**6. BUDGET REVIEW AND RECOMMENDATION REPORT OF THE PORTFOLIO COMMITTEE ON DEFENCE AND MILITARY VETERANS ON THE 2017/18 ANNUAL REPORT OF THE CASTLE CONTROL BOARD (CCB) AND ARMSCOR, DATED 17 OCTOBER 2018.**

***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) for the 2017/18 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 entities fulfil 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 2017.

**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 2017/18 budget hearings, strategic plans and annual report;
* The National Development Plan;
* The 2017 Estimates of National Expenditure;
* The 2017 State of the Nation Address; and
* The Auditor-General Report.

**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 the
 Department for 2017/18.
* Section 5: Overview of service delivery and performance.
* Section 6: Key Committee Observations.
* Section 7: Key Committee recommendations.
1. **Overview of the key relevant policy focus areas**

**2.1** **State of the Nation Address** **2017**

In the State of the Nation Addresses of 9 February 2017, the President stated that “*Guided by the National Development Plan (NDP), we are building a South Africa that must be free from poverty, inequality and unemployment*.” He indicated that it is for this reason that it was decided to focus on a few key areas packaged as the Nine-Point Plan to reignite growth so that the economy can create the much-needed jobs. The focus areas include industrialisation, mining and beneficiation, agriculture and agro-processing, energy, small, medium and micro enterprises (SMMEs), managing workplace conflict, attracting investments, growing the oceans economy and tourism.

It is especially the **Tourism** issue that can be linked to the activities of the CCB. Government has identified tourism as a key job driver. “*We are thus pleased that our tourist arrival numbers for the period January to November 2016 increased to nine million, an increase of just over a million arrivals from 2015. This represents a 13% growth in tourist arrivals.”*

A related issue is the support for **SMME’s**. The SONA refers to government continuing to pursue policies that seek to broaden the participation of black people and SMMEs, including those owned by women and the youth, in the information and communications technology sector. The CCB with its procurement processes should prioritise local SMME’s where possible. The annual intake of especially youthful interns is also welcomed as it supports the drive to address youth unemployment.

**2.2 The National Development Plan**

Similar to the previous CCB APPs, the CCB envisaged contributions are highlighted such as:

* **Tourism:** 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. CCB 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 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 and 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 has a small resource centre which it plans to expand. It will establish a CCB Strategic Research capability, particularly to record, monitor and share the lessons of the multi-million rand renovations project.
* **Fraud and Corruption:** TheCCB will intensify its campaign in fighting fraud and corruption. 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. Note is also taken of its “*zero tolerance*” towards corruption and fraud.

Reference is also made to the ring-fenced R4.5 m annual subsidy as well as the CCB supporting economic objectives articulated in the National Development Plan (NDP). “*The site is already supporting 89 direct employment posts, another 300 temporary opportunities associated with events and runs a very successful internship and learnership programme offering opportunities to at least 30 youth annually.”*

**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 Outcome 3: All people in South Africa are and feel safe.** Since the Castle is associated with safety and security, the CCB has used this outcome to drive its operational plans to ensure the safety of staff and tourists to the Castle. Work will continue in this strategic area and all stakeholders are kept abreast of developments in this regard.

**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 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 Summary of Programme purpose and Output**

The CCB Annual Performance Plan gives effect to the mandate of the CCB which translates into the following purposes of the programmes with their programme outputs:

|  |  |  |
| --- | --- | --- |
| **S/no** | **Programme Purpose** | **Programme Outputs** |
| 1 | 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. This is in alignment with the National Regulatory Framework that guides the submission of SP, Annual Report, APP, and Quarterly Reports to the Executive Authority for tabling in Parliament. |
| 2 | Programme 2: Ensure themaintenance, preservation,interpretation and showcasing ofthe history of the CGH | Delivering of an increased number of innovative museum exhibitions and other displays accessible to the general public and tourists |
| 3 | Programme 3: Maximize thetourist potential of the CGH | Delivering of the CGH as an enhanced tourist attraction as indicated by increased visitor figures and revenue generated through tourism activities. |
| 4 | Programme 4: Increased publicprofile and positive perceptionacross all sectors of thecommunity | Delivering of a set of innovative public education, research internship and other programs aimed at increasing the CGH’s public profile and cultivate positive perception across all sectors of the community. |

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

**3.1 BRRR 2017 recommendations**

In 2017, the Committee made the following recommendations in its BRR Report on performance and financial matters:

* 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-page document and it was requested that this be shared with the Committee as soon as possible.
* 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 these.
* 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 of employees.
* 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 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.
* 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 Committee recommended that the CCB should not only manage the top five risks, but all risks attached to the CGH.
* 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.

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

No specific response was required from the Minister on the 2017 BRRR Recommendations.

**3.3 Committee 2017/18 Budget Report**

The Portfolio Committee made the following recommendations on the 2017/18 Budget Report of the CCB:

* 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.
1. **4. Overview and assessment of financial performance FOR 2017/18**

**4.1 Financial Performance for the 2017/18 Financial Year**

The CCB had an underspending of R85 000 for the FY 2017/18 against its underspending of R1 726 000 in the previous financial year. This is mainly due to the overspending of R118 000 and R24 000 in Programmes 1 and 2 respectively.

