



PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

COMMITTEES

PO Box 15 Cape Town 8000 Republic of South Africa
Tel: 27 (21) 403 2597 Fax: 27 (21) 403 3205
www.parliament.gov.za

The Portfolio Committee on Defence, having conducted departmental briefings on the 2006/2007 Annual Reports of the Department of Defence and Armaments Corporation of South Africa, Limited (Armcor), reports as follows:

1. INTRODUCTION

The Portfolio Committee on Defence conducted departmental briefings on the 2006/2007 Annual Reports of both the Department of Defence and Armcor on 16 and 30 October 2007, respectively.

As per the specifications of the Public Finance Management Act (PFMA), the accounting officer of a department must table in the National Assembly or provincial legislature an annual report of a Department or public entity with both the financial statements and an accompanying audit report within six months after the end of the financial year. The aim of the Annual Report is thus to provide feedback regarding the achievements of specific measurable objectives per programme as contained in the Estimates of National Expenditure (ENE) 2006 and the 2006/2007 Strategic Business Plan.

The Committee report is based on the presentations provided by the Department and Armcor, the 2006/2007 Strategic Business Plan, 2006/2007 Annual Report, and the 2006 Estimates of National Expenditure.

2. DEPARTMENT OF DEFENCE: 2006/2007 Annual Report

2.1 Briefing by the Department of Defence on 2006/2007 Annual Report:

Secretary of Defence, Mr January Masilela, presented the 2006/2007 Annual Report and provided an overview of the programme performance for the period under review. Detailed responses written questions forwarded to the Department before the briefing is provided in appendix 1.

2.1.1 Programme 1 : Defence Administration:

For the financial year under review, the Department aimed to finalise the Update on the White Paper on Defence and Defence Review; improve its capacity management capability; human resource planning and the provision of an accounting service to comply with reporting regulations and standards. The improvement of the process for authorisations of Acquisitions and the installation of modern based bidding/pricing quotation system for all procurements services were also planned. The main risks identified included the servicing of the defence-related Memoranda of Understanding (MOU) between South Africa and other countries as well as the IT based internal control systems.

The Department reported a delay in the implementation of the Internal Financial Management System (IFMS) which impacted on the integration of departmental systems. However, the Balanced Scorecard as a performance management tool had been implemented at the upper structures, command and management bodies. An integrated resource division had been established while the review of the Human Resource Strategy 2010 had begun. Challenges to improved human resource capability included the retention of operational and technical skills as well as the limited impact of the military exit mechanism at lower levels. The Department also faces increased demands from other government departments, especially the Department of Foreign Affairs.

The Minister of Defence provided strategic direction to the finalisation of the White Paper on Defence and Defence Review, while the Memorandum of Understanding provided strategic direction to the transformation of the Defence Industry in conjunction with the Minister of Public Enterprises. While guidelines received from the Minister of Defence had been translated into clear departmental deliverables, the funding priorities of the DoD had also been interrogated and optimised. The latter was presented to National Treasury for consideration.

In response to concerns raised by members regarding the delays in the implementation of IFMS, the Department answered that it was part of an adjudicating team that focused on the application development toolset tender, as well as the definition and contracting of procurement application. The user requirement statement for the asset management solution is also currently being finalised.

2.1.2 Programme 2: Force Employment

Strategically, the Department planned to suspend or scale-down services such as routine internal deployments to strengthen its participation in continental joint or multi-national peace-keeping operations in the Democratic Republic of Congo, Burundi, Ivory Coast, Ethiopia, Eritrea, Sudan and the Comoros to mitigate capacity and funding limitations. It also planned to provide support services to other Departments.

In the period under review, the SANDF has gradually disengaged from ordered commitments in support of the Department of Safety and Security. More than 6000 SANDF members participated in 14 external and two internal operations, while also successfully participating in five joint and nine multinational exercises. However, limited available funding remains a key challenge and this constrained the capabilities required for Peace Support Operations.

The Committee expressed concern over the impact of the immediate withdrawal of SANDF has on border control and requested further elaboration on the hand-over process to the South African Police Service. It was stated that the reasons for the SANDF's decision to withdraw from borders and the nature of the agreement between SAPS and SANDF needed to be clarified, given the problems experienced in the hand-over process.

