



AUDITOR-GENERAL  
SOUTH AFRICA



*Auditing to build public confidence*

**DEPARTMENT OF SMALL BUSINESS DEVELOPMENT  
INVESTIGATION FEEDBACK  
21 AUGUST 2019**

# REPUTATION PROMISE/MISSION



The Auditor-General of South Africa (AGSA) has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, exists to strengthen our country's democracy by **enabling oversight, accountability and governance** in the public sector through auditing, thereby **building public confidence**.



## BACKGROUND

- The former Director General (DG) of the Department of Small Business Development (DSBD) expressed a concern that issues identified by the regularity audit team during the 2016-2017 audit, warranted an investigation to determine the full extent of the irregularities noted relating to two incentive schemes of the DSBD.
- In terms of the AGSA delegations the Auditor-General approved the request for investigation and a letter of engagement in respect of the investigation was signed on 23 March 2018 with the former DG of the department.
- The investigation focussed on the **2015-16** and **2016-17** financial years.



## BACKGROUND cont...



- The focus of the investigation included:
  - Compliance of the DSBD to the guidelines and standard operating procedures (SOP) of the Black Business Supplier Development Programme (BBSDP) and Co-operative Incentive Scheme (CIS);
  - The validity of the processes followed in awarding incentives to grant applicants;
  - Confirmation of the authenticity of suppliers and quotations;
  - Verification that goods and services were actually delivered/received; and
  - Monitoring and reporting processes followed by the DSBD subsequent to the approval and payment of the incentives to the beneficiaries.



## BACKGROUND cont...

- The investigation fieldwork was executed during the period April 2018 to February 2019. The fieldwork consisted amongst others of the following procedures:
  - Analysis of beneficiary payments during 2015-16 and 2016-17 period in order to identify the transactions for further testing. 146 grant applications were selected consisting of 88 BBSDP grant applicants and 58 CIS grant applicants.
  - Comparison of grant applications and claims to the prescriptions per the programme guidelines and SOPs to identify non-compliance or possible irregularities.
  - Conducted 60 site visits (covering both BBSDP and CIS).
  - Attempted to contact grant applicants and service providers to verify existence of goods purchased.



## BACKGROUND cont...

- A draft management report was compiled and issued to the Accounting Officer (AO) on 22 February 2019 and discussed with the AO and Executive Authority on 28 February 2019.
- DSBD management provided responses on our findings and recommendations on 19 and 25 March 2019.
- Delays experienced during the course of the investigation were discussed with Minister Zulu during the meeting with the AGSA held on 28 February 2019. Delays experienced include, amongst others, the following:
  - DSBD's IT system was offline for nearly a month. As such beneficiaries' application files could not be provided to the investigation team.
  - The extension of the sample size for site visits from 30 to 60 and the subsequent additional procedures to confirm existence of grant applicants, service providers and goods purchased.



## BACKGROUND cont...

- A final management report (incorporating management responses) was issued to the AO on 25 April 2019, affording management a final opportunity to respond to the findings raised.
- Section 29(3) of the Public Audit Act requires that a report be compiled on receipt of management comments where after the report will become a public document for tabling in Parliament.
- We are unable to share the report with the committee prior to it being finalised and tabled in Parliament.



# INTRODUCTION



## BBSDP

- During the 2015-16 year, 684 applications for BBSDP grant funding were approved (approximately R307 million). 597 of these were paid in the year (approximately R193 million).
- During the 2016-17 year, 738 applications for BBSDP grant funding were approved (approximately R392 million). 598 of these were paid in the year (approximately R242 million).
- The findings are predominately due to non-adherence to the BBSDP guidelines and SOP in processing, evaluating, adjudicating and recommending grant applicants for approval of the incentive schemes. The findings also point to inadequate internal controls, monitoring and oversight in the awarding of incentives to grant applicants.



