

CHAPTER 3

POST REVIEW OF THE ARMS PROCUREMENT PROCESS

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CHAPTER 3

POST REVIEW OF THE ARMS PROCUREMENT PROCESS

3.1 THE PUBLIC PHASE OF THE INVESTIGATION

The following is a compilation of the testimony given by the witnesses with regard to the process and procedure of the procurement under investigation.

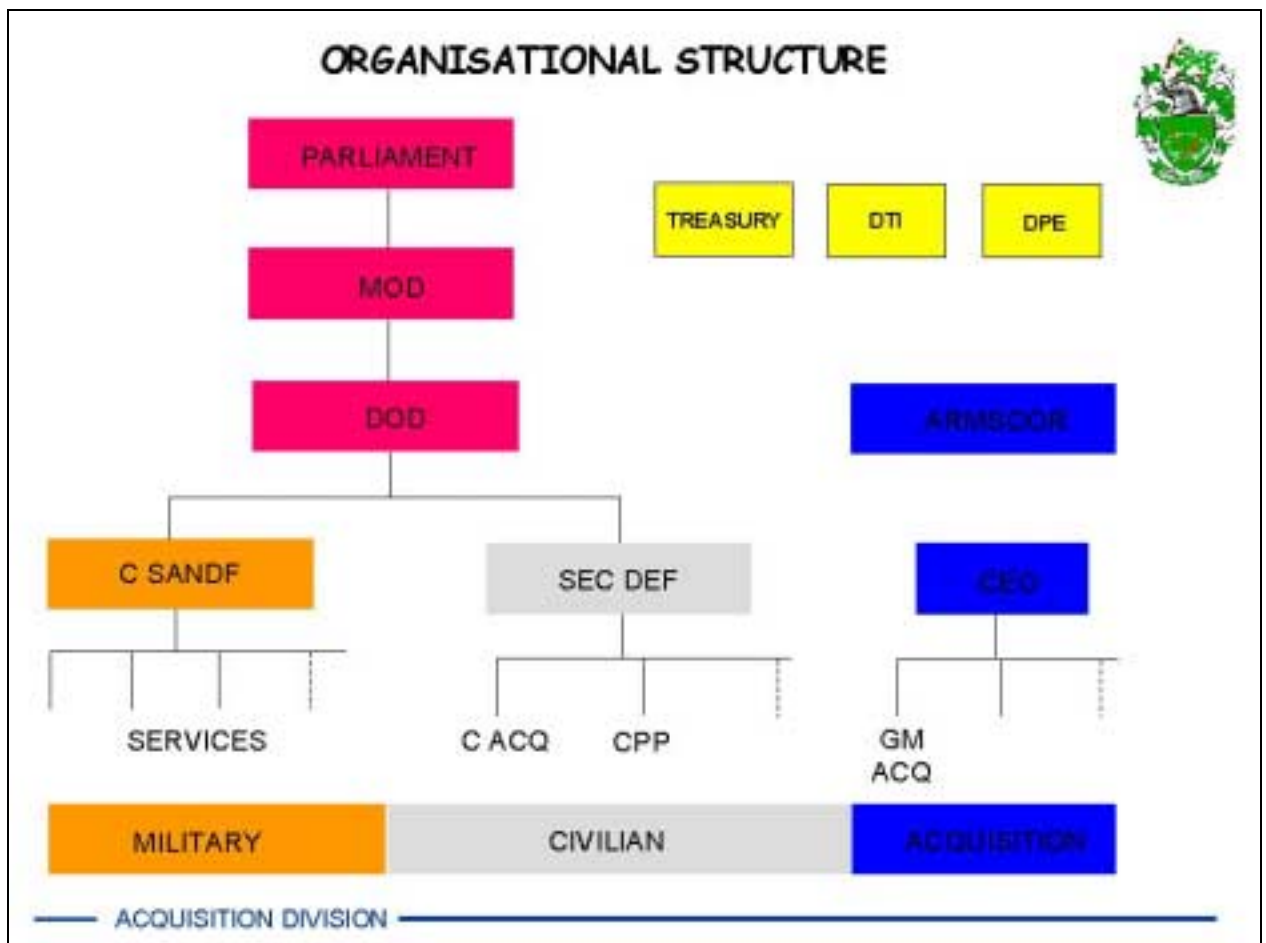
3.1.1 The acquisition process of the Department of Defence

3.1.1.1 The organisational structure

The organisational structure involved in the acquisition of armaments for the SANDF consists of the following four components:

- (a) The military component consisting of the Chiefs of the SANDF and the arms of service. They are mainly the clients of an acquisition programme.
- (b) The civilian component consisting of the Secretary for Defence, the Chief of Acquisitions and the Chief of Policy and Planning.
- (c) The Minister of Defence and his/her department, Cabinet and Parliament.
- (d) The Armaments Corporation of South Africa (Armscor). It was established in terms of the provisions of the Armaments Development and Production Act, 1968 and its core business is to acquire and produce defence material and related services for the Department of Defence. In addition, it also has to:

- (i) participate in the drafting of value systems;
- (ii) provide a system for tender management, tender evaluation and adjudication;
- (iii) contract with the defence industry;
- (iv) conduct professional programme management of acquisition programmes;
- (v) provide scientific support to the requirements definition and value for money assessment processes and manage the DIP programmes.



In the acquisition under consideration there were also other role players involved, such as the Departments of Finance (DoF), Trade and Industry (DTI) and Public Enterprises. DoF dealt with budgetary implications, financial affordability and macro fiscal and economic implications, whilst the Department