The Department explained that the South African Police Service (SAPS) is responsible for the actual patrolling of border posts, while the SANDF lends assistance to "overstressed" borders. SANDF and SAPS co-operate on matters relating to cross-border illegal activities. Since the SAPS is not structured to take-over border patrol functions from the SANDF, problems have been encountered. The decision to withdraw from internal border control was envisaged in the White Paper and Defence Review. The SANDF is responsible for the territorial integrity and should not be involved internal operations. It can only do so when territorial integrity is compromised. An interministerial security committee has begun to address certain practical challenges relating to the hand-over of border control between the SANDF and SAPS. This includes the readiness of the SANDF to pull-out of the borders. These are serious problems, and the plans have not yet been subjected to critical scrutiny.

2.1.3 Programme 3: Landward Defence

The rejuvenation of this programme through the improved implementation of MSDS and Mobility Exit Mechanism was a key strategic objective. The continued closure of Area territorial units and the maintenance of capabilities at minimum levels would mitigate budget constraints.

While a gradual increase in the intake of MSDS troops between 2005 and 2006 were reported, the deteriorating facilities and non-compliance with the Occupational health and Safety regulations impacted negatively on the planned MSDS intakes. The Department reported a R3.989 billion expenditure of the R3.99 billion allocated to this programme. While the department struggles to balance allocated resources and ordered commitments, to revitalise the Technical Service Corps capabilities, the shortage of ammunition and the attrition of skilled technical personnel, the following achievements were highlighted:

- The utilisation of 4638 infantry conventional reservists in external and internal deployments, administration and guards;
- The transfer of 1000 volunteers from army Territorial Reserves to Army Conventional Reserves (rejuvenation programme). The Rejuvenation of the army through the MSDS program was also highlighted.

2.1.4. Programme 4: Air Defence

As a strategic objective, the Department aimed to implement the transformation plan, medium term strategy and HR short-term plan as well as the reduction of flying hours to improve air defence capabilities. Implementation was considered critical given the deterioration in main equipment, weapons systems and the retention of skilled personnel.

The department had exhausted the total allocation (R2.513 billion) to this programme and reported a significant underfunding of the operating budget, while the delays in the release of Hawk Jet Trainer disrupted planned training and conversion schedules. The deterioration of operational infrastructure continues.

The current human resources transformation process increased the number of black candidates for training, while 613 learners had been trained as part of the Military Skills Development System. Initiatives to retain scarce skills had been developed and implemented.

2.1.5 Programme 5: Maritime Defence

Strategically, the Department aimed to defend and protect South Africa by maintaining and providing prepared and supported maritime combat ready forces and facilities to meet the requirements of government. A reprioritisation process and the introduction of the MSDS were to facilitate the achievement of this goal. Certain stores, depots and maintenance units would have been closed – down, the functions of which incorporated into existing units.

The Department has reportedly spent 100 percent of its allocated budget for this programme, this programme remained underfunded. Current funding merely maintained those facilities required for force preparation. The deterioration of facilities continues while the Department battles to retain skills and expertise in diving and technical domains.

Highlights for the period under review include the establishment of the Maritime Reaction Squadron. Strides in the rejuvenation of the SA Navy are being made as 480 MSDS recruits joined the Naval Reserves.

2.1.6 Programme 6: Military Health Support

A key strategic objective for the period under review was to provide prepared and supported military medical health capabilities, services and facilities in support of the defence of South Africa that meet the requirements of government. A reprioritisation process and introduction of incentives to mitigate the deterioration of hospitals, facilities, and equipment, the high rate of medical inflation as well as the high workload of health professionals were cited as critical.

Although the Department has spent 100 percent of its total budgetary allocation (R1.704 billion) for the period under review, the availability and retention of health care practitioners and the renewal of main medical equipment remained key challenges.

However, health support systems have been integrated with the requirements of the Strategic Defence Packages; the renewal and maintenance of health facilities have been prioritised and had started at three military hospitals. A new salary package for health care practitioners was currently being worked on. A new video-conferencing facility has also been installed.

