

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

performance audit of entities that  
are connected with government  
employees and doing business  
with departments of the Gauteng  
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 GAUTENG 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 (SBD)
  - 1.3.3 deviation from the supply chain management process and cases where a conflict of interest existed
  - 1.3.4 non-compliance with value-added tax 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 Gauteng Provincial Administration for the period 1 April 2005 to 31 March 2007 amounted to approximately R26 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 Gauteng 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 Gauteng Provincial Administration had 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 of 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 had awarded the contracts to employee-related entities.
- (d) In certain instances evaluation committees disqualified bids without justifiable reasons and as a result the contracts were incorrectly awarded to employee-related entities.

1.5 There were inconsistencies between departments in rectifying the above shortcomings. 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 (PSC) and the Department of Public Service and Administration (DPSA) indicated that the current legislation and regulations would be reviewed and that 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 Gauteng 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) (PAA). 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 Gauteng Provincial Administration who are directors or members of companies and CCs which 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/or CCs which 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 which did business with other departments of the Gauteng Provincial Administration (annexure C refers).
- 3.2 The transactions included in this report cover the period 1 April 2005 – 31 March 2007, unless stated otherwise.
- 3.3 The scope was limited to the procurement process up to the approval of the payments. The scope also included determining whether employees who had an interest in the company and/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 person 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 person'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 Gauteng 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, the Auditor-General only focused on entities which are connected to employees of the departments of the Gauteng Provincial Administration that did business with the departments and received payments in excess of R100 000 during the 2005-06 and 2006-07 financial years.
- 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 investigations to the Auditor-General. The extent of transactions that the departments should have followed up is indicated in annexures A and B. At the time of compiling this report the various departments were still in the process of investigating these transactions and therefore the outcomes 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 and 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 March 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 relevant supporting documentation was requested from the departments and audited. After the performance audit of each of the departments had been finalised, a management letter/report with findings was submitted to the department for comments. The comments received were considered and incorporated in this report.

## **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 individual 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 Gauteng 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/OR CCs DOING BUSINESS WITH DEPARTMENTS OF THE GAUTENG 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, number of companies

and/or CCs and amounts paid to companies and/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 Gauteng Provincial Administration**

	Number of employees	Number of entities	Amount paid for the period 01/04/2005 to 31/03/2007 R	Annexure
Employee-related companies and/or CCs doing business with own departments	87	86	12 352 184	A
Employees' spouse-related companies and/or CCs doing business with own departments ( <i>Note</i> )	14	14	1 323 438	B
Employee-related companies and/or CCs doing business with other departments of the Gauteng Provincial Administration	92	93	12 465 311	C

**Note:** This exception report was compiled to audit the procurement process followed in awarding tenders or 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 Gauteng 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 87 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 department, had approval to perform 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 R12,4 million.
- (b) In addition, 92 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 R12,5 million.
- (c) From the documentation submitted by the entities it was evident that the employees of departments who are members of CCs that are doing business with the departments did not place all their time at the disposal of the state as stipulated in section 30 of the Public Service Act and the *Code of Conduct for the Public Service* as they are closely involved in the management and/or the administration of the CCs. Indicators that the employees were involved in the management and/or administration of the companies or CCs are as follows:
- (i) Employees were the managing directors of the entities and a percentage of the contract values would be managed or executed by these employees.
  - (ii) Employees signed the quotations and invoices personally on behalf of the entities.
  - (iii) The invoices submitted by the entities indicated that the departments

should pay the value of the transactions into the bank accounts of the employees.

- (iv) Agreements between the departments and the entities were signed by the employees and the appointment letters were addressed to such employees.
- (v) The quotations were faxed by employees during working hours.

