

# PARLIAMENT

## PFMA SECTION 55(2)(b)(i) EXEMPTION TO ESKOM HOLDINGS SOC LTD

PRESENTED BY:

National Treasury

Date: 05 April 2023



**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA



**STAY  
SAFE**

VACCINATE TO SAVE SOUTH AFRICA

# OUTLINE OF THE PRESENTATION

- Context and reasons for the exemption
- Problem Statement
- Rationale for the exemption (transparency and accountability test)
- Research conducted by the National Treasury
- National Treasury Instruction No. 04 of 2022/2023
- How is the government restoring Eskom's long-term financial sustainability?

# CONTEXT TO THE EXEMPTION

- Corruption is ENTRENCHED as identified by Zondo Commission, and new boards trying to nurse SOEs back to health
- A public entity, listed in schedule 2 to the PFMA, often also adheres to the JSE listing requirements and the Companies Act (2008) and reports in terms of the more onerous IFRS standards
- An exemption from the PFMA, such as for Eskom and Transnet, does not diminish adherence to these prescripts and competitiveness against private sector companies  
More importantly, **the exemption(s) don't remove** the legislative and governance requirements to:
  - **Identify and report all corrupt activities to the authorities**
  - Identify all procedural and deliberate non-compliance with laws and regulations, and take actions to recover any losses as a consequence of such
  - Identify weaknesses in internal control and take actions to address and strengthen governance structures and control environment
  - **Reporting of losses to Eskom as a result of criminal or other activities** in the financial statements

# CONTEXT TO THE EXEMPTION REQUEST

- Discussions started in July 2022 and on 26 October 2022, the Energy Procurement and Finance Workgroup of the National Joint Operational and Intelligence Structure supported Eskom's intent to request an exemption
- 09 March 2023, the Chairman of Eskom submitted a request for a section 92 PFMA exemption to the Minister of Finance
- The exemption related to section 55(2)(i)(ii) and (iii) of the PFMA, Regulation 28.2.1 and Instruction No. 4 of 2022/2023 (PFMA Compliance and Reporting Framework)
- The exemption request touched on three areas requested to be disclosed in the annual report and not the financial statements:
  - (a) material losses due to criminal conduct
  - (b) **irregular and fruitless and wasteful expenditure**
  - (c) any losses recovered or written off

For the periods  
22/23, 23/24 &  
24/25

# PROBLEM STATEMENT

## *Commercial mandate of SOEs*

- Major SOEs are bound by both the Companies Act and PFMA, and required to implement more onerous accounting standards (IFRS) and JSE requirements
- Audit opinion goes beyond that of other listed companies, and includes dealing with current and historic irregular expenditure in terms of PFMA
- Audit opinion is often linked to debt covenants which puts SOE's in automatic breach/default should they not receive an unqualified opinion on the financial statements
  - **Majority of SOE's have legacy issues following state capture** → have to identify irregular, fruitless and wasteful expenditure that arose **in the past** and are thus receiving qualifications on the opening balances of irregular, fruitless and wasteful expenditure reported in the financial statements
  - **Significant time and effort is required to review all historical information** in order to identify breaches in laws and regulations and to take appropriate actions as prescribed by NT

# PROBLEM STATEMENT

## *Commercial mandate of SOEs*

- In many cases, this default is accompanied by an increase in cost of borrowing, which puts further strain on already constrained cash reserves.
- In other instances, SOEs have to secure waivers from each and every lender impacted by the default event, such that lenders may not require accelerated or immediate repayment of debt etc.
- Inability to compete with other key players in the same industry

# PROBLEM STATEMENT

- Budget speech, February 2022, Minister of Finance:

*“We must differentiate between corruption and minor transgressions of the rules of policy prescripts that are audited as irregular expenditure.*

*The National Treasury is engaging with the Auditor-General to continue to ensure transparent disclosure of minor transgressions, but outside the financial audit process.”*

- Response of President Ramaphosa to state capture and corruption (6.1.8):

*“The National Treasury and the Auditor-General of South Africa (AGSA) are working together to review the usefulness of the concept of irregular expenditure, and to focus on identifying corrupt or suspicious expenditure, or expenditure made in bad faith. This is part of an effort to address the Commission’s recommendation cited in paragraph 5.3.2.3.”*

