companies should be requested to supply their shareholding, and not just directorship, in the tender documentation to allow departments to identify related-party transactions.
- (g) Consideration should be given to amending the existing regulations with regard to the declaration of interests and the performance of other remunerative work by government employees, as follows:
  - (i) Non-designated employees should disclose their directorships and memberships of companies and/or CCs. These disclosures need only be submitted by non-designated employees who hold directorships or memberships of companies and/or CCs. According to the DPSA, the matter of extending the system to non-designated employees and supply chain management officials has been considered before and it was decided not to

- extend the system. However, in view of the recommendations and findings made in this report the extension of the system will be considered.
- (ii) Non-designated and designated employees should specifically disclose details of directorships and memberships of companies/CCs that had previously transacted with government. An overview of the transactions with government should also be provided.
  - (iii) Non-designated and designated employees should disclose their spouses' directorships and memberships of entities that are transacting with the specific government institution where they are employed.
- (h) Newly appointed government employees should make the disclosure within 30 days of appointment, while government employees who are transferred from one government department to another should again make the required disclosure at the new department within 30 days of transfer.
- (i) The policy should require government employees to disclose changes in circumstances that could have an impact on the completeness or accuracy of the declarations they had provided. Such disclosure should be made within 30 days of the change in circumstances. For example, a newly acquired directorship or membership should be disclosed by a government employee within 30 days of obtaining it.
- (j) Non-designated and designated employees should take personal responsibility for ensuring that CIPRO processes their resignation/termination of directorships and memberships.

#### 7.1.4 Responses from provincial departments

- (a) The **Department of Agriculture and Environmental Affairs** confirmed that employees did not request the necessary approval to perform remunerative work outside their employment. These findings have been forwarded to Labour Relations to initiate appropriate disciplinary measures. The department was developing processes and procedures to regulate the activities of government employees transacting with the Department of Agriculture and Environmental Affairs as well as other departments.
- (b) The **Department of Education** did not have a framework within which the approval and granting of permission to employees to perform other remunerative work outside his/her employment in the public service could be managed. Bearing this in mind and the fact that to pursue any disciplinary actions, the department had to prove that such a framework, policy and procedures exist, the department opted to approach the process to rectify the situation as follows:
- (i) Phase 1 – Data collection and database functionality design

- This process includes an understanding of the current legislation and environment governing the declaration of interests and appointment of project managers to run the project.
  - Allow employees to declare to the employer within a particular time whether or not they have any business interests. However, this will not absolve any employee from charges, criminal or otherwise, if it is found that they or their companies had engaged in illegal or unlawful activities.
  - Match the departmental Persal database with the CIPRO database in order to determine matching identities.
  - Database design onto which all this information will be loaded and maintained going forward.
- (ii) Phase 2 – Data analysis
- Matching of the results from declarations with the CIPRO database to identify any differences.
  - Matching of suppliers' bank details to the departments' payment database.
  - Reviewing the processes through which the companies and/or CCs may have been awarded the work, including matching of companies' and/or CCs details to suspect payments.
- (iii) Phase 3 – Development of procedures
- Development of business processes and procedures
  - Train relevant personnel on the utilisation of the database.
- (iv) Phase 4 – Ongoing maintenance
- All new employees to complete a declaration form which will be loaded onto the database.
  - Annual applications to be made within a particular time and loaded onto the database.
  - Ongoing checking of the database against all bids and quotations accepted to ensure that no conflict exists.
  - Sharing of the database with other departments.
- (v) With regard to the specific actions raised in this report:
- The department will at the conclusion of the project confirm the employees' directorship/membership of companies or CCs and, if any, the termination thereof.
  - The department cannot confirm whether the employee had received any income from these companies or CCs but can confirm whether the department had paid any monies to the companies or CCs concerned through BAS. Further, employees will respond to such questions on the affidavits.
  - At the conclusion of the project, the department will institute disciplinary

and other measures where illegal or non-compliant activities had taken place.

- This process will only be completed in January 2010.