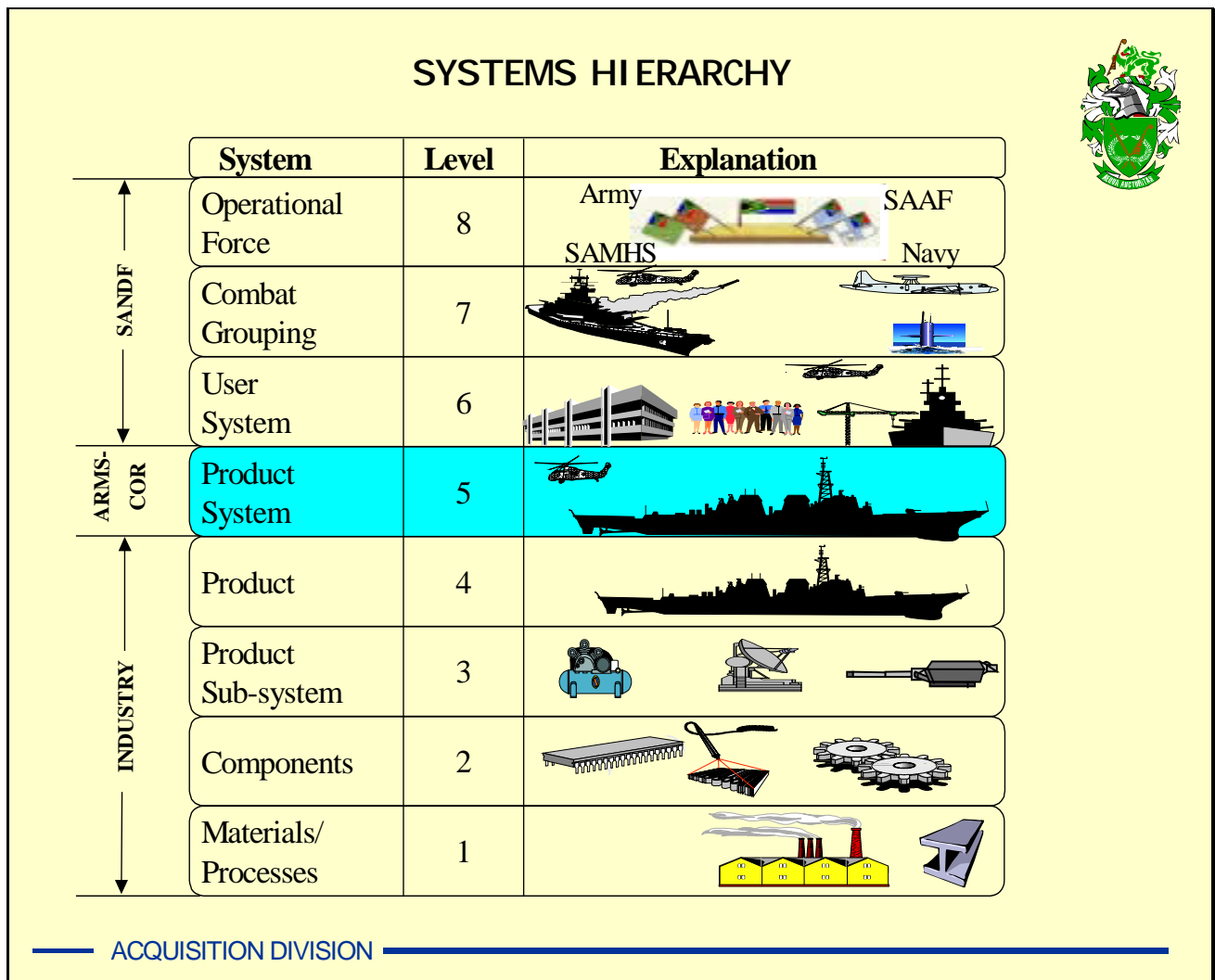
of Public Enterprises was responsible for the aspects relating to state-owned corporations. Industrial Participation was mostly the responsibility of the DTI.

3.1.1.2 The Acquisition Policy

Prior to 1994, South Africa experienced sanctions with regard to the acquisition of armaments in the international domain. Consequently, the modified acquisition policy in many respects did not make provision for armaments acquisitions on international markets. It was not structured to deal with a multi-project as it was the first time that the government acquired armaments of the magnitude of the SDP concerned.

3.1.1.3 The Weapons System Hierarchy

In order to understand the acquisition process fully one has to take note of the different levels of a weapons system.



Level 1 consists of raw material and processes, such as the manufacturing of ceramics. Level 2 consists of components such as integrated circuits, gears, etc. In level 3 one will find sub-systems such as air conditioning plants, radar and guns. Level 4 consists of a product, such as an aircraft or a ship. The Product System referred to in level 5 consists of a combination of level 4 products. Level 6 includes training facilities, airfields, etc. The combat grouping referred to in level 7 consists of a combination of ships, tanks, helicopters, submarines, etc that are grouped together. Level 8 is the full force structure of the SANDF.

The acquisition of the SDP was somewhere between off the shelf purchases and level 5 developments.

3.1.1.4 The milestone documents of an acquisition project

An acquisition project for an arm of service of the SANDF is not authorised at one level only. It is a process of progressive authorisation and each process is depicted in the following prescribed documentation:

(a) The Required Operational Capability

The contents of this document are based on a priority decision as to what is required to address particular deficiencies in the arm of service concerned. It is not a mandatory document.

(b) The Staff Target (ST)

This is a mandatory document containing a decision in respect of the proposed project of acquisition.

(c) The Staff Requirement (SR)

This document deals with the concept decision of what is required and contains the Functional User Requirement Specification. The User Requirement Specification (URS) does not necessarily refer to the technical specifications of what is required, but, in most cases, rather to what it is that the required system, irrespective of its technical specifications, should be able to achieve. The SR is not a mandatory document.

(d) The Project Study Report contains the decision about whether the product required would have to be designed and developed or whether it can be procured off the shelf. It is not a mandatory document.

(e) The Acquisition Plan

This is a mandatory document that indicates a commitment to acquire the product concerned at a specified price. It thus commits the budget of DoD to a particular expenditure.

(f) The Closure Report

This document indicates that the acquisition has been concluded and that no payments or deliveries are outstanding.

PROJECT DOCUMENTATION		
Required Operational Capability	(ROC)	- Priority Decision
Staff Target	(ST)	- Project Decision
Staff Requirement (FURS)	(SR)	- Concept Decision
Project Study Report (A –Specification)	(PSR)	- Make / Buy Decision
Development Plan (B-Specification)	(DP)	- Development Decision
Acquisition Plan (C, D, E-Specifications)	(AP)	- Manufacturing Decision
Closure Report	(CR)	- Operational Decision

ACQUISITION DIVISION

3.1.1.5 The approval forums

The approval of the milestone documents, referred to in paragraph 3.1.1.4 above, has to be granted by forums at different levels within the arms of service and DoD.

These forums are the following:

- (a) The Service Council, such as the Navy Council

This forum is chaired by the Chief of the service concerned.

- (b) The Operations Staff Council
- (c) The Defence Staff Council
- (d) The Armaments Acquisition Control Board (AACB)

The Chairperson of this Board is the Chief of the Acquisition Division of DoD. Its main function is to ensure that the acquisition policy has been followed and that all the submitted milestone documents can be forwarded to the next level for approval.

- (e) The Armaments Acquisition Steering Board (AASB)

This Board is chaired by the Secretary for Defence. It has to approve the ST, Project Study Report and the Acquisition Plan before they are forwarded to the next level of approval.

(f) The Armaments Acquisition Council (AAC)

The Minister of Defence chairs this Council and it, *inter alia*, also has the Deputy Minister of Defence, the Chief of the SANDF and the Chief Executive Officer of Armscor as members. In the case of the SDP the mandatory ST and Acquisition Plan documents had to be approved at this level.

