1. **DRAFT BUDGET REVIEW AND RECOMMENDATION REPORT OF THE PORTFOLIO COMMITTEE ON DEFENCE AND MILITARY VETERANS ON THE 2016/17 ANNUAL REPORT OF THE CASTLE CONTROL BOARD (CCB) AND ARMSCOR, DATED 12 OCTOBER 2017.**

***This Report consists of two parts, with Part A dealing with the Castle Control Board (CCB) and Part B dealing with the Armaments Corporation of South Africa (ARMSCOR).***

The Portfolio Committee on Defence and Military Veterans (PCODMV), having considered the financial and service delivery performance of the Castle Control Board (CCB) and the Armaments Corporation of South Africa (ARMSCOR) on 11 October 2017, for the 2016/17 financial year, reports as follows:

**PART A**: **CASTLE CONTROL BOARD (CCB)**

1. **1. Introduction** 
   1. **Description of core functions of the Castle Control Board**

The Castle Management Act, 1993 (No. 207 of 1993) provides for a Castle Control Board (CCB) to govern and manage the Castle – South Africa’s oldest architectural structure - on behalf of the Minister of Defence and Military Veterans. The National Heritage Resources Act (No. 25 of 1999) provides for the management of the Castle as a national heritage site. The Castle’s objectives are set out in the Castle Management Act as follows:

* To preserve and protect the military and cultural heritage of the Castle;
* To optimise the tourist potential of the Castle; and
* To maximise accessibility to the public.

**1.2 Mandate of Committee**

The Portfolio Committee on Defence and Military Veterans (PCODMV) is mandated to oversee the CCB to ensure that the entity fulfils its mandate through the monitoring of the implementation of legislation and adherence to policies, such as the Castle Management Act, 1993 (No. 207 of 1993), the National Heritage Resources Act (No. 25 of 1999), and the Defence Endowment Property and Account Act (No. 33 of 1922). It must scrutinise legislation which supports the mission statement of Government, the budget and functioning of the CCB.

**1.3 Purpose of the BRR Report**

Section 5 (2) of the Money Bills Procedures and Related Matters Amendment Act (Act 9 of 2009) allows for each Committee to compile a budgetary review and recommendation report (BRRR) which must be tabled in the National Assembly. Section 5(3) provides for a budgetary review and recommendation report to contain the following:

a) an assessment of the department’s and entities’ service delivery performance given available resources;

1. an assessment on the effectiveness and efficiency of departments use and forward allocation of available resource; and
2. recommendations on the forward use of resources

In October of each year, portfolio committees must compile a BRRR that assess service delivery performance given available resources; evaluate the effective and efficient use and forward allocation of resources; and may make recommendations on the forward use of resources. The BRRRs are also source documents for the Standing/Select Committees on Appropriations/Finance when they make recommendations to the Houses of Parliament on the Medium-Term Budget Policy Statement (MTBPS). The comprehensive review and analysis of the previous financial year’s performance, as well as performance to date, form part of this process.

**1.4 Methodology in compiling the report**

The Report is compiled from the various activities of the Committee. It is inclusive of the Committee’s meetings, oversight visits, reports on budget votes, strategic plans, annual performance plans and annual reports, as well as previously published Committee reports.

**1.5 Dates of oversight visits**

The PCODMV did not conduct an Oversight visit to the Castle in 2016.

**1.6 Information used to compile the Report**

Besides the information on the Oversight visit, other information used in the assessment of the service delivery and financial performance included:

* Committee report on the 2016/17 budget hearings, strategic plans and annual report;
* The National Development Plan;
* The 2016 Estimates of National Expenditure;
* The 2016 State of the Nation Address by President Zuma; and
* The Auditor-General Report on the CCB.

**1.7 Structure of the Report**

This Report comprises seven sections:

* Section 1: Introduction – sets out the mandate of the Committee, the purpose of this   
   report (BRRR) and the process to develop this report.
* Section 2: Provides an overview of the key relevant policy focus areas.
* Section 3: Provides an overview and summary of previous key financial and   
   performance recommendations of the Committee(2015/16).
* Section 4: Provides a broad overview and assessment of financial performance of the   
   CCB for 2015/16.
* Section 5: Overview of service delivery and performance.
* Section 6: Key Committee findings.
* Section 7: Key Recommendations.

1. **Overview of the key relevant policy focus areas**

**2.1** **State of the Nation Address** **2016**

In the State of the Nation Addresses of 11 February 2016, the President indicated that government has embarked on radical socio-economic transformation to address the triple challenges of poverty, inequality and unemployment. The additional pronouncements that are considered relate to:

**• Promotion of Local Procurement.** In keeping with the promotion of local procurement and increasing domestic production by having the State Institutions buy 75% of goods and services from South African producers, the CCB’s procurement policy will be aligned to promote local procurement by having the department to procure at least 75% of goods and services from South African producers.

**• Employment of Youth.** Government will introduce further measures to speed up the employment of young people.

**• Expansion of Internship Programmes in Government.** Every government department and public entity will be required to support the initiative to appoint additional interns for the transfer of skills.

**• Resourcing the Defence Mandate.** “The SANDF has been a source of national pride as it participated in peacekeeping missions in the continent. This role will continue and government is looking into the resourcing of the SANDF mandate in line with recently concluded “SA Defence Review 2015”. The DOD has begun planning for the implementation of the SA Defence Review 2015 for the short-, medium and long-term within the context of available resources and the CCB shall support its endeavours.

**• Improved Implementation of the Financial Disclosures Framework.** Taking note that the implementation of the Financial Disclosures Framework is being improved, the CCB shall ensure that it adheres to compliance dates for the submission of SMS Financial Disclosures to external organisations.

**2.2 The National Development Plan**

The NDP and its related policies provide a national framework that will inform the contribution by national departments and public entities. Aspects relevant to the CCB and the envisaged contribution are as follows:

**• Tourism:** The NDP is clear on the strategic role of tourism as a driver for economic growth and job creation. At a national level the National Tourism Sector Strategy will be aligned to meet up with the 2030 targets set out in the NDP. The Castle of Good Hope (CGH) as a premier heritage tourism destination is part of important debates and regularly engages with the tourism industry, government departments, donors and partners to contribute toward the NDP outcomes and targets. The CCB’s Programme 3 deals with Tourism Management and the organisational objective aligned to the NDP is “To maximize the tourism potential of the CGH.”

**• Envisaged Reduction in Youth Unemployment:** The CCB is running a vibrant programme for youth job shadowing and internship. This initiative will be strengthened and refined over the MTEF. In this regard the CCB is working with the Culture, Arts, Tourism, Hospitality & Sports Sector Education and Training Authority to access some of their resources. The CCB’s output objective in Programme 4, which is aligned to the NDP, is “Delivering a range of public programmes with SA schools, cultural groups and special community groups.”

**• Strengthening the National Research and Development Capacity:** The CCB is very mindful of the historical significance of the CGH and its collections. These offer significant opportunities in the areas of education and research. The organisation has a small resource centre which it plans to expand. The CCB will establish a CCB Strategic Research capability, particularly to record, monitor and share the lessons of the multi-million rand renovations project. In this regard, the SANDF’s Regional Works Regiment has been approached to provide assistance and support. The link with the NDP is CCB Programme 2 “Ensure the maintenance, preservation, interpretation and showcasing the history of the Castle.”

**• Fraud and Corruption:** The CCB will intensify its campaign in fighting fraud and corruption. CCB Programme 1 refers to “Ensure clean, sound administration and good governance”. The organisation is involved in a process to review its legislation and has strengthened most of its critical internal controls to ensure a sound, corruption and crime-free organisation.