2.1.7 Programme 7: Defence Intelligence

Strategically, the objective of this programme is to defend and protect South Africa through the provision of military intelligence and counter-intelligence products and services that meet the requirements of Government. A reprioritisation process was to improve the ability to collect digital information, improve imagery efficiency, improve the deteriorating conditions of Defence Military Headquarters building and assist in the retention of experienced personnel.

While the Department had spent the total budget allocation of R147.494 million, the relocation of Defence Intelligence headquarters as well as the retention and recruitment of personnel are persistent challenges. However, training agreements had been signed with South African Police Service (SAPS)

to provide support to SANDF operations, including those continental initiatives. New equipment have been acquired to improve information collection and the improved training efforts.

Following dissatisfaction raised by the Committee regarding the delay in and the tender process for the relocation of the Military Intelligence Headquarters, the Department explained that the ageing facilities; outdated systems and the need for capacity building was a mutual concern. While timelines and measurable objectives have been set and a transactional advisor was appointed to focus on particular projects, the reliance on Department of Public Works and delays in capital projects hampered the relocation process.

2.1.8 Programme 8: Joint Support

The strategic objective of this programme is to support departmental activities through the preparation, maintenance and provision of joint logistic, technological and military policing capabilities. A reprioritisation programme and additional funding would start to address key concerns such as the disposal of ammunition, skills retention and the absence of a suitable enterprise application system.

The Department spent R2.646 billion of the R2.671 billion allocated for the period under review. Although a backlog in the disposal of redundant and unserviceable ammunition persists, the following achievements were highlighted:

- The implementation of DEIS Master Plan has commenced.
- Main ICT equipment is currently being upgraded.
- Progress in the migration of fragmented logistic information systems to OSIS and CALMIS.
- 2000 tons of unserviceable ammunition was destroyed.

In response to concerns raised regarding funding for South Africa's involvement in post conflict reconstruction, the Department replied that South Africa, together with countries such as Angola, Belgium and the Netherlands, was jointly involved in comprehensive sector security reform, in post-conflict areas as a Member of the International Security Sector Reform Group. However, funding for this involvement could not be budgeted for from the normal peacekeeping fund. This is a challenge.

2.1.9 Programme 9: Special Defence Account

A key strategic priority was the management of the inability of the industry to realise 100 percent cashflow. This would have been mitigated through the joint initiative with the Department of Public Enterprises to review the acquisition policy to support local defence related industry, develop defence sector strategy and to increase investment into retention and maintenance of strategic industrial tech

General Defence Account funds were spent according to corporate priorities to ensure cost effective solutions to requirements. A key challenge was the outstanding invoices that would be addressed in the next financial year. The new submarine project has understood on project management due to invoices not being submitted to the project team.

Responding to concerns raised over the usefulness of the purchased Rooivalk aircraft, the Department answered that Denel, responsible for marketing the aircraft, could provide a more detailed response.

2.1.10 Financial Statements:

The Department had under spent by 0.36 percent. A variance of R58 083 million from the Property Asset Management Portfolio was recorded, while R24 924 was recorded for the capital works, while R512 000 transfers were unspent. The variance from the Asset management Portfolio was devolved from Public Works and could not be paid within that financial year.

Financial losses for the period under review had been reduced given the detailed plan in place to curb such losses.

2.2. Report of the Auditor-general:

The Department of Defence received a qualified audit opinion from the Auditor-general for the 2006/2007 financial year. The AG found that the Department did not comply with regulatory requirements as the material inconsistency of with recorded information or lack of information. Treasury was working closely with the Department to work out detailed plans to improve financial management within the Department and will be meeting on a quarterly basis with NT to monitor the progress made in managing these challenges.

Key challenges identified by the AG are related to:

- Tangible and intangible assets
- Irregular expenditure
- Travel and Subsistence
- Prepayment and advances
- Accruals
- Lease commitments
- Regional Service Council Levies
- Contingent Liabilities
- Misclassification of expenditure
- Receivables

The Committee expressed concern at the persistence of certain qualification and that most related to internal controls within the control of the Department. The Department explained that certain challenges around the transformation of financial systems were experienced. The culture of the military had to be transformed to ensure that accounting take place at acceptable levels. A strategy to attract scarce skills through the offer of competitive, market related salaries will be implemented..

