

Report of the Auditor-General on a

performance audit of entities that
are connected with government
employees and doing business
with departments of the Free
State Provincial Administration

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TABLE OF CONTENTS

TITLE		PAGE
1.	Executive summary	1
2.	Purpose and content of the report	2
3.	Audit scope	3
4.	Scope limitation	4
5.	Modus operandi	4
6.	Scope exclusion	5
7.	Overview of employee-related companies and close corporations (CCs) doing business with departments of the Free State Provincial Administration	5
8.	Findings, recommendations and comments from departments	6
8.1	Performance of remunerative work	6
8.2	Declaration of interest on standard bidding documentation	10
8.3	Deviation from the supply chain management process in the adjudication of tenders and quotations	13
8.4	Non-compliance with value-added tax (VAT) legislation	19
9.	Appreciation	21
	Abbreviations and acronyms	22
	Annexure A: Employee-related companies and CCs doing business with own departments	23
	Annexure B: Employees' spouse-related companies and CCs doing business with own departments	24
	Annexure C: Employee-related companies and CCs doing business with other departments	25

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

1. EXECUTIVE SUMMARY

- 1.1 The Auditor-General 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 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:
 - 1.3.1 performance of remunerative work
 - 1.3.2 declaration of interest in standard bidding documentation
 - 1.3.3 deviation from the supply chain management process in the awarding of tenders and quotations
 - 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 Free State Provincial Administration for the period 1 April 2005 to 31 March 2007 amounted to approximately R18 million. Although some of the departments are still determining whether employees who are directors or members of companies and CCs that did business with departments of the Free State Provincial Administration had the necessary approval, the majority of employees did not have approval to perform other remunerative work.
 - 1.4.2 Tenderers also made misrepresentations by not declaring in the tender documentation that employees are related to the companies and CCs that are tendering.
 - 1.4.3 The following transversal findings were made where departments of the Free State Provincial Administration deviated from the supply chain management process without the necessary approval and awarded tenders or contracts to employee-related entities. This

could be an indication of preferential treatment of such employee-related entities or fraudulent activities in the awarding of tenders or contracts.

- (a) Provincial departments did not always obtain three quotations for transactions with a value above R10 000 but not exceeding R200 000, in line with the regulations for the procurement of goods and services.
- (b) Provincial departments did not always apply the prescripts of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPFA) when evaluating quotes that exceeded R30 000.
- (c) In certain instances provincial departments did not invite competitive bids for procurement where the value of the goods or services exceeded R200 000, in accordance with the regulations, and awarded the contracts to employee-related entities.

1.5 There were inconsistencies between departments in rectifying these problems. In some instances departments charged employees with misconduct and discharged the employees or issued final warnings, while others indicated that disciplinary steps could not be taken as employees were not aware that they should have obtained 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 made by the Auditor-General, 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 are doing business with departments of the Free State Provincial Administration, as per section 188(4) of the Constitution of the Republic of South Africa, 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 improved 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 Free State Provincial Administration who are directors or members of companies and CCs that 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 the 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 that did business with other departments of the Free State 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 the approval of 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).
 - 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 for this is that in those

cases the employee's details are loaded on 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 Free State 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 Auditor-General were selected on a sample basis. In most instances, transaction values in excess of R100 000 were selected as part of the audit sample to be audited.

4.2 Furthermore, 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 Auditor-General. The extent of transactions that the departments were requested to follow up on is included 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 Auditor-General.

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.

6. SCOPE EXCLUSION

6.1 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 that the employee had also sold his/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 Free State Provincial Administration.

6.2 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.

7. OVERVIEW OF EMPLOYEE-RELATED COMPANIES AND CCs DOING BUSINESS WITH DEPARTMENTS OF THE FREE STATE PROVINCIAL ADMINISTRATION

7.1 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, the number of companies and amounts paid to companies or CCs that transacted with the departments. Refer to annexures A to C for details.

Summary of employee-related companies and CCs doing business with departments of the Free State Provincial Administration

	Number of employees	Number of companies	Amount paid for the period 01/04/2005 to 31/03/2007	Annexure
Employee-related companies and/or CCs doing business with own departments	36	36	6 069 909	A
Employees' spouse-related companies and/or CCs doing business with own departments (note)	10	10	4 536 101	B
Employee-related companies and/or CCs doing business with other departments of the Free State Provincial Administration	80	81	8 047 150	C

Note: This exception report was compiled to audit the procurement process followed in awarding tenders/contracts to spouse-related companies and/or CCs.