**2.3 The Medium Term Strategic Framework (2014 - 2019)**

The MTSF Outcomes to which CCB will contribute by virtue of its legislative mandate and inherent capabilities are as follows:

**MTSF Outcomes 4 and 5:** “A skilled and capable workforce to support an inclusive growth path” and “Decent employment through inclusive economic growth” are linked to the CCB’s Programme “To maximise the tourism potential of the CGH” with the following outcomes set out in the CCB Strategy Map:

• Deliver a complete offering of visitor services and experience;

• Human resource development and adequate staffing levels;

• Implement a revenue generation plan; and

• Responsible commercialisation drive.

**MTSF Outcome 12:** “An efficient, effective and development orientated public service and an empowered, fair and inclusive citizenship” is linked to CCB programmes 1 and 2, namely “Ensure clean, sound administration and good corporate governance” and “Ensure the maintenance, preservation, interpretation and showcasing of the history of the Castle”. These are linked to the following Strategic Map outcomes:

• Effective and efficient systems of internal control;

• Sound financial control;

• Research and international benchmarking; and

• Integrated resource management.

**2.4 Overview of CCB Strategic Plan and Annual Performance Plan**

The CCB Strategic Plan (2015 - 2020) gives effect to the mandate of the CCB which translates into the following outcomes:

Programme 1: Ensure clean, sound administration and good corporate governance. Delivery of a significantly improved corporate governance environment as measured by the CCB’s annual AGSA audit rating i.e. achievement of a clean audit report.

Programme 2: Ensure the maintenance, preservation, interpretation and showcasing of the history of the Castle. Delivering of an increased number of innovative museum exhibitions and other displays accessible to the general public and tourists.

Programme 3: Maximise the tourist potential of the Castle. Delivering of the Castle as an enhanced tourist attraction as indicated by increased visitor figures and revenue generated through tourism activities.

Programme 4: Increased public profile and positive perception across all sectors of the community

The CCB 2015/16 Annual Performance Plan gives effect to the mandate of the CCB which translates into the following outcomes:

**Strategic Outcomes**

The strategic outcome goals of the CCB articulated in the APP for the 2016/17 financial year were:

* To ensure effective administrative management in terms of corporate governance and project a professional competent corporate image towards optimal resource support and public relations;
* To develop the museum and interpretive components of the Castle and its related themes through continuous research and development;
* To ensure promotion of the Castle as a must-see and vibrant tourist destination accessible to all the citizens of South Africa and the world; and
* To ensure the accessibility of the Castle as an attractive and user-friendly centre of cultural significance by all sectors of the community.

**3. Summary of previous key financial and performance recommendations of the Committee**

**3.1 BRRR 2016 recommendations**

In 2016, the Committee made the following recommendations in its BRR Report on performance and financial matters:

* The CCB was encouraged to further enhance its clean audit opinion by ensuring that the noted Irregular expenditure is avoided in future.
* The Committee agrees with the recommendation by the A-G regarding irregular expenditure that control measures should be strengthened to ensure compliance with legislation.
* The Committee recommended that the CCB should include the list with risks and the action plans to mitigate these, in their Annual Reports.
* The Committee recommended that performance rewards should be managed responsibly and that other staff members should also be considered for these rewards.
* The Committee indicated its concern about the dwindling reserves without a concomitant increase in revenue and recommended that the CCB share it Revenue Optimisation Strategy with the Committee as soon as possible.
* The Committee was especially concern about the increasing salary bill and indicated that the CCB should manage this situation prudently.
* The CCB indicated that the military tattoo is a legacy project but given the funding modality of it, it plans to end this historical arrangement.

**3.2 Response by the Minister of Finance:**

No specific response was required from the Minister on the 2016 BRRR Recommendations.

**3.3 Committee 2016/17 Budget Report**

The Committee made the following recommendations in terms of the 2016/17 Annual Performance Plan and Strategic Plan (2015 - 2020):

* The Committee recommends that the Castle Control Board capitalise on opportunities such as Het Bakhuys and a conference center to enhance its financial sustainability.
* The Board is encouraged to further ensure that the Castle becomes more accessible to cultural communities to incorporate them in their annual activities.
* The Committee recommends that the Board present its plans to get the Castle listed as an UNESCO World Heritage Site.
* The Committee urges the Board to get clarity of the basis on which Iziko is entitled to one third of its gate takings, especially as this can be an impediment to get listed as an UNESCO site.

1. **4. Overview and assessment of financial performance FOR 2016/17**

**4.1 Overview of Vote allocation and spending for 2016/17 FY**

The budgetary allocation for the CCB is listed in Table 1 below.

**Table 1: CCB Budgetary allocation 2016/17**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Programme** | **Budget** | | | | **Nominal Rand change** | **Real increase/decrease** | **Nominal percent change** | **Real percent change** |
| R thousand | **2014/15** | **2015/16** | **2016/17** | **2017/18** | **2016/17** | **2016/17** | **2016/17** | **2016/17** |
| Programme 1: Administration | 4 180.0 | 5 091.0 | 5 428.0 | 5 674.0 | 337.0 | 0.9 | 6.62 percent | 0.02 percent |
| Programme 2: Conservation | 1 863.0 | 1 950.0 | 2 020.0 | 2 121.0 | 70.0 | -55.1 | 3.59 percent | -2.82 percent |
| Programme 3: Tourism Promotion | 75.0 | 130.0 | 150.0 | 158.0 | 20.0 | 10.7 | 15.38 percent | 8.24 percent |
| Programme 3: Public Access | 260.0 | 330.0 | 347.0 | 364.0 | 17.0 | -4.5 | 5.15 percent | -1.36 percent |
| ***TOTAL*** | ***6 378.0*** | ***7 501.0*** | ***7 945.0*** | ***8 317.0*** | ***444.0*** | ***-47.9*** | ***5.9 percent*** | ***-0.64 percent*** |

**Programme 1:** **Administration**

The aim of this programme is to ensure clean, sound administration and good corporate governance.

**Programme 2:** **Maintenance and conservation of the Castle**

The aim of this programme is to ensure the maintenance, preservation, interpretation and showcasing of the history of the Castle.

**Programme 3:** **Tourism**

The aim of this programme is to maximise the tourism potential of the Castle of Good Hope.

**Programme 4:** **Public Access**

The aim of this programme is to achieve an increased public profile and positive perception across all sectors of the community.

**4.1.1 Performance Information**

**Table 2: Performance Information for 2016/17**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Performance Indicator** | **Audited Performance** | **Actual Performance** | **Planned target for** | **Actual Performance** | **Deviations** |
| **2013/14** | **2014/15** | **2015/16** | **2015/16** |
| Number of critical corporate governance measures | - | 8  **(3)** | 5 | 7 | +2 |
| Percentage of adverse AG findings successfully resolved | - | 100% | 100% | 100% | Clean Audit |
| CCB APP submitted to the Executive Authority | Baseline | 100% | 100% | 100% | 0 |
| CCB AR submitted to the Executive Authority | Baseline | 100% | 100% | 100% | 0 |
| Percentage completion of all approved, scheduled repair and maintenance | New indicator | 100% | 100% | 100% | 0 |
| Annual increase in the actual number of new, innovative heritage projects and programmes | New indicator | 4  **(8)** | 6 | 17 | +11  Addition of 350 year programme |
| Percentage completion of all approved, scheduled logistics and movements during renovations | New indicator | 100% | 100% | 100% | 0 |
| Total number of tourists per annum | 141 084 | 149 940  **(168 514)** | 152 000 | 154 067 | +2076 |
| Total Gross Revenue per annum | R3.5m | R3.47 million | R3.9 m | R4,259 871 | +R301 798 High yield film and leisure events |
| Year-on-year increase in the number of people reached through positive media coverage as measured by independent monitoring systems | Baseline | 5 million | 10 million | 107 million | +97 million Driven by 17 events and functions |
| Number of students interns successfully mentored by the CCB at the CGH | New indicator | 20 | 25 | 26 | +1 |
| Number of successful community, educational and heritage programmes | - | Baseline established | 12 | 15 | +3 Combination of heritage and 350 commemoration |

**4.2 Quarterly spending for 2015/16**

The National Treasury does not include the entities in its quarterly analysis nor do the Committee review the performance of the entities on a quarterly basis.

