

Detailed audit findings

ANNEXURE A: MATTERS AFFECTING THE AUDITOR'S REPORT

Procurement and Contract Management

1. Central Lake Trading t/a Empire Technology award not procured through SITA

Requirements

TR16A6.6 states that "the accounting officer or accounting authority may on behalf of department, constitutional institution or public entity, participate in any contract arranged by means of competitive bidding process by any other organ of state subject to the written approval of such organ of state and the relevant contractors"

TR16A6.3(e) states that "the accounting officer or accounting authority must ensure that contracts relating to information technology are prepared in accordance with the State Information Act, 1998 (Act No.88 of 1998) and any regulation made in terms of that Act.

Section 7(3) of the SITA Act states that "despite any other law to the contrary, every department must, subject to subsection (4) procure all information technology goods or services through the agency"

and information technology is defined in the SITA Act of 1998 to mean "all aspects of technology which are used to manage and supports the efficient gathering, processing, storing and dissemination of information as a strategic resource"

Section 7(1)(a) of the SITA Act states that " the Agency –

- (a) must, on behalf of a department, and may, on behalf of a public body, which so requests in terms of subsection (4) or (5)—
 - (i) provide or maintain a private telecommunication network or a value-added network service in accordance with the Telecommunications Act, 1996 (Act No. 103 of 1996);
 - (ii) provide or maintain transversal information systems; and
 - (iii) provide data-processing or associated services for transversal information systems; and
- (b) may, on behalf of a department or public body, which so requests in terms of subsection (4) or (5), provide —
 - (i) training in information technology or information systems;
 - (ii) application software development;
 - (iii) maintenance services for information technology software or infrastructure;
 - (iv) data-processing or associated services for departmentally specific information technology applications or systems;
 - (v) technical, functional or business advice or support, or research, regarding information technology; and
 - (vi) management services for information technology or information systems.

Practice Note 05 of 2009/10 provision under paragraph 3.2. States that SITA must provide the following services to national and provincial departments:

- Provide or maintain a private telecommunication network or value added network;
- Provide and maintain transversal or department specific information system of specific information system;
- Provide data-processing or associated services for transversal or departmental specific information systems;

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- Provide IT (Information Technology) for government;
- Set standards for interoperability;
- Set standards for ISS (Information security standards);
- Set standards for Certification of IT acquisition;
- Certify all acquisitions for standard compliance;
- Eliminate duplication; and
- Leverage economies of scale.

Paragraph 3.3. of Practice Note 05 of 2009/10 also states that "departments are required to acquire these services from SITA in accordance with business and service level agreements, should SITA indicate in writing that it is unable to provide the service itself, SITA will act as the procurement agent to acquire such services on behalf of departments"

Paragraph 3.1 of Practice Note 06 of 2007/2008 states that "accounting officers and accounting authorities are required to report within ten (10) working days to the relevant treasury and the Auditor-General, all cases where goods and services above the value of R 1 million (VAT included) were procured in terms of Treasury Regulation 16A6.4. "

Nature

During the 2016/17 financial year end audit, it was identified that contrary to the above requirements, the procurement of the programme management system from Central Lake Trading t/a Empire Technology was not procured through SITA even though the objectives of the information system meet the definition of information technology as explained above.

It was further noted that the department entered into a new contract with the above supplier and did not participate in contract that was awarded by Free State provincial treasury due to product specifications and price paid by the department not matching what was provided to the first organ of state by the supplier. This has resulted in non- compliance with the requirements of TR16A6.6.

NB - info of issued new contract not old contract as per view's specified

Internal control deficiency

Management did not review and monitor compliance with laws and regulation.

Recommendation:

Management should ensure that:

- Information technology goods and services are procured through SITA. Before considering the different procurement processes to follow, management should have approached SITA in terms of the SITA Act, SITA regulations and NT practice note 05 of 2009/10.
- The product specification developed by the department must match what the contractor is currently providing to the first organ of state (the organ of state that secured the original contract) and should be at prices charged to that other organ of state.

overlooked from first tender.

