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# SPECIAL REVIEW

BY THE

**AUDITOR-GENERAL**

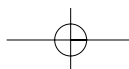
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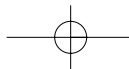
**SELECTION PROCESS OF STRATEGIC DEFENCE PACKAGES FOR THE  
ACQUISITION OF ARMAMENTS AT THE DEPARTMENT  
OF DEFENCE**

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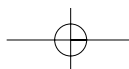
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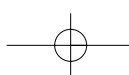
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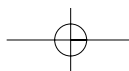


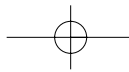


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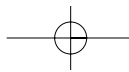
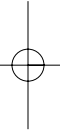
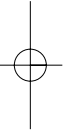
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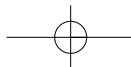
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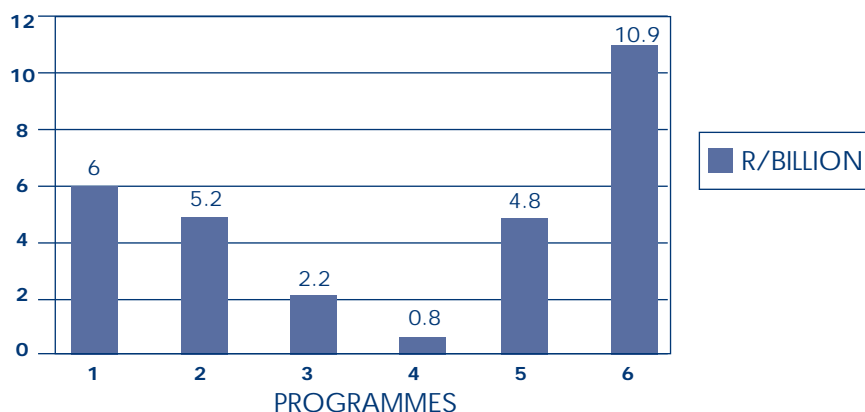
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## SPECIAL REVIEW BY THE AUDITOR-GENERAL OF THE SELECTION PROCESS OF STRATEGIC DEFENCE PACKAGES FOR THE ACQUISITION OF ARMAMENTS AT THE DEPARTMENT OF DEFENCE (DoD)

### 1. INTRODUCTION

The Special Defence Account (SDA) was instituted in terms of section 1 of the Defence Special Account Act, 1974 (Act No. 6 of 1974), to defray the expenditure and purchases incurred for special defence activities as approved from time to time by the Ministers of Finance and Defence.

In a government communication letter dated 15 September 1999, the announcement was made that negotiations had been entered into with preferred bidders to supply military equipment. The significance of this announcement was that it committed the South African government to the sum of R29,9 billion comprising 6 programmes (equipment) illustrated in the graph below.

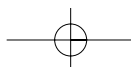


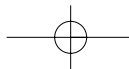
PROGRAMME	EQUIPMENT
1	Corvettes
2	Submarines
3	Light Utility Helicopter (LUH)
4	Maritime Helicopter (MH)
5	Lead In Fighter Trainer (LIFT)
6	Advanced Light Fighter Aircraft (ALFA)

The cost of the equipment would flow via the Special Defence Account.

Offsets in contracted industrial participation commitments were estimated at about R110 billion which would create more than 65 000 job opportunities.

Contracts were eventually signed for five of the programmes. The decision to purchase the Maritime Helicopter has been deferred to a later date. The final





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package cost was R30.3 billion while the final industrial participation offer was approximately R104 billion.

Numerous allegations regarding possible irregularities pertaining to the awarding of the contracts currently exist. However, many of the allegations pertain to contracts awarded to subcontractors. This did not fall within the scope of this review, which focused mainly on the awarding of contracts to the prime contractors. A forensic audit of this next level of the process may need to be considered.