**4.3 Report of the Auditor General (AG)**

The CCB received a **clean audit opinion** from the Auditor-General for the FY2015/16 and for FY2016/17. The AGSA however, lists an Emphasis of matter namely the Restatement of corresponding figures, which does alter his audit opinion. This refers to “*Comparative figures for expenditure items were reclassified during the year under review”* but also states that “*these reclassifications have no influence on both Surplus for the prior year and Accumulated Surplus as at 31 March 2015*.”

**Irregular expenditure**

An amount of R57 195.00 (which was condoned/written off by the Board) was listed as Irregular expenditure for FY2015/16 and for FY2016/17 it is R1.724 869.00. The explanation provided states that the “CCB holds formal written approval from its Executive Authority and from National Treasury to supplement its authorised expenditure budget for the 2017 financial year with drawdowns from its accumulated surplus which can be used by the entity for specific, pre-agreed purposes. Notwithstanding such approval and pre-authorisation, this expenditure is classified as irregular expenditure because it does not relate to the normal approved budget for the period. This expenditure amounted to a total of R1 724 869.00 and was directly monitored and controlled by the Board.

**Unauthorised Expenditure and Fruitless and Wasteful Expenditure**

No Unauthorised, Fruitless and Wastefulexpenditure was incurred during the year under review.

**5. OVERVIEW AND ASSESSMENT OF PERFORMANCE**

**Financial Performance for the 2016/17 Financial Year**

The CCB had an *overspending* of R1 726 000 for the FY 2016/17 against an *underspending* of R75 000 in the previous financial year.

**Table 3: Budget for FY2016/17**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Programme | 2014/15  **R’000 (***R thousand)* | | 2015/16  **R’000 (***R thousand)* | | 2016/17  **R’000 (***R thousand* | | (Over)/Under  Expenditure |
|  | Budget | Actual expenditure | Budget | Actual Expenditure | Budget | Actual Expenditure |  |
| Administration | 4.182 | 5.172 | 5 091 | 5 658 | 6 637 | 8 010 | (1 373) |
| Conservation | 1.254 | 656 | 1 950 | 282 | 369 | 260 | 109 |
| Tourism Promotion | 75 | 60 | 130 | 10 | 41 | 30 | 11 |
| Public Access | 260 | 350 | 330 | 1 476 | 1 167 | 1 640 | (473) |
| Total | **5 771** | **6 238** | **7 501** | **7 426** | **8 214** | **9 940** | **(1 726)** |

**Table 4: Revenue FY 2016/17**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Source of revenue** | **2014/15** | |  | | **2015/16** | | **2016/17** | | |
| **Estimate** | **Amount collected** |  | | **Estimate** | **Amount collected** | **Estimate** | **Amount collected** | **(Over)/under collection** |
|  | | | **R’000** | | | | |  |
| **Sales** | 3 000 | 3 278 |  | | 3 730 | 2 942 | 4 000 | 2 295 | 1 705 |
| **Rental income** | 2 171 | 743 |  | | 3 156 | 1 277 | 3 410 | 1 139 | 2 271 |
| **Other income** | 164 | 292 |  | | 15 | 41 | 204 | 163 | 41 |
| **Interest income** | 600 | 677 |  | | 600 | 646 | 600 | 397 | 203 |
| **TOTAL** | **5 771** | **4 697** |  | | **7 501** | **4 905** | **8 214** | **3 994** | **4 220** |

In terms of Revenue Collection, the Reports shows a decrease of R911 000 where R4 905 000 was collected in 2015/16 and R3 994 000 was collected in 2016/17. The main concern is that for the third year in a row (R1 074 000 in FY 2014/15, R2 596 000 in FY 2015/16 and R4 220 000 in FY 2016/17), the CCB has under-collected on their planned revenue. Either the estimates are unrealistic or there is a lack of proper planning/estimation in this regard.

**Non-financial performance**

The Annual Report 2016/17 indicates that only one (1) of the CCB’s 17 key performance indicators was missed. Seven were met whilst the majority (9) were exceeded.

***Programme 1: Administration and Good Corporate Governance***

All KPI-targets dealing with the operations of the Board, Board sub-committees and general administration, were met. The Board approved its Petty Cash Policy as well as Travel and Subsistence Policy.

***Programme 2: Preservation, Interpretation and Showcasing of the History of the Castle***

All 4 of the APP targets in this area, were met. The combination of heritage and 350 Commemoration activities and programmes has driven this performance. This was made possible by the November 2016 Board approval of R1,7m (deemed as irregular expenditure as disclosed in the notes to the AFS) for 350 Commemoration programme purposes. The community support and media and publicity generated by these events was apparently unprecedented.

***Programme 3: Maximising the Tourist Potentia****l*

Visitor figures to the Castle increased significantly from the previous year. The numbers were mainly driven by the following KPI’s namely commercial events (40 in total, which is 15 over target), film shoots (32 in total and 15 over target), new tourism attractions (7 and 5 over target) and the number of joint marketing agreements with business partners (11 and 8 over target).

***Programme 4: Increased Public Profile and Positive Perception Across all Sectors of the Community***

Under the slogan “Bringing People to the Castle and Taking the Castle to the People”, the CCB managed to meet all its four KPI targets under this Key Performance Area. One of the highlights, is the number of potential tourists reached through positive media coverage.

**6. GOVERNANCE**

The Annual Report refers to various issues under this section, *inter alia* that it operates as a Schedule 3A Public Entity and that the Board’s composition should adhere to certain conditions in the Castle Management Act.

**6.1 Risk Management**

The Annual Report refers to its Risk Management and that it has developed a Risk Register which forms the basis for regular risk assessments to determine the effectiveness of its risk management strategy and to identify new and emerging risks. It further states that “*The management of the organization is performed on an “enterprise risk management” basis i.e. the most important risks that would potentially compromise our ability to attain our strategic objectives are articulated in a Risk Register, ranked and regularly evaluated.”*

**6.2 Fraud and corruption**

The Annual Report states that the CCB does not have an anti-criminality plan but has a fully-fledged Fraught (sic) Prevention Policy. It aims to make losses due to fraud and corruption intolerable and will institute training covering these aspects. It states that criminal activities would more likely be internally induced, and feels that the Department’s guidelines in this regard are sufficient to deal with the issue.

**6.3 Audit Committee and Internal Audit**

The Audit Committee is fully functional and should be commended for its support to the CCB to achieve a clean audit opinion, and its interaction with the A-G to ensure that there are no unresolved issues. Internal audit services were provided by an outsourced professional auditing firm namely *Sizwe-Ntsaluba Gobodo*, in terms of a short-term contract, supplemented by the Board’s own internal audit charter.