8. FINDINGS, RECOMMENDATIONS AND COMMENTS FROM DEPARTMENTS

8.1 Performance of remunerative work

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

8.1.1 Regulations

- (a) Chapter VII, sections 30 and 31 of the Public Service Act, 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: *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 service* (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.

8.1.2 Findings

- (a) A total of 36 employees were identified who are directors or members of companies or CCs that did business with the provincial department where the person is employed (annexure A refers). With respect to obtaining approval to perform remunerative work, it was found that one of these employees, as verified by the respective departments, had approval to perform such other remunerative work. However, in various instances the departments are 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 R6 million.
- (b) In addition, 80 employees were identified who are directors or members of companies or CCs that did business with other provincial departments (annexure C refers). With respect to obtaining approval to perform remunerative work, it was found that one of these employees had approval to perform other remunerative work. However, in various instances the departments are still determining whether employees had approval to perform other remunerative work. The total amount paid to these companies and CCs during the period under review was R8 million.
- (c) The following cases were identified where employees performed administrative tasks and functions on behalf of their respective entities. Therefore, a possibility exists that these employees did not place all their time at the disposal of the state as stipulated in section 30 of the Public Service Act and paragraph 4.5.5 of the *Code of conduct for the public service*.

Employees performing administrative tasks on behalf of their entities			
Department	Number of employees	Nature of work performed	Transaction value R
Education	1	Submission and signing of quotations on behalf of the entity.	54 955
Health	4	Signing and faxing of quotations/invoices. Completion of preferential points forms on behalf of the entity. Contact person on behalf of the entity.	311 235

8.1.3 Recommendations by the Auditor-General

- (a) As indicated in subparagraphs 8.1.2(a) and (b) above, only a few employees had requested 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 Free State Provincial Administration but who had not requested approval to perform other remunerative work.
- (b) The departments should implement action plans to monitor the progress made with the disciplinary action taken against the employees who had not applied for and received approval to perform other remunerative work. The departments should also report back to the provincial legislature on the outcomes of the disciplinary action and the action plans implemented.
- (c) The departments should monitor on a yearly basis the extent of business conducted by their employees. If it is found that the extent of business conducted by these entities are 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 an executive authority is certain that 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 disclose 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 who hold directorships or membership of companies and/or CCs should disclose their directorship and membership of such companies and/or CCs. According to the DPSA the matter of extending the system to non-designated employees and supply chain management officials had been considered before and it was decided not to extend the system. However, in light of the recommendations and findings made in this report, the extension of the system should be reconsidered.
 - (ii) Non-designated and designated employees should specifically disclose details of directorships and memberships of companies and/or 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 institutions 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.

8.1.4 Responses from provincial departments

- (a) The **Department of Agriculture** indicated that it had sent letters to the respective employees advising them to disclose the information requested by the Auditor-General.
- (b) The **Department of Education** indicated that:
 - (i) Where employees are educators who had no approval to perform remunerative work outside the department, their cases would be referred to the Labour Relations Directorate with a view to disciplinary action.
 - (ii) The internal audit directorate recommended that the department conduct a

forensic investigation to determine whether management would like to know the impact of performing remunerative outside the department on the daily duties of the employees concerned.

- (c) The **Department of Health** will conduct an in-depth investigation to determine the reason why officials do not apply for approval to perform other remunerative work and to institute possible disciplinary action against such officials.
- (d) The **Office of the Premier** is currently investigating the matter and the outcome of the investigation will be reported to the Auditor-General in due course.
- (e) The **Department of Public Works, Roads and Transport** informed the relevant employee of her duty to apply for approval to perform other remunerative work. The employee indicated that she had resigned as a member from the CC.
- (f) The **Department of Sports, Arts and Culture** indicated that declaration of interest forms were distributed to all staff. The Manager: Human Resources will follow up outstanding forms that had not been returned to Human Resources by supervisors.
- (g) The **Department of Social Development** indicated that most officials cited lack of knowledge as a reason for not applying for approval to perform other work. The department's Labour Relations and Legal Services have implemented the following corrective measures to address non-compliance with the Public Service Act:
 - (i) Officials who are still in the employ of the department will be reprimanded for non-compliance with the Public Service Act in their business dealings with the department.
 - (ii) A memo will be circulated throughout the department to sensitise officials on compliance with the Public Service Act and a presentation would be made to all officials regarding a *Manual on the code of conduct for the public service*.

