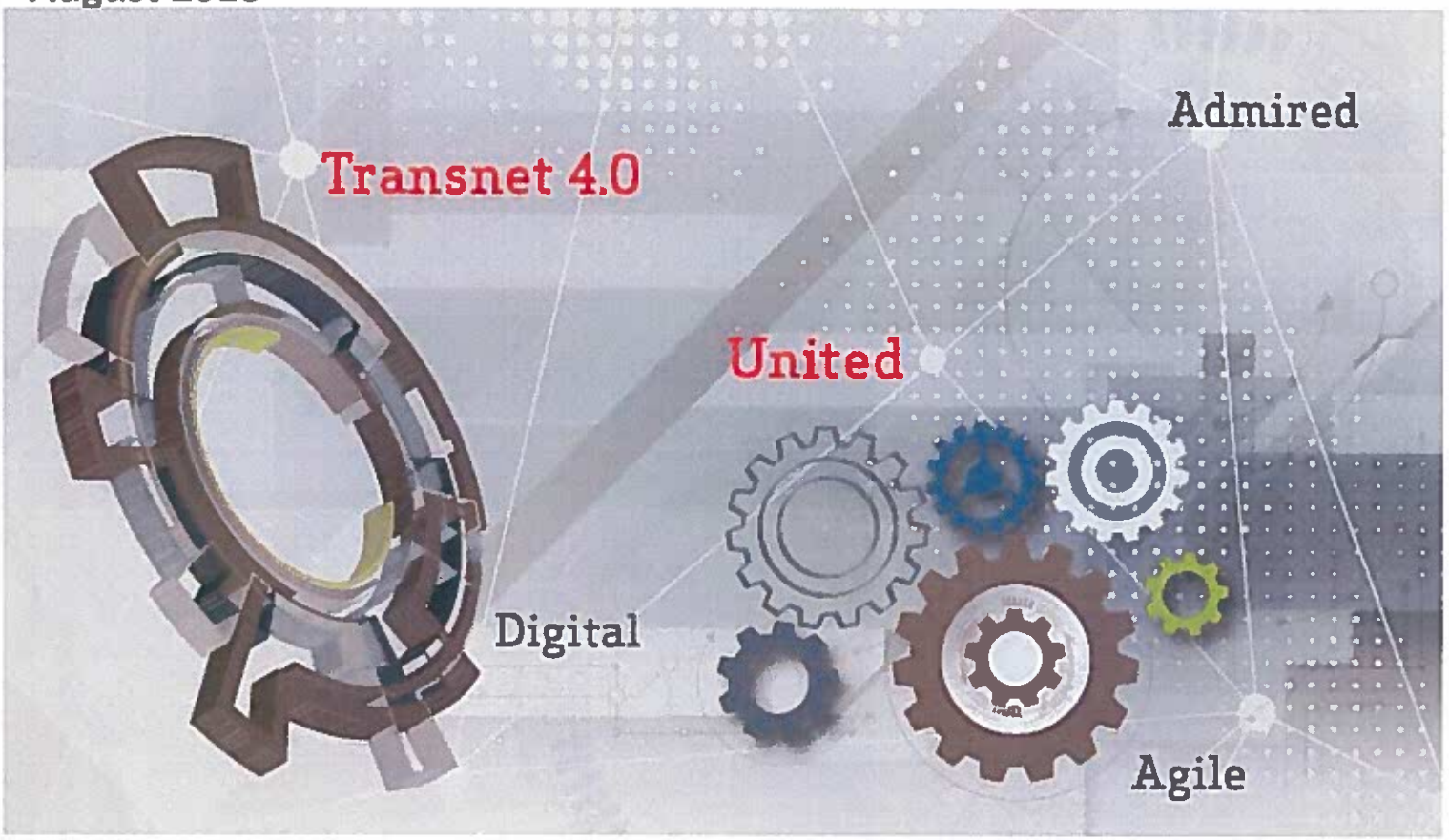
Transnet Internal Audit Report to Parliament