# RATIONALE FOR THE EXEMPTION

## Transparency Test

*“Eskom to disclose financial and non-financial information on irregular, fruitless and wasteful expenditure in its annual report”*

### Notes to the Annual Financial Statements

	Note	2022	2021
Irregular Expenditure incurred in the financial year	404,222	324,852	

Information retained in the notes to the AFS by all PFMA institutions

And

Extent of exemption granted to Eskom, but losses from criminal activities must still be disclosed in AFS

### Annual Report (or integrated report)

#### 25. IRREGULAR EXPENDITURE

##### 25.1 Reconciliation of irregular expenditure

Opening balance	806 412	40 490
Prior period error	-	-
As restated	806 412	40 490
Add Irregular expenditure—relating to prior year	67 719	444 302
Add Irregular expenditure—relating to current year	404 222	324 852
Less: Prior year amounts condoned	667 456	(148)
Less: Current year amounts condoned	(278)	(128)
Irregular expenditure awaiting condonation	583 649	806 412

##### 25.2 Details of irregular expenditure condoned

Issue	Underlying Code/Category	R2019
Value added without a contract	Accounting Error	25
Contract for internal systems was awarded without following competition	Accounting Error	9751
Condoned of funds to the commission for the security services	Accounting Error	4
Condoned of amounts without following the tender process	Accounting Error	5
The payment of R20.3 million for the RFP award	Accounting Error	8000
<b>Total</b>		<b>8078</b>

##### 2 Details of irregular expenditure - added current year relating to current and prior year

Issue	Category description	R2019
2019 Non-Office system	Internal with no communication or progress for implementation by management	420
2019 IT services without contract	Under investigation by internal audit	67
2019 IT services without contract	Under investigation by internal audit	128
2019 IT services without contract	Under investigation by internal audit	207
2019 IT services without contract	Internal with no communication or progress for implementation by management	181
2019 IT services without contract	Agreement of 2019 year amounts was approved by the accounting officer and signed by the controller	25

Information on IE previously required in the notes to the AFS has been moved to a compliance report (for 2022/2023 financial year)



# RATIONALE FOR THE EXEMPTION (cont.)

## Accountability Test

- Eskom to report on material losses due to criminal conduct in the Annual Financial Statements (AFS) (55(2)(b)(i) of the PFMA)
- Criminal and disciplinary steps taken as a consequence of such losses or irregular, fruitless and wasteful expenditure must still be disclosed in the AFS (sections 51(1)(e) and 55(2)(b)(ii) of the PFMA)
- Losses recovered and written off must still be disclosed in the AFS (55(2)(b)(iii) of the PFMA)
- Eskom's board still required to prevent irregular, fruitless and wasteful expenditure in terms of section 51(1)(b)(ii) of the PFMA
- Assurance in reported information (regularity audit-AFS and agreed upon procedure- annual report)
- Ensuring that agreed upon procedures are conducted on information reported in the annual report by external auditors, a condition of the exemption

# RATIONALE FOR THE EXEMPTION (cont.)

## Accountability Test

- Eskom will continue to report on material losses due to criminal conduct in the AFS as per the illustration
- This will include the following:
  - Theft of conductors, cabling and related equipment
  - Estimated non-technical revenue losses
  - Fraud

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NOTES TO THE FINANCIAL STATEMENTS continued  
for the year ended 31 March 2022.

**51. Information required by the Public Finance Management Act (continued)**

**51.3 Criminal conduct**  
Material losses caused by criminal conduct and any disciplinary, civil or criminal action taken in respect of such losses are reported in terms of the materiality framework.

	Note	Group		Company	
		2022	2021	2022	2021
<b>Losses incurred (Rm)</b>					
Theft of conductors, cabling and related equipment	(a)	316	139	315	139
Estimated non-technical revenue losses	(b)	2 291	2 319	2 291	2 319
Fraud	(c)	14	12	10	4
Other crimes					
Immaterial incidents (less than R25 million)		174	77	128	77
		<b>2 795</b>	<b>2 547</b>	<b>2 744</b>	<b>2 529</b>
<b>Losses recovered (Rm)</b>					
Theft of conductors, cabling and related equipment	(a)	18	5	18	5
Estimated non-technical revenue losses	(b)	447	563	447	563
Fraud	(c)	1	8	1	–
Other crimes					
Immaterial incidents (less than R25 million)		4	6	3	6
		<b>470</b>	<b>582</b>	<b>469</b>	<b>574</b>
<b>Number of incidents</b>					
Theft of conductors, cabling and related equipment	(a)	3 226	3 765	3 220	3 763
Fraud	(c)	65	17	20	9
Other crimes					
Immaterial incidents (less than R25 million)		1 568	1 692	1 457	1 680
		<b>4 859</b>	<b>5 474</b>	<b>4 697</b>	<b>5 452</b>
<b>Number of arrests</b>					
Theft of conductors, cabling and related equipment	(a)	244	111	243	111
Estimated non-technical revenue losses	(b)	16	–	16	–
Fraud	(c)	7	1	6	–
Other crimes					
Immaterial incidents (less than R25 million)		176	84	165	84
		<b>443</b>	<b>196</b>	<b>430</b>	<b>195</b>