8.2 Declaration of interest in standard bidding documentation

8.2.1 Regulations

- (a) The National Treasury issued *Practice note no. SCM 1 of 2003* on 5 December 2003, which prescribes the declaration of interest by using the SBD 4 (declaration of interest) form.
- (b) The SBD 4 form issued as part of the standard bidding documents utilised for tenders requires the bidder to declare the following:
 - (i) Whether any person connected to the bidder is employed by the principal

- (ii) Whether any person connected to the bidder has any relationship with a person employed by the principal who may be involved with the evaluation and/or adjudication of the bid.
 - (iii) Whether any person connected to the bidder is aware of any relationship between the bidder and any person employed by the principal who may be involved with the evaluation and/or adjudication of the bid.
- (c) The declaration of interest forms used by the Free State Province (FST 11 and FSBF 4 forms) require tenderers to declare the following:
- *Are you or any person connected with the tenderer employed by the Province?*
 - *Do you or any person connected with the tenderer have any relationship (family, friend, other) with a person employed in the department concerned or with the Tender Board or its administration and who may be involved with the evaluation or adjudication of this tender?*
- (d) Furthermore, paragraph 2.8.1 of the *Fraud and corruption of the supply chain management – a guide for accounting officers/authorities* (guide) defines “fraudulent practice” as a misrepresentation of facts in order to influence a selection process.

8.2.2 Findings

- (a) Three instances were identified at the **Department of Education** where entities misrepresented facts on the FST 11/FSBF 4 forms by not declaring that employees of the department or their spouses were directors or members of companies or CCs of the entity that submitted the tenders and was subsequently awarded the tenders.

Misrepresentations on FST 11/FSBF 4 declaration of interest forms	
Tender no.	Transaction amount R
WET 165/2005/2006	151 155
E21/2004/2005	546 675
E19/2003/2004	715 352
Total	1 413 182

- (b) Another instance was identified at the **Department of Education** where an entity misrepresented facts on the FST 11/FSBF 4 form by not declaring that an employee of the Department of Social Development was a member of the CC that submitted and was awarded the tender for the supply of toilet paper. Total payments of R1 054 215 were made to the employee-related entity in this regard.

8.2.3 Recommendations by the Auditor-General

The departments should investigate the contracts awarded to the entities that made false declarations of interest in their bidding documents and should consider cancelling contracts with these entities. The departments should furthermore consider blacklisting these entities at the National Treasury.

8.2.4 Responses from provincial departments

- (a) The **Department of Education's** internal audit directorate has recommended that disciplinary action be taken against the employees who supplied incorrect information when completing quotation/tender documents. The internal audit directorate also recommended that the department should review the declaration of interest form (FSBF 4) and make adjustments to accommodate the disclosure of officials who are employed by other departments as this would assist the department to verify whether the officials have approval to perform remunerative work outside their employment in the public service.
- (b) In this regard the **Accountant-General** also indicated as follows:
 - (i) The declaration of interest form should be amended to also indicate the position occupied by the shareholder/director/member in the department, as well as the name of the department. Directors/members/shareholders of companies tendering should also declare their interests in other related companies, whether or not such related companies are tendering.
 - (ii) Spouses' directorship/shareholding/membership in companies that had transacted with the state during the 12 months of the past financial year should be declared. A database of all closed projects, with their performance results, should be kept and where tenders are subsequently received from companies that had previously tendered with government departments, reference to their previous performance should be made and the decision to award the tender should be influenced by the latter.
 - (iii) An integration of the Public Service Commission (PSC) system and CIPRO should be considered. An investigation will have to be conducted into whether the forms are kept manually or electronically. If the system is manual, a feasibility study on whether to change from manual to electronic forms is recommended.