In a supplementary briefing to the Standing Committee on Public Accounts, the Office of the Auditor-general identified the following internal deficiencies:

- The lack of appropriate policies, procedures, techniques and mechanisms for the proper identification and recording of irregular expenditure.
- The lack of proper classification of transactions and other significant events.
- The understatement of regional council levies was due to the lack of management review at an activity or functional level.
- The completeness of contingent liabilities could not be confirmed due to a lack of appropriate procedures and policies for proper identification and recording of such liabilities.
- The completeness of receivables could not be confirmed, because departmental employees are not provided with orientation, training and tools to perform their duties and responsibilities; improve performance and enhance capabilities.

2.3. Briefing by the Department of Defence to the Standing Committee on Public Accounts:

The Standing Committee on Public Accounts conducted its hearing with the Department of Defence on the 2006/2007 Annual Report on 21 November 2007. Below follows a summary of the key outcomes of the meeting:

SCOPA noted and raised the following key matters relating to the 2006/2007 Annual Report:

- The lack of proper record keeping resulting in the failure to submit proper documentation for auditing purposes. The Department committed itself to resolve this matter in the 2008/2009 financial year.
- The lack of progress made in the implementation of targets set in the Departmental Action Plan for resolving recurring qualifications. The Department reiterated that the targets set in the Action Plan would be met by 31 March 2008.

- The measures in place to address the problems relating to the re-imburement of soldiers participating on peace support operations. While not providing details, the Department confirmed that measures were in place to rectify the matter.
- The loss of revenue due to the limited serviceability of equipment was a cause of concern. This was also noted by the United Nations. The Department responded that a revenue manager had been appointed in August 2008, to address the accounting for the servicing of equipment.
- The failure to comply with proper financial accounting procedures and internal monitoring procedures was also a cause of concern.
- Details of how the Department managed the two claims against the state, as referred to the Joint Standing Committee on Intelligence, was requested. The department responded these were very sensitive cases but was currently being investigated.
- The lack of spending of the Special Defence Account was a cause of concern.
- Regarding the NCACC, the Department explained that this body was directly accountable to Parliament.

3. COMMITTEE RECOMMENDATIONS:

- **Contingent Liabilities:** Problems related to the sensitive contracts/transactions, as noted by the AG remains a cause of concern.
- **South Africa's role in post-conflict reconstruction:** Given limited available funding to the Department, the financial implications of South Africa's increasing role on post-conflict reconstruction needs to be clarified. Does South Africa have agreements in place with those countries where peacekeeping is taking place?
- **Border control and the hand-over process to the South African Police Service:** The reasons for the SANDF's decision to withdraw from borders and the nature of the agreement between SAPS and SANDF needed to be clarified, given the problems experienced in the hand-over process.
- **Utility of Rooivalk Aircraft:** The usefulness of the Rooivalk aircraft remains a cause of concern. These aircrafts have not yet been deployed.
- **Military Intelligence headquarters:** The persistent lack of progress in the relocation of the Military Intelligence headquarters is unacceptable. The possible contracting of a private company to construct this building is a cause of concern and the committee urges a review of the tendering process.
- **Transformation of the Military Justice System:** More information on this process is needed.
- **Implementation of the Military Exit Mechanism and well-being of Military Veterans:** A thorough engagement with the Department is necessary to assess the progress made in the implementation of the MEM as this strategy is key in managing issues relating to military veterans.
- **Operational Readiness of the SANDF:** The information contained in the Annual report and the implications on the actual operational readiness of the SANDF needed to be assessed. The committee will hold a thorough engagement with the Department is due course.
- **Capacity to service weapons:** Funding for the maintenance of weapons are clearly inadequate and remains a cause of concern, especially in light of the dispute with the United Nations over the country's capacity to service and maintain weapons.
- **Persistent qualifications:** The Committee notes the inadequate budget of the Department, but could not recommend an increase in allocations if persistent deficiencies in the internal control systems, lack of compliance with processes and policies are not resolved.