(g) The Council on Defence (CoD)

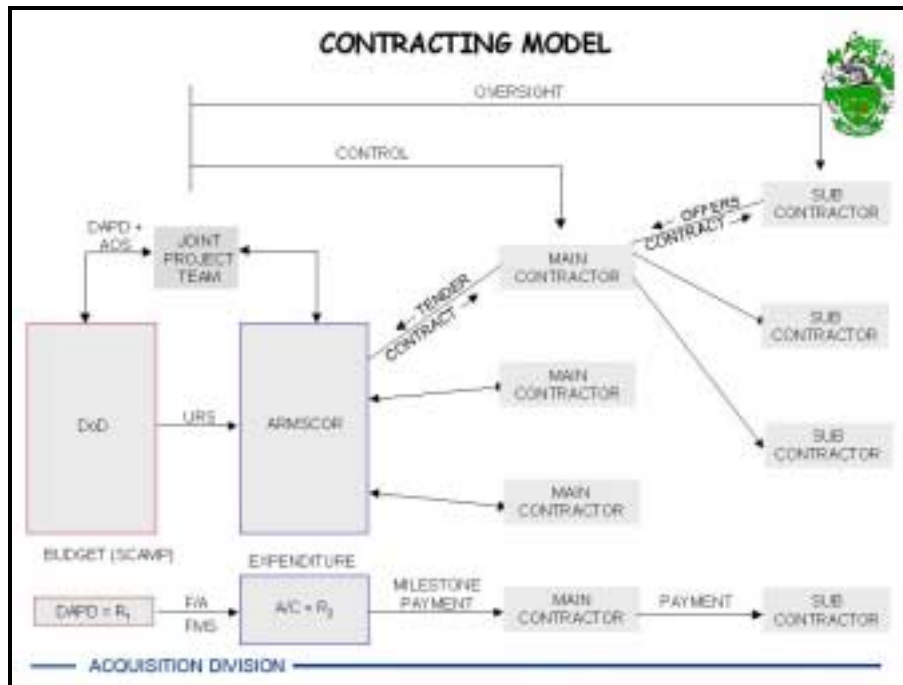
This Council is virtually the same as the AAC, but it also has some other functions.

The next step would be to refer the matter to a Ministers' Committee or directly to Cabinet, depending on the circumstances. Once Cabinet approves the acquisition, the project is referred to Armscor for implementation.

3.1.1.6 *The contractual relationship between the Department of Defence and contractors*

The Department does not pay suppliers. The contractual relationship exists between Armscor and the contractor. It is for the main contractor to contract with subcontractors for the provision of services and products required to deliver the product described in the main contract. However, the Department, in certain cases can deliver some input with regard to the approval of subcontractors, although this does not constitute total control over the decision about which subcontractor is appointed by the main contractor. Issues such as a history of poor delivery by a subcontractor or the risk involved in using a particular subcontractor may be brought to the attention of the main contractor. The final decision about which subcontractor should be used

remains the responsibility and the right of the main contractor. (For more detail on the selection of sub-contractors, see chapter 10 of the report)

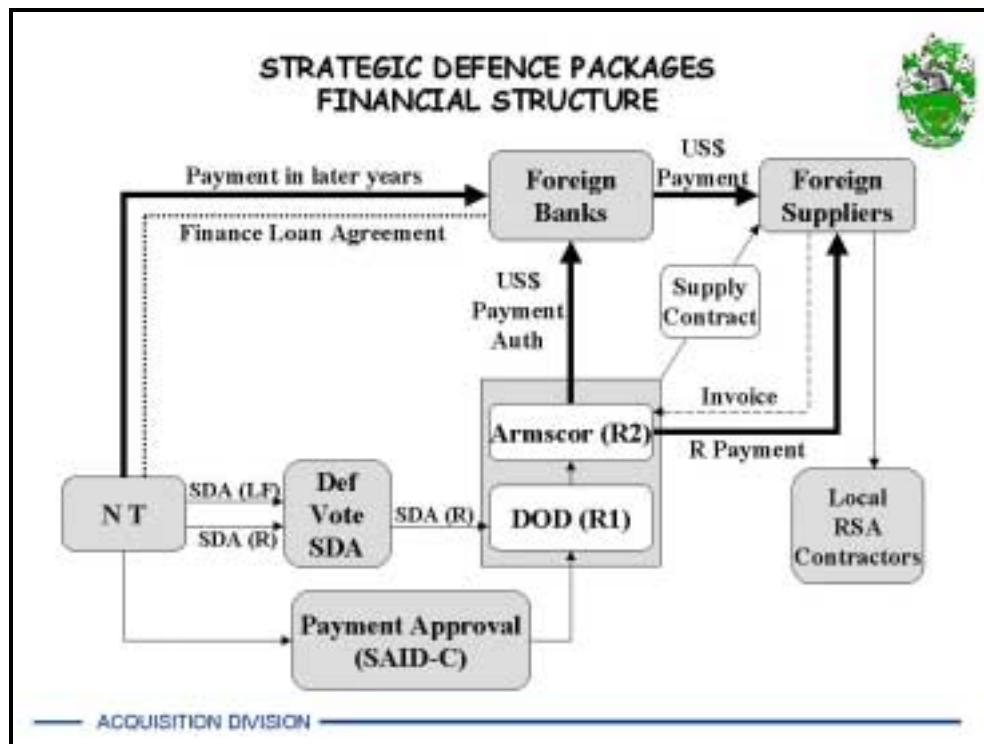


3.1.1.7 The financial structure of the Strategic Defence Packages

There are two types of funds for the SDP. On the one hand there is the funding provided in South African currency *via* the Special Defence Account. The Chief of Acquisitions tasks Armscor, as the expenditure authority, to pay the supplier (main contractor) for the product or service provided. If the money claimed by a foreign supplier is for the payment of a local subcontractor, the payment will be made in Rands.

On the other hand, there is a Special Defence Account approval for loan funds or so-called "quasi-money". If a foreign supplier submits an invoice for payment to be made to itself or a foreign subcontractor, Armscor is instructed to authorise a foreign bank, with which an arrangement has been made, to pay the supplier. The funds for such payment are drawn from a loan pool in terms of an agreement between foreign banks and the Department of Finance

(National Treasury). The currency of payment is also determined in terms of the agreement, taking into account the most suitable exchange rate at the time of payment.



3.1.2 The role of Armscor in the acquisition process

Armscor is governed by a Board of Directors and the Chairperson of the Board is accountable to the Minister of Defence. As indicated above, Armscor is the acquisition agency of the Department of Defence. The core business of Armscor is briefly explained by the following presentation:

ARMSCOR : CORE BUSINESS

- Core business of Armscor is to acquire/produce defence matériel and related services for the Department of Defence (Para 3(2)(l) of act)
- Tasks of Armscor
 - Participating in the drafting of value systems
 - Providing a system for tender management, tender evaluation and tender adjudication.
 - Contracting of Industry to satisfy DoD requirements
 - Professional Programme Management
 - Providing scientific support during requirements definition process and value for money assessment process
 - Management of Defence Industrial Participation programmes
 - Expenditure Authority for selected Capital and Operating budget elements (Including SDP funds)



3.1.2.1 Armscor as a tender board

The Armscor Board of Directors is also a tender board as provided for by the provisions of the State Tender Board Act. It functions as a defence matériel tender board. In this capacity, the Board considers and evaluates all acquisition recommendations made by project teams. The Board has to approve the supplier, the product and the agreed price. As the contracting authority for the acquisition of all defence material, the Board must also take into account specific performance criteria and risk factors pertaining to a particular proposed acquisition. The Board may delegate some of its authorisation responsibilities to subordinate committees and has done so in terms of very specific policy documents.