# INTRODUCTION cont...



## CIS

- The total value of approved applications for CIS grant funding for the 2015-16 financial year amounted to approximately R84,4 million, of which R74,9 million was paid.
- The total value of approved applications for CIS grant funding for the 2016-17 financial year amounted to approximately R65,7 million, of which R63,8 million was paid.
- The findings in respect of the CIS are predominately attributable to the non-adherence to the CIS guidelines and SOP in processing, evaluating, adjudicating and recommending grant applicants for approval of the incentive schemes. The findings also point to inadequate internal controls, monitoring and oversight by the DSBD in the awarding of incentives to grant applicants.



# FINDINGS

## Non-compliance to incentive schemes guidelines and SOPs

- BBSDP guidelines and SOP contradict each other in some instances. The BBSDP guidelines and SOP have also not been adequately updated to include procedures and guidance in the event that the grant applicant has fully paid for goods and services for which grant funding was applied for, and is subsequently reimbursed by the DSBD.
- The BBSDP and CIS guidelines was the primary guidelines used by the DSBD for the grant/incentive programme. These guidelines were also available on the DSBD website and intranet, therefore the DSBD employees had to have been aware that they needed to comply with such. We used the BBSDP and CIS guidelines to determine compliance with regard to the awarding of grants/incentives to grant applicants. Only in instances where the guidelines contained no information on certain issues did we refer to the SOPs.
- During the application, approval and payment of incentives, the AO and officials did not ensure compliance to the BBSDP and CIS guidelines and SOPs in all instances.



## FINDINGS cont...

### Non-compliance to incentive schemes guidelines and SOPs

- The AGSA inspected 88 application files. 37 (42%) of these contained no evidence that inspections had been performed before submission of the applications to the adjudication committee for approval, in contravention of the BBSDP guidelines. All 37 applications were approved by the adjudication committee. Eight officials were implicated in this regard.



## FINDINGS cont...



### Non-compliance to incentive schemes guidelines and SOPs

- 23 out of 88 applications (26%) of the sample tested were accepted and approved despite the application amounts exceeding 30% of the applicant's previous year turnover (according to the financial statements) or there was no evidence to substantiate the 30% previous year turnover requirement, in contravention of the BBSDP guidelines/ SOP. Four officials were implicated in this regard.
- 34 of the 88 (39%) application samples investigated did not contain the required documentation relating to the requirement for copies of Identity documents (IDs) of key managers, directors, shareholders and list of employees of the entity, in contravention of the guidelines. Officials submitted these applications to the adjudication committee and they were approved without the required documentation. Six officials were implicated in this regard.



## FINDINGS cont...



### Non-compliance to incentive schemes guidelines and SOPs

- According to the financial statements from the sample selected, 16 out of the 88 (18%) applications did not have the financial capacity to fund 50% of the total cost of equipment applied for as their current liabilities greatly exceeded current assets. Furthermore, the diagnostic reports prepared by NFs in most instances did not indicate how the applicant's 50% contribution will be funded.
- 19 out of 72 claims (26%) tested were paid without the requisite documentation. Five officials were implicated in this regard.



## FINDINGS cont...



### Non-compliance to incentive schemes guidelines and SOPs

- For 9 of the 58 (16%) applications investigated the Trade and Industry Advisor (TIA) did not perform site visits prior to submitting applications to adjudication committee. One official was implicated in this regard.
- 20 of the 58 (34%) applications investigated were processed and approved without the required documentation. Five officials were implicated in this regard.
- For 4 of the 58 (7%) applications investigated the TIAs did not confirmed that three quotations were submitted for each activity applied for. Three officials were implicated in this regard.
- For 2 of the 58 (3%) applications investigated the lowest quotation was not accepted, without documenting reasons for not accepting the lowest quotation. Two officials were implicated in this regard.
- 12 of the 58 (21%) applications were approved by the adjudication committee with less than three quotations however the motivation for deviations were not approved by the AO. One official was implicated in this regard.