**Table 1: Budget for FY2017/18**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Programme | 2015/16**R’000 (***R thousand)* | 2016/17**R’000 (***R thousand)* | 2017/18**R’000 (***R thousand)* | (Over)/UnderExpenditure  |
|  | Budget | Actual Expenditure | Budget | Actual Expenditure | Budget | Actual Expenditure |  |
| Administration  | 5 091 | 5 658 | 6 637 | 8 010 | 7 683 | 7 565 | 118 |
| Conservation  | 1 950 | 282 | 369 | 260 | 528 | 570 | (42) |
| Tourism Promotion  | 130 | 10 | 41 | 30 | 63 | 39 | 24 |
| Public Access  | 330 | 1 476 | 1 167 | 1 640 | 264 | 279 | (15) |
| Total | **7 501** | **7 426** | **8 214** | **9 940** | **8 538** | **8 453** | **85** |

**Table 2: Revenue FY 2017/18**

|  |  |  |  |
| --- | --- | --- | --- |
| **Source of revenue** | **2015/16** | **2016/17** | **2017/18** |
| **Estimate** | **Amount collected** | **Estimate** | **Amount collected** | **Estimate** | **Amount collected** | **(Over)/under collection** |
| ***R’000*** |
| **Sales** | 3 730 | 2 942 | 4 000 | 2 295 | 4 500 | 4 124 | 376 |
| **Rental income** | 3 156 | 1 277 | 3 410 | 1 139 | 3 465 | 1 132 | 2 333 |
| **Other income** | 15 | 41 | 204 | 163 | 324 | 450 | (126) |
| **Interest income** | 600 | 646 | 600 | 397 | 249 | 117 | 132 |
| **TOTAL** | **7 501** | **4 905** | **8 214** | **3 994** | **8 538** | **5 823** | **2 715** |

Similar to the FY2016/17 comment, the CCB states that “*Sales income is in line with our estimates for the year. However, the provision made to compensate for the access to our historic surplus funds, skews this estimate thus painting a picture of under-performance.”*

The CCB Annual Report explains that the “Other income” was lower than expected because *“A new service provider to run the restaurant was appointed in October 2017 and hence revenue expected from the restaurant was lower than expected.”*

In terms of Revenue Collection, the Reports shows an increase of decrease of R911 000 where R4 905 000 was collected in 2015/16 and R3 994 000 was collected in 2016/17, against R5 823 000 for the year under review.

Similar to the FY2016/17 Annual Report, the CCB plans to address the revenue challenge through *inter alia* the roll-out of their Revenue Generation Strategy. They have opened a Gift Shop, started to promote the state-of-art Conference Centre to generate income, recruited a new restauranteur to improve turnover and will focus on high-yield events for the site. In the areas of administration, they will settle their human resource component.

**4.2 Quarterly spending for 2017/18**

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 Financial statements**

**Irregular expenditure**

No Irregular expenditure has been listed for the FY 2017/18 versus the R57 195 for FY2015/16 and FY2016/17 in R1.724 869.

**Unauthorised Expenditure and Fruitless and Wasteful Expenditure**

No unauthorised expenditure nor Fruitless and Wasteful Expenditurewere incurred during the year under review, nor in the previous financial year.

**4.4 Findings of the Auditor-General of South Africa**

The CCB received a **clean audit opinion** from the Auditor-General for FY2016/17 and for FY2017/18.

**4.4.1 Going Concern**

The A-G refers to “*Material uncertainty relating to going concern/ financial sustainability*” stating that he draws attention to this because the financial statements indicate that the entity incurred a net loss of R 2 630 141 during the year ended 31 March 2018. The entity’s current liabilities exceeded its current assets by R 236 296. These events or conditions, indicate that a material uncertainty exists that may cast significant doubt on the entity’s ability to continue as a going concern.

The CCB feels that it is economically viable and *“confident that the organisation will remain a going concern in the foreseeable future. Our basis for this assertion is the* ***time-tested formula*** *of reducing expenditure and increasing revenue to balance a relatively small annual budget of R7.85 million.”*

*“The Board is aware of financial challenges that have a negative impact on the CCB’s ability to continue as a going concern. However, the Board believes that the CCB has access to adequate financial resources, through the intervention of the Ministry of Defence, to continue operations for the foreseeable future and accordingly the annual financial statements have been prepared on a going concern basis.”*

***4.4.2* Emphasis of matter**

The AGSA lists an *Emphasis of matter* namely the Material losses /impairments – trade debtors. The A-G found that material losses of R 270 000 were incurred as a result of a write-off of irrecoverable trade debtors.

**5. OVERVIEW AND ASSESSMENT OF PROGRAMME PERFORMANCE**

**Non-financial performance**

The Annual Report 2017/18 indicates that three (3) of the CCB’s 18 key performance indicators were missed as opposed to one in the previous financial year. 15 of the 18 targets were met against a spending of 99%.

|  |  |
| --- | --- |
| Total targets set | 18 |
| Targets achieved | 15/18 |
| Targets not achieved  | 3/18 |
| Success rate | 83.33% |
| Total Budget Spent (%) | 99% (R8 453/R8 538) |

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

All four APP targets were met, against overspending of R118 000 versus R1 373 000 on this programme in the previous financial year. All four KPI-targets dealing with the operations of the Board, Board sub-committees and general administration, were met. The Board reviewed and approved ICT policies.

|  |  |
| --- | --- |
| Programme 1 targets  | 4 |
| Targets achieved | 4/4 |
| Targets not achieved  | 0/4 |
| Success rate | 100% |
| Programme Budget Spent (%) | 98.46% (R7 565/R7 683) |