(d) The number of employees, per department, who are closely involved in the management of entities, as well as the transaction values are indicated below:

<b>Employees closely involved in the management of entities</b>		
<b>Department</b>	<b>Number of employees identified</b>	<b>Tender or transaction value for the period 01/04/2005 to 31/03/2007 R</b>
Education	7	5 522 867
Health	1	142 334
Shared Services Centre	1	555 408
<b>Total</b>	<b>9</b>	<b>6 220 609</b>

(e) In the following instances the employees indicated to the departments that they had received income as a result of their directorship and/or membership in companies and/or CCs and that they were not aware that they should have applied for approval to perform other remunerative work:

<b>Employees received income as a result of their directorship and/or membership in companies and/or CCs</b>		
<b>Department</b>	<b>Number of employees who received income</b>	<b>Amount paid by the department for the period 01/04/05 to 31/03/07 R</b>
Health	3	19 460
Public Transport, Roads and Works	1	92 349
Shared Services	1	42 253
Social Development	1	10 750
<b>Total</b>	<b>6</b>	<b>164 812</b>

### **8.1.3 Recommendations by the Auditor-General**

(a) As indicated in paragraph 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 Gauteng Provincial Administration and had not requested approval to perform other remunerative work.

- (b) The departments should implement action plans to monitor progress made with the disciplinary action taken against 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 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 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 (senior manager) 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 (levels 1 to 12) who hold directorships or memberships of companies and/or CCs should disclose such directorships and memberships. 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 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 have 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 Community Safety** recommended that the one employee identified in this report be charged with fraud, corruption and misconduct.
- (b) The **Department of Education** had previously initiated a similar process by engaging the services of an independent firm of accountants in 2006. Similar findings were made, such as instances where the employees of the department were found to be directors of companies or members of CCs that are on the department's supplier database and where possibilities of conflict of interest existed. The department has since taken the following actions as part of the disciplinary enquiry process:
  - (i) Verification of whether the implicated employees had completed and submitted the declaration of interest forms.
  - (ii) Verification of whether implicated employees had applied to the executive authority to perform remunerative work outside their employment in the public service.
  - (iii) A stipulation that all employees should henceforth complete and submit the declaration of interest forms.

- (iv) Initiation of disciplinary action against the implicated officials.
- (v) Raising awareness within the department regarding the code of conduct, declaration and conflict of interest as well as obtaining prior permission for undertaking remunerative work outside the public service.
- (vi) Immediately requested the Gauteng Shared Services Centre (GSSC) to restrict the use of the relevant service providers until the matter has been finalised.

The Department of Education will implement the recommendations of the Auditor-General's report in line with the action plans previously put in place as mentioned above.

(c) The **Department of Health** will institute/has instituted the following corrective measures:

- (i) Action will be taken where officials did not adhere to prescripts and had deliberately failed to request permission for remunerative work outside the public service.
- (ii) A circular was issued with regard to remunerative work outside public service.
- (iii) The Directorate Risk Management and Internal Control has commenced with a transversal audit on remunerative work outside the public service.
- (iv) Access to the CIPRO website will be requested to verify completeness of declared directorships and memberships in companies and/or CCs.
- (v) The department recognises the need for control over sessional employees and will request these employees to declare their interest in any entity transacting with government.

(d) The **Department of Public Transport, Roads and Works** is in the process of developing a manual or policy to ensure that employees in the department obtain approval from the relevant executive authority to perform remunerative work outside their employment. The manual or policy must be communicated to all departmental employees.

(e) The **GSSC** indicated that written warnings and instructions to complete the relevant financial disclosure forms were issued to the implicated employees.

(f) The Human Resources component of the **Department of Social Development** has issued directives to all departmental officials to the effect that their financial interest should be declared on an annual basis and that permission must be obtained for performing remunerative work outside official duties.