**7. HUMAN RESOURCES**

The Castle has no dedicated Human Resources Unit and has a staff complement of 39 members of which three are remunerated by the Department of Defence, and thus not included in HR tables. The CCB has appointed the Events, Tourism and Heritage Managers as of 1 April 2016. The total expenditure for the 36 employees (24 in FY2015/16) amount to R5 393 000 (R3 362 000 in FY2015/16) of the Castle’s total expenditure of R9 939 000 (R7 425 000 in FY 2015/16) which represents a 54.3% (45.2% in FY2015/16) of personnel expenditure as a percentage of total expenditure.

**7.1 Performance rewards**

Provisionis being made for performance rewards of R368 935 (R313 371 in FY2015/16). These are for three employee categories composed of R161 000 (Top management), R179 000 (Senior Management) and R21 000 (professional qualified), although these are indicated as provisional amounts. The Report on page 110 shows the performance bonus of the CEO as R90 347 (R165 174 in FY2015/16) and R70 524 (R128 927 in FY2015/16) for the CFO, totalling R160 871 (R294 101 in FY2015/16). In FY2014/15, the CEO received a performance bonus of R154 368 and the CFO, R120 493.

**Table 5: Performance Bonuses**

|  |  |  |  |
| --- | --- | --- | --- |
| **Remuneration of CEO** | **2017** | **2016** | **2015** |
| Performance Bonus | 90 347 | 165 174 | R154 368 |
| **Remuneration of CFO** | **2017** | **2016** | **2015** |
| Performance Bonus | 70 524 | 128 927 | R120 493 |

**Table 6: Performance rewards**

|  |  |  |  |
| --- | --- | --- | --- |
| **Employment category** | **Performance reward (R’000)** | **Personnel expenditure (R’000)** | **% performance reward to total personnel cost** |
| **Top Management** | R161 | R5 393 | 3.0% |
| **Senior Management** | R179 | R5 393 | 3.3% |
| **Professionally qualified** | R21 | R5 393 | 0.4% |
| **TOTAL** | **R361** | **R5 393** | **6.7%** |

The Annual Report (p.110) outlines the performance bonuses as set out in Table 4, while Table 5 outlines the Performance rewards (p. 43).

**7.2 Employee related costs**

The Report indicates that the cost related to employees for FY 2016/17 was R5 393 000 as opposed to R3 361 566 in FY2015/16. It was R3 092 162 in FY 2014/15, and R1 775 000 in FY 2013/14.

**8. COMMITTEE KEY FINDINGS: CASTLE CONTROL BOARD**

The following findings were made regarding the CCB:

* The Committee applauded the CCB for its second consecutive clean audit opinion, hosting the successful 350 Commemoration programme, and achieving 16 of the 17 targets, many of which were exceeded.
* The Committee noted the utilisation of the accumulated surplus and the fact that National Treasury prescripts do not allow public entities to make a profit. It was however still concerned that the accumulated surplus has decreased from R10 120 340 in 2015/2016 to R4 175 966 in FY2016/17.
* Irregular Expenditure for FY2016/17 is R1.724 869.00, an increase on the previous years’ R57 195.00, was noted by the Committee
* The Committee noted the CCB’s plans to supplement its revenue through the utilisation of a Conference center, gift shop and settling the human resource component as part of its Revenue Optimisation Strategy.
* The Committee enquired about the contractual arrangements of the CEO, and it was indicted that this has been extended until 2019.
* Concern was expressed at the 54.3% spent on the compensation of employees versus the recommended ratio of 40/30/30 with 40% for human resources and 30% each for capital expenditure and operational expenditure.
* The Committee enquired about the progress being made by the CCB to ensure that it is managing the CGH as a single entity.
* The ill-discipline of soldiers guarding the CGH is deemed as unacceptable and the Committee wanted to know about progress being made in this regard.
* The Committee required more information on the request for an additional ring-fenced annual operational subsidy of R4.5 million from the DOD.
* The Committee enquired about the anti-criminality plan for the CGH, given the challenges around people staying on the outside of the CGH.
* The CCB indicated that it operates on an Enterprise Risk Management system, which identifies the five main risks and which are managed as priorities by the CCB in cooperation with the Internal Audit.
* Questions were raised around the performance awards, the differences between performance awards and bonuses as well as the reasons these amounts have been listed as provisional.
* The Committee raised concern about the “Het Bakhuys” restaurant as it was raised previously with no apparent resolution to its migration to the CCB.
* The Committee noted the expenses related to local and international travel and enquired around the nature and purpose of these travels.

**9. COMMITTEE Recommendations**

* The Committee recommended that even though the accumulated surplus and its utilisation has been sanctioned by National Treasury, the surplus should be utilised prudently and with the understanding that revenue shortfalls, should be covered by the Revenue Optimisation Strategy.
* The CCB indicated that the Revenue Optimisation Strategy is a 110 pager and it was requested that this be shared with the Committee, as soon as possible. It is recommended that the strategy be operationalised to generate income to prevent the depletion of the surplus which will impact on the running of CGH, in case the R4.5 million is not provided by the DOD. In addition, the CCB should provide the Committee with the projected figures for each of the highlighted projects.
* The CCB was encouraged to further enhance its clean audit opinion by ensuring that the noted Irregular Expenditure is avoided in future.
* The Committee reiterated that it was not against the awarding of performance bonuses/awards, especially against the good performance of the CCB, but stressed that all personnel should be considered for this.
* The Committee encouraged the CCB to enhance its revenue strategies, not only to improve its finances, but also to address the high cost of compensation to employees.
* The CCB indicated that progress is being made with its plans to solely manage the Castle, and it was encouraged to further these attempts to ensure that it is in a position to optimally manage the whole precinct.
* Given that no specific answer was given to the requested R4.5 million annual subsidy from the Department of Defence, it is recommended that the CCB provides more information on this issue at its next meeting.
* The Committee was encouraged by the response by Chief of Logistics that he will address the ill-discipline of SANDF soldiers guarding the CGH, and they were requested to share these plans and progress in this regard with the Committee.
* The CCB should provide more information on the anti-criminality plan given the challenges in this regard, and especially how it impacts on the image of the CGH.
* The Committee recommended that the CCB should not only manage the top five risks, but all risks attached to the CGH.
* The CCB is required to explain the difference in amounts between performance rewards and performance bonuses, given that they indicated that these terms were used interchangeable, as well as when these amounts will be finalised.
* Given that the CCB indicated that progress has been made with the migration of “Het Bakhuys” to them, the Committee recommended that the CCB keeps it abreast of developments in this regard. The CCB should also provide the Committee with the current and projected figures regarding the finances of “Het Bakhuys.”
* The CCB should provide the Committee with more information around local and international travels undertaken by members of the CCB.

**Report to be considered.**

**PART B: ARMAMENTS CORPORATION OF SOUTH AFRICA (ARMSCOR)**

1. **1. Introduction**

**Description of core functions of the entity**

Armscor was established in terms of the Armaments Production and Development Act (No. 57 of 1968) to satisfy the requirements of the South African National Defence Force (SANDF) in respect of Defence Matériel. The Armscor Act (No. 51 of 2003) was enacted to provide for the continued existence of Armscor, and to provide for the functions, accountability and finances of the Corporation, as well as for matters connected therewith.

**1.2 Mandate of Committee**

The Portfolio Committee on Defence and Military Veterans (PCODMV) is mandated to oversee Armscor to ensure that it fulfils its mandate through the monitoring of the implementation of legislation and adherence to policies, such as the Armaments Production and Development Act (No. 57 of 1968) and the Armscor Act (No. 51 of 2003).