- (c) The **Department of Local Government and Traditional Affairs** on 19 November 2004 implemented a policy in respect of employees performing remunerative work outside the public service. However, the policy does not expressly require employees to declare their interests in companies or CCs that transact with the department or other departments, and to request approval to transact with the department. The term remunerative work does not necessarily include transactions alluded to by the AGSA. The department was informed by the Office of the Premier that the DPSA was in the process of developing a conflict of interest policy that will specifically make provision for the nature of transactions referred to by the AGSA.

In order to ensure consistency between departments it was proposed that any new policy or amendments to existing policy be informed by a framework developed either nationally or provincially. While this matter is being addressed provincially/nationally, this department will review the current policy.

- (d) The **Department of Community Safety and Liaison** will attempt to reply to the findings with the urgency it deserves and to comply with all reporting requirements as stipulated in the PFMA. The chief financial officer had issued letters to the individuals cited in the report of the AGSA to respond to the issues raised.
- (e) The **Department of Economic Development and Planning** indicated that the findings were discussed at the departmental Management Committee (Manco) meeting on 16 July 2009.
- (i) At present the department does not have a policy for level 12 and below. The departmental Manco agreed that there was an urgent need for a policy and that the first draft must be available for discussions at the next Executive Committee Meeting on 11 August 2009. The intention was to have this policy approved by the end of the second quarter, 30 September 2009.
- (ii) Manco also took a decision that all staff within supply chain management and all senior managers should be subject to a process of disclosing all interests, and that a service provider should be sourced to run this exercise, which must be completed by the end of August 2009, with the rest of the department to be completed by the end of December 2009.
- (iii) Manco also decided that all staff who had obtained approval from the previous executive authority to run businesses would need to apply again, meaning that all approvals would be invalid with immediate effect. It was also decided that all staff should be reminded that approvals were only valid for one year.
- (f) The **Provincial Treasury** indicated that the Legal Services, in conjunction with

Supply Chain Management, would design a framework for disclosure/declarations concerning the private interests of committee members or board members in provincial government.

A circular / directive would be issued to staff to ensure that staff are urged to solicit approval before undertaking remunerative work outside the public service and also to declare/disclose private interests that may be conceived as a conflict of interest.

- (g) The **Department of Health** will consider the AGSA's recommendations in the development of a policy to regulate financial disclosures specifically with regard to non-designated employees. It was anticipated that processes relating to the development of a policy in this regard would be initiated by 1 September 2008.

Further, it should be noted that the respective institutional managers have since been requested to provide the Audit and Risk Management component with the following information to enable the department to adequately report to the AGSA on the issues raised in the findings:

- (i) Whether the employee was a director/member of the company or CC and, if not, the date of resignation or an affidavit stating that she/he was not a director/member.
- (ii) Whether the employee had received any income from these companies or CCs.
- (iii) Whether the employee had applied for approval to perform remunerative work outside their official duties and, if so, to provide copies thereof.
- (iv) Where the employee had not applied for approval to perform other remunerative work outside their employment, the reasons for not applying.
- (v) Where employees had not applied for the requisite approval, action to be taken against the said officials.

It was anticipated that a consolidated and comprehensive report on these matters would be made available to the AGSA upon completion thereof.

## **7.2 Deviation from the supply chain management process in the awarding of tenders and acceptance of quotations**

### **7.2.1 Prescripts relating to quotations**

#### **7.2.1.1 Regulations**

Paragraph 3.1 of *Practice Note Number supply chain management 2 of 2005*, states: *Accounting officers / authorities should invite and accept written price quotations for requirements up to an estimated value of R200 000,00 from as many suppliers as possible, that are registered on the list of prospective suppliers.* Paragraph 3.3 states: *If it*

*is not possible to obtain at least three (3) written price quotations, the reasons should be recorded and approved by the accounting officer / authority or his / her delegate.*

#### 7.2.1.2 Findings

The following instances were identified where the departments procured goods/services with fewer than three quotations being obtained. Reasons for the deviation were not recorded and approval by the accounting officer/ authority or his/her delegate to deviate from the procurement process as stipulated in *Practice Note Number 2 of 2005*, was not evident.