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

One of the targets was missed namely “*Annual increase in the number of tangible heritage projects implemented at the CGH*” against overspending of R42 00 versus an underspending of R109 000 in the previous financial year.

|  |  |
| --- | --- |
| Programme 2 targets  | 4 |
| Targets achieved | 3/4 |
| Targets not achieved  | 1/4 |
| Success rate | 75% |
| Programme Budget Spent (%) | 107.95% (R570 000/R528 000) |

***5.3 Programme 3: Maximising the Tourist Potential***

Five of the six APP targets were met, a success rate of 83.33 %, against underspending of R24 000 versus an underspending of R11 000 in the previous financial year.

|  |  |
| --- | --- |
| Programme 3 targets  | 6 |
| Targets achieved | 5/6 |
| Targets not achieved  | 1/6 |
| Success rate | 83.33% |
| Programme Budget Spent (%) | 61.9% (R39 000/R63 000) |

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

One of the targets was missed namely “*Number of student learnerships and internships offered per annum”* against overspending of R 15 000 (R42 00 in FY 2016/17).

|  |  |
| --- | --- |
| Programme 4 targets  | 4 |
| Targets achieved | 3/4 |
| Targets not achieved  | 1/4 |
| Success rate | 75% |
| Programme Budget Spent (%) | 105.68% (R279 000/R264 000) |

**6. GOVERNANCE**

The Annual Report refers to various issues under this section, *inter alia* its engagements with the Portfolio Committee, that it operates as a Schedule 3A Public Entity, and it states that a Risk Register has been developed to determine the effectiveness of its risk management strategy and to identify new and emerging risks.

**6.1 Risk Management**

The Annual Report 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.”*

The strategic risks identified include:

* Managing negative perceptions caused by hitherto unfounded claims of corporate infringements against the CCB and the winding down of the Castle Military Museum Foundation;
* The glaring shortcomings and contradictions in the Castle Control Board’s founding Act through an urgent and thorough legislative review;
* The institutional and governance arrangements of the Castle Control Board *inter alia* the composition of its Board, the signing of a shareholder’s agreement with the Ministry and the activating of the partnerships with other government departments.
* Marketing and promoting the Castle of Good Hope not only as a heritage-educational site but also as a highly sought-after venue open for tourism, conference and events business whilst ensuring that these two elements are well-balanced;
* The safety and security concerns of staff and visitors to the Castle; and
* Finalising the space-allocation, utilisation and sustainability of the Castle Control Board.

**6.2 Fraud and corruption**

As in the previous Annual Report, CCB states that it does not have an anti-criminality plan but has a fully-fledged Fraud 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.

**7. HUMAN RESOURCES**

The CCB has a team of 16 full time CCB remunerated staff members. 3 museum artists paid by the DOD, 26 short term staff (interns) and 12 casuals, bringing the staff complement to 57, while the CCB indicates that they had 54 staff members for the FY2017/18.

The total expenditure for employees is R5 797 000 (R5 939 000 in FY2016/17) of the Castle’s total expenditure of R8 453 000 (R9 939 000 in FY 2016/17) which represents a 68.57% (54 % in FY2016/17) of personnel expenditure as a percentage of total expenditure.

**7.1 Performance rewards**

Provisionis being made for performance rewards of R386 553 (R368 935 in FY2016/17). These are for three employee categories composed of R169 000 (R161 000 FY 2016/17) (Top management), R209 000 (R179 000 FY 2016/17) (Senior Management) and R9 000 (R21 000 FY 2016/17) (professional qualified), although these are indicated as provisional amounts.

*“Performance Bonuses accrue to senior managers and have been provided for at a maximum allowable amount according to the employment contracts and performance contracts of those individuals who may qualify or be considered for a bonus. The actual amount payable cannot be determined until performance evaluation processes have been duly completed by the Board. Any bonus that may be or become payable would ordinarily be paid within the next 12 months.”*

**Table 3: Remuneration of key management**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2016** | **2017** | **2018** |
| **CEO: Remuneration** | 825 869 | 903 476 | 985 920 |
| **CEO:**  Performance Bonus | 165 174 | 90 347 | 98 592 |
| **CFO: Remuneration** | 644 636 | 705 246 | 794 127 |
| **CFO:**  Performance Bonus | 128 927 | 70 524 | 79 413 |

**Table 4: Performance rewards**

|  |  |  |  |
| --- | --- | --- | --- |
| **Employment category** | **Performance reward (R’000)** | **Personnel expenditure (R’000)** | **% performance reward to total personnel cost** |
| **Top Management**  | R169 | R1 896 | 8.9 (3.0% FY 2016/17) |
| **Senior Management**  | R209 | R1 179 | 17.7% (3.3% FY 2016/17 |
| **Professionally qualified**  | R9 | R532 | 1.7% (0.4% FY 2016/17 |
| **TOTAL** | **R387** | **R3 607** | **10.7 (6.7%** FY 2016/17) |

**7.2 Employee related costs**

The Report indicates that the cost related to employees for FY 2017/18 was R5 796 662 as opposed to R5 393 000 for FY 2016/17 and 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 OBSERVATIONS: CASTLE CONTROL BOARD**

The following Observation were made regarding the CCB:

1. The Auditor-General and the Committee have expressed concern about the viability of the CCB as a *Going concern* for various reasons including that the entity incurred a net loss of R 2 630 141, and that its current liabilities exceeded its current assets by R 236 296, in the year under review. The Committee further noted with concern the intention to request “*direct funding grant from National Treasury*.”
2. The Committee enquired about the progress made with the security and safety aspects of both visitors and staff at the CGH, given that this has been raised as a strategic risk over the last three years.
3. The Committee, as in the previous financial year, observed the amounts provisionally allocated as performance rewards for especially the CEO and the CFO. It reiterated that it was not against the awarding of performance rewards, but wanted to know the amounts paid to the CEO and CFO in the three preceding financial years.
4. Given that the A-G found that material losses of R 270 000 were incurred as a result of a write-off of irrecoverable trade debtors, the Committee requested more information on this issue, especially since R220 000 of the amount, was due to a transaction with the Department of Military Veterans.
5. The Committee observed that the winding down of the Castle Military Museum Foundation was listed as a strategic risk and required more information on this issue.
6. The ring-fenced R4.5 million “subsidy” from the Department of Defence for emergency, preventative and general maintenance and repairs at the CGH to the CCB was received for the first time in the year under review and the Committee requested more information in this regard.
7. The Committee observed the numerous number of heritage events, events and film shoots and exhibitions at the CGH and wanted to know the criteria for utilising the facility for these purposes.
8. The listing of the “*signing of a shareholder’s agreement with the Ministry and the activating of the partnerships with other government departments*” was listed as a strategic risk and the Committee wanted this clarified.
9. As with the 2016/17 Budgetary Review and Recommendation Report and the 2017/18 Budget Report, the Committee observed that the much-vaunted Revenue Optimisation Strategy is not delivering the revenue projected and questioned the projections and viability of the Revenue Optimisation Strategy.
10. The Committee requested more information on the Strategic risk related to “*negative perceptions caused by hitherto unfounded claims of corporate infringements against the CCB*.”
11. One of the most pressing issues observed by the Committee - in addition to the poor return of the Revenue Optimisation Strategy and the concerns regarding the *Going Concern*– was the high cost of employees. The total expenditure for employees was R5 797 000 versus the Revenue collected of R5 823 000 and which represents 68.57% of the total expenditure of R8 453 000. The Committee requires more information on this issue and especially how the CCB plan to address it.

**7. COMMITTEE Recommendations**

The Committee made the following Recommendations regarding the CCB:

1. Although the CCB indicated that they have a remedial plan to address the *Going Concern* issues, the Committee recommended that the CCB should further enhance its efforts to raise the revenue levels and to depend less on external sources of funding such as a the R4.5m subsidy, utilisation of the historic surplus, and the mooted possibility of a direct funding grant from National Treasury. The Committee further recommended that it should be consulted before a request for a direct funding grant from National Treasury, is submitted.
2. The Committee commended the CCB for the progress made with ensuring that the CGH is safer and more secure for staff and visitors but stressed that these efforts should be sustained to prevent negative publicity in this regard.
3. The CCB indicated that given the dire financial status of the CCB for the year under review, it is unlikely that performance rewards will be paid. The Committee stressed that in future, the CCB should indicate the amounts paid out for the preceding financial years in order to establish what transpired in this regard. Specifically, the CCB should provide the Committee with the amounts for the performance rewards for the three preceding years the 2017/18 financial year.
4. The CCB explained that the amount of R220 000 incurred as irrecoverable related the cancelation of a training and refurbishment project that DMV wanted to recover as the amount they paid to the service provider through the CCB. The Committee expressed its concern regarding the transaction and implored the CCB to ensure that such transactions are managed in terms of acceptable accounting procedures and that the Auditor-General’s approval is sourced.
5. The CCB indicated that the Castle Military Museum Foundation was a private institution and that its closure will not have any impact on the Castle. The Committee requested that the CCB kept it informed about developments in this regard to ensure that this remain the case.
6. The ring-fenced R4.5 m annual “subsidy” is to be managed by the Chief of Logistics of the SANDF through the General Support Base (GSB) in Simonstown and the CCB will not have direct access to it. The Committee encouraged the CCB to ensure that the subsidy is indeed utilised for this purpose to facilitate the sustainability and good condition of the CGH after more than R100 million has been spent on renovating it.
7. The CCB indicated that hiring of the facility is done through a deposit and that the amount is determined by the kind of activity, the number of people expected, that cancelation fees are required when applicable, and that damages are compensated for when incurred. The Committee recommended that such the renting out of the facility should be strictly and properly recorded in order to ensure that the CCB gets the full amount due to it. The Committee also recommended that the CCB should target "upper market clientele” to further enhance the image of the CGH as a destination for events and functions around Cape Town.
8. The CCB indicated that the signing of a shareholder’s agreement with the Ministry would provide the CCB with a legal basis to engage other government departments, as their legal basis for doing so, can currently be queried. The Committee wants the CCB to keep it abreast of developments in this regard and should challenges be encountered, the Committee is willing to assist.
9. The CCB indicated that there is an improvement in the revenue generated, but the Committee recommended that serious and urgent attention be paid to this strategy given that the financial sustainability of the CGH is being doubted. The Committee also wants the CCB to submit its revenue projections, regarding the ticket sales, functions, Iziko’s share of ticket sales, centres, etc, to the Committee as a matter of urgency.
10. Given that the Minister launched an investigation into the claims of corporate infringements against the CCB, the Committee recommends that the Minister shares the Report with the Committee, as soon as it has been completed.
11. The CCB stated that it will seriously engage with the cost of employees and gave the Committee the assurance that the Human Resources component has now been settled. The Committee recommended to the CCB that it should explore additional avenues for revenue collection and that current revenue streams should be further exploited to address their dire financial situation. The Committee will monitor the CCB closely in this regard.