**1.3 Purpose of the BRR Report**

Section 5 (2) of the Money Bills Procedures and Related Matters Amendment Act (No. 9 of 2009) allows for each Committee to compile a budgetary review and recommendation report (BRRR) which must be tabled in the National Assembly. Section 5(3) provides for a budgetary review and recommendation report to contain the following:

* an assessment of the department’s service delivery performance given available resources;
* an assessment on the effectiveness and efficiency of departments use and forward allocation of available resource; and
* recommendations on the forward use of resources

The above is done in October of each year, and the BRRR is also a source documents for the Standing/Select Committees on Appropriations/Finance when they make recommendations to the Houses of Parliament on the Medium-Term Budget Policy Statement (MTBPS). The comprehensive review and analysis of the previous financial year’s performance, as well as performance to date, form part of this process.

**1.4 Methodology in compiling the report**

The Report is compiled from the various activities of the Committee. It is inclusive of the Committee’s meetings, oversight visits, reports on budget votes, strategic plans, annual performance plans and annual reports, as well as previously published Committee reports.

**1.5 Dates of oversight visits**

No oversight visits to Armscor facilities were conducted during the 2016/17 financial year.

**1.6 Information used to compile the Report**

Besides the information on the Oversight visit, other information used in the assessment of the service delivery and financial performance included the:

* Committee reports on the 2016/17 budget hearings, strategic plans and annual report;
* The National Development Plan;
* The 2016 Estimates of National Expenditure;
* The 2016 Budget Speech of the Minister of Finance;
* The 2016 State of the Nation address by President Zuma; and
* The Auditor-General Report on the DOD

**1.7 Structure of the Report**

This report comprises seven sections:

* Section 1: Introduction – sets out the mandate of the Committee, the purpose of this report (BRRR) and the process to develop this report.
* Section 2: Provides an overview of the key relevant policy focus areas.
* Section 3: Provides an overview and summary of previous key financial and performance recommendations of Committee(2016/17).
* Section 4: Provides a broad overview and assessment of financial performance of Armscor for 2016/17.
* Section 5: Overview of service delivery and performance.
* Section 6: Key Committee findings.
* Section 7: Key recommendations.

**2. Overview of the key relevant policy focus areas**

**2.1** **State of the Nation Address**

In the State of the Nation Addresses of 11 February 2016, the President indicated that government has embarked on radical socio-economic transformation to address the triple challenges of poverty, inequality and unemployment. The additional pronouncements that are considered in this APP relates to:

**• Promotion of Local Procurement.** Armscoras the main defence acquisition entity is placed strategically to promote local procurement.As such it can support the DOD’s procurement policy to be aligned to promote local procurement by having the department and its entities procure at least 75% of goods and services from South African producers.

**• Employment of Youth. Armscor has a** Youth Development Programme (YDP) and aims to give high school learners more insight into career opportunities in the aviation and defence industries. The YDP proved to be a success with Armscor having almost 10 000 learners taking part in the programme.

**• Expansion of Internship Programmes in Government.** Every government department and public entity will be required to support the initiative to appoint additional interns for the transfer of skills. Armscor has, been involved in socially responsible initiatives, with the main emphasis on education, particularly supporting initiatives in the areas of science, technology, engineering and mathematics (STEM) subjects at schools; bursaries and internships. In July 2016, Armscor partnered with the University of Fort Hare (UFH) in an effort to create capability and capacity for, and support the development and maintenance of the Department of Defence capabilities.

**• Resourcing the Defence Mandate.** Armscor is continuously involved in supporting the SANDF with cost-saving or income generating measures. One such measure aims to reduce the SANDF’s expenditure on the leasing of property by providing permanent solutions within existing facilities. An example in this regard is where Armscor is the supervisory entity for migrating the Defence Intelligence Headquarters from a leased facility to a permanent Armscor owned facility that can accommodate densification. Multiple investigations are ongoing for sweating SANDF endowment properties where feasible, without the SANDF losing ownership of them.

**2.2 National Development Plan (NDP)**

The National Development Plan (NDP) identifies Small medium and micro sized enterprises (SMMEs) as key areas for development. Armscor is playing its part in this arena, and strives to increase fairness in the playing field between the established big players in defence, related industries, and the new smaller entrants. In support of imperatives that advance the strategic initiatives of a developmental state as defined in the National Development Plan (NDP) and the Industrial Policy Action Plan (IPAP), Armscor hosted the Armscor Supplier Open Day which was held on 19 May 2016; the first of its kind for Armscor. Under the theme *“Empowering SMMEs for global competitiveness.”*

Armscor is striving to create employment in the RSA by increasing the probability of RSA industry members becoming service providers to United Nations activities in Africa. Armscor is registered on the United Nations (UN) supplier database and opportunities are being followed up. Armscor further contributes to the NDP’s Chapter 3 (Economy and employment) through the employment of 1 502 full-time personnel and creating many more economic opportunities through its business endeavours with the South African defence industry. This is an increase from the 1 383 permanent employees Armscor had in 2015/16. Armscor also assists in terms of Chapter 9 of the NDP (Improving Education, Training and Innovation). In 2016/17, Armscor awarded 116 bursaries to students, which is a marked increase from 2015/16 when it awarded 55 bursaries. The institution also provided 23 Dockyard employees with training opportunities and 76 employees with the Adult Education and Training Programme.

**2.3 Medium Term Strategic Framework (MTSF) 2014 - 2019**

Armscor’s Strategic Priorities are aligned to several MTSF outcomes, including Outcomes 2, 3, 4, 5, 11 and 12. For 2016/17, Armscor contributed to the following MTSF outcomes:

***Outcome 4: Decent employment through inclusive economic growth.***Armscor continued to employ 1 502 members during the period under review. It created DIP credits to the value of R135 471 664 during the 2016/17 financial year. This is from the 12 existing DIP agreements that Armscor is currently managing. Despite a reduction in allocated funds and limited DOD contracting, revenue generated by Armscor only decreased marginally from R1 412 million to R 1 398 million.

***Outcome 5: A skilled and capable workforce to support an inclusive growth path***.

Armscor’s most valuable asset is its professional and highly skilled corps of technical personnel. During the review period, Armscor to provide experience to young engineers and scientists that is required by Engineering Council of South Africa (ECSA) for professional registration. A number of newly graduated engineers are placed in industry for a period of 1 to 2 years to obtain those required outcomes that cannot be obtained within the ambit of Armscor’s normal activities.

Armscor runs a highly successful Research and Development programme which includes, *inter alia*, the Gerotek test facilities, projects in Armour development, Protechknic Laboratories, Ergonomics technologies, Hazmat protective systems and the institute for Maritime Technology. Technology funding for 2015/16 totalled R590 million and for 2016/17 it was R854m.

**2.4 Strategic Objectives**

Armscor’s Strategic Objectives according its 2016 Corporate Plan are:

* **Financial turnaround and business re-orientation** – to ensure that Armscor generates sufficient income to meet its funding needs in the near to medium term through innovative business initiatives.
* **Acquisition excellence** – to meet the SANDF’s materiel requirements on time and in time, based on compliant governance policy, processes and procedures.
* **Technology advancement** – to direct and sustain research and development in line with the capability requirements of the DOD.
* **Industry sustainability** – to sustain and support the South African Defence Industry (SADI) so that it meets the requirements of the SANDF and contributes to economic development.
* **Stakeholder engagement** – to build, maintain and strengthen relationships with all stakeholders through different marketing communication and engagement platforms.