Management response

Management comment on audit finding:

Part 1 of the finding – Do not agree with the finding of AG on procuring the system through SITA. Department participated in the contract arranged by Free State Provincial Treasury using TR16A6.6. Refer to National Treasury letter (Annexure A)

"Before the department participates in a contract it must establish the following"

- The contract has been secured by means of a competitive bidding process
- The department has no reason to believe that such a contract was not irregularly awarded

- The other organ of state and the service provider have consented to such procurement in writing
- Terms and conditions are similar to the planned procurement

Before participating in the contract obtained the following documents from Free State Provincial Treasury:

- The contract has been secured by means of competitive bidding process (Annexure B)
- The Department has no reason to believe that a contract was irregularly awarded (Annexure B)
- The other organ of state and the service provider have consented in writing (Annexure C)
- Terms and conditions are similar to the planned procurement (Annexure E, see attached Bid document of Free State Bid Number FSPT 001/14/15 and Department TOR)

The system is not a network in accordance with Telecommunications Act

The system is not transversal system

The system is not data processing or associated transversal as provided for in section 7(1)(a) of the SITA Act

The development and implementation of the system is non-mandatory services in terms of the Practice Note Number 05 of 2009/2010 and therefore does not require the involvement of SITA

Part 2 of the finding – Do not agree with the finding. The Department participated in the contract Free State Provincial Treasury in terms of TR Sec 16A6.6. The product specifications of the department matched the product specifications of Free State (Annexure E refer to attach Bid Document of Free State – Bid number FSPT 011/14/15)

Management comment on internal control deficiencies:

Do not agree with internal control deficiencies

Management comment on recommendation:

The recommendation is not agreed with

Remedial action :

No remedial actions as internal controls are in place

What actions will be taken:
Since Department is not in agreement with the finding there is no action to be taken

By whom:

By when:



Auditor's conclusion

Management comment has been noted, however:

The Department was supposed to consult SITA as required by SITA Act prior to finalizing the specification and contacting Free State Provincial Treasury. SITA would have assisted the Department in ensuring that the specification addresses all the requirements of the Department.

SITA would have, based on the finalized specification, and compared this specification with the specification of Free State Provincial Treasury in order to determine if these were the same.

SITA would have provided proper advice on whether the Department should participate in the contract that was entered by the Free State Provincial Treasury.

The process followed by the Department was not a fair process due to the fact that the price and the specification was not the same as the one for Free State Treasury. The Department went ahead and negotiated a different price than the one offered to Free State Provincial Treasury by the supplier. The Department could have obtained a cheaper price if this award was extended to other suppliers (facilitated by SITA). The process was not fair because other suppliers were not given an opportunity to tender and Empire Technology had the opportunity to quote own price without competing with other suppliers

There have been debates on what is meant by "transversal information systems" and this debate was cleared by the National Treasury through Practice Note 05 of 2009/10 which includes the following provision under paragraph 3.2:

3.2 SITA must provide the following services to national and provincial departments:

- Provide or maintain a private telecommunication network or a value added network
- Provide and maintain transversal or departmental specific information system
- Provide data-processing or associated services for transversal or department specific information systems
- Provide IT (Information Technology) for Government
- Set standards for interoperability
- Set standards for ISS (Information security standards)
- Set standards for certification of IT acquisition
- Certify all acquisitions for standard compliance
- Eliminate duplication; and
- Leverage economies of scale

Whereas paragraph 3.3 states that: "Departments are required to acquire these services from SITA in accordance with business and service level agreements. Should SITA indicate in writing that it is unable to provide the service itself, SITA will act as the procurement agent to acquire such services on behalf of the department"

In terms of paragraph 4 of the SITA regulations, the agency must, after consultation with all relevant stakeholders, develop a strategy regarding the convergence of information systems and other systems for departments and may do so for public bodies. Regulations are subordinate legislation

* NBK
WOOE
cb not
legally
act as
procurement
agent!!

Therefore, before considering the different procurement processes to follow, the department of energy should have approached SITA in terms of the SITA Act, SITA regulations and NT practice note 05 of 2009/10, as the programme management system is an information technology as defined and provide data processing or associated services for department specific information system, provide and maintain departmental specific information (The Nuclear Build Programme is specific to the department of energy) therefore before deciding on any procurement process to follow, the department should have acquired this services from SITA and should SITA indicate in writing that it is unable to provide the service itself, SITA will act as the procurement agent to

acquire such services on behalf of the department, The participation of department of energy in a contract using TR16A6.6 is a procurement process (The participation does not exclude the department from complying with the SITA Act), the department of energy should have approached SITA in terms of the SITA Act, SITA regulations and NT practice note 05 of 2009/10 before a procurement process is decided on. 1.

2. The participating department participates in a contract and does not create another contract. A contract is defined (As per the general conditions of a contract) as an agreement that creates rights and obligations. One of the rights in the contract is to procure a certain identified commodity/service at a certain price and/or at a certain date, time etc.