8.3 Deviation from the supply chain management process in the adjudication of tenders and quotations

8.3.1 Inviting tenders and quotations

8.3.1.1 Regulations

- (a) Paragraph 3.1 of *Practice note no. SCM 2 of 2005* prescribes the procurement process of goods and services for the different thresholds as follows: *Above the value of R10 000,00 but not exceeding R200 000,00 (VAT included) the accounting officer should invite and accept written price quotations from as many suppliers as possible.* Furthermore, paragraph 3.3 states that *if it is not possible to obtain at least three (3) quotations, the reasons should be recorded and approved by accounting officer/authority or his/her delegate.*
- (b) The Free State Department of Health supply chain management policy, paragraph 3.4.1(iv) states that *quotations must be obtained from suppliers as per supplier's database on a rotational basis to avoid any accusations of favouritism. A minimum of three quotations must be obtained. Where this is not possible, each case should be dealt with on its own merits. The reasons for not obtaining at least three quotations should be recorded and approved by the Accounting officer/ authority or his/her delegate.*
- (c) The Free State Department of Public Works, Roads and Transport supply chain management policy, delegation 3, states that *the tender process should be followed for all transaction in excess of R100 000.*
- (d) *Practice note no. 2 of 2005*, paragraph 4.2 states that *goods, works or services may not deliberately be split into parts or items of lesser value merely to avoid complying with the requirements of the prescribed thresholds. When determining transaction values, a requirement for goods, works or services consisting of different parts or items must as far as possible be treated and dealt with as a single transaction.*

8.3.1.2 Findings

- (a) From payments made to employee-related entities, the following cases were identified where three written quotations had not been obtained for transactions above R10 000 but not exceeding R200 000. The deviation from paragraph 3.3 of *Practice note no. SCM 2 of 2005* was not approved by the accounting officers and no reasons were supplied for the deviation from the prescripts.

Three written quotations not obtained		
Department	Number of instances	Transaction value R
Education	4	77 522
Health	18	356 277
Total	22	433 799

- (b) Two instances were identified at the **Department of Public Works, Roads and Transport** where quotations were obtained on behalf of the Department of Education for the renovation of schools and houses. However, as payments to the value of R504 003 and R130 946 were paid to the successful employee-related entities, the department should have invited competitive bids instead of procuring these services on quotation. Reasons for the deviation from the normal tender procedures were not approved by the HoD.
- (c) The HoD for the **Department of Agriculture** approved a submission to deviate from the normal tender procedures and to procure tractors and implements by inviting quotations. However, reasons for not inviting competitive bids were not recorded and approved by the accounting officer in accordance with the Treasury Regulations (TR16A 6.4). The employee involved in the entity is employed at the Office of the Premier and the total payments made to the employee-related entity for the period 1 April 2005 to 31 March 2007 amounted to R1 467 836.
- (d) The following instance was identified at the **Department of Health** where orders for similar goods purchased according to the quotation process from an employee-related entity were split to avoid inviting competitive bids for transactions in excess of R200 000.

Orders placed for similar goods		
Department	Number of individual transactions	Transaction value R
Health	5	753 583

8.3.1.3 Responses from provincial departments

- (a) The **Department of Education's** internal audit directorate has recommended that the responsible managers should provide motivations where the requisitions deviate from prescribed procedures.
- (b) The **Department of Health** has requested the internal audit directorate to investigate the findings contained in the management report, after which the necessary corrective measures would be implemented. A *Departmental Circular* will be issued to avoid misuse of delegated powers for procurement and to ensure compliance with procedures. Furthermore, the Employment Relations Subdirectorate conducted an

internal investigation into officials who had not adhered to the relevant policies and procedures. These officials were issued with letters asking them to respond to the allegations. Disciplinary hearings would be scheduled as soon as the presiding officers have been identified.

- (c) **Department of Public Works, Roads and Transport:** No response was received from the department with regard to this finding.
- (d) The **Department of Agriculture** indicated that:
 - (i) The payments made were procedural due to the fact that the deviation from normal tender procedures was approved by the accounting officer.
 - (ii) **Auditor-General's response:** It is the Auditor-General's view that such payments should be regarded as irregular expenditure as the department had not complied with TR16A 6.4 and reasons for not inviting competitive bids were not recorded and approved by the accounting officer.

8.3.2 Awarding of contracts

8.3.2.1 Regulations

Paragraphs 3(4) and 4(4) of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPFA) stipulates that *only the tender with the highest number of points scored may be selected*. Paragraph 9 of the PPPFA stipulates that *despite regulations 3(4) and 4(4), a contract may, on reasonable and justifiable grounds, be awarded to a tender that did not score the highest number of points*.