## 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. In this regard the SBD 4 form replaced the Standard Tender 12 (ST 12) form.
- (b) The SBD 4 form, which replaced the ST 12 form issued as part of the standard bidding documents utilised for tenders, requires the bidder to declare the following:
  - (i) *If any person connected to the bidder is employed by the principal*
  - (ii) *If any person connected to the bidder has any relationship with a person employed by the principal and who may be involved with the evaluation and/or adjudication of the bid*
  - (iii) *If 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 previously used ST 12 form, issued as part of the standard bidding documents utilised for tenders, had required the bidder to declare the following:
  - (i) *If any person connected to the bidder is employed by the state*
  - (ii) *If any person connected to the bidder has any relationship with a person employed by the state and who may be involved with the evaluation and/or adjudication of the bid*
  - (iii) *If any person connected to the bidder is aware of any relationship between the bidder and any person employed by the state who may be involved with the evaluation and/or adjudication of the bid.*
- (d) With the implementation of the SBD 4 form, the scope of the declaration of interest was therefore limited. With the ST12 forms the bidder had to indicate whether there was a connection with a person employed by the state. The SBD 4 form only requires a declaration as to whether the bidder has a relationship with a person employed by the principal. The principal in this regard refers to the department that issued the tender. In the case where an employee of a department is a director or member of a company or CC and that company conducts business with another department, there is no obligation to disclose his or her or their spouses' interest in the company.
- (e) 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) Various instances were identified where entities misrepresented facts on the SBD 4 forms by not declaring that employees of a department or their spouses were directors or members of companies or CCs of the entity that had submitted the tenders and were subsequently awarded the tenders based on such misrepresentation. A summary of transactions and the number of entities that had not provided the correct information is set out below per department.

<b>Misrepresentations on SBD 4 declaration of interest forms</b>		
<b>Department</b>	<b>Total payments R</b>	<b>Number of entities</b>
Education	1 190 844	5

- (b) The following instances were identified where the tender documentation was not provided to the Auditor-General and it was therefore not possible to determine whether the bidders had declared on the SBD 4 form that the employees of the departments were members of the entities concerned. The following table refers:

<b>Tender documentation not provided</b>		
<b>Department</b>	<b>Transaction value R</b>	<b>Number of entities</b>
Education	6 495 297	1
Health	2 422 246	4
Public Transport, Roads and Works	3 854 636	1
<b>Total</b>	<b>12 772 179</b>	<b>6</b>

## 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 the departments 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** is in the process of auditing the implementation of procurement procedures, in line with the legislative mandates, and the levels at which the department complies.
- (b) The **Department of Health** is in the process of following it up with the GSSC as the payments were generated through the Systems Application Protocol (SAP).



- (c) The **Department of Public Transport, Roads and Works** will ensure that all declaration of interest forms submitted by bidders are verified to ensure that no government employees are members of such companies. If there are such employees, the section will verify whether permission had been granted by the accounting officer/executive authority to perform remunerative work outside the place of employment.
- (d) In this regard the **Accountant-General** also responded as follows:
  - (i) Form SBD4 should be amended to 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 in 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 subsequent tenders are 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 as to whether the forms are kept manually or electronically must be conducted. If the system is manual, a feasibility study on whether to change from manual to electronic 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 number 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 the accounting officer/authority or his/her delegate.*



- (b) Paragraph 4.1 of *Practice note number SCM 2 of 2005* states that *the accounting officer should invite competitive bids for all procurement above R200 000. Competitive bids should be advertised in at least the Government Tender Bulletin and in other appropriate media.* Furthermore, paragraph 4.4 states that *should it be impractical to invite competitive bids for specific procurement, e.g. in urgent or emergency cases or in case of a sole supplier, the accounting officer/authority may procure the required goods or services, in accordance with Treasury Regulation 16A6.4 by other means, such as price quotations or negotiations. The reasons for deviating from inviting competitive bids should be recorded and approved by the accounting officer/authority or his/her delegate.*
- (c) Paragraph 4.2 of *Practice note number SCM 2 of 2005* states: *Goods, works or services may not deliberately be split into parts or items or 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 number SCM 2 of 2005* was not approved by the accounting officers and no reasons were supplied for deviation from the prescripts.

Three written quotations not obtained		
Department	Number of instances	Transaction value R
Education	4	253 000
Health	2	145 473
Local Government	3	196 885
Office of the Premier	3	396 779
Public Transport, Roads and Works	2	205 736
Sport, Arts and Culture	3	192 950
<b>Total</b>	<b>16</b>	<b>1 390 823</b>

- (b) In the following instances the departments procured goods or services in excess of R200 000 from suppliers without inviting competitive bids. In all the instances employees and/or their spouses had interests in the CCs that were the successful bidders. The reasons for not inviting competitive bids were not recorded and approved by the accounting officer/authority or his/her delegate, as stipulated in Treasury Regulation 16A6.4.

