

REPORT OF THE AUDITOR-GENERAL

ON THE SPECIAL AUDIT OF THE N2 GATEWAY PROJECT

AT THE

NATIONAL DEPARTMENT OF HOUSING

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TABLE OF CONTENTS		Page
1.	Introduction	1
2.	Mandate of the Auditor-General	2
3.	Purpose and limitations of the report	3
4.	Scope of the special audit	4
5.	Overview	4
6.	Findings and recommendations by the Auditor-General as well as comments of the accounting officer	5
6.1	Enabling legislation and policies	5
6.2	Compliance with roles and responsibilities	6
6.3	Planning	8
6.4	Time frame and affordability	10
6.5	Funding	12
6.6	Appointment of the previous project manager	13
6.7	Appointment of the current project manager	15
6.8	Appointment of the implementing consortia	17
6.9	Quality of units at Joe Slovo phase 1	18
6.10	Payments made to implementing consortia	19
7.	Appreciation	20
	Appendix A: Abbreviations	21

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1. INTRODUCTION

- 1.1 The Auditor-General (AG) was requested by the national Department of Housing (NDoH) to conduct a special audit of the N2 Gateway Project (N2GP). The audit focused on the N2GP from its inception, as well as the achievement of goals regarding sustainable human settlements and the collaboration of the three spheres of government to successfully achieve the common objective. A formal agreement was entered into as documented in the letter of engagement with the NDoH dated 4 July 2006. Various challenges were encountered during the audit to obtain relevant documentation; meet all the stakeholders and agree on the factual correctness of findings. This delayed the finalisation of the report. The management report was issued to the NDoH on 3 March 2008 for management comments. Signed formal comments dated 15 April 2008 were received from the accounting officer and additional comments were received on 5 June 2008.
- 1.2 This special audit report highlights areas of concern, summarised below, indicating that the N2GP was not managed economically, efficiently and effectively.
- 1.2.1 Legislation and approved policies to enable the parties involved to meet the objectives of the N2GP were not in place (paragraph 6.1.1).
- 1.2.2 The roles and responsibilities of the three spheres of government were not clearly defined in the memorandum of understanding (MoU), which resulted in uncertainties as to who needed to take responsibility for and ownership of which specified functions (paragraph 6.2.1).
- 1.2.3 These challenges contributed to the following:
- 1.2.4 The identification and securing of sufficient land was not finalised prior to the construction of the N2GP (paragraph 6.3.1 (b)).
- 1.2.5 Detailed geotechnical surveys, indicating the true seriousness of the soil problems, were not completed prior to the commencement of the N2GP (paragraph 6.3.1 (c)).
- 1.2.6 The selection of beneficiaries was not finalised prior to the commencement of construction (paragraph 6.3.1 (d)).

- 1.2.7 The time frame for the completion of the N2GP was not realistic (paragraph 6.4.1 (a)).
- 1.2.8 Affordable housing was not provided for the target market identified (paragraph 6.4.1 (c)).
- 1.2.9 The typology of the N2GP was changed after the construction had started, which resulted in delays and avoidable costs being incurred (paragraph 6.4.1 (d)).
- 1.2.10 Funding arrangements for the N2GP were not finalised and secured (paragraph 6.5.1).
- 1.3 To ensure the successful implementation of the N2GP and similar housing projects, the AG recommended as follows:
 - 1.3.1 All the role players should learn from the N2GP and implement policies and monitoring functions to address the shortcomings identified.
 - 1.3.2 All identified non-compliance with the social housing policy should be rectified.
 - 1.3.3 The following should be finalised as a matter of urgency:
 - (i) Securing of funding.
 - (ii) Ensuring that sufficient land is available.
 - (iii) Finalising the identification of beneficiaries.
 - 1.3.4 Corrective actions, which include training, coaching, recovery of possible fruitless and wasteful expenditure as well as possible disciplinary action, should be taken to address the shortcomings highlighted in this report.
- 1.4 The accounting officer of the NDoH indicated that his department, other spheres of government and the current project manager would ensure that all corrective and necessary control measures are put in place as a matter of urgency. He also indicated that lessons learnt from the successful implementation of the N2GP would be shared with other state-funded projects nationally.

2. MANDATE OF THE AUDITOR-GENERAL

- 2.1 The functions of the AG in supporting constitutional democracy in South Africa are described in section 188 of the Constitution of the Republic of South Africa, 1996. Section 5(1)(d) of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) gives the AG the discretion to "determine the nature and extent of the audit to be carried out". Section 5(3) of the PAA provides that the AG may, in the public interest, report on any

matter within the functions of the AG and submit such a report to the relevant legislature and to any other organ of state with a direct interest in the matter.