8.3.2.2 Findings

The Department of **Public Works, Roads and Transport** procured cotton caps by obtaining two quotations. Notwithstanding the fact that quotations were obtained from two suppliers, the cotton caps were procured at an amount of R34 086 from an employee-related entity that had not submitted a quotation. Reasons were not supplied and approved by the accounting officer/authority or his/her delegate for the deviation from the procurement process.

8.3.2.3 Response from the Department of Public Works, Roads and Transport

No response was received from the department with regard to the finding.

8.3.3 Collusive tendering

8.3.3.1 Regulations

Section 4 of the Competition Act, 1998 (Act No. 89 of 1998) states: *(1) an agreement between, or concerted by, firms, or a decision by an association of firms, is prohibited if it is between parties in a horizontal relationship (a relationship between competitors) and if it involves collusive tendering. (2) An agreement to engage in a restrictive horizontal practice referred to in subsection (1) is presumed to exist between one or more firms if they have at least one director or substantial shareholder in common.*

8.3.3.2 Findings

The **Department of Education** obtained three quotations for the procurement of folding machines to the value of R56 825. However, the entities that submitted quotations had the same director and collusive tendering is therefore presumed to have taken place, as contemplated in terms of section 4 of the Competition Act, 1998. These bidders should therefore have been disqualified.

8.3.3.3 Response from the Department of Education

The department recommended that officials should review the quotations thoroughly to pick up irregularities. Companies or close corporations that do not disclose their interests honestly should be disqualified.

8.3.4 Approval of payments

8.3.4.1 Regulations

Paragraph 40 of the Free State Department of Health supply chain management delegation of powers states that it is the responsibility of the chief executive officer (levels 11 - 13) or managers (levels 11 and 12) to approve the purchase of office furniture. Furthermore, paragraph 2 states that it is the responsibility of the senior provisioning admin officer (level 8) or higher to approve the purchase of goods/services up to the value of R10 000 and that of assistant managers (levels 9 -10) or higher to approve purchases up to the value of R29 999.

8.3.4.2 Findings

The following cases were identified at the **Department of Health** where payments for certain goods and services were approved by employees who were not authorised in terms of their delegated powers to approve such payments due to the nature and value of these payments.

Payments approved by employees at inappropriate designation		
Post level of official who approved transaction	Rank of official who is required to approved the transaction	Transaction value R
Assistant managers (levels 9 – 10) and senior admin clerks (levels 4 - 6)	CEO (levels 11 - 13) or manager (levels 11 - 12).	98 413
Senior admin clerk (levels 4 - 6)	Senior provisioning admin officer or higher (level 8)	44 355

8.3.4.3 Response from the Department of Health

The department has requested the internal audit directorate to investigate any deviations from the procurement process after which corrective measures would be implemented. A *Departmental Circular* will be issued to avoid misuse of delegated powers for procurement and to ensure compliance with procedures.

8.3.5 Prescripts of the Preferential Procurement Policy Framework Act

8.3.5.1 Regulations

Paragraph 3.4 of *Practice note no. SCM 2 of 2005* states: *Accounting officers should apply the prescripts of the PPPFA and its associated regulations for all procurement equal to or above R30 000 (VAT included).*

8.3.5.2 Findings

In the following instances quotations above R30 000 (VAT included) were not adjudicated in accordance with the PPPFA. Therefore the objective of the PPPFA and its regulations to empower historically disadvantaged individuals through preferential procurement was not achieved.

Prescripts of PPPFA not applied		
Department	Number of instances	Transaction value R
Health	4	319 669
Public Works, Roads and Transport	6	496 090
Public Safety, Security and Liaison	2	191 592
Tourism, Environmental and Economic Affairs	3	184 881
Total	15	1 192 232

8.3.5.3 Responses from the provincial departments

- (a) The **Department of Health** confirmed that supply chain management policies and procedures are in place in accordance with the PPPFA. In addition, a monthly report

on quotations received and contracts awarded by the department is submitted to the Management Subdirectorate. An internal control checklist was implemented to ensure that quotations are handled in line with departmental policies and procedures.