**2.5 SA Defence Review 2015**

The period under review was characterised by a steady progress in the DOD in refining the detailed requirements for creating the envisioned SANDF. The demands on the national fiscus indicate that the DOD will not receive the full funding it needs to fully implement the Defence Review. During the period under review, multiple ideas to improve the efficiency of the SANDF and to define income streams that will not burden Treasury were identified and quantified. Armscor is continuously involved in supporting the SANDF with some of these cost-saving or income generating measures. One such measure aims to reduce the SANDF’s expenditure on the leasing of property by providing permanent solutions within existing facilities. An example in this regard is where Armscor is the supervisory entity for migrating the Defence Intelligence Headquarters from a leased facility to a permanent Armscor owned facility that can accommodate densification. Multiple investigations are ongoing for sweating SANDF endowment properties where feasible, without the SANDF losing ownership of them.

**2.6 Overview of Armscor’s Corporate Plan for 2016/17**

The Corporate Plan 2016/17 highlights the main focus areas as outlined in its Strategic Plan. It aims to:

* Customer satisfaction through service delivery standards.
* Accountability in the execution of the mandate.
* Research and Development, which provides research, development, test and evaluation support to Acquisition and SANDF operational users.
* Financial responsibility and the responsible utilisation of scarce financial resources.
* Efficiency, effectiveness, and economical service delivery.
* Utilisation of the human resources of Armscor to provide the services required from Armscor.

**3. Summary of previous recommendations of the Committee**

**3.1. 2016 BRRR Recommendations**

The PCODMV makes the following recommendations with regards to Armscor:

* That the coexistence agreement with the Square Kilometre Array project be finalised as soon as possible and that the Committee be informed in writing when the final agreement has been signed.
* For the duration of the official transition period, Armscor (in conjunction with the SA Navy) should provide the PCODMV with written quarterly updates on the status of the Dockyard. This information should include details on whether suspensive conditions were met in that quarter; employee figures at the Dockyard; a synopsis of the financial status of the dockyard; compliance to deadlines for vessel repairs and other services to the SA Navy; the number of artisans and other students under training at the Dockyard; and, commercial opportunities explored and unlocked at the dockyard. Progress with regards to the raising of capital for the Dockyard should also be reported.
* The Committee urges Armscor to increase its revenue collection streams as a matter of urgency. Future Annual Reports should include details on the capitalisation of Intellectual Property and outline other avenues explored for commercialisation. Simultaneously the Committee should also be provided with a long-term sustainability plan from Armscor.
* Armscor should aim to reach its set target for the employment of people with disabilities before the end of the 2016/17 financial year.
* Although outside the control of Armscor, the Committee notes with concern the delays in the acquisition of new vessels for the SA Navy under Projects Hotel and Biro. The Committee urges Armscor to expedite the acquisition of these vessels once the procurement process returns to the ambit of Armscor. Armscor should inform the PCODMV, at the resumption of the contracting for these vessels, what plans have been put in place to expedite the delivery of the vessels under these projects. Detailed timelines and cost-breakdowns for the two projects should also be provided to the Committee within 30 days of the official awarding of the respective tenders.

**3.2 Response by Department and Minister of Finance:**

No responses were made with regard to Armscor by the Minister of Finance in his responses to the 2016 BRRR recommendations.

**3.3. Committee 2016/17 Budget Report**

* The Committee recommends that Armscor enhance its efforts to ensure greater participation of local businesses in its procurement processes.
* Armscor should update the Committee on its progress to source additional avenues of revenue to sustainably fund its operations.
* The amount of the claim in Lisbon, Portugal is concerning to the Committee and Armscor is implored to update the Committee on developments in this regard on a regular basis.
* The Corporation is encouraged to earnestly investigate and exploit opportunities to support the United Nations and African Union peace support operations in Africa based on its proximity and knowledge of the Continent.
* The Committee encourages the Corporation to enhance its efforts to attract and retain especially black and female scientists.

1. **4. Overview and assessment of financial performance**

**4.1. Overview of Armscor’s 2016/17 financial outlook**

The Group’s reserves decreased from R2 125,6 million to R1 998,7 million mainly as a result of the deficit during the year. Cash and cash equivalents form a significant part of the assets, and are reserved to finance specific future obligations. The Group invested R32,7 million in acquiring plant, intangible assets and equipment to capacitate existing facilities.

The net financial result of the Group reflects a deficit of R126,9 million compared to a surplus of R208,5 million in the previous financial year. Total revenue increased with 9,6% while operating expenditure, excluding depreciation, decreased by 6,3%.

***The main contributors to the deviation for the year under review are the following:***

* **Personnel Costs**

The net underspending in personnel cost is due to the freezing of vacancies, except for those deemed critical for the continued operations of the organisation.

* **Allocation for operating expenditure/Gross contributions**

Allocation for operating expenditure is received to defray the cost of the Group’s operations for the year under review, to address additional services to be rendered, and to ensure that Armscor’s contracted service delivery to the Department of Defence, in terms of the Service Level Agreement (SLA), is effectively and efficiently met.

**Funding of Armscor**

Armscor’s main funding remains by means of a transfer payment via the DODMV. During the year under review, Armscor’s transfer payment was impacted the most by the three year reduction in the transfer payment, as directed by National Treasury, whereby it was required that Armscor should fund the shortfall allocated by National Treasury from its own reserves. This shortfall in the allocated transfer payment led to the significant deficit budgeted for the period under review. To this extent, Armscor continued to implement cost containment and cost prioritisation in order to reduce the budgeted deficit, and to reduce the impact on its own internal resources. This led to a 39,2% reduction in the deficit budgeted for the year.

**Unrecoverable debts**

An amount of R9,5 million (2016: R1,7 million) relating to unrecoverable debts was written off during the year.

**Irregular expenditure**

Irregular expenditure of R9.78 million (R13.2 million in 2015/16) was incurred during the year as a result of procurement that occurred without following the competitive bidding process. R4,7 million of this expense relate to security services contracts that were extended pending finalisation of discussions to transfer the physical security of its head office and strategic facilities to the Department of Defence, whilst R2,2million was treated as single source procurement without the required approval.

**Fruitless and wasteful expenditure**

Expenditure amounting to R3 million (2016: R823) was incurred during the year, and is deemed to be fruitless and wasteful. The expenditure was as a result of interest paid on late payments (R733), uninsured damages to third party client property (R0,8 million) and expenditure with no corresponding benefit to the organisation (R2,1 million). Processes are underway to determine appropriate action to be taken.

**4.2 Report of the Auditor General (AG) for 2015/16 and risk management**

**Clean Audit**

The external audit concluded by the office of the Auditor- General of South Africa (AGSA) resulted in a clean Audit report - as was the case in 2015/16. Armscor was awarded a clean audit award and a certificate of excellence by the Auditor-General of South Africa. This follows on from Armscor’s clean audit opinion, with no qualifications from the Auditor-General of South Africa for the 2014/15 financial year. The Auditor-General of South Africa audits 10 of the 21 major public entities. Of these state entities, Armscor is one of the few entities that received a clean audit opinion for the 2015/16 financial year - sustained from the previous year.

**5. OVERVIEW AND ASSESSMENT OF PERFORMANCE**

This section will provide an overview of achievements in the key focus areas of Armscor for 2016/17, its official performance against targets and human resources matters.

**5.1 Achievements in the key focus areas**

Acquisitions for the SANDF and other government departments reflect Armscor’s core function. During the 2016/17 financial year, Armscor achieved the following in terms of contract management:

* R4.519bn or 39.8% of the total portfolio related to procurement and maintenance and support contracts, against R5.631 billion the previous year.
* R6.842bn, or 60.2% of the total portfolio related to technology and capital acquisition projects R6.315 billion in FY2015/16.