T-Systems, SAP and McKinsey Reported Findings

August 2018



T-System ceded part of its contract to Zestilor

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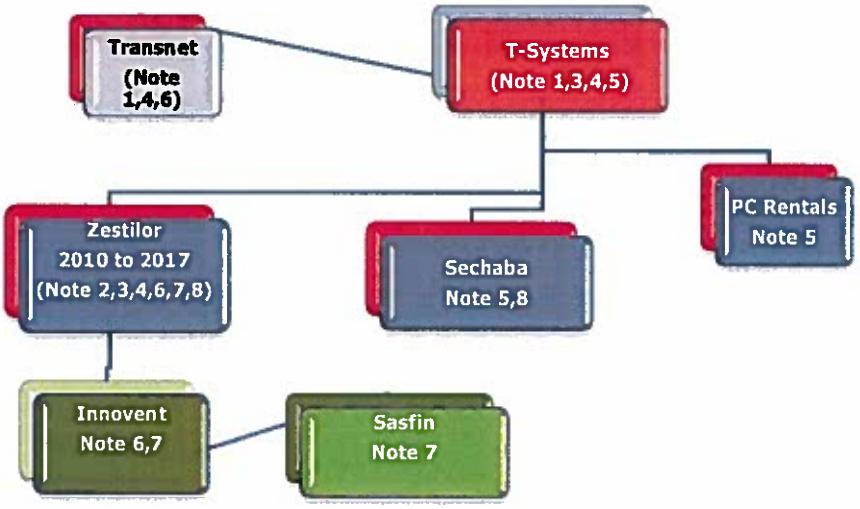
Zestilor (Pty) Limited was a company supplying Transnet with end-user devices, such as laptops, tablets, desktops and associated accessories on a rent-only basis. They are one of the Transnet suppliers selected for this review (as listed in 1.2 .above). The diagram below represents our understanding of the relationship between Zestilor and other related parties:



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Findings and observations

- T-Systems ceded part of its 5 year contract with Transnet (August 2010) to Zestillor despite the latter having financial challenges. The contract had an option for a 2 year extension which was exercised. The contract was further ceded to Innovent and later to SASFIN (for financing).
- A further 2 year contract extension was effected until May 2018. However it was terminated by Zestilor due to financial challenges.
- Various payment irregularities were noted such as possible duplicate payments.
- There was an increase in contract value by 340% (i.e. from R165 million per annum or R 1.16 billion over 7 years) to R3.6 billion. This was documented in the National Treasury memo dated 15 December 2016. As a result of the relationship with T-System contract, Zestilor automatically benefited from the increase of the contract value, despite the evidence that Zestilor should not have been accepted as a cessionary to the T-Systems contract due o financial challenges.

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2. McKinsey group

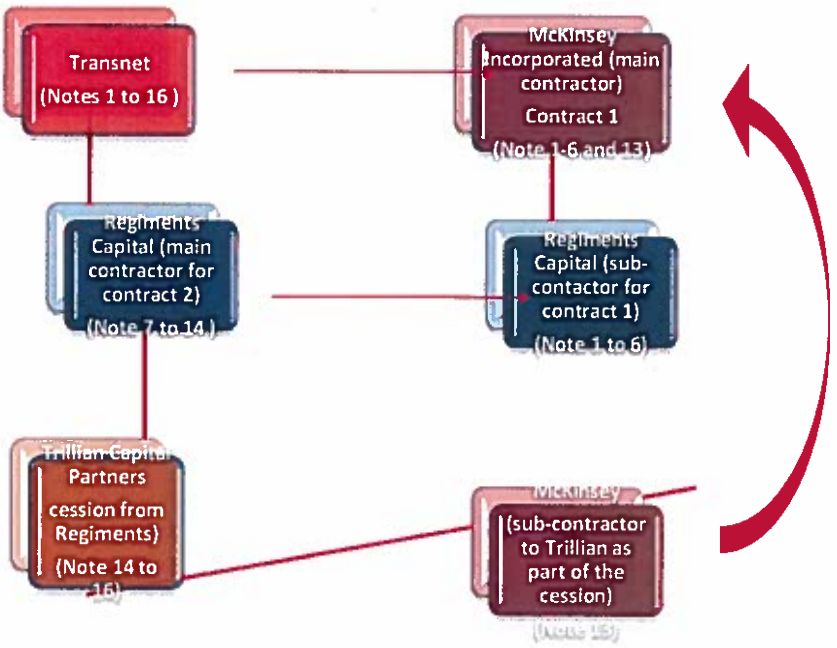
And related parties (Trillian and Regiments)

Background

McKinsey – Advisors/Consultants to Transnet. They were the lead consortium partner providing advisory services for the 1064 Locomotives Tender.

Regiments – A sub-contractor to McKinsey that replaced Nedbank and Utho (JV) and Letsema. They were the transaction advisory consultants for the 1064 Locomotives tender as part of the McKinsey consortium

Trillian – Cessionary. Regiments contract was ceded to Trillian.



Findings and Observations

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McKinsey Incorporated and Regiments Capital (Pty) Ltd

In May 2012, the former Group CE of Transnet approved a confinement for the appointment of a service provider in respect of RFP (GSM/12/05/0447) to provide advisory services required for the acquisition of the 1064 Locomotives. The confinement was to the following service providers:

- ✓ KPMG, PWC, Aurecon, Letsema, McKinsey that were selected based on prior experience with Transnet and extensive knowledge and experience in project finance; and
- ✓ Webber Wentzel, David Potter, Ledwaba Mazwai and Mac consulting were selected as they were engaged by Prasa in recent procurement of locomotives and coaches.