Therefore the product specification developed by the participating department must match what the contractor is currently providing to the first organ of state (the organ of state that secured the original contract) and should be at prices charged to that other organ of state. After inspecting the additional documents that were provided with management response it was noted that the product specification for the department matched the ones from the first organ of state but it was noted that award value at DoE was R171 000 000, while at Free State Treasury was R60 911 000, no additional documents were provided by management to justify the price difference.

the product specification was altered by "management" specification

Engineering Spec A'ded to meet Spec of free-state tender.

Procurement and Contract Management

3. Participation in contracts secured by another organ of state

Audit Finding

Requirements

TR16A6.6 which states that "the accounting officer or accounting authority may on behalf of department, constitutional institution or public entity, participate in any contract arranged by means of competitive bidding process by any other organ of state subject to the written approval of such organ of state and the relevant contractors"

Section 217 (1) of the Constitution of the Republic of South Africa, 1996, states that "When an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost effective."

Paragraph 3.1 of Practice Note 06 of 2007/2008 states that "accounting officers and accounting authorities are required to report within ten (10) working days to the relevant treasury and the Auditor-General, all cases where goods and services above the value of R 1 million (VAT included) were procured in terms of Treasury Regulation 16A6.4."

Section 38(1)(h)(iii) and Section 51(1)(e)(iii) of the PFMA Act, states "that the accounting officer or accounting authority must take effective and appropriate disciplinary steps against any official in the service of their respective institutions who makes or permits irregular expenditure"

Practice Note Number SCM 1 of 2003: General Conditions of Contracts (GCC) and Standardised Bidding Documents paragraph 1.2. states that "all bids and contracts should be subject to the GCC and standard wording should not be amended".

Department of Energy supply Chain Management policy Section 8.2.2. states that "the BAC adjudicates and recommends to the accounting officer in line with the procurement delegations all submissions"

National Treasury Instruction SCM Instruction Note 03 of 2016/2017: Preventing and Combating Abuse In The Supply Chain Management System Paragraph 08 and 09 which states that" (8.1.) - the accounting officer/accounting authority must only deviate from inviting competitive bids in cases of emergency and sole supplier status, (8.2.) - an emergency procurement may occur when there is a serious and unexpected situation that poses an immediate risk to health, life, property or environment which calls an agency to action and there is insufficient time to invite competitive bids, (8.3.) - Sole source procurement may occur when there is evidence that only one supplier possesses the unique and singularly available capacity to meet the requirements of the institution, (8.4.) - the accounting officer/accounting authority must invite as many suppliers as possible and select the preferred supplier using the competitive bid committee system, (8.5.) - Any other deviation will be allowed in exceptional cases subject to the prior written approval from relevant treasury. .) - The accounting officer/accounting authority must ensure that contracts are not varied by more than 20% or R20 million (including VAT) for construction related goods, works and or services and 15% or R15 million (Including VAT) for all other goods and or services of the original contract, (9.2.) - Any deviation in excess of the prescribed thresholds will only be allowed in exceptional cases subject prior written approval from relevant treasury"

approval from treasury

Nature

Part 1: Appointment of transactional advisors to review the state of readiness for the nuclear new build programme:

During the 2016/17 financial year end audit, it was identified that:

1. Contrary to the above requirements the department of energy in utilising TR16A6.6 from NECSA did not take into consideration the product specification as required by the regulation, the specifications regarding transactional advisors emanating from the original contract (NECSA) are as follows:

- Development of bankable business case
- Undertake financial modelling and structuring
- Prepare financial investor and relevant funding documents, such as project information memorandum
 - Co-ordinate the work of other professionals and advisors
 - Assist in obtaining relevant approval
 - Provide support in negotiations with all potential funders/partners as advisors
 - Source appropriate funding and capital
 - Co-ordinate appropriate training
 - Provide support to relevant stakeholder consultation
 - Provide the required support consistent with the respective assignment
 - Developing procedures, policies and record keeping

original contract specification

Whereas product specifications derived from DoE are as follows:

- Review procurement strategy
- Review pre-procurement activities
- Review request for proposals
- Discussion on legislation exemptions

revised DoE specification

Therefore the product specification developed by the participating department must match what the contractor is currently providing to the first organ of state (the organ of state that secured the original contract) and should be at prices charged to that of other organ of state. In this case, the DOE is procuring a totally different product. They are not participating in a contract but merely utilising the same supplier.

2. Prior the department awarding the contract to Mahlako A Phahla they requested the quotations from the suppliers that participated in the competitive bid at NECSA (six suppliers) and evaluated them again based on specifications of the products required by the department in contrary with TR16A6.6.