Transactions where fewer than three quotations were obtained		
Department	Number of instances	Transaction value R
Education	25	650 162
Health and Social Services	24	157 348
<b>Total</b>	<b>49</b>	<b>870 510</b>

#### 7.2.1.3 Recommendations by the AGSA

- (a) The departments should investigate the cases above where three quotations were not obtained and the deviations were not recorded and approved.
- (b) The departments should ensure that the prescribed procurement process is complied with when goods/services are procured. An approved list of potential suppliers providing a specific type of service/goods should be maintained and contacted for quotations when a need arises in order to ensure that the most competitive price is obtained.

#### 7.2.1.4 Responses from provincial departments

- (a) The **Department of Education** agreed with the finding and will implement the recommendation.
- (b) The **Department of Health** will investigate the transactions to determine the reasons for the deviation and will report thereon.

#### 7.2.2 Selection criteria

##### 7.2.2.1 Regulations

In terms of section 38(1)(a)(iii) of the Public Finance Management Act, 1999 (Act No.1 of 1999) (PFMA), the accounting officer for a department must ensure that that department has and maintains an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective.



#### **7.2.2.2 Findings**

In one instance, the **Department of Education** accepted the second lowest quote of R47 500 submitted by an employee-related entity. The lowest quote of R20 400 was not accepted on the basis that the requirements of a CC registration number (CK number) and VAT registration number were not met. The fact that the latter was not a CC and therefore would not have a CK number was disregarded. Furthermore the successful entity was also not a registered VAT vendor. Unless an entity is required by legislation to register as a VAT vendor or CC, there are no valid grounds to exclude such an entity from being selected.

#### **7.2.2.3 Recommendations by the AGSA**

The departments should ensure that the prescribed procurement process is complied with when goods/services are procured. The criteria for assessing successful entities should be uniformly applied.

#### **7.2.2.4 Response from the Department of Education**

The **Department of Education** agreed with the finding and will implement the recommendation.

### **7.3 Non-compliance with VAT legislation**

#### **7.3.1 Taxable supplies or services exceeding R300 000**

##### **7.3.1.1 Regulations**

Paragraph 23(1) of the Value-Added Tax Act, 1991 (Act No. 89 of 1991) (VAT Act) states that *all trading entities must register for VAT if taxable supplies or services rendered during a 12-month period, exceeded or are likely to exceed R300 000.*

##### **7.3.1.2 Findings**

The following cases were identified where companies and CCs of which employees are directors or members, did business in excess of R300 000,00, but had not raised VAT on goods / services supplied:

Companies or CCs not registered for VAT				
No.	Department	Number of entities	Number of transactions	Value of transactions R
1	Education	1	8	382 160
2	Health	3	31	1 396 595

#### 7.3.1.3 Recommendations by the AGSA

The department should identify its key suppliers, suppliers with large volume and high value transactions, and suppliers with whom they transact regularly. Such suppliers should be evaluated for compliance with the VAT Act and tax clearance certificates should be inspected specifically for VAT details. A preliminary screening of suppliers can be done through a VAT search on the SARS website. An appropriate validation should be obtained prior to transacting with the supplier. Training of employees to identify non-compliant suppliers should also be considered.

#### 7.3.1.4 Responses from provincial departments

- (a) The **Department of Education** agreed with the finding and will implement the recommendations. The department does perform regular checks on accumulated payments exceeding R300 000 and also requires VAT registration for transactions above the threshold.
- (b) The **Department of Health** noted the findings. In this regard, the department does request tax clearance certificates to be furnished by prospective suppliers during the bidding processes. However, in light of the query raised, all institutions will be requested to ensure that stricter compliance checks are undertaken to obviate possible non-compliance with the applicable legislation. Furthermore, a verification exercise will be undertaken to establish whether the suppliers, as identified by the AGSA, are in fact registered VAT vendors and the necessary action will be taken. In addition, a circular detailing the minimum requirements for a tax invoice will be issued to all institutions transacting with the department.