Competitive bids not invited		
Department	Number of instances	Transaction value R
Education	8	3 192 013
Health	3	3 024 655
<b>Total</b>	<b>11</b>	<b>6 216 668</b>

### 8.3.1.3 Responses from provincial departments

- (a) The **Department of Education** is in the process of auditing the implementation of procurement procedures, in line with the legislative mandates, and the levels at which the department complies.
- (b) The **Department of Health** takes note of the findings. A large number of queries are as a result of the procurement process being outsourced to the GSSC.
- (c) The **Department of Local Government** acknowledges the fact that in some instances, particularly with regard to this service provider, procurement processes were not followed but this is due to the fact that other service providers had failed the department on numerous occasions.
- (d) The **Office of the Premier** acknowledges the findings. Corrective measures have already been instated for the approval of sole and nominated service providers by the Departmental Acquisition Council (DAC) of the Office. In order to fast-track sole or nominated service providers in future, the DAC Charter is being amended, which will indicate the approach to be followed for all deviations from normal procurement procedures.
- (e) The **Department of Public Transport, Roads and Works'** vetting section of the Directorate: Procurement and BEE will ensure that all the required documentation is submitted after which it will be forwarded to the Departmental Acquisition Committee for approval.
- (f) No response was received from the **Department of Sports, Arts and Culture**.

### 8.3.2 Prescripts of the Preferential Procurement Policy Framework Act

#### 8.3.2.1 Regulations

*Practice note no. SCM 2 of 2005 states: If the value of the goods or services procured is above R30 000,00 the accounting officer should apply the PPPFA in adjudicating the quotation or tender.*

### 8.3.2.2 Findings

With regard to the payments made to employee-related entities, in the following instances quotations above R30 000 (VAT included) were not adjudicated in accordance with the PPPFA, which is in contradiction to *Practice note number SCM 2 of 2005*. Therefore the objective of the PPPFA and its regulations to empower historically disadvantaged individuals through preferential procurement was not achieved.

Prescripts of the PPPFA not applied		
Department	Number of instances	Transaction value R
Education	10	481 001
Finance	1	92 360
Health	8	474 281
<b>Total</b>	<b>19</b>	<b>1 047 642</b>

### 8.3.2.3 Responses from provincial departments

- (a) The **Department of Education** is in the process of auditing the implementation of procurement procedures in line with the legislative mandates, and the levels at which the offices of the departments comply.
- (b) The **Department of Finance** commented that the GSSC is the custodian of the PPPFA and its associated regulations, and monitors to ensure that all prospective suppliers adhere to procurement procedures before they are eligible for appointment to provide a particular service or supply certain goods.
- (c) The **Department of Health** takes note of the findings. A large number of the queries are as a result of the procurement process being outsourced to the GSSC.

### 8.3.3 Evaluation of bids

#### 8.3.3.1 Regulations

The circular issued by National Treasury dated 10 May 2005, which relates to the evaluation of bids, calculation of points and timeous payments of accounts, states as follows in paragraph 1 – Evaluation of bids: *A bid is regarded as acceptable if...*

- *it complies in all respects with the specifications and conditions of the bid;...*

*Deviation by more than a predetermined percentage from the cost estimate of the project / commodity cannot be regarded as a justifiable reason for the rejection of a bid and has, therefore, not been approved as an evaluation norm by the National*

*Treasury.” “Bids may only be evaluated in accordance with the evaluation criteria stipulated in the bid documentation. When any bid is passed over the reasons for passing over such bid must be defensible in court.*

### 8.3.3.2 Findings

The following instances were identified where the departments had disqualified bids or quotations submitted by entities for deviating by more than a predetermined percentage from the cost estimate of the project or the commodity procured, and awarded the tenders/contracts to employee-related entities, which is in contradiction to circular dated 10 May 2005 above. The following table refers:

<b>Bids disqualified for deviating by more than a predetermined percentage from the cost estimate</b>			
<b>Name of the department on whose behalf the tender was evaluated and awarded</b>	<b>Tender price of bid accepted R</b>	<b>Lowest acceptable bid disqualified for submitting a bid price lower than a predetermined estimate R</b>	<b>Difference R</b>
Education	2 483 082	1 142 857	1 340 225
Education	4 012 215	1 981 521	2 030 694
Education	3 498 272	2 098 224	1 400 048
Education	65 602	16 318	49 284
Education	43 734	12 318	31 416
Public Transport, Roads and Works	3 854 636	1 244 234	2 610 402
			<b>7 462 069</b>

### 8.3.3.3 Responses from provincial departments

- (a) The **Department of Education** is in the process of auditing the implementation of procurement procedures in line with the legislative mandates and the levels at which the department complies.
- (b) The **Department of Public Transport, Roads and Works** will review the procurement process on evaluation of bids and will remove the section on disqualification of bids for being below the predetermined percentage deviation from the cost estimate as this is in contradiction to the practice note.

### 8.3.4 Collusive tendering

#### 8.3.4.1 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.*

#### 8.3.4.2 Findings

- (a) The **Department of Education** procured security services over a period of six months to the value of R215 103 from an employee-related entity. Quotations were obtained from the potential suppliers. The employee had an interest in all three entities that submitted quotations for the rendering of security services and was therefore engaged in collusive tendering according to the Competition Act, section 4. If quotations are obtained from different entities with the same director/member, it has the effect of substantially preventing or lessening competition in the market. The entities should therefore have been disqualified.
- (b) In another instance at the **Department of Education**, two of the three entities that supplied quotations for the rendering of external training to the value of R40 000, had one member in common and were therefore engaged in collusive tendering according to the Competition Act, section 4. The quotations of the two entities should therefore not have been accepted.

#### 8.3.4.3 Responses from the Department of Education

The department is in the process of auditing the implementation of procurement procedures in line with the legislative mandates and the levels at which the department complies.

### 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) Cases were identified at the following departments where companies and CCs, of which employees are directors or members, did business with departments in excess of R300 000 although such companies or CCs were not registered for VAT:

Companies or CCs not registered for VAT		
Department	Transaction value	Number of companies
Education	2 442 674	4
Health	1 031 573	2
<b>Total</b>	<b>3 474 247</b>	<b>6</b>

- (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 South African Revenue Service:

Charged VAT although not registered for VAT		
Department	VAT claimed by entities	No. of entities
Education	177 826	4
Health	8 649	1
Sport, Arts and Culture	7 565	1
<b>Total</b>	<b>194 040</b>	<b>6</b>

- (c) Although paragraph 7.1 of *Practice note no. SCM 2 of 2005* stipulates that the accounting officer had to be in possession of a valid tax clearance certificate for procurement in excess of R15 000 or R30 000 as from 23 January 2006, the following cases were identified at the said departments where payments were made to suppliers without a tax clearance certificate attached to the payment documentation.

Number of tax clearance certificates		
Department	Transaction value R	Number of entities
Agriculture	893 163	1
Community Safety	1 334 159	2
Education	4 010 611	11
Finance	113 351	1
Health	1 280 849	7
Local Government	396 747	1
Office of the Premier	396 779	1
Public Transport, Roads and Works	360 046	3
<b>Total</b>	<b>8 785 705</b>	<b>27</b>

#### 8.4.3 Responses from departments

- (a) The **Department of Agriculture** has developed a checklist to ensure that all documents are checked thoroughly prior to any awards being made.
- (b) The **Department of Community Safety** is still waiting for a copy of the tax certificate that was submitted during the time of the suppliers' appointment.

- (c) The **Department of Education** is in the process of auditing the implementation of procurement procedures in line with the legislative mandates and the levels at which the *offices* of the departments comply.
- (d) The **Department of Sport, Arts and Culture** acknowledges that the invoices received from the supplier indicated that amounts charged were VAT inclusive although the quotes did not indicate any value-added tax. The department will refer the matter to the South African Revenue Service for the necessary investigation into the status of the company.
- (e) The Directorate of Procurement and Black Economic Empowerment of the **Department of Public Transport, Roads and Works** will put processes in place to ensure that copies of tax clearance certificates are submitted for quotations exceeding R30 000.
- (f) **General response from the provincial departments:** A large number of the queries regarding tax clearance certificates are as a result of the procurement process being outsourced to the GSSC and the department's reliance on the GSSC as a central procurement reference point to advise on all procurement-related matters. Tax clearance certificates must be obtained by the GSSCs vendor management section before registering an entity on the BAS or SAP database of accredited vendors. The departments have not yet obtained the tax clearance certificates from the GSSC and could therefore not submit them to the Auditor-General.