# FINDINGS cont...



## Validity of awarding BBSDP incentives

- 34 grant applicants that had a turnover above R1 million, however these applicants were not registered for VAT .
- We noted multiple instances where preferred service providers that quoted above R1 000 000 did not include VAT in their quotations. They also failed to provide their VAT registration number on their quotations. These quotations, amounting to R12 050 625 were accepted by the BDOs.
- One supplier was registered for VAT according to the SARS website but did not charge VAT on their invoice. The invoice was for an amount of R1 360 000.
- During the investigation we identified that directors of multiple companies applied for and received grants exceeding the R1 million threshold .



# FINDINGS cont...



## Authenticity of BBSDP suppliers and quotations

- In one instance CIPC searches indicated that the service providers who submitted quotations for tools and equipment share a common director.

## False declaration of interest by the grant applicant

- \One instance was noted where a member of a co-operative appears to have made a false declaration in their application submitted. The application reflected that the applicant and service provider are not connected. However CIPC searches reflected that a member of the co-operative, is also a director of the approved and paid supplier.



## FINDINGS cont...



### Verification that goods and services were delivered/received by the BBSDP grant applicant

- The AGSA performed site visits at the premises of 50 approved grant applicants. In 32 of the 50 (64%) site visits, the AGSA was unable to locate or verify the existence of such premises and/or assets for which the grant funding was provided. DSBD paid R19 921 877 to these 32 entities.
- Three different grant applicants indicated the same address on application forms and the inspection report compiled by the BDO for one of these applicants confirmed the address. The AGSA investigation team visited the address and confirmed the address belongs to a homeless shelter. A total amount of R1 287 720 was paid to two of these grant applicants at the draft management report (22 February 2019).



## FINDINGS cont...



### Verification that goods and services were delivered/received by the BBSDP grant applicant (cont...)

- One instance was noted where a grant applicant applied for and was paid an incentive for equipment amounting to R800 000. The inspection report contained photos of a digital packing machine reflecting the serial number of the equipment. During the AGSA inspection an old analogue machine was found on site, with a serial number which corresponded to the pictures on file. However, the equipment differed.
- In three instances, grant applicants received incentives for weighbridges amounting to R2 400 000. The inspection reports indicated that equipment had been delivered to the applicants. The AGSA visited the premises and determined that the weighbridges belonged to other third parties and not the applicants .



## FINDINGS cont...



### Verification that goods and services were delivered/received by the CIS grant applicant (cont...)

- The AGSA selected 10 co-operatives of the 58 sampled to physically verify whether the entities existed and if goods and services were actually delivered. Of the 10 co-operatives, the AGSA was unable to verify the existence of five of them (50%). The amount paid by DSBD to the five co-operatives amounted to R 1 692 792.



## FINDINGS cont...



### Monitoring and reporting processes followed by DSBD subsequent to the approval of the grant applicants

- It was confirmed by the BBSDP Director and BBSDP Deputy Director that no post-approval site visits were conducted for the BBSDP applications approved and paid.
- It was also confirmed by the CIS Deputy Director that the DSBD does not conduct post investment site visits on funded co-operatives.



## FINDINGS cont...

### Possible fraudulent BBSDP claims

- One instance was noted where a grant applicant submitted an extract of its bank statement to DSBD as proof that they paid the full amount of R1 504 100 on 20 November 2015 for equipment to a service provider. The AGSA however noted that the bank statement also reflected that the same amount (R1 504 100) was paid by the service provider into the grant applicant's bank account on 20 November 2015. The net effect of the money transfer is zero. On the BBSDP claim file the BDO, indicated that the equipment was delivered. However, the AGSA could not locate the premises at the address indicated on the BBSDP inspection report. The AGSA was therefore unable to establish whether the equipment was delivered .
- The AGSA noted one instance where the grant applicant applied for a BBSDP grant to purchase equipment, however we noted from the available documents that the applicant possibly already had the equipment in their possession before applying for the grant.



# FINDINGS cont...



## Possible fraudulent BBSDP claims cont...

- Another grant applicant procured imported machinery from a service provider based in the USA. However, we noted that the machinery differed from the photo evidence submitted with the inspection report and that the machinery was manufactured in 2010 by a Chinese based company. This suggests that the applicant possibly already owned the machinery before applying for the grant. Furthermore, there is a possible conflict of interest between the grant applicant and the service provider in that the director/member of the grant applicant and the director of the service provider appear to be spouses based on their social media profiles.