- 2.2 The primary responsibility for the prevention and detection of fraud and error rests with both those charged with the governance and the management of an entity. Management, with the oversight of those charged with governance, needs to set the proper tone, create and maintain a culture of honesty and high ethics and establish appropriate controls to prevent and detect fraud and error within the entity.
- 2.3 It is the responsibility of those charged with the governance of an entity to ensure, through the oversight of management, the integrity of an entity's accounting and financial reporting systems and that appropriate controls are in place, including those for monitoring risk, financial control and compliance with the law.
- 2.4 It is the responsibility of the management of an entity to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring the orderly and efficient conduct of the entity's business. This responsibility includes implementing and ensuring the continued operation of accounting and internal control systems that are designed to prevent and detect fraud and error. Such systems reduce but do not eliminate the risk of misstatements. Accordingly, management assumes responsibility for any remaining risk.

3. PURPOSE AND LIMITATIONS OF THE REPORT

- 3.1 The purpose of the report is to make known the findings emanating from an independent special audit conducted at the request of the NDoH. The special audit was an objective evaluation to comply with the request received from the NDoH.
- 3.2 The special audit was performed in terms of the South African Auditing Standards, where applicable, and the internal guidelines for the planning, execution, reporting and follow-up of forensic audit investigations.
- 3.3 Although the work performed incorporates the AG's understanding of the law as it stands, the AG does not express an opinion on the legal effect of the facts or the guilt or innocence of any person(s) or party. The AG has merely stated the facts as they have come to its attention.
- 3.4 The report is based on the facts established from documentation provided and/or information obtained during the course of the special audit. If any further information was to be obtained, the conclusion may be influenced.

4. SCOPE OF THE SPECIAL AUDIT

- 4.1 The scope of our work, as set out in the engagement letter dated 4 July 2006, was as follows:
- 4.1.1 To audit the process flow, identify deviations from planned activities and time frames, and determine related root causes and role players.
- 4.1.2 To study the MoUs between various role players and audit adherence to responsibilities and commitments.
- 4.1.3 To highlight any inefficiency in the policies, processes or structures involved in the N2GP that came to our attention during the special audit.
- 4.2 In conducting the special audit we relied on the documentation and other information provided by the relevant role players in the N2GP as well as the information obtained during formal meetings.
- 4.3 It should, however, be noted that the purpose of this special audit was determined by instructions received from the NDoH as well as relevant facts obtained. The special audit was not a comprehensive evaluation of the N2GP and excluded the concern about sub-letting by residents and reports about foreigners living in the N2GP housing units.
- 4.4 The period under review was from the commencement date of the N2GP to July 2007, and the conclusions were based on the facts established from documentation provided and/or information obtained during the course of the special audit.

5. OVERVIEW

- 5.1 In the State of the Nation address in May 2004, the President referred to a *comprehensive (housing) programme dealing with human settlement and social infrastructure, including rental-housing stock for the poor*. Subsequently the NDoH released the document entitled *Breaking New Ground: A Comprehensive Plan for the Development of Sustainable Human Settlements* (September 2004) (Breaking New Ground plan) and cabinet approved the N2GP as a pilot and lead project for the Breaking New Ground plan.
- 5.2 The N2GP, which is a joint initiative of the three spheres of government, namely the NDoH, the Provincial Government of the Western Cape (PGWC) and the City of Cape Town (CoCT), entails the provision of a higher level of specification and end product than those contained in the current Housing Subsidy Scheme and the municipal

infrastructure grant (MIG). The increased specification applied within the N2GP requires change at two principal levels:

- 5.2.1 Suspension of existing policy and codes relating to housing typologies and specifications and the standards of bulk and internal services to be provided.
- 5.2.2 The supply of additional or “top-up” funding required to fund the cost differential between the service levels approved under the current Housing Subsidy Scheme and the current MIG framework and the new standards being tested.
- 5.3 The main purpose of the N2GP is to comprehensively address the housing and development needs of the informal settlements adjacent to the N2 highway between the Bhunga Avenue interchange near Langa and Boys Town in Crossroads, and the 6 650 households on the CoCT’s waiting list currently residing in backyard dwellings. This includes the following settlements:

Boys Town	Boys Town extension
Lusaka	Vukuzenzele
Europe	Barcelona
Kanana	Gxagxa
New Rest	Joe Slovo
Joe Slovo North	District Six

- 5.4 In order to define the roles and responsibilities of the three spheres of government, an MoU was signed between the NDoH, PGWC and CoCT on 14 February 2005, in terms of which the NDoH was required to assure compliance of the N2GP with national legislation, facilitate policy and channel financial support to the CoCT. The PGWC was to facilitate policy and channel funds and support to the CoCT. The CoCT was responsible for all elements of implementation of the project. All the parties were to appoint representatives to the N2GP’s steering committee (SteerCom).