**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/corporate 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 any oversight visits to Armscor or related facilities in 2017/18.

**1.6 Information used to compile the Report**

Information used in the assessment of the service delivery and financial performance includes the following:

* Committee reports on the 2017/18 budget hearings, strategic/corporate plans and annual report;
* The National Development Plan;
* The 2017 Estimates of National Expenditure;
* The 2017 Budget Speech of the Minister of Finance;
* The 2017 State of the Nation address; and
* The Auditor-General Report on Armscor

**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(2016/17).
* Section 4: Provides a broad overview and assessment of financial performance of the Department for 2017/18.
* Section 5: Overview of 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 9 February 2017, the President noted several aspects that relates directly and indirectly to Armscor, including the following:

* **Armscor Dockyard:** The President noted the role of the SA Navy in Operation Phakisa, aimed at growing the Oceans Economy from an estimated Gross Domestic Product (GDP) contribution of R54 billion in 2010 to R129.177 billion by 2033. The President specifically noted the SA Navy/ARMSCOR/Denel partnership at the Simon’s Town Dockyard which will be responsible for the maintenance and repair of all government-owned vessels
* **The Armscor Alkantpan facility.** The Square Kilometre Array (SKA) project in the Northern Cape was noted for continuing to make important contributions to socio-economic development in South Africa. It was stated previously that Armscor’s Alkantpan facility falls within the radio-frequency field of this project and may impact thereupon. As such, an agreement between Armscor and the SKA is urgently required.
* **Broad-based Black Economic Empowerment.** The furthering of Broad-based Black Economic Empowerment and Small, Medium and Micro-Sized Enterprises (SMME) was noted as crucial by the President. This relates to a large extent to local procurement. With regards to local procurement, it is crucial that both the SANDF and Armscor, which is responsible for the acquisition of defence materiel for the SANDF, adhere to this requirement.

**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 continues to play 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 this regard, Armscor set itself the target to ‘Support Industry on development of SMMEs by reviewing RFO and Conditions of Contracts to include ESD requirement as prescribed in the Defence Sector Charter.’ Armscor achieved its target in this regard.

In addition, Armscor aimed to focus on the following NDP aspects:

* Sharpening South Africa’s innovative edge by continuing its contribution to global scientific and technological advancement;
* Implementing greater investment in Research and Development (R&D) and better use of existing resources;
* Facilitating innovation and enhanced co-operation between public service, technology institutions and the private sector in areas of potential dual use (military and civilian application); and
* Committing to procurement approaches that stimulate domestic industry and job creation.

**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 2017/18, Armscor contributed to the following MTSF outcomes:

***Outcome 4: Decent employment through inclusive economic growth.***Armscor continued to employ 1 463 members during 2017/18, which is a decrease from the 1 502 members during the previous financial year. The corporation also granted Defence Industrial Participation (DIP) credits to the value of R157 million during 2017/18 financial year. This is from the 14 existing DIP agreements that Armscor is managed during the year under review. A major concern remains the need to finalise the MDBA DIP agreement that is yet to be offset and stems from the 1999 Strategic Arms Procurement Package.

***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 continued to provide experience to young engineers and scientists.

Armscor runs a highly successful Research and Development programme which includes, *inter alia*, the Gerotek test facilities, projects in Armour development, Protechnik Laboratories, Ergonomics technologies, Hazmat protective systems and the institute for Maritime Technology. Technology funding for 2015/16 totalled R775 million and for 2017/18 it increased to R854 million.

**2.4 Strategic Objectives**

The period under review experienced a further drive towards transformation of Armscor at a strategic level. The turnaround implementation phase introduced the following:

* A new Armscor Vision
* The adoption of four Strategic Objectives
* A new Organisational Structure, which aimed to reduce the Executive Committee, group functions together and the establishment of a Business Enablement Unit, Supply Chain Management department and Enterprise Project Management Office.

Based on the review above, Armscor revised the Strategic Objectives to align them to Armscor’s strategy with a focus on building a self-sustaining business, which includes:

* Revenue Generation
* Cost Management
* Efficient and Effective Delivery
* Stakeholder Management

**2.5 Overview of Armscor’s Corporate Plan for 2017/18**

The Corporate Plan 2017 highlights the main focus areas as outlined in its Strategic Plan. It aims to:

* Organisational transformation for efficiency and effectiveness of the turnaround strategy
* Business development and commercialisation for financial sustainability, support of national objectives and support of industry.
* National, continental, global growth and expansion of Armscor services in support of its mandate.

The key focus areas should be seen in the context of the Turnaround Strategy and subsequently developed turnaround objectives, including organisational transformation, establishing an efficient and relevant organisation as well as the development of business and commercialisation.

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

**3.1. 2017 BRRR 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.

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

No responses were made with regard to Armscor by the Minister of Finance in response to the 2017 BRRR recommendations.

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

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

The total comprehensive income of the Group increased from a loss of R126.9 million in 2016/17 to reflect a profit of R1.7 million in 2017/18. Revenue generated increased significantly from R1 399 million in 2016/17 to R1 668 million in 2017/18. However, this increase should be seen in context as it is largely due to an increased state allocation. The state allocation increased from R860 million in 2016/17 to R1 057 million in 2017/18. Nonetheless, Armscor did increase its sale of goods and services from R403 million in 2016/17 to R467 million in 2017/18. Other income also increased by R9.5 million.