ARMSCOR AS A TENDER BOARD

- Armscor Board functions as Defence Matériel Tender Board
- Considers and evaluates all acquisition recommendations made by project teams for purposes of approving
 - The supplier
 - The product
 - The agreed price
- Makes recommendations and directs performance on
 - Specific contracting conditions and considerations
 - Specific performance criteria
 - Specific and appropriate controls
 - Specific financial risk management plans & actions
- Contracting Authority for the acquisition of all defence matériel

 Formally issues delegations to subservient authorization committees by means of A-Proc-019 (Clause 5B(1) of Act)

3.1.2.2 *The standard Armscor acquisition process*

Being the acquisition agency of the DoD, Armscor is involved in the initial stages of determining the needs of the arm of service involved, the development of plans to address the user requirements and the selection of the best possible alternatives. However, the arm of service involved leads these processes.

Once approval has been obtained for the acquisition to be effected, a Request for Proposal (RFP) document is generated during a process of identifying potential suppliers of the product required. Armscor has a process by which tenders are not only solicited from such suppliers, but a RFP is also advertised on a bulletin board which makes it available to all other unknown potential suppliers. The RFP document contains all the requirements of the product or service required, the industrial participation requirements, if applicable, and the

evaluation criteria that would be used to evaluate the tenders, excluding the weightings of the criteria. The Procurement Secretariat of Armscor has to verify that an approved value system is lodged prior to the distribution of a RFP. The value system is developed to ensure that the successful offer would best meet the need as described in the RFO, keeping in mind also the best value for money. After receipt of the offers, a joint evaluation team evaluates them against the approved value system. The recommendation of the evaluation team is then submitted to the Armscor Board. Once it is approved, an order is issued and the contract managed by Armscor.

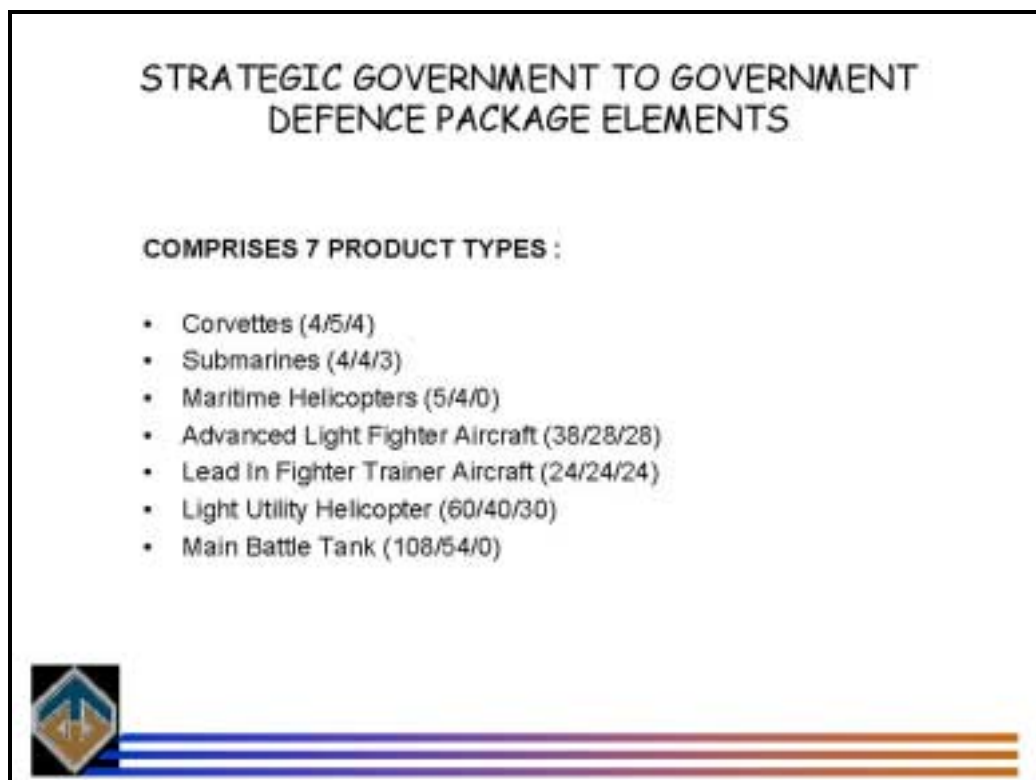
3.1.2.3 The acquisition of the Strategic Defence Packages

The seven core capability requirements of the SANDF that were identified by the Defence Review are the following:

CAPABILITY	EQUIPMENT	QTY	SOURCE
Surface Combat	Corvette (+ Helicopter)	4 (+6)	Foreign
Sea	Submarine	4	Foreign
Combat Air Transport	Light Utility Helicopter	60	Foreign
Air Space Control	Fighter Aircraft	38	Foreign
	Trainer Aircraft	24	
Armour	Main Battle Tank	108	Foreign
	Infantry Fighting Vehicle	-	Local
	Personnel Carrier	-	Local
Air Defence	SAM (Portable + Towed)	-	To be defined
	Fire Control System	-	To be defined
Anti Armour	Combat Support Helicopter	16	Local
	Anti Armour Missile	-	To be defined

This force design was revised during 1998. The numbers in brackets in the table below indicate the following:

- (a) The first number refers to the initial force design quantity. These were the numbers which were requested during the Request for Information (RFI) phase.
- (b) The second number indicates the revised force design.
- (c) The third number indicates the final quantity of the particular product that was contracted for, following the negotiation process.