- **The relationship between the Department of Public Works and Defence:** Problems in the working relationship between the Departments of Public Works and Defence remains a cause of concern. There is a need for greater inter-departmental co-operation and the Committee will schedule a briefing with both Departments to hear and make recommendations prompt resolution of challenges. Detailed information and a list of capital projects on military bases were requested.
- **Regular briefings with the Portfolio Committee on Defence:** The Committee will hold quarterly briefings with the Department to monitor the progress made in the implementation of recommendations.
- **Landward Defence Capabilities:** The improvement in the capacity of landward defence is a priority. A more detailed presentation is needed on the current capability of Landward Defence and the planned strategies to enhance this programme capacity.

4. ARMAMENTS CORPORATION OF SOUTH AFRICA, LIMITED (ARMSCOR) ON 2006/2007 ANNUAL REPORT AND AUDITED FINANCIAL STATEMENTS:

4.1 Briefing by Armaments Corporation of South Africa, Limited (Armcor):

4.1.1 Armcor Group Consolidated Income Statement for the period 1 April to 31 March 2007:

It was reported that, although Armcor received an unqualified audit report, the transformation of the organization and business is still incomplete. A task team had been set up to investigate the delays in the transformation process.

Armcor's income statement reveals a variance in the actual expenditure and the available budget. This is partly due to the rental dispute between Armcor and the Department of Public Works as the actual increase in rental costs were not included in the budget. Post retirement benefits were re-evaluated while the cost of filling vacancies and late appointments resulted in an under spending.

The committee noted that the Internal Audit Committee report is weak. Critical information such as attendance records; the number of meetings held and the name of audit committee members were not provided. This committee has also not commented on the internal controls of the organization. Armcor explained that certain challenges plague the internal audit committee given the uncertainty around the continued existence of the Board. The terms of office of the Chairperson had lapsed and this contract would not be renewed.

Furthermore, the Committee noted that the reports of the Chairperson and Board of Directors failed to mention the impact the value of the transfer payment from the Department had on the performance of the organization. In response to this question, it was explained that the Department of Defence benefited more from the services provided by Armcor than the monetary value of the transfers to the corporation. This is partly due to Armcor's provision of services that are not covered by the service level agreement.

4.1.2 SUMMARY OF PERFORMANCE OF ARMSCOR GOALS:

(a) Goal 1: Management of defence technology, research, test and evaluation requirements of the department of defence:

The recorded increase in sales was mainly due to an additional 4 hawk aircraft imported and cleared to the value of R282 million, while the rate of exchange profit on all foreign stock sales amounted to R5.6 million. A total income deficit on this programme is R31 million.

Members expressed a need for further clarification of the reasons why Armcor failed to finalise its realignment to comply with new Departmental technologies needed to be explored.

(b) Goal 2: Management of Defence Industrial Participation (DIP)

89 percent of the total available budget has been spent. The value of credit granted to overseas suppliers is valued at R2.2 billion, an increase to 122 percent. The recorded 10.3 percent under spending was mainly due to the under spending on subsistence and travel costs. The benefit to South African Industry from Strategic Defence packages amounted to 11.4 billion.

(c) Goal 3: Acquisition of CAT 1 Defence materiel excluding strategic defence acquisition:

Planned spending for acquisition activities in the first quarter amounted to R187.6 billion; however actual spending was only R175.5 billion. The last quarter reflected actual spending of R252.8 billion as opposed to the planned spending of R340.6 billion. The slight increase was due to operational funds received. One of the goals of ARMSCOR was the acquisition of category 1 defence material (excluding strategic defence acquisition). Contracts actually placed by ARMSCOR were R3.28 billion, 74.8% of the baseline. The deviations from this goal were due to the limited contracts placed being since all requirements neither were nor received. The under spending on cash flow was due to the receipt of insufficient requirements and underperformance by the industry, that included the late delivery of Ground Based Air Defence requirements.

(d) Goal 4: Strategic Defence Strategic Programmes:

This programme recorded an 89 percent expenditure of budget, while the under spending on cash flow in strategic defence package programmes is due to savings on Return on Equity (ROE) and underperformance by the industry. The logistics and milestones relating to the Hawk Aircraft were not achieved and conversion of four aircraft up to required operational capability was not completed.

(e) Goal 5: Procurement and Product System Support (Maintenance)

An under spending on cash flow was recorded due to vacancies and late appointments as well as under spending on subsistence and travel costs.