6. FINDINGS AND RECOMMENDATIONS BY THE AUDITOR-GENERAL AS WELL AS COMMENTS OF THE ACCOUNTING OFFICER

6.1 Enabling legislation and policies

6.1.1 Findings

- (a) The NDoH should have ensured that the Social Housing Act, which is the enabling legislation to implement the social housing policy, was promulgated early in 2005. The Social Housing Bill, which inter alia specifies the functions and legal forms of a social housing institution and government support mechanisms,

was only published for public comment in November 2006. The National Assembly adopted the Social Housing Bill during March 2008. Members of Parliament had to take it to their constituencies during the May/June 2008 parliamentary recess period after which the Social Housing Act still needed to be approved by Parliament.

- (b) The social housing policy, which is a key component in meeting the objectives of the Breaking New Ground plan and addressing challenges in the social housing sector, was not approved prior to the commencement of the construction of the N2GP.

6.1.2 Recommendation by the Auditor-General

The NDoH should ensure that projects only commence once the applicable policies and legislation have been approved.

6.1.3 Comment of the accounting officer

The NDoH will ensure that in future, relevant policies are finalised, including Acts of Parliament where applicable, before a new subsidy programme is implemented.

6.2 Compliance with roles and responsibilities

6.2.1 Findings

- (a) The specific roles and functions allocated to the different spheres of government in terms of the Housing Act, 1997 (Act No. 107 of 1997) (Housing Act) and the social housing policy were not adhered to. The roles and responsibilities set out in the MoU were not clearly defined and were inconsistent within the MoU, resulting in uncertainties as to who needed to take responsibility for and ownership of which specified functions. For example, it was noted that the roles and responsibilities section indicated that it was the responsibility of the CoCT to drive the process of preparing the business plan, while the PGWC and the NDoH had to provide support regarding the above-mentioned process. However, according to the institutional arrangements section of the MoU, SteerCom was responsible for the preparation of the business plan. Further, the detailed roles and responsibilities in the MoU differed from the information indicated in the summary section.
- (b) The salient instances of non-compliance with roles and responsibilities occurred regarding the following aspects listed in the Housing Act and the MoU:
 - (i) Administering the housing process in a transparent, accountable and equitable manner, based on the principles of good governance.

- (ii) Determining national policy.
 - (iii) Identifying and designating land for housing development.
 - (iv) Driving community participation and support.
 - (v) Funding the housing programmes.
 - (vi) Compiling a detailed project implementation plan indicating cash flow, agreed project milestones and progress payments.
 - (vii) Ensuring that the N2GP is conducted in accordance with national legislation and policies.
 - (viii) Signing contracts with the project manager and the various implementing consortia.
- (c) The SteerCom was established in terms of the MoU to drive the N2GP, provide guidance on the implementation of the N2GP and direct, manage and supervise the project manager. The meetings of the SteerCom stopped after 10 May 2006, with the result that the driving and monitoring function of the SteerCom fell away.

6.2.2 Recommendations by the Auditor-General

- (a) The three spheres of government should ensure that they comply with the Housing Act and the social housing policy.
- (b) The three spheres of government should revisit the MoU and make the necessary adjustments to ensure that roles and responsibilities are clearly defined and consistent throughout and that responsibilities are complied with.
- (c) The SteerCom should be reinstated to ensure that overall monitoring of the N2GP is enforced.

6.2.3 Comments of the accounting officer

- (a) The NDoH is currently finalising the Social Housing Bill, which will regulate the formation and management of Social Housing Institutions nationally, through the Social Housing Regulatory Agency. However, the NDoH will always endeavour to ensure that policy is articulated and cascaded efficiently among all role players.
- (b) The SteerCom has been resuscitated, in which officials of all three spheres of government participate. In future, stricter agreements will be considered which will withstand changes in political leadership of stakeholder institutions, to ensure that project implementation is not unfairly prejudiced by such changes.