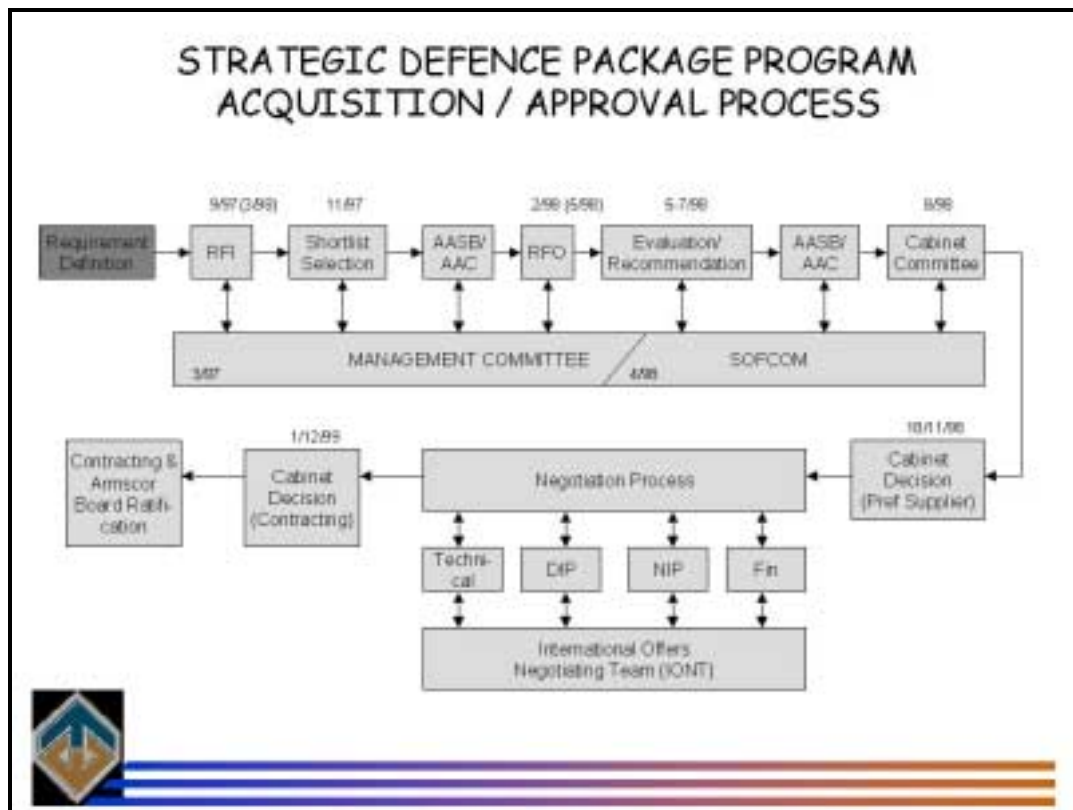


Following the in-principle authorisation by Government of the acquisition of the SDP, a document entitled "Request for Information" in respect of each of the required product types was forwarded to the embassies of 9 countries during September 1997 and March 1998. The purpose of this process was to establish

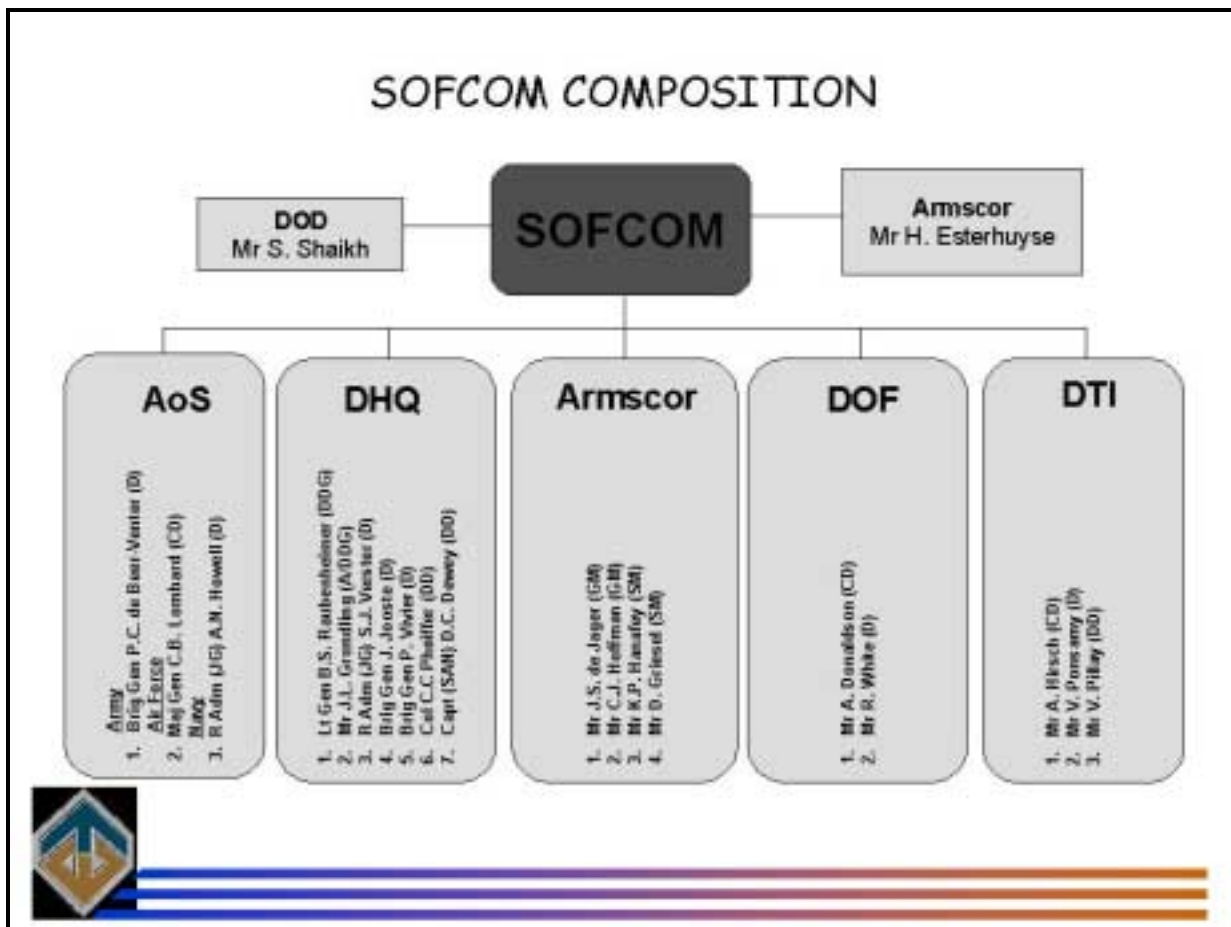
who could potentially provide the required weapon systems. Responses were received from 11 countries (3 unsolicited countries also responded). In total 37 responses were received for the 7 product types (system level 4).

The next process was to select a short list of the equipment available according to a value system. The short list essentially indicated which products within each category met the minimum requirements of the respective end users. The short list was presented to the AASB who made a recommendation to the AAC. During February and May 1998, Armscor forwarded RFOs to the potential suppliers of the equipment, as per the short list. This was done in order to solicit the best and final offers for the supply of the equipment involved. This request included reference to all the requirements, such as the technical specifications, industrial participation and financing of the acquisition.

On receipt of the bids in response to the RFOs, the evaluation phase commenced. This happened during the period May to July 1998. The recommendation as to who the preferred supplier should be was then made to the AASB for further recommendation to the AAC. At this time it was decided not to continue with the proposed acquisition of the main battle tank. The packages were thus reduced to 6. After the AAC made the recommendation in September 1998, it was submitted to the Cabinet Committee (the Ministers' Committee) responsible for the acquisition of the SDP. The Ministers' Committee consisted of the Ministers of Finance, Trade and Industry, Public Enterprises and Defence and was chaired by the Deputy President. The Cabinet decision regarding the preferred suppliers was made on 18 November 1998.