## 2. SCOPE

The inherent nature of the contracts between the DoD and the prime contractors resulted in the prime contractors taking ultimate responsibility for a programme. This meant that each of the prime contractors had to administer its own process with regard to the sourcing of subcontractors and the provision for risk premiums for certain components: the DoD had limited control over the selection of subsystem components in each programme. Hence the review focussed mainly on the process followed up to the signing of the final contract with each individual prime contractor and the adequacy of performance guarantees regarding the national industrial participation. The review did not include the process followed by the prime contractors in their sourcing of subcontractors and their provision for risk premiums for certain subsystem components.

I believe that the review provides a reasonable basis for my key findings.

## 3. KEY FINDINGS

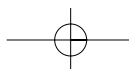
### 3.1 Overall independence of role players

Based on the findings, I am of the opinion that the aspects of independence, fairness and impartiality could have been addressed more significantly. Although the role players were subjected to a security clearance, the potential conflict of interest that could have existed was not adequately addressed by this process. This aspect could have been addressed more significantly by way of obtaining declarations prior to the strategic offers process.

### 3.2 Technical evaluation: Lead in Fighter Training (LIFT)

The offers of each individual bidder in respect of all the programmes were evaluated by separate individual teams on the following basis:

- (i) National industrial participation (NIP) and defence industrial participation (DIP)





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- (ii) Technical evaluation
- (iii) Financial evaluation

All programmes included a cost factor as part of the technical evaluation. In respect of the evaluation a value system was adopted whereby the technical score would be calculated by dividing the military value of the equipment by the life cycle cost. However, in the case of the LIFT programme the Armaments Acquisition Council (AAC), after the adoption and implementation of the value system, requested that cost should not be a limiting factor.

The LIFT team thus performed two technical evaluations: The first was based on the above-mentioned value system, which took the cost of the programme into consideration (costed option). The second evaluation did not take the cost element into consideration (non-costed option).

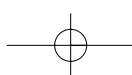
The result of performing both the "costed" and "non-costed" evaluation had no influence on the final recommendation by the technical evaluation team where bidder "A" was the preferred bidder. In the overall evaluation which took into consideration the industrial participation and financial scores, bidder "A" was again the preferred bidder in the costed option but bidder "C" was the preferred bidder in the non-costed option. Bidder "C" was ultimately chosen to provide the LIFT programme.

The table below indicates the individual positioning of the bidders after each evaluation process.

Technical evaluation			Overall evaluation		
	Costed	Non-costed		Costed	Non-costed
1	Bidder "A"	Bidder "A"	1	Bidder "A"	Bidder "C"
2	Bidder "B"	Bidder "C"	2	Bidder "C"	Bidder "A"
3	Bidder "C"	Bidder "B"	3	Bidder "B"	Bidder "B"
4	Bidder "D"	Bidder "D"	4	Bidder "D"	Bidder "D"

The fact that a non-costed option was used to determine the successful bidder, is in my opinion a material deviation from the originally adopted value system. This ultimately had the effect that a different bidder ("C"), at a significantly higher cost, was eventually chosen on the overall evaluation.

The DoD in reply to the finding was of the opinion that amongst others, the shortlisting of contenders during the technical evaluation using only the costed option would unfairly favour the bidder who was the ultimate winner in any military value/cost-competitive

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evaluation, even before solicitation of offers took place. This was not considered up front and it was not included in the request for the proposal. In order to solicit competitive offers an additional evaluation where cost was not considered as a limiting factor, was therefore requested from the evaluation team. This instruction resulted in two options being presented to the relevant approval authorities.

In addition to the evaluation basis mentioned in (i) - (iii) above all programmes included a risk analysis as part of the technical evaluation. Risk adjustments were made in respect of the Light Utility Helicopter (LUH), Maritime Helicopter (MH) and LIFT programmes. Only the LUH and MH adjustments were included in the adopted value systems. In the case of the LUH a risk adjustment factor was included in the calculation of the military figure of merit. Although the risk was not quantified in the case of the MH, the risk was included as part of the evaluation.

As the LIFT value system did not include a risk adjustment factor as part of the technical score calculation, the LIFT project team was later requested by the SAAF Project Steering Committee to make a risk adjustment to the technical scores. The effect of this risk adjustment resulted in the repositioning of bidder "C" from third position to second position, by the technical evaluation team.