3. The deviation from competitive bidding processes with regard to Mahlako A Phahla with a transaction value of R20 174 423.82 were not reported to the relevant treasury and the auditor general and/or such report was not submitted

∴ original appointment invalid

Part 2: Appointment of transactional advisors to assist the department in reaching a state of readiness to issue a responsive Request for Proposal to the market:

During the audit of procurement it was noted that the :

1. Services that were supplied by Mahlako A Phahla for the above award were paid without a valid written signed contract between the supplier and department.
2. Identified that the submission for deviation and terms of reference were not tabled before the BAC for consideration and recommendation to the Accounting Officer.
3. Department of Energy did not receive written approval from national treasury for the deviation exceeding the expansion or variation orders of 15% or R15 million (Including VAT) of original contract value.

Internal control deficiency

Management did not review and monitor compliance with laws and regulations

Recommendation

Management should ensure that:

1. The product specification developed by the department must match what the contractor is currently providing to the first organ of state (the organ of state that secured the original contract) and should be at prices charged to that other organ of state.
2. The deviations above R1 million are reported to the relevant treasury and auditor general.

Management comment on audit finding:

Part 1

1. Do not agree with the finding that the specifications of the Department are not the same as NECSA specifications.

The DoE participated in NECSA contract which had a scope with different work streams: (a) Lead advisory services, (b) Transactional advisory services, (c) Financial accounting, Taxation valuations, (d) Business case development € Capital Rising and (f) Independent review (annexure A, NECSA contact NTC – 0756)

The department intended to participate in all the work streams, as reflected in the submission to BAC (paragraph 3.1.3 – 3.15 and 7) to acquire a comprehensive advisory for the nuclear new build programme transaction until the programme reach a stage for financial close. However, in the initial phase the department focused on independent review as reflected in paragraph 3.1 of department's terms of reference. The intention of the department was to use the rest of the services in the scope from NECSA as and when the services are needed during duration of the nuclear Nuclear New Build Programme (NNBP), utilising the same engagement as NECSA.

2. The department recognises the error in the evaluation process followe; however, the evaluation on functionality had no bearing on the BEC recommendation. The BEC recommendation was based on total points scored for price and BBBEE as per the engagement model of NECSA.

3. Do not agree with the finding that the transaction for Mahlako- A- Phahla was deviation as the Department participated in NECSA contract as per TR16A.6. Thus there is no requirement that the transaction should be reported to the relevant treasury or AGSA

Part 2

Agree with finding. The transaction in question was for phase two (2) and it was reported as irregular expenditure in the records

Management comment on internal control deficiencies:

Internal controls were strengthened to ensure department complies with financial and performance reporting going forward.

Management comment on recommendation:

The recommendation is noted, however the finding is not agreed with that the specification were not matching and that the transaction was a deviation.

Remedial action :

What actions will be taken:

Any variations to original contract (as reported in part 2 of the contract) will serve in the BAC for recommendation after SCM has ensured compliance with all the statutory requirements. Consequence management will be affected against official found to have transgressed in the following prescripts.

By whom:

Ms. B. Musi – Director SCM

By when:

Immediately from 12 July 2017

Auditor's conclusion

Management comment noted however:

1. In terms of TR16A6.6 as used by the department to procure Transactions Advisory Services used by NECSA, The participating department (Department of Energy) should participate in a contract and not create another contract. A contract as defined by National Treasury General Conditions of Contract as an agreement that creates rights and obligations, one of the rights in a contract is to procure a certain identified commodity/services at a certain price and/or at certain date, time etc.

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Therefore the product specification developed by the participating department must match what the contractor or service provider is currently providing to the first organ of state (the organ of state that secured the original contract, i.e. NECSA) and should be at prices charged to that of organ of state

NECSA Scope of work/Service/Specification and terms of reference

NECSA requires a service provider to provide on call transactional and financial advisory services for a variety of activities. The services include, but are not limited to: the types listed below as well as oversight of all work typically required for the successful delivery of the various projects:

- Development of bankable business case
- Undertake financial modelling and structuring
- Prepare financial investor and relevant funding documents, such as project information memorandum
- Co-ordinate the work of other professionals and advisors
- Assist in obtaining relevant approvals
- Provide support in negotiations with all potential funders/partners and advisors
- Source appropriate funding and capital
- Co-ordinate appropriate training
- Provide support to relevant stakeholders consultations
- Provide the required support consistent with the perspective assignments

The service provider will also assist in developing procedures, policies, record keeping and other duties related to the overall administration of NECSA's projects. The successful service provider will manage other tasks that support finance and business development overall strategic objectives.