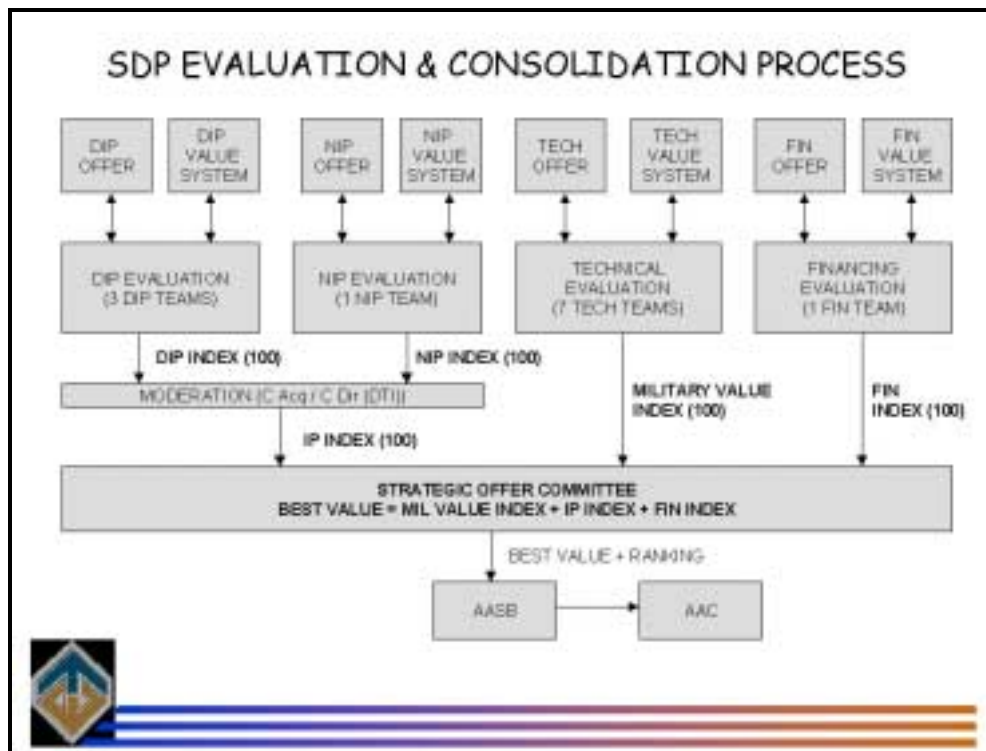


The process from the RFO stage up to the recommendation to the Ministers' Committee was initially co-ordinated by a Management Committee that was constituted in March 1997. It initially consisted of members of DoD and Armscor. However, it was expanded over time to include members of the Departments of Trade and Industry, Finance and Public Enterprises. During April 1998, the Management Committee was replaced by a more formal inter-departmental committee called the Strategic Offers Committee (SOFCOM). The participation of these committees in an acquisition process is not normal procedure. It was, however, thought prudent to have such a co-ordinating structure under the circumstances, to effect additional safeguards, where seven acquisition programmes were running simultaneously so as to ensure uniformity in all respects, including evaluation. SOFCOM was constituted as follows:



The representation of DTI on the SOFCOM changed as a result of the absence of Mr Hirsch from the department and the departure of Mr V Ponsamy. Mr V Pillay was the remaining DTI representative and he reported to the then Director-General.

The evaluation and consolidation processes pertaining to the SDP are explained by the following diagram:



The industrial participation (refer chapter 12), military value and financing parts of the offers each had an index of 100 points. The different evaluation teams met early in July 1998 with SOFCOM and the final consolidation was done. The military value was added to the industrial participation and financing values and the offerer with the highest score was recommended as the preferred supplier to the AASB and AAC, as indicated earlier.

It is not the policy of Armscor to interfere with the selection of subcontractors.

The prime contractor is held responsible for providing the service or product contracted for.

In the case of the acquisition of the SDP, Armscor had to deviate from its policy in the sense that the Board could not insist on having financial authority from DoD prior to approving a preferred bidder for the purposes of negotiation. In this case the financial authorisation had to come from Cabinet once the total

impact of the acquisition, not only on the defence budget, but also on the financial well being of the country as a whole, had been considered.

3.2 THE FORENSIC INVESTIGATION BY THE OFFICE OF THE AUDITOR-GENERAL

The forensic investigation by the Office of the Auditor-General of the procurement process of the SDP should be considered in addition to the evidence obtained during the public phase of the investigation in this regard.

3.2.1 The scope of the forensic investigation

3.2.1.1 Documenting the overall process followed and comparing this with approved or standard procedures.

3.2.1.2 Documenting the role played by various committees, individuals and Cabinet in this process, from the specification stage up to the awarding of contracts.

3.2.1.3 Evaluating State Tender Board process, Armscor process, and general procurement practices, and recommending best practice.

3.2.2 Approach

3.2.2.1 During the course of the investigation, the procedures dealt with below were performed.

3.2.2.2 The "*Special Review by the Auditor-General*" issued on 15 September 2000, was studied, and the key findings regarding the following were investigated:

- (a) Ministry of Defence (MoD) Policy
- (b) Armaments Acquisition Policy

- 3.2.2.3 The response of DoD with regard to the Special Review was studied.
- 3.2.2.4 The following documents (policies) were reviewed to obtain an understanding of the acquisition process and to achieve the above objectives:
- (a) Armscor
 - Armaments Development and Production Act No 57 of 1968
 - VB1000 – Armscor general policy for the management of category 1 matériel acquisition process
 - KB1000 – Armscor Acquisition Policy
 - A-PROC-097 – Armscor practice for the selection of contractual sources
 - (b) Department of Defence
 - Defence Act No 44 of 1957
 - MODAC Investigation of Technology and Armaments: Acquisition in the Department of Defence
 - DoD Policy Directive No 4/147: MoD policy for dealing with International Defence Equipment offers in the MoD
 - DoD instruction No ACQ/1/98: Policy on the acquisition of armaments
 - (c) Defence Review 1998
 - Chapter 13, The Acquisition Management Process
 - (d) International Arms Procurement Procedures
 - The Acquisition Handbook: United Kingdom

- Defence Procurement Policy Manual: Australia

3.2.2.5 Interviews were conducted with various role players in order to obtain evidence pertaining to the acquisition process of the SDP and to discuss areas of concern regarding the acquisition process.

3.2.2.6 The testimony given by witnesses in the public phase of the investigation was also considered.

3.2.3 Background – DoD’s response to the Special Review of the Auditor-General

During the Special Review of the Auditor-General [RP161/2000], certain procedures during the acquisition process were found not to be in accordance with the procedures laid down for armaments acquisition. In response, the DoD verified the following:

3.2.3.1 VB1000

(a) The DoD and Armscor procedures relating to proper acquisition management were incorporated into a single document called VB1000, by merging LOG 12 Pamphlet 2 of the DoD and KB1000 of Armscor. The fundamental basis of this policy relates to risk abatement during the transformation of an operational needs statement through conceptual design and detail design development culminating in industrialisation and the eventual manufacturing of the product. In essence this policy was created to control the creation of new locally designed and developed weapon system products. The VB1000 is both an engineering management tool as well as a programme management tool used and interpreted by comprehensively trained engineering and programme

management staff in order to transform operational requirements into a weapon systems product by means of the systems engineering process.