6.3 Planning

6.3.1 Findings

- (a) The business plan for the construction of the N2GP had not been finalised and approved before the actual construction of the N2GP commenced, with the result that the SteerCom, M3 (the executive committee of political office bearers) and the three spheres of government failed to meet their responsibilities in terms of the MoU. No final approved business plan was submitted to the audit team.
- (b) The identification and securing of sufficient land was not finalised prior to the construction of the N2GP. As at 22 May 2006 sufficient land was not available for the building of a further 8 800 housing units and the CoCT and the PGWC only signed a land availability agreement for the N2GP on 7 March 2007, more than two years after construction had commenced. Furthermore, it is not clear why the agreement was signed between these parties since the PGWC was no longer the developer.
- (c) Geotechnical surveys indicating the true seriousness of the soil problems were not completed prior to the commencement of the N2GP, which resulted in costly improvement of the soil conditions and delayed the delivery of the programme at critical stages. For one sub-project, expenditure of more than R6 million was incurred for land rehabilitation before construction could commence.
- (d) The selection of beneficiaries was not finalised prior to the commencement of construction, resulting in non-compliance with the prescribed requirement of listing the beneficiaries in the final business plan and loading these details on the National Housing Subsidy database prior to project implementation. The selection of the beneficiaries for the first 705 units was only finalised as at 28 February 2007 – almost two years after the N2GP had commenced.
- (e) The national Housing Code, the Breaking New Ground plan and the draft business plan were not consistent with regard to the qualifying criteria for proposed beneficiaries, especially in respect of the monthly household income requirement. It was also noted that the criteria communicated to the different communities were not consistent.

6.3.2 Recommendations by the Auditor-General

- (a) In future, construction should not commence prior to the approval of the business plan.
- (b) The three spheres of government should ensure that actions are taken to ensure that sufficient land is secured as a matter of urgency. Furthermore, a land

availability agreement should be signed between the CoCT and the new developer.

- (c) The three spheres of government should implement measures to ensure that the beneficiaries of the various sub-projects are identified in a timely manner to comply with prescripts. Furthermore, during the planning phase of a project, the qualifying criteria should be finalised to ensure that a consistent message is conveyed to the relevant role players.

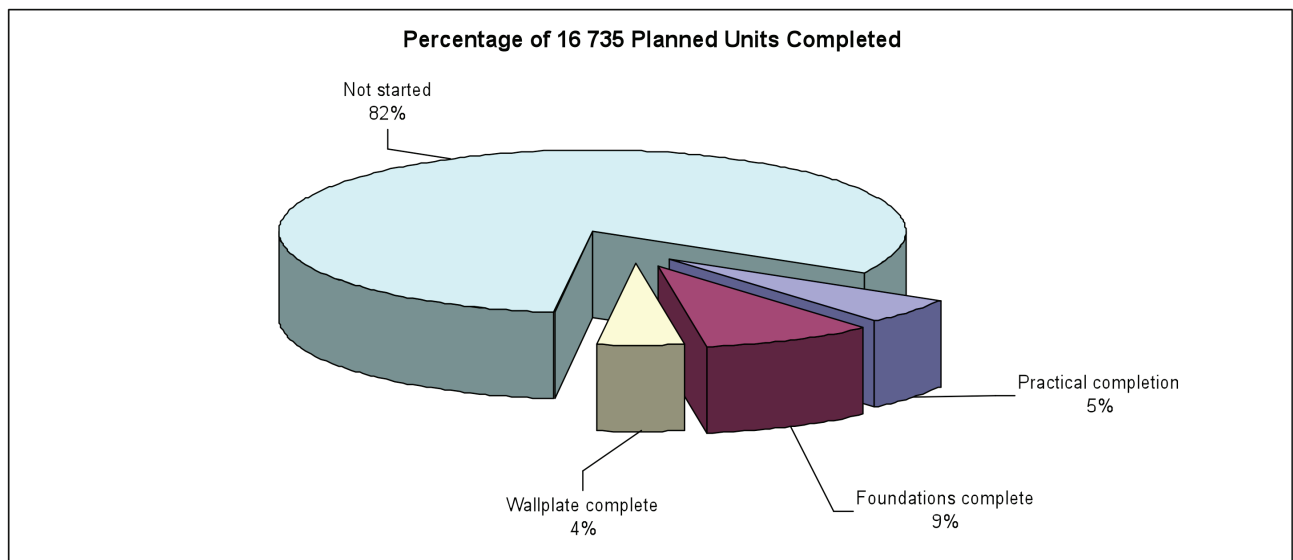
6.3.3 **Comments of the accounting officer**