## FINDINGS cont...



### Possible fraudulent BBSDP claims cont...

- Four separate grant applicants applied for grants from DSBD during 2014 to 2016. DSBD paid grants totalling R3 118 411 to these four entities. Results from the inspection of the claim files and CIPC searches is suggestive of the possibility that the four entities are connected. The BDOs that performed the site visits relating to these claims indicated in the inspection reports that the equipment was delivered however, when the AGSA visited the address indicated on the BBSDP inspection report, there was no sign of such businesses at the indicated address.



# FINDINGS cont...



## Possible fraudulent BBSDP claims cont...

- The AGSA inspected the bank statements of a grant applicant for proof of payment of 50% contribution to the service provider. However, according to the bank statement a separate government agency funded R686 250 for the equipment. According to paragraph 6.1.6 of the BBSDP guidelines entities are not eligible for funding if interventions are already funded by another government scheme. BBSDP officials did not comply with paragraph 6.1.6 of the guideline. The BDO was negligent in performing his/her duties, as the information showing the government funding was contained in the application file, which appears to have been overlooked by the BDO. Therefore the state paid for 100% of the cost of equipment amounting to R1 211 250 (approximately 50% other government agency and 50% DSBD).





## Network Facilitators findings relating to BBSDP

- In 34 instances (39%) the NFs did not check that the grant applicants complied with the requirements .
- In 16 instances (18%) it was identified that NFs did not ensure the submission of three valid competitive quotations .
- Fifteen instances (17%) were noted where NFs possibly made misrepresentations in diagnostic reports .
- Certain NFs (15 instances) and AFS preparers (5 instances) appear to be involved with possible misrepresentation of financial information contained in the Annual Financial Statements (AFS) and on the diagnostic reports .
- Furthermore, per the samples tested, nine NFs did not meet the criteria or did not submit the required documents to qualify to be on the approved list of NFs .



# FINDINGS cont...



## Network Facilitators findings relating to BBSDP cont...

- Three instances were noted where the NFs received a facilitation fee of R10 550 for facilitating applications for entities they are directors of. The BBSDP guidelines are silent with regards to NFs facilitating applications on behalf of applicants in which they have a directorship.
- We also noted seven instances where it appears that the NFs were involved with the submission of possible fictitious quotations.



# MANAGEMENT RESPONSE TO DRAFT MANAGEMENT REPORT

- Management has indicated that they will arrange training for all officials working with the processing of applications and claims to ensure compliance. Training interventions will comprise of the following:
  - Continuous refresher training to ensure that staff are updated on all new developments.
  - A suitable course to retrain all the TIAs has been sourced and SCM processes are in process to appoint a training provider.
  - The DSBD HR Unit is assisting with the process and it is envisaged that training will resume in the first quarter of the new financial year 2019/20.
- Management intends to institute disciplinary action against officials for non-compliance with the BBSDP guidelines.



# MANAGEMENT RESPONSE TO DRAFT MANAGEMENT REPORT

## cont...



- Management also intends to open cases of fraud against the officials, grant applicants and service providers with the South African Police Service.
- Management has decided to blacklist NFs that appear to have made misrepresentations in diagnostic reports and potentially colluded with officials.
- Furthermore, management will consider deregistering NFs that did not qualify to be registered as NFs or did not submit all required documentation.



## WAY FORWARD – DISCIPLINARY HEARINGS

- The AGSA has been assisting the legal counsel representing the DSBD in the disciplinary hearings with the drafting of the charge sheets issued to the DSBD officials in preparation for the disciplinary hearings.
- Disciplinary hearings have been provisionally set to be held on 12 – 13 September 2019.



# DEPARTMENT OF SMALL BUSINESS DEVELOPMENT INVESTIGATION FEEDBACK