- (b) **Department of Public Works, Roads and Transport:** No response was received from the department with regard to this finding.
- (c) The **Department of Public Safety, Security and Liaison** indicated as follows:
 - (i) Paragraph 3.4 of *Practice note no. SCM 2 of 2005* of the PPPFA was not applicable as the implementation date of the practice note was after the date on which the quotations were obtained.
 - (ii) **Auditor-General's response:** Although the department obtained the quotations before the implementation date of *Practice note no. SCM 2 of 2005*, the Auditor-General is of the view that the quotations should have been evaluated based on the prescripts of the PPPFA as the implementation date of this regulation was 10 August 2001.
- (d) The **Department of Tourism, Environmental and Economic Affairs** acknowledged that the correct procurement process had not been followed in this regard. The department has put all necessary systems in place and is currently adhering to the requirements of the PPPFA.

8.3.6 Suppliers database

8.3.6.1 Regulations

- (a) Paragraph 3.2.9 of the Free State Department of Health supply chain management policy states that *it is the aim of the Government to incorporate as many as possible SMMEs within the process of public sector procurement. For the promotion of HDIs, SMMEs and BEE, institutions should keep a database of prospective suppliers. The list of prospective suppliers must be updated quarterly to incorporate newly established small businesses.*
- (b) Paragraph 2.2.2 of the Free State Department of Public Works, Roads and Transport supply chain management policy states that *the departmental database of suppliers must be utilised for all procurement actions. The database must be updated every six months.*

8.3.6.2 Findings

In the following instances departments awarded tenders/contracts to employee-related entities that were not listed as registered suppliers on the respective departments' supplier

database. There is a possibility that officials of the department afforded these entities undue preferential treatment when awarding the contracts.

Suppliers not registered on the supplier database		
Department	Number of entities	Transaction value R
Health	11	1 055 363
Public Works, Roads and Transport	6	763 472
Total	17	1 818 835

8.3.6.3 Responses from provincial departments

- (a) The **Department of Health** is using the electronic database. Treasury will be requested to take into account the recommendations of the Auditor-General to ensure that the system provides for these requirements, i.e. the department should maintain and update the list of potential/prospective suppliers providing a specific type of service/goods and should request quotations from these suppliers when the need arises.
- (b) **Department of Public Works, Roads and Transport:** No response was received from the department with regard to this finding.

8.4 Non-compliance with value-added tax (VAT) legislation

8.4.1 Regulations

- (a) Section 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.*
- (b) Paragraph 7.1 of *Practice note no. SCM 2 of 2005* states that *accounting officers/authorities must be in possession of a valid tax clearance certificate for all price quotations/competitive bids over R15 000 (VAT included) (increased to R30 000 after 23 January 2006).*

8.4.2 Findings

- (a) One instance was identified at the **Department of Education** where an employee-related entity did business with the department to the amount of R1 050 701 for the period 1 April 2005 to 31 March 2007 while the entity was not registered for VAT.
- (b) Cases were identified at the following departments where companies or CCs charged VAT on their invoices although they were not registered for VAT according to the South African Revenue Service (SARS):

Companies or CCs not registered for VAT		
Department	VAT claimed by entities R	Number of entities
Education	28 868	6
Health	22 219	1
Public Works, Roads and Transport	287 287	5
Total	338 374	12

- (c) Cases were identified at the following departments where payments were made to suppliers without a tax clearance certificate attached to the payment documentation. In all the cases the value of the quotation was in excess of R15 000, although paragraph 7.1 of *Practice note no. SCM 2 of 2005* stipulates that the accounting officer must be in possession of a valid tax clearance certificate for procurement in excess of R15 000.

No tax clearance certificates		
Department	Transaction value R	Number of companies
Education	187 494	5
Health	165 788	2
Public Works, Roads and Transport	1 081 524	7
Total	1 434 806	14

8.4.3 Responses from provincial departments

- (a) A *Departmental Circular* is being formulated by the **Department of Health** to instruct officials to adhere to the requirements by ensuring that suppliers submit tax clearance certificates for quotations exceeding R30 000 and that no payment is made without this. In addition, the electronic database through which quotations are handled will exclude suppliers if a valid tax clearance certificate is not provided. Furthermore, a *Departmental Circular* will be issued to enforce compliance with the requirements, thus ensuring that all VAT registrations are verified with SARS. Irregularities will be reported to SARS.
- (b) **Department of Public Works, Roads and Transport:** No response was received from the department with regard to this finding.
- (c) **Department of Education** indicated as follows:
- (i) The department's internal audit component concurred with the Auditor-General's finding. The department further indicated that each company was required to submit a valid and original tax clearance certificate and that failure to submit such certificates with the bid documents would lead to the

immediate disqualification of the offer as prescribed in the Standard Bidding Conditions, Framework for Supply Chain Management and PPPFA. Tax clearance certificates must be valid at the time of closing the bid. During the bid evaluation process VAT registration is not verified by the Demand, Acquisition and Logistics Management directorate as this is not prescribed. Fixed quantities are not indicated in the specification and therefore the total amount payable to the service provider for the entire period cannot be determined beforehand. Currently the department sends copies of the letters of acceptance/contracts and the tax clearance certificates of the successful service providers to SARS.