- (a) The business plan was approved by the Director-General on 10 April 2008.
- (b) A two-pronged strategy has been adopted and is being implemented by the NDoH. Negotiations are under way with the Department of Public Works and Transnet (not excluding private land owners) in order to secure well-located land for immediate use in housing developments, primarily the N2GP. Secondly, the Housing Development Agency is intending to acquire land on which housing developments will take place, not only for the N2GP but also for use by other provincial housing departments, as well as municipalities. In future, the NDoH will ensure that thorough planning is done for mega-projects, including the prior acquisition of resources such as land, funding, agreements and technical expertise.
- (c) The CoCT as landowner of most of the precincts on the N2GP including Joe Slovo, Delft Symphony, Delft 7-9, New Rest and Boys Town, concluded a land availability agreement with the PGWC on 7 March 2007. In turn, the PGWC signed an agreement with the current project manager (its developer and implementing agent) to ensure that the current project manager is able to enter into further development agreements with contracting consortia. Within the MoU, the CoCT has undertaken to assist the NDoH or its implementing agent in its operations to implement the housing project.
- (d) Environmental impact assessments of geotechnical surveys are standard features of every housing development. Although these were not thoroughly performed prior to the construction of Joe Slovo phase 1 flats, such studies had been carried out later. In future, the NDoH shall endeavour to persuade people residing on land that is unsuitable to consider relocating to alternative and better areas in order to avoid spending money on soil rehabilitation.

6.4 Time frame and affordability

6.4.1 Findings

- (a) The time frame of six months within which interested parties had to deliver the initial 22 000 planned units was insufficient to address the four fundamental risks associated with the N2GP (i.e., securing funding, land and active cooperation from project beneficiaries as well as ensuring policy and statutory approvals to enable rapid project execution) and was not based on an approved project and business plan.
- (b) As at 31 May 2007 (two years after the N2GP had commenced) only 871 (5%) units of the revised 16 735 planned units had been completed, while 21% of the total budget had been utilised (refer chart below).



- (c) The households that were removed from the informal settlements adjacent to the N2GP and accommodated in temporary residential areas (TRAs) could not return to the rental units constructed in Joe Slovo phase 1 due to affordability problems. Although the average income of households in the region was approximately R1 200 per month according to the earlier versions of the business plan and communities had raised their concern regarding affordability, the actual tenant profile indicated that the income of 99,6% of the current tenants ranged from R1 500 to R7 500 per month. Consequently affordable housing was not provided for the target market identified.

- (d) Although construction of the N2GP had started on 15 March 2005, the typology¹ of the N2GP changed subsequently, which had a direct impact on the cost and time frame for the completion of the N2GP and resulted in the following:
 - (i) Legal claims for abortive work and standing time totalling approximately R43 million were made against the CoCT.
 - (ii) The design changes affecting Boys Town, Boys Town TRA and Joe Slovo phase 2 totalled R19 977 804, which could be regarded as fruitless and wasteful expenditure since reasonable care was not exercised during the planning phase when cost-benefit analysis had to be performed prior to the construction phase.

6.4.2 Recommendations by the Auditor-General

- (a) In future sufficient time should be budgeted for the completion of projects based on the guidance given in the Housing Programming Guide as well as actual delivery in the past.
- (b) Measures should be implemented to ensure that affordable housing is provided to those individuals identified during the enumeration process² as the potential beneficiaries.
- (c) In future a detailed cost-benefit analysis should be performed prior to the approval of a project's business plan in order to ensure that the selected typology is a feasible solution for the identified need.
- (d) The three spheres of government should disclose the identified fruitless and wasteful expenditure as prescribed.

6.4.3 Comments of the accounting officer

- (a) The time frames have been revised and the N2GP is expected to be completed during the financial year 2010-11.
- (b) The NDoH will ensure that further beneficiaries are sourced from verified databases. In the case of rental accommodation, the allocation committee comprising all three spheres will ensure that only beneficiaries from their database are allocated houses, with affordability qualifications being standardised and fair.

¹ The initial 70:30 allocation between multi-storey (rental) units and single-storey (ownership) units was changed to 10:90, resulting in claims for abortive work, standing time and loss of profit from all three consortia engaged on the N2GP

² To determine how many individuals were living in the informal settlements of the N2GP

- (c) When designs for Joe Slovo were first produced, the intention was that the entire precinct would become a medium density development in which 70% would be medium density whilst 30% would become freehold houses in terms of the Breaking New Ground plan. This determination was reviewed in favour of more freehold units as a result of three critical issues, namely (i) that medium density units were very expensive with final prices coming close to R120 000 per unit; (ii) that most beneficiaries were not willing to take up flats, instead they preferred freehold; (iii) and finally, the high cost created disparity of benefits that would not be easily replicable. In future, the NDoH will ensure that sufficient and exhaustive consultation processes are clearly and timeously followed to ensure buy-in of beneficiaries, as well as options offered.