#### 7.3.2 Details not included/ incorrect on tax invoice

##### 7.3.2.1 Regulations:

According to section 20(4) of the VAT Act, 1991 (Act No. 89 of 1991) a tax invoice should contain the name and address of the entity and, where the entity is a registered VAT vendor, the VAT registration number of the entity. Furthermore, in terms of section 20(4)(g) of the VAT Act, a tax invoice should also contain the value of the supply, the amount of tax charged and the consideration for the supply, or where the amount of the tax charged is calculated applying the tax fraction to the consideration, the consideration

for the supply and either the amount of the tax charged or a statement to the effect that it includes a charge in respect of the tax and the rate at which the tax was charged.

#### 7.3.2.2 Findings

- (a) Tax invoices of four suppliers in respect of 13 transactions with the Department of Education totalling R186 834 did not include the amount of VAT charged or a statement that the consideration of supply includes a charge in respect of the tax and the rate at which the tax was charged.
- (b) The VAT registration number disclosed on the invoice of one supplier who transacted with the Department of Education on six occasions, totalling R16 206, was invalid according to the search done on the SARS website.
- (c) According to a search done on the SARS website, the VAT registration number recorded on the tax clearance certificate was invalid in respect of one supplier who transacted three times with the Department of Education, totalling R23 177.
- (d) The following cases were identified where companies or CCs had charged VAT yet there were no VAT registration numbers on their invoices to validate that the supplier was a valid VAT vendor.

Companies or CCs that charged VAT although no VAT registration number was indicated on their invoices				
No.	Department	Number of entities	Number of transactions	Value of transactions R
1	Office of the Premier	1	5	134 900
2	Health	3	17	15 783
	<b>Total</b>			<b>150 683</b>

#### 7.3.2.3 Recommendations by the AGSA

- (a) All suppliers should be appropriately screened for compliance with the VAT Act before the department enters into any transactions with a supplier. Payments must be made only on legitimate invoices which contain disclosures required by legislation, such as the VAT Act, for example, disclosure of the VAT registration number.
- (b) A VAT vendor search on the SARS website should be performed to confirm that a supplier is a valid VAT vendor.

#### 7.3.2.4 Responses from provincial departments

- (a) The **Department of Education** agrees with the finding, and will utilise the SARS hotline to verify the correctness of VAT registration numbers.
- (b) The **Office of the Premier** agreed with the finding and the recommendations will be implemented.
- (c) The **Department of Health** noted the finding. The department does require a tax clearance certificate to be furnished by the prospective supplier during the bidding process. However, in the light of the query raised all institutions will be requested to ensure that stricter compliance checks are undertaken to obviate possible non-compliance with the applicable legislation. Further, a verification exercise will be undertaken to establish whether the supplier, as identified by the AGSA, is in fact a registered VAT vendor and, in instances where these suppliers are not registered, the necessary processes will be initiated to recover the overpayment.

#### 8. APPRECIATION

- 8.1 The assistance of all role players involved during the performance audit is sincerely appreciated.

*Auditor - General*

Pretoria

12 October 2009



AUDITOR - GENERAL

## ABBREVIATIONS AND ACRONYMS

Word or phrase	Description
AGSA	The Auditor-General of South Africa, the institution contemplated in section 181(1)(e) of the Constitution
AG	The Auditor-General, the individual, namely Mr Terence Nombembe
BAS	Basic Accounting System
CAATs	Computer-assisted audit techniques
CIPRO	Companies and Intellectual Property Registration Office
CC	Close corporation
Designated employee	Any person occupying a post on SMS grade C (13) in a national department
DPSA	Department of Public Service and Administration
Employee-related companies/CCs	Companies/CCs that are connected with government employees in terms of directorship or membership
Government employee	A person in the public service who holds a post on the fixed establishment of a state institution
Non-designated employee	Employees other than designated employees
PAA	Public Audit Act, 2004 (Act No. 25 of 2004)
Persal	Personnel and Salary System
PFMA	Public Finance Management Act, 1999 (Act No. 1 of 1999)
PPPFA	Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000)
PSA	Public Service Act, 1994 (Act No. 103 of 1994)
R	Rands
SARS	South African Revenue Service
SBD	Standard bidding documentation
SCM	Supply chain management
SMS	Senior management staff
VAT Act	Value-added Tax Act, 1991 (Act No. 89 of 1991)
VAT	Value-added tax

# **EMPLOYEE-RELATED COMPANIES AND CLOSE CORPORATIONS DOING BUSINESS WITH OWN DEPARTMENTS**

The table is a summary of employees who are directors or members of companies and/or CCs, whose companies or CCs did business with the departments where they are employed.