Whereas,

Department of Energy Scope of work/Service/Specification and terms of reference

Review Procurement Strategy

- Deliverable 1: Review and Compliance Report

Review Pre-procurement Activities

- Deliverable: Review and Compliance Report

Review request for proposals

- Deliverable 1: Review and Compliance Report
- Deliverable 2: Revised request for proposals
- Deliverable 3: Legislative exemptions required and applications for exemptions

It is therefore against this background that the department of energy is procuring a totally different product. They are not participating in a contract but merely utilising the same supplier, this is not within the ambit of TR16A.6

2. Contrary to TR16A6.6, which requires the department to participate in a contract arranged by means of a competitive bidding process, the senior procurement specialist on behalf of the department, requested bids/proposals from suppliers with bid number: RFQ/002/2016/17, with closing date and time of 26th April 2016 at 11H00, subsequent to that the Bid Evaluation Committee was held on the 04th of May 2016 in which suppliers that responded to the proposals were evaluated and allocated points based on: The service providers understanding of the project scope, proposed approach and methodology, services providers previous experience, relevant qualifications of team leaders in relation to the project.

It was on this basis that the evaluation was done and recommendation made to the bid adjudication committee and subsequently to the Director General for approval and appointment of Mahlako A Phahla

All of the above processes undertaken were not consistent or in the ambit with the application of TR16A6.6, as this are provisions for competitive bidding process, as amongst:

- The invitation of bids
- Receipts of bids
- And evaluation of bids was done

It's against this backdrop that department was merely utilizing the same supplier used by NECSA and that is not within the ambit of TR16A6.6

3. The department did not apply TR16A6.6 as it is intended and did not follow proper procurement processes and did not follow the SCM policy as the procurement was done outside SCM unit and its policy. It against this backdrop, that the procurement of services from Mahlako A Phahla is a deviation and should have been reported to national treasury as well as the auditor general, in terms of section 41 of the PFMA, TR16A6.4 and PN6 of 2007/2008, when institutions deviate from competitive bidding processes and award bids with a transactional value in excess of R1 million, the accounting officer or accounting authority must within 10 working days, furnish the relevant treasury and the auditor general with required information after the award of such bid.

4. We have noted that the Department has disclosed part of the expenditure incurred as irregular Expenditure. The total expenditure incurred on this contract (Mahlako A Phahla) should be disclosed as irregular expenditure due to reasons mentioned above.

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3. AoPO – Performance targets and indicators not consistent

Audit Finding

Treasury Regulations 5.1.1 states that "The accounting officer of an institution must prepare a strategic plan that is consistent with the period covered by the medium term expenditure framework for approval relevant executive authority"

Treasury Regulations 5.2.4 states that "The strategic plan must form the basis for the annual reports of accounting officers as required by section 40(1)(d) and (e) of PFMA Act.

PFMA Act section 40 (3) (a) states that "The annual report and audited financial statements referred to in subsection (1) (d) must—

(a) fairly present the state of affairs of the department, trading entity or constitutional institution, its business, its financial results, its performance against predetermined objectives and its financial position as at the end of the financial year concerned"

The National Treasury annual report guide paragraph 2.4.4 states that "A table must also be provided where departments should report on strategic objectives, performance indicators and targets for each programme or every sub-programme as specified in the Estimates of National Expenditure/ Estimates of Provincial Revenue and Expenditure and Annual Performance Plan for both national and provincial departments.

- Calculate the variance between the planned targets and actual achievements for the current year.
- Comment on all deviations.

In terms of paragraph 3.3 of the Framework for Managing Programme Performance Information (FMPPI) a useful set of criteria for selecting performance targets is the "SMART" criterion:

- Specific: the nature and the required level of performance can be clearly identified
- Measurable: the required performance can be measured
- Achievable: the target is realistic given existing capacity
- Relevant: the required performance is linked to the achievement of a goal
- Time-bound: the time period or deadline for delivery is specified.

During the audit of predetermined objectives it was noted that:

1. The planned performance target in the annual performance plan was not consistent with the performance target in the annual performance report:

No	Programme	Performance target in annual performance plan	Performance target in annual performance report
1	Petroleum and petroleum Products regulations	50% of licence applications approved have 50% BEE ownership.	Achieved 82.78% of license inspections approved have more than 50% HDSA ownership.
2	Electrification and energy programme and project management	National EMP for 2016/17 developed.	NIEP for 2016/17 developed.
3	Electrification and energy programme and project management	4 quarterly reports on energy infrastructure development covering INEP (challenges, mitigation plans & interventions)	4 quarterly reports & 1 annual report on energy infrastructure development covering INEP (challenges, mitigation plans & interventions)