6.5 Funding

6.5.1 Findings

- (a) Funding to complete the N2GP was not secured before the commencement of the N2GP. As at 13 July 2007, only R2,5 billion of the estimated project cost of R4,2 billion had been budgeted for/made available by the various government institutions.
- (b) In terms of the draft business plan dated September 2006, a total of R3,42 billion is required to complete the N2GP by 2009-10, resulting in an overall shortfall of approximately R1,7 billion, of which the NDoH must provide R1,68 billion. The NDoH could not indicate how they would pay the said amount while the PGWC and the CoCT indicated that they had not been requested to provide inputs on the business plan and that the business plan's budgeted amounts were unrealistic.
- (c) The quality standards of housing units envisaged in the Breaking New Ground plan are not adequately provided for by the existing subsidy quantum in the Housing Code since the size of the units required by the Breaking New Ground plan is 40m² while the Housing Code refers to 32m², resulting in a delay in delivery as other sources (provinces, municipalities or individuals) had to provide the necessary funding.
- (d) Problems were also experienced with MIG funding. The CoCT indicated that the MIG requirements had not been met and that they could therefore not release the funding and had in fact not budgeted for the N2GP for the medium-term expenditure framework cycle 2007-2010.

6.5.2 Recommendations by the Auditor-General

- (a) Funding should be secured prior to project implementation and the three spheres of government should ensure that the funding required in terms of the business

plan is realistic and that all role players are aware of and agree to their portion of the funding required.

- (b) The existing subsidy quantum should be revisited to ensure compliance with the Breaking New Ground plan's new requirements.
- (c) The current project manager should comply with the MIG requirements and submit the necessary documentation to the CoCT to ensure that MIG funding would be available for the finalisation of this project.

6.5.3 Comments of the accounting officer

- (a) At the time the N2GP commenced, neither had enough funding been allocated to the N2GP, nor had funding been earmarked for the N2GP. However, during ongoing negotiations with all parties involved, it became clear that various agencies would have to make appropriate provisions for the N2GP.
- (b) The final approved N2 Gateway Business Plan has a budget outlined up to 2011-12, with a projected cumulative budget reaching R4,5 billion by 2012. Having finalised this budget, the NDoH has embarked on consulting various government departments that are required to contribute for specific services. These include the Department of Provincial and Local Government with MIG, the Department of Water Affairs with bulk services, the Department of Minerals and Energy with electricity budgets and the National Treasury with shortfall and/or additional funds required.

6.6 Appointment of the previous project manager

6.6.1 Findings

- (a) According to an investigation report by a private firm, the previous project manager (a company) was appointed in spite of the following:
 - (i) The company failed to prepare its costing in compliance with the terms and conditions of the request for proposal (RFP), thereby rendering its bid non-responsive.
 - (ii) Notwithstanding the fact that the company ranked number 6 in the evaluation committee's evaluation, the supply chain management committee awarded the contract to the company based on the Goods, Services and Property Advisory Board's recommendation. Consequently, all payments made to the company are irregular. This amounts to R12 080 635.

- (iii) The NDoH was not represented in the evaluation committee even though the RFP stipulated it would comprise officials from all spheres of government.
- (b) No formal contract was entered into with the company.
- (c) Even though the contract was not formally extended, two additional payments in excess of the initial contract amount of R5 008 000 were made to the company.
- (d) The company lacked sufficient in-house and specialist expertise to perform various project management functions, with the result that the company obtained a third-party specialist and the company raised a 10% mark-up, known as a “management fee”, on these services. Although it is understood that the management fee charged is an industry norm, this additional expenditure was not covered adequately in the tender application.
- (e) The project management fees paid to the company exceeded the industry norm by 4% and were not performance based, as the company was paid 252% of the original tender amount (R12 080 635 in total) although the N2GP had not yet been completed (only 721 houses of the planned 22 000 were complete).

6.6.2 Recommendations by the Auditor-General

- (a) The CoCT and the PGWC should ensure that all prescripts and the RFP are adhered to in the awarding of tenders.
- (b) Prior to the awarding of a tender, it should be ensured that the bidders have sufficient in-house and specialist expertise. Furthermore, any management fee charged should be adequately covered in the tender application.
- (c) Measures should be implemented to ensure that project management fees are in line with industry norms and that it is performance based in order to ensure that project goals are achieved.

6.6.3 Comments of the accounting officer

- (a) The CoCT has acknowledged concerns raised by the AG with regard to the appointment of the previous project manager, including its internal procurement processes. The CoCT has since disbanded the Goods, Services and Property Advisory Board and has replaced it with a procurement process provided for by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) and its regulations.

- (b) The company was hired following the CoCT's Goods and Services procurement procedures. It was thus anticipated that the CoCT would again follow its procedures when effecting adjustment to the contract, which had since exceeded the tendered amount. The SteerCom was made aware of this problem, which was largely as a result of increased capacity required within the company in order to enable them not only to supervise the process of acquiring contractors, but also to begin to manage the work of appointed contractors on site. This required that the company acquire a variety of professional expertise within their team. The company's contract was terminated in January 2006.