- (ii) Original tax clearance certificates must be submitted and are verified for validity at the time of closing of the quotation/bid. The department does not verify the VAT registration as it is not prescribed. Suppliers will be informed of VAT implications during briefing sessions.

9. APPRECIATION

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

Auditor-General

Pretoria
August 2008



A U D I T O R - G E N E R A L

ABBREVIATIONS AND ACRONYMS

Word or phrase	Description
Auditor-General	(a) As an institution, means the institution contemplated in section 181(1)(e) of the Constitution (b) As an individual, means the individual appointed as Auditor-General, Mr Terence Nombembe
BAS	Basic Accounting System
CAATs	Computer-assisted audit techniques
CFO	Chief financial officer
CIPRO	Companies and Intellectual Property Registration Office
CC	Close corporation
Designated employee	Any person occupying a post on SMS grade C (13) in a 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
HoD	Head of department
MPL	Members of the provincial legislature
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)
PSC	Public Service Commission
PSR	Public Service Regulations, 2001
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 CCs DOING BUSINESS WITH OWN DEPARTMENTS

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

List of employees doing business with their own department						
No.	Department	Number of employees	Number of companies	Amount paid for the period 01/04/2005 to 31/01/2007	Number of employees with approval already verified by the departments	Transaction value internally investigated by the department
1	Agriculture	2	2	12 000	0	12 000
2	Education	18	17	2 019 893	0	438 782
3	Health	11	12	3 947 016	1	159 478
4	Office of the Premier	None	None	None	None	None
5	Social Development	5	5	91 000	0	91 000
6	Sports, Arts and Culture	None	None	None	None	None
7	Tourism, Environmental and Economic Affairs	None	None	None	None	None
8	Public Works, Roads and Transport	None	None	None	None	None
9	Public Safety, Security and Liaison	None	None	None	None	None
10	Treasury	None	None	None	None	None
	Total	36	36	6 069 909	1	701 260

EMPLOYEES' SPOUSE-RELATED COMPANIES AND CCs DOING BUSINESS WITH OWN DEPARTMENTS

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

Employees' spouses doing business with departments where their spouses are employed					
No.	Department	Number of employees	Number of companies	Amount paid for the period 01/04/2005 to 31/01/2007	Transaction value internally investigated by the department
1	Agriculture	None	None	None	0
2	Education	6	6	3 999 416	77 513
3	Health	4	4	536 685	35 845
4	Office of the Premier	None	None	None	None
5	Social Development	None	None	None	None
6	Sports, Arts and Culture	None	None	None	None
7	Tourism, Environmental and Economic Affairs	None	None	None	None
8	Public Works, Roads and Transport	None	None	None	None
9	Public Safety, Security and Liaison	None	None	None	None
10	Treasury	None	None	None	None
	Total	10	10	4 536 101	113 358

EMPLOYEE-RELATED COMPANIES AND CCs DOING BUSINESS WITH OTHER DEPARTMENTS IN THE FREE STATE PROVINCIAL ADMINISTRATION

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

List of employees doing business with other departments					
No.	Department	Number of employees	Number of companies	Amount paid by other departments to employee-related entities for the period 01/04/2005 to 31/01/2007	Number of employees with approval already verified by the departments
1	Agriculture	3	3	78 457	0
2	Education	45	44	2 449 938	0
3	Health	14	15	1 415 565	0
4	Office of the Premier	3	3	2 124 968	0
5	Social Development	11	12	1 724 402	0
6	Sports, Arts and Culture	1	1	8 630	0
7	Tourism, Environmental and Economic Affairs	1	1	490	0
8	Public Works, Roads and Transport	1	1	13 500	0
9	Public Safety, Security and Liaison	None	None	None	None
10	Treasury	1	1	231 200	1
	Total	80	81	8 047 150	1