## 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; and (b) as an individual, means the individual appointed as Auditor-General, 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 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
GSSC	Gauteng Shared Services Centre
Government employee	A person in the public service who holds a post on the fixed establishment of a state institution
NCT	Northern Cape tender documentation
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
SAP	Systems Application Protocol
SARS	South African Revenue Service
SBD	Standard Bidding Documentation
SCM	Supply chain management
SMS	Senior management staff
ST	Standard Tender
TR	Treasury Regulation
VAT Act	Value-Added Tax Act, 1991 (Act No. 89 of 1991)
VAT	Value-added tax



# ANNEXURE A

## 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 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 entities	Amount paid for the period 01/04/2005 to 31/03/2007 R	Number of employees with approval already verified by the departments	Value of transactions to be followed up by the departments R
1	Agriculture	0	0	0	n/a	n/a
2	Community Safety	1	1	4 104	0	4 104
3	Education	57	57	9 275 731	0	1 217 181
4	Finance	0	0	0	n/a	n/a
5	Health	27	26	3 018 248	0	406 688
6	Local Government	0	0	0	n/a	15 150
7	Office of the Premier	0	0	0	n/a	n/a
8	Public Transport, Roads and Works	1	1	39 932	0	109 856
9	Gauteng Shared Services Centre	0	0	0	n/a	n/a
10	Social Development	1	1	14 169	1	14 169
11	Sport, Arts and Culture	0	0	0	n/a	n/a
	<b>Total</b>	<b>87</b>	<b>86</b>	<b>12 352 184</b>	<b>1</b>	<b>1 767 148</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 that did business with the departments where their spouses are employed.

Employees' spouses doing business with departments where their spouses are employed					
	Department	Number of employees	Number of entities	Amount paid for the period 01/04/2005 to 31/03/2007 R	Value of transactions to be followed up by the departments R
1	Agriculture	0	0	0	n/a
2	Community Safety	0	0	0	n/a
3	Education	6	6	631 852	n/a
4	Finance	0	0	0	n/a
5	Health	8	8	691 586	65 773
6	Local Government	0	0	0	n/a
7	Office of the Premier	0	0	0	n/a
8	Public Transport, Roads and Works	0	0	0	n/a
9	Gauteng Shared Service Centre	0	0	0	n/a
10	Social Development	0	0	0	n/a
11	Sport, Arts and Culture	0	0	0	n/a
	<b>Total</b>	<b>14</b>	<b>14</b>	<b>1 323 438</b>	<b>65 773</b>

**EMPLOYEE-RELATED COMPANIES AND CCs DOING BUSINESS WITH OTHER DEPARTMENTS IN THE GAUTENG 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.

<b>List of employees doing business with other departments</b>					
<b>No.</b>	<b>Department</b>	<b>Number of employees</b>	<b>Number of entities</b>	<b>Amount paid by other departments to the employee-related entities for the period 01/04/2005 to 31/03/2007 R</b>	<b>Number of employees with approval already verified by the departments</b>
1	Agriculture	1	1	114 000	0
2	Community Safety	0	0	0	n/a
3	Education	50	51	10 176 218	0
4	Finance	1	1	25 510	0
5	Health	27	27	1 052 623	0
6	Local Government	0	0	0	n/a
7	Office of the Premier	0	0	0	n/a
8	Public Transport, Roads and Works	1	1	52 417	0
9	Gauteng Shared Service Centre	7	7	868 772	0
10	Social Development	4	4	172 771	1
11	Sport, Arts and Culture	1	1	3 000	0
	<b>Total</b>	<b>92</b>	<b>93</b>	<b>12 465 311</b>	<b>1</b>