List of employees doing business with their own departments.					
No.	Department	Number of employees	Amount paid for the period 01/04/005 to 31/03/2007 R	Number of employees whose approval was already verified with the department	Value of transactions to be followed up by the department R
1	Agriculture and Environmental Affairs	6	156 874	0	156 874
2	Arts and Culture	1	28 500	0	28 500
3	Community Safety and Liaison	0	0	0	0
4	Economic Development and Planning	1	116 052	0	0
5	Education	220	15 642 237	0	7 680 294
6	Health	77	9 297 058	0	1 558 050
7	Housing	0	0	0	0
8	KwaZulu-Natal Legislature	1	66 000	0	66 000
9	Local Government and Traditional Affairs	1	590 346	0	0
10	Office of the Premier	0	0	0	0
11	Provincial Treasury	0	0	0	0
12	Public Works	0	0	0	0
13	Sports and Recreation.	0	0	0	0
14	Social Development	1	150	0	150
15	Transport	0	0	0	0
	<b>Total</b>	<b>308</b>	<b>25 897 217</b>	<b>0</b>	<b>9 489 868</b>

**ANNEXURE B****EMPLOYEES' SPOUSE-RELATED COMPANIES AND CLOSE CORPORATIONS DOING BUSINESS WITH OWN DEPARTMENTS**

The table is a summary of employees' spouses who are directors or members of companies and/or CCs, whose companies or CCs did business with the departments where their spouses are employed.

<b>Spouse-related companies doing business with department where spouses are employed</b>				
<b>No.</b>	<b>Department</b>	<b>Number of employees</b>	<b>Amount paid for the period 01/04/005 to 31/03/2007 R</b>	<b>Value of transactions to be followed up by the department R</b>
1	Agriculture and Environmental Affairs	2	111 327	96 327
2	Arts and Culture	0	0	0
3	Community Safety and Liaison	0	0	0
4	Economic Development and Planning	0	0	0
5	Education	33	15 202 422	14 133 047
6	Health	32	19 223 438	746 201
7	Housing	0	0	0
8	KwaZulu-Natal Legislature	0	0	0
9	Local Government and Traditional Affairs	0	0	0
10	Office of the Premier	1	145 578	0
11	Provincial Treasury	1	176 320	0
12	Public Works	0	0	0
13	Sports and Recreation.	0	0	0
14	Social Development	0	0	0
15	Transport	0	0	0
	<b>Total</b>	<b>69</b>	<b>34 859 085</b>	<b>14 975 575</b>

# ANNEXURE C

## EMPLOYEE-RELATED COMPANIES AND CLOSE CORPORATIONS DOING BUSINESS WITH OTHER DEPARTMENTS

The table is a summary of employees who are directors or members of companies and/or CCs, whose companies or CCs did business with other departments.

List of employees' doing business with other departments				
No.	Department	Number of employees	Amount paid for the period 01/04/005 to 31/03/2007 R	Number of employees whose approval was already verified with the department
1	Agriculture and Environmental Affairs	20	1 042 442	0
2	Arts and Culture	4	94 810	0
3	Community Safety and Liaison	2	999 697	0
4	Economic Development and Planning	5	2 447 750	0
5	Education	359	34 806 765	0
6	Health	114	23 757 899	0
7	Housing	2	28 470	0
8	KwaZulu-Natal Legislature	3	207 762	0
9	Local Government and Traditional Affairs	13	10 019 971	0
10	Office of the Premier	2	9 992	0
11	Provincial Treasury	6	1 755 850	0
12	Public Works	3	53 470	0
13	Sports and Recreation.	2	81 161	0
14	Social Development	4	171 486	0
15	Transport	0	0	0
	<b>Total</b>	<b>539</b>	<b>75 477 526</b>	<b>0</b>