- (b) DoD and Armscor developed the VB1000 during the sanctions period prior to 1994, when local design-development was paramount. The lifting of the arms embargo created new opportunities in the acquisition management process. It was therefore important to interpret the acquisition management document, which, in its proper perspective, is a risk abatement strategy document.
- (c) The SDP can therefore be considered to be unique acquisition management programmes, in which seven cardinal projects had to be brought to a common starting baseline. This required extensive interaction within the arms of service with regard to individual authorisation procedures. Approvals and recommendations had then to be submitted to DoD and Armscor at corporate level for final approval and execution. The distinguishing feature of the SDP lies therein that they are basically all existing foreign designed and developed weapon system products. Hence it was necessary to adapt and interpret VB1000 in order to merge it with a foreign procurement programme.
- (d) The VB1000 policy document states clearly that the only two non-negotiable milestone documents of a project are the ST and the Acquisition Plan. Submission of all other prescribed milestone documents is a derivative of the nature of the programme undertaken.

3.2.4 MODAC

Although DoD indicated that the VB1000 was used during the acquisition of the SDP, the following other policies were approved during the acquisition, since

international defence equipment offers fall outside the scope of the existing policies and a policy about this had to be established.

3.2.4.1 *Modac Investigation of technology and armament: Acquisition in the DoD*

In August 1994, the former Minister of Defence issued an instruction that the acquisition function in DoD should be investigated. The objective was to comply with the White Paper on Defence, which stated that the management expertise for the specialised procurement function should be located within DoD. A Steering Committee, under the chairmanship of the Minister, and a Departmental Project Team were appointed. The project team became known as the MODAC work-group. This work-group was instructed to investigate and make proposals with regard to the management, execution and structure of the acquisition function in DoD. The work-group conducted the investigation in three phases, and produced the following reports:

- (a) MODAC 1 – Technology and Armament Acquisition Management in the Department of Defence:

The MODAC 1 report defined the roles of different parties within the Department of Defence, and established a new acquisition management process and approval structure. This included the establishment of the AACB, AASB and the AAC, which replaced the existing mechanism, namely the Project Control Board, the Defence Command Council and the Defence Planning Council. This report was approved by the Steering Committee on 10 February 1995.

- (b) MODAC 2 – Defence Industry Policy:

This policy deals with acquisition, industrial development and arms trade. The policy also stated that all major foreign procurement contracts should

contain counter trade agreements. This report was approved by the Steering Committee on 26 September 1995.

(c) MODAC 3 – The Organisational Structure of the Defence Acquisition Programme Management Organisation:

The organisational structure of the Defence Acquisition Programme Management Organisation (Armscor) was investigated. A standard value-analysis methodology was used to analyse alternative structures. The MODAC 3 analysis was presented to the Steering Committee on 31 May 1996 and the Minister decided that Armscor should continue to operate as a state-owned entity with statutory powers.

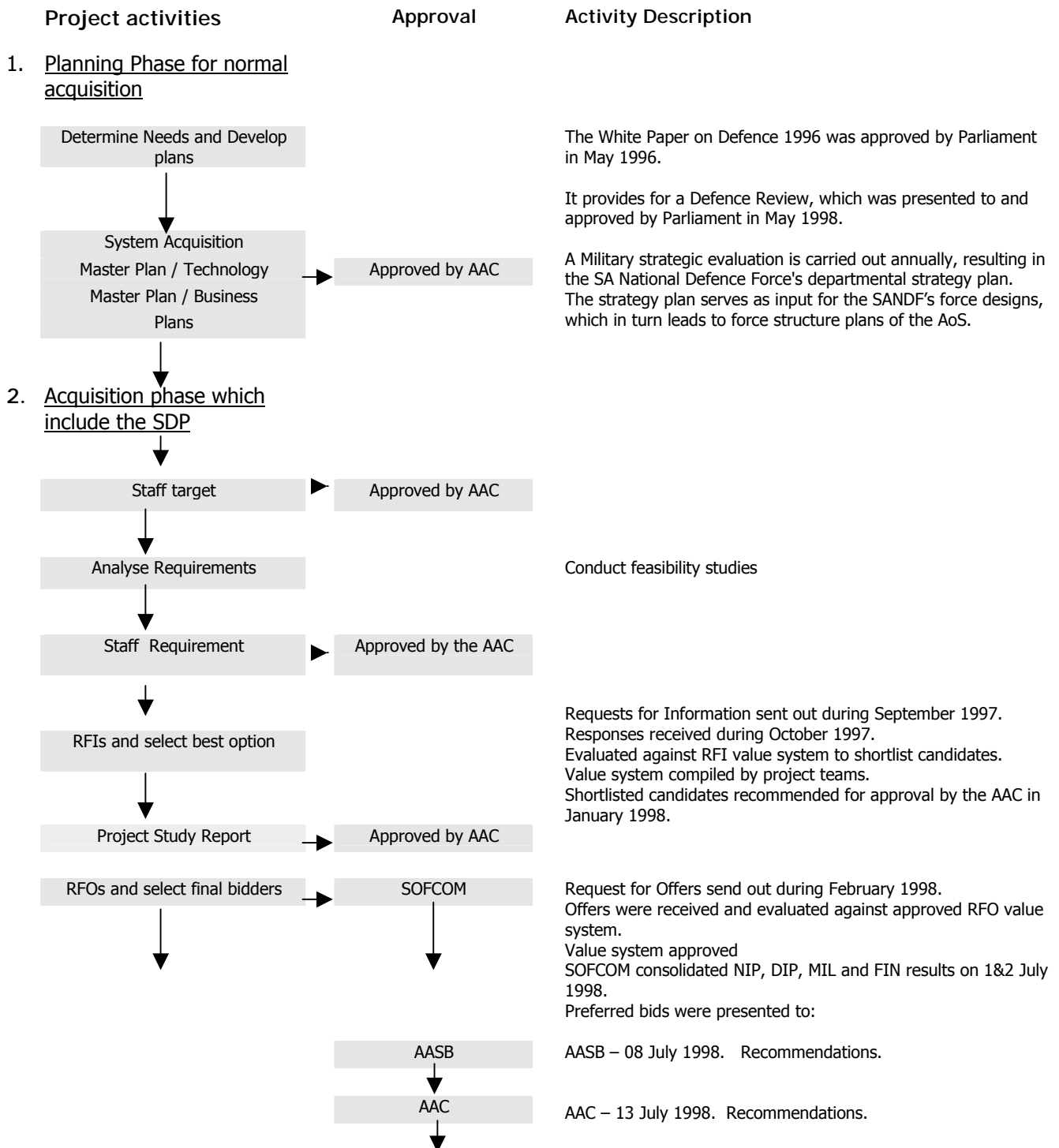
These reports were approved by the Steering Committee as departmental policies. The former Minister of Defence, Mr J Modise, signed the reports on 8 August 1996.