6.7 Appointment of the current project manager

6.7.1 Findings

- (a) A tender process, as required in terms of the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA), the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) and the Preferential Procurement Regulations, 2001, was not followed by the PGWC (in line with the amended M3 agreement) in the current project manager's appointment (a section 21 company) to replace the previous project manager and the CoCT as implementing agent of the N2GP. Furthermore, no formal resolutions, motivating why the CoCT was removed from the project as implementing agent, could be provided.
- (b) Since the section 21 company was appointed without following a proper procurement process, it cannot be concluded whether a proper assessment of their capacity to manage a project of this size and complexity had been performed.
- (c) No contract or MoU has been concluded between the NDoH and the section 21 company. This is contrary to the amended MoU which requires that all three spheres of government should conclude appropriate agreements with the project manager.
- (d) Although a contract was entered into between the PGWC and the section 21 company, this contract was cancelled by the PGWC on 7 September 2006 due to a breach of contract by the section 21 company. Since it was resolved at a MINMEC (committee of the national Minister and provincial members of the executive committee) meeting on 14 September 2006 that the section 21 company still had the overall responsibility for implementing the project and was directly accountable to the Director-General of the NDoH and the Minister, the section 21 company was operating as implementing agent and project manager without a contract or specific terms of reference.

- (e) The project management fees paid to the section 21 company are not performance based and since the breach of contract with the PGWC on 7 September 2006, the section 21 company had not been paid a project management fee (R100 000 monthly fee) and is currently absorbing the fee as part of their operational budget. This could therefore result in a potential claim against the NDoH.

6.7.2 Recommendations by the Auditor-General

- (a) The CoCT and PGWC should ensure that all prescripts are adhered to in the awarding of tenders.
- (b) The reasons for removing the CoCT as implementing agent should be properly documented and considered by the relevant role players.
- (c) Prior to the awarding of a tender, it should be ensured that the bidders have sufficient in-house and specialist expertise.
- (d) The NDoH and the section 21 company should, as a matter of urgency, conclude a written contract or MoU as required.
- (e) Measures should be implemented to ensure that project management fees are in line with industry norms and that it is performance based in order to ensure that project goals are achieved.
- (f) The NDoH should assess what the section 21 company's potential claim is since their last payment and take formal measures to address the risk.

6.7.3 Comments of the accounting officer

- (a) The current project manager is an agency of the NDoH, established to assist the NDoH in its mandate of driving housing and human settlement policy nationally. Its mandates and operations are guided by the national Minister of Housing. As such, when directives are issued to any of its provincial counterparts, a letter from the national Minister is deemed sufficient to ensure that such institutions are legitimate. The section 21 company will, however, conclude a service level agreement with designated institutions such as the PGWC in this regard. The AG believes that the Minister as competent executing authority cannot give instructions to a government agency that has been created to solely assist a national Minister in the execution of her mandate within her portfolio. The AG, instead, believes that such instruction should be subjected to an open tender process wherein private service providers might also submit proposals. This view unfortunately renders the very purpose for which such an agency was created wasteful. The NDoH will, however, obtain legal opinion in this regard.

- (b) Although their capacity was not geared up to meet the challenges of the N2GP, the section 21 company has since increased their staff complement, especially their technical division.
- (c) A dispute arose between the section 21 company and the PGWC, with one claiming that they could unilaterally cancel the service level agreement on the grounds that reporting requirements had been violated. This dispute has since been resolved and each of the institutions honoured its obligations, which included monthly reconciliation of work and funds spent on the N2GP from the section 21 company to the PGWC, as well as monthly management fee drawdown in favour of the section 21 company from the PGWC. The revised MoU between the PGWC and the section 21 company makes provision for performance-based payment milestones. Going forward, the PGWC will ensure that the section 21 company performs according to the MoU. Equally, the PGWC shall not unduly delay its performance in favour of the section 21 company.

6.7.4 Response by the Auditor-General

No proof was submitted that the section 21 company is a national business enterprise or a national public entity as defined in section 1 of the PFMA. Furthermore, neither the memorandum nor the articles of association of the section 21 company appoint the AG as the auditor of the section 21 company as would be expected for a national business enterprise or national public entity.

6.8 Appointment of the implementing consortia

6.8.1 Findings

According to an investigation report by a private firm, the following was noted regarding the appointment of the implementing consortia:

- (a) The tender for the award of the N2GP precincts did not remain open for 21 days and was advertised on 29 December 2004, which fell within the statutory Builder's Holiday period, making tender preparation difficult.
- (b) The prescribed tender process was not followed before the supply chain management committee awarded various contracts for the TRAs to the implementing consortia, with the result that expenditure totalling R71,9 million was irregular.
- (c) When the N2GP commenced, no contracts were signed with the implementing consortia even though the Supply Chain Management Act requires it.