**Defence Industrial Participation (DIP)**

Defence Industrial Participation (DIP) relates to the obligation of a foreign supplier to reciprocate defence related business in South Africa as a result of a Defence acquisition. Armscor is currently managing 12 existing DIP agreements resulting from capital acquisition projects, a single obligation that stems from the SDPs, and one DIP agreement resulting from the procurement of pistols on behalf of the SAPS. It created DIP credits to the value of R135 471 664 during the 2016/17 financial year. The only remaining SDP related DIP obligation is one incurred by MBDA for the acquisition of the Exocet surface-to-surface missile, for deployment on the frigates of the SA Navy. The DIP agreement has been extended to March 2019 to give Armscor and MBDA an opportunity to identify suitable projects involving local companies to discharge the outstanding obligation.

**Research and Development**

In accordance with the mandate given to Armscor, the Research and Development (R&D) Department manages the strategic capabilities and facilities under its control. The Department managed to earn 34% of the total business portfolio of R451,3m from commercial contracts, and 66% from the Department of Defence and Military Veterans. The Alkantpan and Gerotek Test Ranges, as well as Hazmat Protective Systems mainly contribute to the local and foreign commercial income. The department is still facing the challenge of insufficient funding to ensure the effective execution of its mandate. Commercial opportunities created by research and development activities are actively being exploited to contribute to long-term financial sustainability.

**The Dockyard**

The Dockyard achieved all its performance deliverables, which were signed off by the SA Navy, in accordance with the performance agreement with the Dockyard for the reporting period. ability. The Dockyard transfer process from Armscor to Denel continued to gain momentum during the period under review. The key outstanding actions include key approvals by National Treasury and an agreement with Denel’s strategic partner. Both processes are underway. This transfer will culminate in the SA Navy retaining sovereign control, and Armscor being the contracting authority, with Denel being the operator. Armscor permanently absorbed a number of employees who were previously employed through labour brokers. This would ensure that these employees enjoy the same full benefits as any other permanent employee. The Dockyard continued with its apprenticeship programme, thus ensuring a much needed feeder scheme to the technical domains.

The transfer of the Dockyard from Armscor to Denel is progressing and awaiting the necessary approvals. This process will culminate in a business model whereby the SA Navy will have sovereign control, Armscor will become the Contracting Authority in accordance with its mandate, whilst Denel will manage and operate the capability. In this process, Denel will have a strategic partner to ensure the much needed investment, capability rejuvenation and commercial involvement. Finalisation of this process is planned for the next reporting period.

**Military Veterans**

Armscor continues to collaborate with, and enhance its relationship with the Department of Defence and Military Veterans. A dedicated programme to address real needs of Military Veterans through various projects was established by Armscor. Armscor supported the launch of the Women Military Veterans Association (WOMVASA). Armscor maintains a database of Military Veterans suppliers. On 23 March 2017, Armscor held a workshop for Military Veterans suppliers, to provide them with information on Armscor’s procurement and acquisition processes. Currently, there are Military Veterans companies that have been awarded tenders in Armscor’s core business to the tune of approximately R30m. Others have been appointed through the ESD initiative as suppliers to main contractors to the tune of approximately R40m, while other projects of this nature are still being processed. Other initiatives include 5 bursaries worth R218 000 awarded to Military Veterans’ beneficiaries.

**5.2 Performance against set targets**

The Armscor three year integrated Corporate Plan defines two categories of performance indicators. The first category addresses performance indicators that measure the execution of Armscor’s functions, as defined in the Armscor Act and as agreed on in the SLA with the DOD, while the second category measures the attainment of the strategic objectives of the Group. A total of 53 Key Performance Indicators (goals) were set for 2015/16. Armscor managed to achieve 48 of these, with one which they did not have the opportunity to execute (KPI 2.3.1 Engage with the DOD to influence better alignment of capital projects), which results in a success rate of 90.56 per cent. Targets not achieved are reflected in table below.

**Table : Key Performance Indicators not achieved during 2015/16**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Objective** | **KPI** | **Goal** | **Achieved** | **Performance against goal** |
| **Objective 3.1** | 3.1 Average time taken from receipt of  requirement (URR for capital acquisition) to  placement of contract. | 90 days for  standard  acquisition /  procurement | 93 days | An average of 93 days taken from  receipt of obligation to placement of  contract.  **Objective not achieved.** |
| **Objective 1.3.1** | Profile Armscor personnel against the  requirements of Armscor Acquisition,  Armscor R&D and a possibly-to-be established  Business Development / Deal making entity. | Profiling  completion  date 31 May  2016 | 26 April 2017 | Profiling was delayed due to the  Turnaround contract only being  finalised in June 2016, which was  a prerequisite for profiling.  **Objective not achieved.** |
| **Objective 1.8.1** | Renew application systems to improve  effectiveness and efficiency.  • Implement Finance Module. | 31 March 2017 | 31 March 2017 | Armscor is developing an ERP application system on the iDempiere platform. A delay was experienced with the development of the Budget and Forecasting Module that also influenced the Finance Model. The project to improve the effectiveness and efficiency by renewing the Finance Module  application system is currently in the analysis stage. The implementation of the Finance Module was delayed due to challenges experienced in the development of the Budgeting Module. The revised implementation date was extended to March 2018.  **Objective not achieved.** |
| **Objective 2.1.2** | Investigate and implement e-procurement  for identified Commercial and Military off  the shelf procurement | Report on the  viability of the  e-procurement  process.  31 March 2017 | 31 March 2017 | The requirements for an  e-procurement solution have not been developed due to a delay in the ERP project. An e-procurement solution will be designed as part of the detailed requirements gathering  process for acquisition, and the subsequent analysis process.  **Objective not achieved.** |
| **Objective 2.3.1** | Engage with the DOD to influence better  alignment of capital projects. | First iteration  of optimised  master plan to  be completed. | DOD placed  a hold on the  project in August  2016. | Armscor participated in the  DOD Through Life Capability  Management (TLCM) project, which amongst other things, has the intention to develop a model whereby capital projects can be better aligned. The intention of the past year was to develop a first iteration of  an optimized capital acquisition master plan, however, the DOD  placed a hold on the project in August 2016. Therefore, this objective could not be accomplished as the TLCM project is a DOD responsibility.  **No opportunity to perform.** |
| **Objective 4.2.1** | Increase percentage of local industry spend  in respect of Special Defence Account and  General Defence Account managed by  Armscor (increase based on previous year’s  spending). | 1%  Improvement | (2,66%) | **2015/16**: Total payment for year: R7 194bn; Local: R5 683bn. **2016/17**: Total payments for year: R7 523bn; Local: R5 743bn. Actual local spending represents 76.34% of total compared to 79% for 2015/16. This results in a decrease of 2.66% compared to previous year’s percentage  spending.  **Objective not achieved.** |

## 5.3 Personnel information

The 2016/17 Annual Report indicates that Armscor, including the Armscor Dockyard, has a staff complement of 1 502, which is lower than the 2015/16 figure of 1 383. The year under review is the last year of the term of the Employment Equity Plan, and the goals were achieved as follows:

• The goal was set to increase black employees from 66% to 68% and 77,32% performance was achieved; and

• The goal for females was set to increase from 34% to 36% and 36% performance was achieved.

The targets for people with disabilities were surpassed, especially the female group. However, there were

terminations of service in the male category resulting from retirements during the year under review, and

consequently, the goals were not achieved.