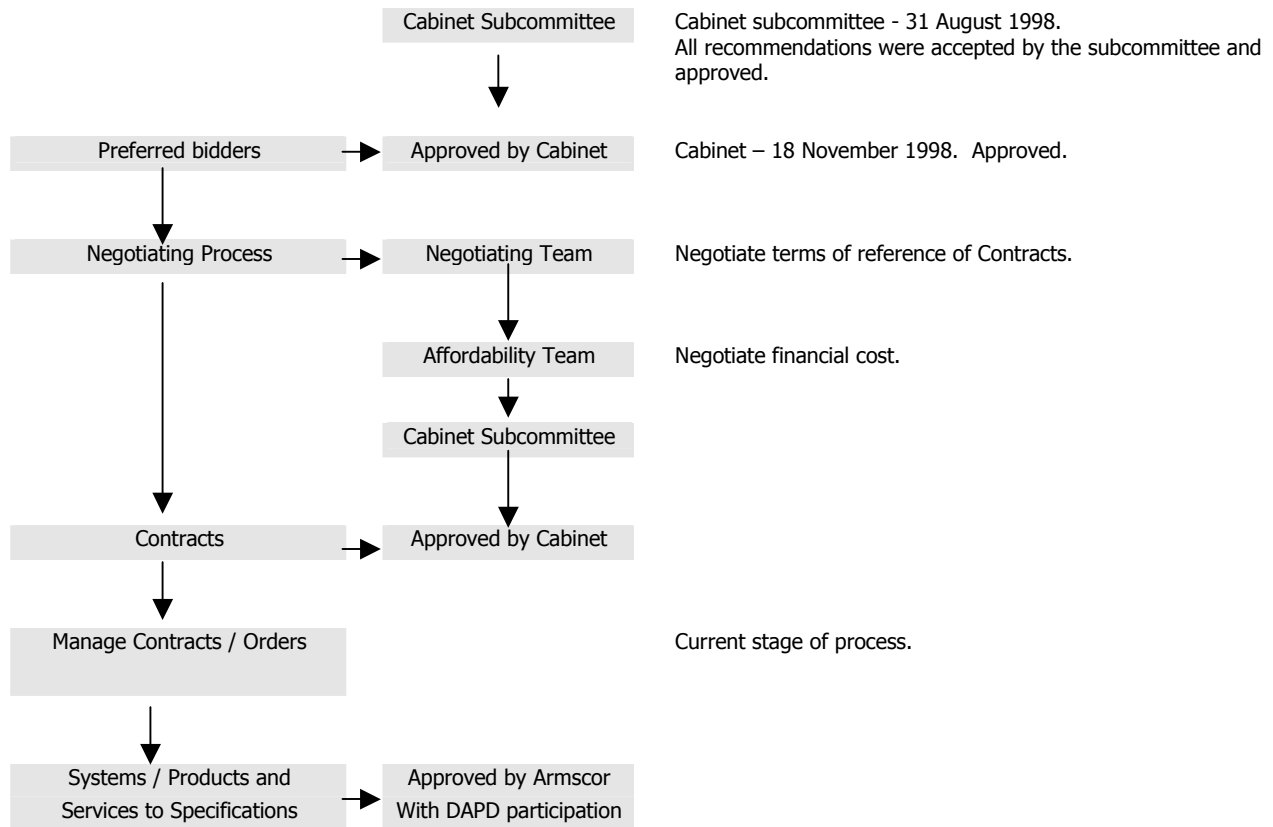
3.2.5 DoD instruction No ACQ/1/98: Policy on the acquisition of armaments

DoD issued instruction No ACQ/1/98: Policy on the acquisition of armaments, which was authorised by the Acting Secretary for Defence and implemented on 19 July 1999. It provides for the acquisition of armaments for the DoD in pursuit of national objectives, defines accountability and responsibilities, the armaments acquisition approach, as well as the armaments acquisition management policy and project management. The policy includes the necessary procedures and authorising bodies in order for the DoD and Armscor to be able to deal with international defence equipment procurement in future. During the investigation, similar policies of the United Kingdom and Australia were considered and found to compare favourably with the mentioned policy developed during the acquisition process of the SDP, referred to above.

3.2.6 The acquisition process

During the forensic investigation, the process followed for the acquisition of the SDP was documented and can be summarised as follows:





Note: according to the VB1000, the Staff Target and Acquisition Plan are the only mandatory non-negotiable milestones. The other milestone documents are a derivative of the nature of the programme.

3.3 FINDINGS

From the public phase and the forensic investigation it appears that:

- 3.3.1 The Strategic Defence Packages were unique to South Africa. Firstly, it was the first time that a “package approach” to the acquisition of armaments was adopted. Secondly, the acquisition consisted mainly of foreign designed and developed weapon systems.
- 3.3.2 Due to the sanctions imposed on the acquisition of arms prior to 1994, an adequate acquisition policy to accommodate the procurement of armaments for the SANDF in the international markets did not exist.

- 3.3.3 DoD recognised the limitations of the procurement policy (i.e. VB1000), which existed during the acquisition process in question and the need to adapt and interpret it, in order to render it suitable for the international procurement programmes.
- 3.3.4 In addition to the VB1000, a number of departmental policies (MODAC) were developed during the acquisition process in question to comply with the White Paper, at the instance of the former Minister of Defence, which culminated in DoD Instruction No ACQ/1/98:Policy on the Acquisition of Armaments.
- 3.3.5 The MODAC policies gave rise to the replacement of the former Project Control Board, the Defence Command Council and the Defence Planning Council by the AACB, AASB and the AAC as the highest approval authority.
- 3.3.6 An additional body, namely SOFCOM has been established during the acquisition phase of the SDP to consolidate evaluation results for presentation to authorising bodies. The constitution of SOFCOM did not provide for decision-making authority. However, it was entitled to submit recommendations to CoD.
- 3.3.7 During the procurement process of the SDP, due to its magnitude and the cost involved the following was included, in addition to normal procedure:
- (a) Approved value systems for National Industrial Participation and Defence Industrial Participation as well as evaluation teams.
 - (b) Approved negotiation and affordability teams to negotiate terms of reference for contracts and to negotiate final costs before signing the contracts.
 - (c) SOFCOM, as reflected in paragraph 3.3.6, to consolidate evaluation results for presentations to authorising bodies.

(d) The Ministers' Committee, which considered recommendations presented to it and submitted final recommendations to Cabinet.

(e) The procurement process required the final approval by Cabinet.

3.3.8 The policy on the acquisition of armaments that evolved during SDP procurement process and that was approved in July 1999 (ACQ/1/98), consists of the necessary procedures and authorising bodies to enable DoD and Armscor effectively to deal with international defence equipment procurement. This policy compares favourably with defence procurement policies in the United Kingdom and Australia.

3.3.9 The variances from standard procurement practices were reported in the Special Review of the Auditor-General and included, *inter alia*, the fact that Staff Targets and Staff Requirements were not approved before sending out RFOs. It has been established during the investigation that the VB 1000 did not contain specific instructions in this regard.

3.4 RECOMMENDATION

It is recommended that the policy document (ACQ/1/98) referred in paragraph 3.2.5 above be further refined with specific reference to the lessons learnt from the acquisition process under investigation as reflected in this report. The staff of DoD and Armscor involved in procurement should be properly trained to ensure that they assimilate and fully understand the policy with a view to its effective implementation.