Group reserves increased from R1 998 million to R2 000 million mainly as a result of the surplus during the year.

The following additional financial matters should be noted:

* Payment to employees as salaries and wages increased from R995.2 million in 2016/17 to R1 118 million in 2017/18. This translates to a 21.3 per cent increase in costs paid to employees.
* Compensation for executive directors increased from R6.295 million in 2016/17 to R7.124 million in 2017/18. This translates to a 13 per cent increase in income. (Executive income was R4.994 million in 2015/16)

**Irregular expenditure**

Irregular expenditure of R12.3 million (R9.7 million in 2016/17) was incurred during the year under review. Of this total, R11.2 million was incurred during the year as a result of procurement that occurred without following the competitive bidding process. R8.0 million (R4.7 million in 2016/17) 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 DOD. R2.0 million (R2.2 million in 2016/17) incurred related to non-competitive contracts awarded and R1,2 million was treated as single source procurement without the required approval. In line with internal disciplinary processes, responsible officials were given verbal warnings as a consequence of related irregular expenditure.

**Fruitless and wasteful expenditure**

Expenditure amounting to R4.1 million (R3 million in 2016/17) was incurred during the year, and is deemed to be fruitless and wasteful. The expenditure was as a result of penalties charged for late deliveries in terms of contracts (R1,2 million) and R2,9 million expenditure with no corresponding benefit to the organisation.

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

**Unqualified Audit**

The external audit concluded by the office of the Auditor- General of South Africa (AGSA) resulted in an unqualified audit opinion. The finding noted by the AGSA relates to Expenditure Management. Effective steps were not taken to prevent irregular expenditure of R12.321 million disclosed. In terms of Financial Management, the AGSA noted that Management detected current year irregular expenditure; however, the review and monitoring processes were not sufficient to prevent these instances of irregular expenditure.

**5. OVERVIEW AND ASSESSMENT OF PERFORMANCE**

This section will provide an overview of achievements in the key focus areas of Armscor for 2017/18, 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 2017/18 financial year, Armscor undertook acquisition activities to the value of R6.564 billion of which only R21.2 million was for entities other than defence.

 **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. The DIP Policy was revised in October 2015. In 2017/18, Armscor continued to manage 14 such agreements, which is higher than the 12 managed in 2016/17. The value of DIP credits being managed remained similar to the previous financial year and comes to a total of R22.571 million. Of this, only R7.276 million relates to the 14 current ongoing DIP agreements in the defence domain.

One DIP agreement related to the 1999 Strategic Defence Procurement remains under the management of Armscor. This refers to an agreement with MBDA (a European based missile developer and manufacturer). The outstanding obligation in this regard equates to R933 million. The 2015/16 Annual Report indicated that the DIP agreement will be extended to 2019 to allow for the identification of new projects to offset the DIP. The 2017/18 Annual Report notes the same extension, thus raising a question whether any progress was made in this regard.

**Research and Development**

The Annual Report indicates that Armscor managed to earn 27 per cent of the total portfolio of R493.7 million from commercial contracts while the rest is attributed to contracts from the DOD in 2017/18. This is a decline compared to 2016/17 when Armscor earned 34 per cent of the total portfolio of R541.3 million from commercial contracts. The 2017/18 Annual Report further notes that Armscor is exploring the possibility of business partnering under the Turnaround Strategy to ensure the sustainability and effective management of Research and Development. The bulk of such services took place at Research and Development Facilities such as the *Gerotek and Alkantpan* test facilities as well as *Hazmat protective systems.*

*Alkantpan* is a munitions test range in the Northern Cape Province and attracts a number of international clients. Several international clients from, *inter alia*, Singapore and Germany conducted tests at the facility in 2017/18. The 2017/18 Annual Report does not indicate the exact income from sales at Alkantpan. In 2016/17, R86.2 million was generated by Alkantpan. The Alkantpan facility has also signed an agreement with the Square Kilometre Array (SKA) to ensure the viability of both facilities in the same geographic area.

*Hazmat* produces respiratory equipment for military and commercial purposes. The subsidiary managed to achieve a positive net income through the implementation of a conscious cost saving effort. This is considered an achievement considering the current economic climate. Hazmat is a self-sufficient entity that can serve the needs of all its major clients. The income generated from Hazmat’s activities is not reflected in the Annual Report. In 2016/17, R14.6 million in sales was derived from commercial initiatives.

Other defence science technology institutes that receive the bulk of their funding from the DOD include:

* *Armour Development*: Conducting of defensive and reactive armour development. Funded by the Research and Development Board. In 2017/18, all tests were completed and a new three-year quotation submitted for the development of armour Protection Technology.
* *Protechnik laboratories*: Focus on chemical and biological defence. Previously the Armscor Annual Reports indicated the laboratory’s achievement against its research/development services to the DOD and private sector. This breakdown was not provided in the 2017/18 Annual Report.
* *Ergonomics technologies*: Focus on integrating ergonomics into the SANDF. The 2016/17 Annual Report notes, among others that the institution assist with the selection of SA Air Force flight crews.
* *Institute for Maritime Technology*: Provision of techno-military expertise to support naval decision-making. In 2016/17, sales increased to R94.2 million and required funding from the DOD also decreased from 93 per cent to 86.7 per cent. This information was not provided in the 2017/18 Annual Report. One of the major projects that the Institute is working on is the Ultrasonic Broken Rail Detector, which has significant commercial potential. It is indicated that a commercial product is to be available by the end of 2018/19.
* *Defence division support institute*: Provision of decision support to the DOD.
* *Flamengro*: Computer aided engineering centre of excellence.