On 22 August 2012, the Group CE approved the appointment of the McKinsey consortium for the complete advisory services and Webber Wentzel for the legal advisory work as transaction advisors on the 1064 locomotive tender. The estimated cost of R50 million with the following % split of work per service provider was approved: McKinsey – 35%; Letsema - 20%; Utho and Nedbank – 10%; Webber Wentzel – 20%; and Advanced Rail Technologies – 15%

A letter of Intent dated 30 November 2012 was issued to the McKinsey consortium for the provision of Advisory Services related to the acquisition of the 1064 locomotive tender. The consortium then included Regiments Capital (replacing Letsema), Advanced Rail Technologies, Nedbank Capital and Utho Capital.

In May 2013 a potential conflict was raised with McKinsey concerning Nedbank Capital which resulted in Regiments replacing Nedbank Capital in the consortium.

On 16 April 2014, communication was received from McKinsey wherein all rights and obligations were ceded to Regiments Capital.

Regiments

On 23 March 2015, a submission was compiled by then Chief Executive of Transnet Freight Rail, requesting for "the confinement and award" for the provision of professional services to support Transnet in increasing General Freight business with a breakthrough to reach the planned volume targets for the financial years 2015/2016 and 2016/2017. The purpose of the submission was to request the Acquisitions and Disposals Committee ("ADC") to:

- ✓ Approve the confinement and award for the General Freight Business breakthrough to achieve the volume targets initiative, which includes an initiative for sales and commercial capabilities, processes and solutions, to Regiments Capital for R 375 million; and
- ✓ Delegate Authority to the Group Chief Executive acting at the time to approve all documentation and contract amendments related to this transaction including process approval and award.

The submission was recommended and approved by the former Group Chief Financial Officer and the former Group Chief Executive on 23 March 2015 and 24 March 2015 respectively.

According to the above-mentioned, the ADC approved the RFP for issue on 30 March 2015. The actual RFP was then issued on 02 April 2015. The closing date of the RFP was 17 April 2015, calculated to 15 days after issue. This RFP was issued as a confinement as defined in the Procurement Procedure Manual ("PPM").

The agreement between Transnet and Regiments was signed by the then Acting Group Chief Executive and Regiments Capital's Executive Director on 30 November 2015. The commencement date was indicated as 19 May 2015 and the expiry date was indicated as 18 May 2017. The contract price was R375 million, of which R135 million related to fixed fees and R240 million related to Outcome Based fees for financial years 2015/16 and 2016/2017. We noted that the contract was signed more than six (6) months after the commencement date.

Findings and Observations (Cont.)

TRANSNET

Regiments

In October 2015, another memo (hereafter referred to as "memo 2") was compiled by then Acting Group Chief Supply Chain Officer requesting for "the approval of the amendment to the scope of work for the provision of professional services to support Transnet in increasing General Freight Business with a breakthrough to reach the planned volume targets (GSM/15/03/1255)". The purpose of the submission was to request the ADC to approve the amendment to the GFB breakthrough to achieve the volume targets initiative in terms of the following:

- ✓ Amendments to the scope of work;
- ✓ Amendment to the split in the fee structure (Fixed and contingent fee); and
- ✓ Amendment to the split of work between Lead Contract and Sub-Contractor.
- ✓ On 28 October 2015 memo 2 was recommended for and approved by the then Acting Group Chief Financial Officer and Acting Group Chief Executive respectively. We cannot confirm whether or when the ADC approved the above request as the resolution has still not been provided to us for review at the time of this report.

Memo 2 also included information regarding the post tender negotiation ("PTN") process which resulted in the decrease of the contract value from R 375million to R 300 million. This contract reduction was not effected.

Findings and observations (Cont.)

TRANSNET

Regiments

- Various payment irregularities were noted such as possible duplicate and advance payments. Hourly rates also varied from invoice to invoice and expenses not supported by source documents.
- Payments totalling R 191 574 576, 82 were made to Regiments Capital without being linked to any of the contracts received. Similarly a payment of R93 480 000.00 was made to Trillian but not linked to a contract.
- The sub-contracting arrangement for both contracts 1 and 2 did not appear to promote the vision of the sub-contracting conditions set out by Transnet as the companies listed as sub-contractors did not meet the qualifying criteria of the advancement of small businesses in South Africa.
- A significant change in the McKinsey consortium the parties such as the removal of Letsema, Nedbank etc. on whom the evaluations were conducted and eventually ceding to regiments.
- Potential low balling and bid rigging of the contract as the value was increased one year after award.

Thank You