6.8.2 Recommendation by the Auditor-General

The CoCT and the PGWC should ensure that all prescripts are adhered to in the awarding of tenders.

6.8.3 Comment of the accounting officer

When the N2GP commenced, contracts were not signed. This was because the CoCT's policies required that appropriate funding be secured first in their accounts, before they could commit to signing contracts with contractors. At that time, funds were not yet secured and contractors were requested to commence with work based on the appointment letters received from the CoCT. Officials were also required to negotiate the draft contracts with the implementing consortia, especially the costs of services per precinct, as well as the cost of units to be constructed. This was done and agreed with the implementing consortia, who went on site. However, as soon as initial funding was secured, as budget projections going forward were negotiated with the National Treasury, some degree of certainty was achieved on the funding streams and future drawdown. It was after these milestones that contracts were concluded with the implementing consortia.

6.9 Quality of units at Joe Slovo phase 1

6.9.1 Findings

- (a) Various physical shortcomings were identified by the Social Housing Foundation as well as the AG which included, amongst others:
- (i) The certificate of completion for the building contract issued by the principal agent was erroneously issued.
 - (ii) Compliance with registration and inspection procedures ranging from the National Building Regulations to the National Home Builders' Registration Council (NHBRC), construction regulations, inspections by local authorities and professionals and occupation certificates, could not be verified.
 - (iii) Fourteen instances were identified where "as built" specifications did not comply with minimum specifications for social housing.
 - (iv) Nine instances of deviations from contract specifications were identified.
 - (v) The large public storm-water canal constituted a foul health hazard.
 - (vi) Site inspections revealed numerous cracks in the walls and floors, peeling paint, doors that were not fitted properly, loose fittings and uncovered drain pipes and blocked drains.

The NHBRC agreed that, due to the problems identified, a forensic investigation of Joe Slovo phase 1 should be completed to determine whether a quality product was indeed provided.

6.9.2 **Comment of the accounting officer**

A private service provider has conducted an audit of Joe Slovo phase 1. The audit found that there were no fundamental structural challenges to the buildings. However, the audit found that there were shortcomings on the roofs and some of the plumbing works, which could all be repaired. The audit thus recommended that the implementing consortia be called to rectify the deficiencies identified. The implementing consortia have since commenced with the rectification work.

6.10 **Payments made to implementing consortia**

6.10.1 **Findings**

- (a) Work commenced on certain sites prior to the individual project approval from the PGWC, resulting in irregular expenditure totalling R71,8 million up to 31 July 2007.
- (b) The total cost overrun incurred on Joe Slovo phase 1 was R28,2 million (705 units x R40 000 per unit). The CoCT had up to 31 July 2007 not paid the extra costs as no evidence exists that the implementing consortia were authorised to spend the extra R40 000 per unit. However, the NDoH indicated to the audit team that the R40 000 “excess above R80 900 subsidy” had to be carried by the housing institution responsible for the collection of rent income since they take ownership of the asset.

6.10.2 **Recommendations by the Auditor-General**

- (a) The three spheres of government should disclose the identified irregular expenditure as prescribed.
- (b) The NDoH should investigate the cost overrun and take appropriate action to ensure that the responsible party provides the necessary funding in this regard.

6.10.3 **Comment of the accounting officer**

No comments were received in this regard

7. APPRECIATION

The assistance rendered during the special audit by the officials of the spheres of government involved in housing is appreciated.

Auditor-General

Pretoria

July 2008



A U D I T O R - G E N E R A L

ABBREVIATIONS

Abbreviation	Description
AG	Auditor-General
Breaking New Ground	Commonly used term for the Comprehensive Housing Plan
CoCT	City of Cape Town
Constitution	Constitution of the Republic of South Africa, 1996
Housing Act	Housing Act, 1997 (Act No. 107 of 1997)
M3	Executive Committee
MIG	Municipal Infrastructure Grant
MINMEC	Committee of national Minister and provincial MECs
Minister	Minister of Housing
MoU	Memorandum of Understanding
N2GP	N2 Gateway Project
NDoH	National Department of Housing
NHBRC	National Home Builders' Registration Council
PAA	Public Audit Act, 2004 (Act No. 25 of 2004)
PFMA	Public Finance Management Act, 1999 (Act No. 1 of 1999)
PGWC	Provincial Government of the Western Cape
RFP	Request for proposal
SteerCom	Steering Committee
TRA	Temporary relocation area