**The Dockyard**

The Armscor Dockyard serves as the primary maintenance supplier to the SA Navy. As was noted in a number of previous years, the Dockyard is facing significant concerns. As such, a decision was previously taken to change the management of the dockyard. Subsequently, the Minister of Defence called for a “harmonious approach” to management comprising Armscor, Denel and the SA Navy. However, the 2017/18 Annual Report notes that the “transfer of the Dockyard from Armscor to Denel was governed by the transfer agreement. These agreements contain suspensive conditions, which Denel had to fulfil by the 28 February 2018. The Minister of Defence and Military Veterans took account of the fact that Denel had not met the suspensive conditions for the transfer of the Dockyard to it, despite previous extensions. Thus, the Honourable Minister correctly concluded that the Dockyard Transfer Agreement had lapsed.” The CEO of Armscor further notes in the Annual Report that “the Dockyard will continue to explore a variety of collaborative measures with the private sector to reduce the Dockyard deficit and enhance the ongoing sustainability of the Dockyard.

In 2017/18, repair and maintenance were done on a number of SA Navy vessels. Armscor submitted Financial Authority requests for materials/spares and casual labour (fixed-term contractors) to the SA Navy for 2017/18. R18.497 million was approved and a total of R17.542 was paid equating to a 94.48 per cent spent.

**5.2 Performance against set targets**

Armscor performed relatively well when performance against set targets are measured. A total of 53 Key Performance Indicators (goals) were set for 2017/18. Armscor managed to achieve 39 of these, which is a success rate of 73.58 per cent. This is, however, a decrease in performance when compared to 2016/17. 14 Targets were either not achieved, partially achieved or no opportunity to perform presented itself.

The KPIs not achieved include the following as per Table 1:

**Table: Selected Key Performance Indicators not achieved during 2017/18**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Objective**  | **KPI** | **Goal** | **Achievement** | **Comments** |
| **Procurement** | 90 days for standard procurement  | 90 days | 101 days | This reflects a regression from the achievement of 93 days in 2016/17 |
| **Procurement** | 60 days for commercial off-the-shelf items | 60 days | 114 | Significant regression from 60 days achieved in 2016/17 |
| **Defence Industrial Participation (DIP)** | Value of DIP credits to be granted | R235.6 million | R157 million | Delays in project Hoefyster, the A-Darter system and other contracts |
| **Generate additional income** | Earn a fee based income from brokering deals | R34 million | R23.8 million | No comment |
| **New business initiative** | Sweating of DOD Assets | 31 March 2018 | No opportunity to perform | DOD strategy still to be developed |
| **Transformation** | Improving gender composition | 37% Female employees | 36.34% Female employees | No comment |
| **Employee satisfaction** | Employee satisfaction | 1% improvement | 0.74% decline | No comment |
| **Infrastructure renewal** | Completion of implementation of finance model | 31 March 2018 | Not achieved | Most of the development work on Finance module was mainly on the Acquisition Purchases |
| **Infrastructure renewal** | Developing HR Modules | 31 March 2018 | Not achieved | The development of all nine submodules for HR & Payroll module had only progressed to just over 50%. |
| **Infrastructure renewal** | Investigate and implement e-procurement for identified Commercial and Military off the Shelf procurement | 31 March 2018 Implementationof selected e-procurement process | New target date:March 2020 | This solution has a dependency on the Supply-Chain Management module |
| **Acquisition excellence** | Engage with DOD to influence better alignment of capital projects | Finalisation of Through Life Capability Management acquisition policy | Project on Hold | DOD placed project on hold |
| **Military Veterans Support** | Submit application for set asides for Military Veterans with National Treasury. | 31 March 2018 | No longer required | Due to the change of legal requirements (as the Preferential Procurement Regulations gazetted in January 2017 provide for Military Veterans) this objective is not pursued anymore. |

## 5.3 Personnel information

The 2017/18 Annual Report indicates that Armscor, including the Armscor Dockyard, has a staff complement of 1 463, which is lower than the 2016/17 figure of 1 502. In terms of representation, a target was set to increase black employees from 66 to 68 per cent and performance of 77.32 per cent was already achieved in 2016/17. This increased further to 78.61 per cent in 2017/18. Female employees now comprise 35.27 per cent of Armscor.

Armscor should also be lauded for identifying capability retention and succession planning as key focus areas. As such, in 2017/18, at least 46 key position were identified as well as 74 potential successors. This translates to an 83.69 per cent compliance with the development plan as contracted with successors.

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

* International Training Programmes. Three employees completed their studies at the Naval Post Graduate School in the USA in engineering. Four employees are registered for Masters in Science: Military Aerospace and Airworthiness. Two employees commenced with studies for the Advanced Masters in Unmanned Aircraft Systems Management programme.
* Talent Development Programme. In 2016/17, 35 candidates were included in this graduate training programme. In 2017/18, 44 talent development candidates went through the programme.
* Bursaries. A total of 36 Bursaries were made available to undergraduate students at various universities. Although the target of 33 bursaries was exceeded, it is a major reduction from the 116 bursaries afforded in 2016/17.
* Dockyard training. The Dockyard provided training to 92 apprentices. Of these, three have qualified as artisans, 40 are preparing for their trade tests and 48 are continuing with the theoretical foundation training.