In order to address skills shortage, Armscor continues to provide skills development through a number of programmes, the following of which are noteworthy:

* Five employees continued with studies enrolled since December 2014 at the Naval Postgraduate School in Monterey, California.
* One employee is currently registered at Cranfield to complete the Aircraft Certification programme. She completed two blocks in 2016, and the remainder of the programme will be completed in 2017.
* Seventy-six employees were registered on various levels of the AET programme during the period of reporting. From 76, 60 are registered for matric, and 16 for the AET levels 1 - 4.
* Thirty-five graduates were appointed to the Talent Development programme during the year under review. The programme comprises 14 African males, 19 African females, one Indian male and one White female pursuing opportunities in the disciplines of Science, Engineering and Information Communication Technology.
* One-hundred-and-sixteen bursaries were awarded to undergraduates at various local universities during the period under review. The bursaries are funded through the Armscor bursary scheme, the Armscor Defence Industry Bursary Scheme (ADIBS) and the Department of Defence (DOD) Ledger Fund.
* A total of 23 SA Navy students were enrolled at the training centre for P1 Mechanical Engineering and P2 Electrical Engineering respectively. Two of these learners enrolled for trade test preparation
* The Manufacturing Engineering and Related Services Seta (MERSETA) awarded Armscor Dockyard a R1 672 200 discretionary grant for 12 learners for the apprenticeship programme. The first tranche payment of R836 100 was paid in June 2016.

**6. COMMITTEE KEY FINDINGS: ARMSCOR**

During its engagement with Armscor, the PCODMV made the following key findings:

* The Committee notes and welcomes Armscor’s expansion of service provision to state departments (other than the DOD) as well as other states such as Nigeria and Ghana.
* The Committee notes the cancellation of the contracting for the Offshore Patrol Vessels and the potential negative impact that this can have in the medium-term in terms of the SA Navy’s patrol capability.
* The Committee notes the potential delays in terms of the acquisitions of Project Hoefyster (Infantry Fighting Vehicles). Such delays are of key concern to the SANDF’s operational readiness. The Committee is cognisant of the fact that such delays largely relate to the manufacturing agent, Denel.
* The agreement between the Square Kilometre Array (SKA) project and Armscor’s Alkantpan facility is welcomed by the Committee. The Committee stresses that the aim should remain not to reduce revenue generated from this facility as a result of limitations placed on testing by the SKA-agreement.
* The successful increase in income from commercial sources by some of the Armscor facilities is welcomed.
* The Committee expresses concern regarding the delays in the transfer of the Dockyard to the planned cooperative management of Armscor, Denel and the SA Navy. The facility is of immense strategic value and its functioning imperative to the operational capacity of the SA Navy, in line with the Government Garage concept, as announced by the President, related to Operation Phakisa. The Committee acknowledges that Armscor awaits Denel’s final position on the potential transfer of the Dockyard.
* The Committee welcomes the maintenance of a clean audit by Armscor for 2016/17.
* The advances in terms of Employment Equity by Armscor are welcomed.
* Several successful training and education initiatives have been implemented by Armscor and the continued implementation of such initiatives are encouraged.
* The decrease in operating expenditure by Armscor is a major achievement in ensuring the longevity of the Armscor Group. This initiative should continue to bring down operating expenditure in the medium-term. However, the Committee stresses concern regarding the long-term financial sustainability of Armscor given limited income and a decreased state transfer.
* The Committee notes Armscor’s concerns related to Denel’s capabilities and its lack of ability to adequately support the SANDF, which invariably impacts on Armscor.
* The Committee stresses the importance of addressing ICT concerns at Armscor raised by the Auditor General.
* The ongoing delay in finalising the outstanding DIP agreement from the Strategic Defence Procurement Package (the MBDA DIP Agreement) is a major concern to the Committee and the finalisation thereof should be prioritised.
* The Committee notes the commitment by the Deputy Chairperson of the Armscor Board that Armscor will increase its involvement with the military veterans’ community.
* The Committee notes initial progress with the Truck Africa project which aims to produce a new logistics vehicle for the SANDF. The need exists to manage this in an efficient way as to ensure the delivery of a high-quality, cost-effective vehicle to the SANDF.
* It is acknowledged by the Committee that Armscor is not currently involved in any sweating of assets by the DOD as a means of funding the 2015 Defence Review.
* The Committee welcomes the establishment of a Defence Industry Fund as this may serve as a valuable tool to ensure the growth of the domestic defence industry, especially as it relate to the potential growth of SMME’s operating in the defence domain.
* Intellectual Property (IP) management is essential to ensure both the maintenance of sovereign defence capabilities and exploiting such IP for commercial use, where viable.

**7. COMMITTEE Recommendations**

The PCODMV makes the following recommendations with regards to Armscor:

* In the context of limited DOD contracting, the Committee recommends Armscor to continue to exploit commercial opportunities for revenue collection as a means to ensure the sustainability of the Group.
* The Committee notes the cancellation of the contracting for Offshore Patrol Vessels as a major concern as it impacts negatively on the operational capacity of the SA Navy. The Committee recommends that the DOD and Armscor find a lasting solution in this regard to ensure SA Navy’s patrolling capacity. This is of special importance in the context of Operation Phakisa that aims to exploit the ocean’s economy.
* The Committee recommends that the DOD and Armscor meet urgently with Denel to ensure that the extended target (March 2019) for the first delivery of Infantry Fighting Vehicles is met. Failure to meet this target impacts negatively on the SANDF’s operational capacity. Armscor and/or the DOD should provide feedback on progress in this regard to the PCDMV within 45 days of the adoption of this report. The Committee will utilise this engagement for future interactions with Denel.
* Delays in the transfer of the Dockyard is of a major concern to the Committee. The Committee acknowledges that Armscor awaits Denel’s final position on the potential transfer of the Dockyard. The Committee recommends that the DOD and Armscor meet urgently with Denel to ensure the finalisation of this process or the identification of an alternative management initiative. Armscor and/or the DOD should provide feedback on progress in this regard within 45 days of the adoption of this report, including alternative management structures for the Dockyard. The Committee will use this feedback from the DOD and Armscor for future interactions with Denel.
* The Committee recommends that Armscor implements, as a matter of urgency, its identified corrective measures related to the AG’s Information Technology concerns.
* The Committee notes ongoing initiatives by Armscor to offset the DIP credits with the European Missile Producer, MBDA. It is recommended that the finalisation of this DIP agreement be prioritised for finalisation while ensuring maximum benefit for the state. Feedback in this regard should be provided no later than 1 June 2018.
* Feedback on the additional 11 DIP agreements and where/how these credits will be utilised should be provided to the Committee no later than 31 March 2018.
* Armscor should provide feedback on progress with the Truck Africa project no later than 31 March 2018. The Committee recommends that Armscor ensures that the vehicles are suitable for operational areas in Africa where the SANDF deploys.
* Armscor should provide feedback on the status of the Defence Industry Fund by no later than 31 March 2018.
* The Committee recommends that Armscor continues to manage IP in a responsible manner for the state, as there are billions worth of IP in Denel, and other organisations outside the defence environment, which need to be protected. This is to ensure commercialisation where viable as a means of gaining revenue. Armscor should report on challenges in this regard no later than 31 March 2018. This report should also include whether current legislation sufficiently protect defence-related IP and whether there are any threats to sovereign IP?
* Armscor should provide feedback in relation to progress of (1) Project Hotel and (2) Project Biro for the SA Navy. Such reporting should include detailed timelines on the production and delivery of these vessels. Reporting should be done by no later than 31 March 2018.
* The Committee recommends that Denel, which is currently under the Department of Public Enterprises, should migrate to the Ministry of Defence and Military Veterans, as recommended by the Presidential Committee on review of the State Owned Enterprises in 2012.

**Report to be considered.**