The Committee noted with concern that the trial implementation of tender contract management systems between 1 April 2006 and 31 March 2008 was not achieved

(f) Goal 6: Black Economic Empowerment and Human Resources:

The organisation had to have a certain number of black, disabled, and female employees in order to receive the funding from the transformation grant. The total target of black people was 80% and the actual achievement was 95%. The target of female appointees in technical functional groups was 20%, but only 12% could be reached due to the scarcity of women with technical skills in the labour market.

A 95 percent achievement in the percentage of external black employees was reported, surpassing the 80 percent target set. However, Arm Scor under performed in the external appointees in technical functional groups to be women.

In response to concerns raised by Committee regarding the recruitment challenges faced by Arm Scor, it was explained that ARMSCOR had set up a specialised orientation program based on the skills, competencies and experience of the person being employed. This programme was specifically designed to orientate a person, based on their capabilities, as opposed to that person simply being placed somewhere and being expected to grow and expand into other departments. The delays in filling posts were due to the difficulties experienced in finding the appropriately qualified candidate or poor responses to advertised position. This meant that posts needed to be readvertised.

5. COMMITTEE RECOMMENDATIONS:

Oversight of Arm Scor: The Committee will hold quarterly briefings with Arm Scor to monitor the progress made in the implementation of committee recommendations and the resolution of organizational challenges.

Re-evaluation of recruitment strategy: It is clear that, given the delays in finding appropriately qualified candidates to fill vacant posts, Armscor needs to assess the reach of advertised employment opportunities. It could be that advertisement are not published in broadly read newspapers, thus limiting the responses to such advertisements.

The resolution of going concern: The Committee welcomes the unqualified audit report received from the AG. However, the going concern cited needs prompt resolution, as this could possibly lead to a qualification.

The retention of skills: The Committee remains concerned over the limited retention of skills within Armscor. The newly acquired facility, the Simonstown Naval Dockyard, struggled to retain and attract skilled personnel.

Outstanding Information: The Committee requests greater details on the financial implications of the upgrade of the two Hawk aircraft needed to be clarified. This information must be supplied to the Committee before its next scheduled interaction with Armscor.

Mandate of the Armscor: The Committee recommend the revision of Armscor mandate and core business.

Strategic facilities: The strategic facilities of the corporation are critical aspects of the transformation of Armscor business. The Committee needed to be kept informed about the progress made in discussions between Armscor and the Department about this process. A detailed report about these strategic facilities needed to be submitted to the Committee before the next reporting session

Weaknesses in programme management system: The Committee is concerned over the suitability of the current current programme management system as stated in the Annual Report. It is recommended that details of the progress made in the implementation of alternative management systems needed to be provided.

Outstanding debts owed to Armscor: Debts owed to Armscor were a cause of concern and strategies to limit such debt needed to be provided to the committee.

Funding to Armscor: The Committee is concerned over the possible impact of increasing SANDF involvement in continental peacekeeping operations and its internal transformation may have on the funding of Armscor. The planned establishment of the Development Evaluation and Research Institute [DERI] to consolidate defence research and evaluation capabilities also pose a funding challenge.

6. OUTSTANDING ANNUAL REPORTS:

The Committee wishes to report that the following reports were not submitted to Parliament as required by the relevant legislation:

- 2007 Annual Report of the National Conventional Arms Control Committee [NCACC]
- 2006/2007 Annual Report of the Castle Control Board. [Late submission notification published in ATC on 8 November 2007.

Report to be considered.

APPENDIX 1**OFFICIALS FROM THE DEPARTMENT OF DEFENCE**

Mr January Masilela (Secretary for Defence and Director General of the Department)

Mr Tsepe Motumi (Deputy Director General and Chief Director Policy and Planning)

Lieutenant General Rinus van Rensburg (SANDF Chief: Corporate Staff)

Lieutenant General Mtanzima (Chief Human Resources)

Mr Anton Visser, (Chief Director Strategy)

Mr Rodney Rautenbach (Chief Director Budget)

Brigadier Fakir (Director Military Strategy)

Brigadier Meyer (Director Human Resources)

Mr Barney Engelbrecht (Director Budget)

Ms Ntsaluba (Director Strategy)