**6. COMMITTEE KEY FINDINGS: ARMSCOR**

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

* The Committee noted the increase in spending on compensation of employees despite the actual number of employees having been reduced. While appreciate of the importance of human capital to Armscor, such expenditure should be carefully controlled amid existing financial constraints.
* The Committee noted with concern the slow pace of the sweating of assets for the DOD. While a SLA has been established between Armscor and the DOD, no properties have been transferred to Armscor for capitalisation.
* Armscor received an unqualified audit, which represents regressions from its clean audit opinion in 2016/17.
* The Committee welcomes the finalisation of negotiations with the Square Kilometre Array (SKA) project in the Northern Cape to ensure a mutually beneficial existence with Armscor’s Alkantpan facility.
* Irregular expenditure of R12.3 million and fruitless and wasteful expenditure of R4.1 million is of an ongoing concern for the Committee.
* The renewal plan for the Armscor Dockyard is welcomed. The Committee appreciated the fact that the SA Navy remains the primary client of the Dockyard as a strategic national asset. It is further appreciated that ventures are sought to exploit the potential commercial value of the Dockyard.
* Concern was raised regarding the outstanding DIP agreement with the MBDA. A recent programme related to maintaining the missiles for the SA Navy was identified as a possible offset for the agreement. However, due to concerns at Denel this may not take place. As such, a final agreement for offsetting the DIP agreement is still expected.
* The Committee expressed its concern regarding the impact of operational concerns at Denel on the work of Armscor and acquisition for the SANDF. Of particular concern is the fact that it was noted that the acquisition of new Infantry Fighting Vehicles for the SA Army under Project Hoefyster is already delayed by 32 months and further substantial delays can now be expected.
* The Committee welcomed the ongoing efforts to exploit local Intellectual Property as a means of generating revenue. Of particular interest is ongoing work to see the full commercialisation of the Ultrasonic Broken Rail Detector System as well as the Shark Repellent System.
* The final contracting for Projects Hotel and Biro are welcomed and Armscor is encouraged to see that the delivery of vessels under these projects transpire on time and within budget.
* The Committee raised a concern regarding the increases in remuneration for both executive and non-executive directors at Armscor. This is of concern given that, amid decreased defence spending in South Africa, Armscor has less opportunity to fulfill its primary acquisition function.
* The Committee is concerned about the high rate of Irregular as well as Fruitless and Wasteful expenditure and identifies these as areas where urgent turnaround is necessary. As such, the internal audit and control capabilities should be strengthened.

**7. COMMITTEE Recommendations**

The PCODMV makes the following recommendations with regards to Armscor:

* Armscor and the DOD should provide the Committee with a joint written report on its plans to sweat some of the DOD assets within the remainder of 2018/19 and 2019/20. This plan should include details of the types of assets to be sweated and the potential income that can be generated for Armscor and the DOD, respectively. The report should include a copy of the SLA between the DOD and Armscor regarding the sweating of assets. The written report should be submitted to Parliament no later than 20 November 2018.
* Armscor should aim to return to a clean audit in 2018/19 and put measures in place to ensure that this transpires.
* The Committee welcomes the renewal plan for the Armscor Dockyard, noting that this plan is being implemented. With the view of tracking such implementation, the Dockyard should submit a written report to the Committee on (1) a high-level overview of its plans to bring about stabilisation, and (2) plans to attract private partnership and/or commercialisation opportunities. This report should be submitted to Parliament no later than 30 January 2019.
* Operational concerns at Denel and the impact thereof on Armscor is of major concern to the Committee. Armscor is therefore encouraged to develop means of limiting the impact thereof on revenue generation and contracting. Armscor should submit a written report to the Committee on the main challenges it faces regarding Denel, what mitigating plans are being put in place and whether the transfer of Denel to the Defence portfolio is still being considered. The report should be submitted no later than 20 November 2018.
* Armscor is to submit a written report to the Committee on the status of Project Hoefyster. The report should be submitted to Parliament no later than 20 November 2018 and should include, *inter alia,* information on (1) the original contracting costs for the project (2) the original number of platforms ordered, (3) the originally envisaged development and delivery dates, (4) revised delivery dates, and (5) revised costing for the project. The report should further indicate whether, despite major delays, the levels of technology would still adhere to the requirements of the DOD for its Infantry Fighting Vehicles.
* Armscor is encouraged to ensure that Projects Hotel and Biro are delivered on time and within the agreed budget. Armscor should submit bi-annual reports on progress with these two projects to the Committee. The first report should be submitted by 31 March 2019. These details should also be reported in the Annual Reports of Armscor.
* Armscor should, in future Annual Reports, include the figures of profits/losses of its Research and Development facilities.
* Armscor is encouraged to speed up the commercialisation of the Ultrasonic Broken Rail Detector System, the Shark Repellent System and other potential Intellectual Property products.
* Armscor should provide a detailed report on increases for executive and non-executive directors from 2015/16 to 2017/18. The report should justify and explain the logic behind these increases given that Armscor cannot fully fulfil its acquisition role amid limited defence spending. This report should be submitted no later than 5 November 2018.
* Irregular and fruitless and wasteful expenditure are major concerns to the Committee. A detailed breakdown of such expenditure should be submitted to the PCODMV no later than 5 November 2018. The report should also include an overview of the internal audit capability at Armscor.

**Report to be considered.**