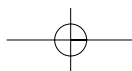
Although it did not influence the final recommendation by the technical evaluation team it is a deviation in principle from the approved third-order value system.

### **3.3 Adequacy of performance guarantees: National industrial participation (NIP)**

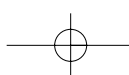
All bidders with whom contracts had been finalised had to sign performance guarantees regarding their NIP commitments. The guarantees were on average approximately 10% of the contract price. I am of the opinion that the guarantees, in case of non-performance, may be inadequate to ensure delivery of the NIP commitments. This could undermine one of the major objectives of the strategic defence packages which was the counter-trade element of the armaments package deal.

### **3.4 Ministry of Defence (MoD) policy**

The following was not in line with the requirements of the MoD policy for dealing with international offers:







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3.4.1 First-order value system was not established.

3.4.2 MoD working group was not appointed.

The failure to establish a first-order value system and MoD working group as mentioned in paragraph 3.4.1 and 3.4.2 above resulted in the military strategic advantage not being determined by military appreciation.

### 3.5 Armaments acquisition policy

The following sequence of events was not in line with the procedures laid down for armaments acquisition:

3.5.1 The Advanced Light Fighter Aircraft (ALFA) project did not have a prior approved staff target and staff requirement. These approvals were only obtained for the Advanced Fighter Trainer (AFT) project, which was later changed to ALFA.

3.5.2 The Light Utility Helicopter (LUH) project only had an approved staff target and no staff requirement, mainly because this could not be funded by the budget.

3.5.3 The SUBMARINES programme had no approved staff requirement.

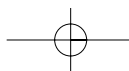
3.5.4 The Lead In Fighter Trainer (LIFT) programme did not have a prior approved staff target and staff requirement as required by the armaments acquisition policy.

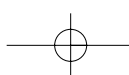
### 3.6 Negotiation stage

#### 3.6.1 *Frigates (corvettes)*

A local company that was at that stage performing certain technological work on behalf of the SANDF, which was funded from a previous technology retention project, was not selected for one of the subsystems of the corvette namely the Integrated Management System (IMS). Although the SA Navy preferred the technical potential offered by the local company, this was outweighed by prohibitive risk-driven cost implications as determined by the prime contractor. The prime contractor, who had to accept unlimited risk for delivery, added a risk premium of approximately R40 million to the local product, which resulted in the acceptance of the French product.

As a complaint was lodged with the Office on this matter and the basis of determining the risk premiums did not fall within the scope of the audit, a forensic audit of the matter should be considered.





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### 3.7 Tender procedure: Subcontracting: Negotiation phase

Although procedures were in place to obtain capacity to support the International Offers Negotiation Team (IONT), the required ARMSCOR tendering procedure was not followed in all instances.

### 3.8 Budget

No formal budget was compiled as required by governmental financial regulations at the request for information (RFI) stage. The total cost of the military equipment was approved by Cabinet only during the negotiation phase.

### 3.9 Arithmetical and clerical errors

A number of errors were found which were forwarded to the DoD and addressed accordingly. The errors had no material influence on the overall process.

## 4. CONCLUSION

As mentioned in paragraphs 3.1 and 3.2 material deviations from generally accepted procurement practice were discovered. The explanation provided by DoD for this material deviation does not appear to be satisfactory. Based on the review performed at prime contractor level there were no other material findings other than those mentioned in paragraphs 3.3 - 3.9.

The review focussed mainly on the awarding of contracts to prime contractors. Many allegations regarding possible irregularities in contracts awarded to subcontractors exist, of which the finding in paragraph 3.6.1 is an example. I recommend that a forensic audit or special investigation into these areas be initiated.

Furthermore I am concerned that the guarantees for national industrial participation may not be sufficient.

## 5. APPRECIATION

The assistance rendered by the officials of the DoD and their staff during the audit is sincerely appreciated.

S A Fakie  
Auditor-General

Pretoria 15/9/2000