**(a) Theft of conductors, cabling and related equipment**  
Actions to combat losses through criminal conduct are managed in collaboration with other affected state-owned companies, industry role players, the NPA and the SAPS, including:

- realignment of security contracts (scope and resources) and optimisation of deployment
- review of the Eskom asset disposal process and strategies
- focus on asset management and protection, including implementation of unique marking and tracking capabilities
- drive policy and legislative changes to address scrap and market regulation
- introduction of integrated, intelligent and smart security technologies and systems to reduce dependence on the human factor such as use of drones, intelligent cameras, alarm systems
- focused strategies and projects on revenue losses – metering, vending, tampering, disruptive operations, etc.

**(b) Estimated non-technical revenue losses**  
Non-technical losses arise mainly from meter tampering and bypasses, illegal connections to the electricity network and illegal vending of electricity. The management of non-technical losses focuses on ensuring that all energy supplied is accounted for. The energy losses management programme focused on minimising the non-technical revenue losses.

Eskom invoiced R752 million (2021: R685 million) of revenue relating to these losses during the year, of which R447 million (2021: R363 million) has been received.

**(c) Fraud**  
Material incidents (greater than R25 million)  
There were no individually material incidents that occurred in the year.

Immaterial incidents (less than R25 million)  
Eskom concluded 85 (2021: 17) investigations into fraud during the year. The internal control measures in the year were reviewed and enhancements recommended to the accountable line managers for implementation. The disciplinary, criminal and civil proceedings against those involved.

**51.4 Matters under assessment and determination**  
Matters under assessment and determination include the following:

- various non-compliance to PFMA section 51(1)(a)(ii) regarding the principles of fair, equitable, transparent, cost-effective procurement including inappropriate:
  - use of sole sources and emergencies
  - modifications to contracts
  - emergency procurements
- various non-adherence to tender processes including breacher of delegation of authority
- application of Preferential Procurement Regulations
  - tax non-compliance
  - application of evaluation criteria for measuring functionality
  - designated sectors
- potential losses due to a lack of reasonable care in project and contract management
- interest and penalties being levied against Eskom due to instances of late payment of suppliers

Some of the reviews and assessments are conducted by independent external parties.

Relevant disclosure will be made in a subsequent financial year should any losses or expenditure incurred prove fruitless and wasteful or due to criminal conduct.

**52. Reportable irregularities and matters under investigation**

**52.1 Reportable irregularities**  
The external auditors raised certain reportable irregularities in terms of section 45 of the Auditing Profession Act in the previous year end and new items identified in the current year.

The table below reflects the status of the reportable irregularities at 31 March 2022. The discussion focused on its status at the previous year end and new items identified in the current year.

Description	Action	5
<b>Reportable irregularities – 30 September 2021</b>		
1. A parliamentary inquiry was held into perceived misadministration, governance and procurement issues at Eskom. Certain representations made by previous and current directors and officials indicated that there could have been a breach of fiduciary duties in terms of the requirements of the Companies Act.	Action plans have been initiated to deal with the findings of the Zondo Commission. The detail actions are discussed in the directors' report. Eskom is working with the investigating and prosecuting authorities. An accounting policy, investigation into possible corruption and related impact on capital projects, was developed to account for any capitalised costs associated with fraud and corruption. The directors' report presents Eskom's response to the Zondo Commission report.	6
<b>Reportable irregularities – 31 March 2020</b>		
2. The underlying irregular expenditure register used to disclose irregular expenditure as part of the annual financial statements, per the requirements of PFMA section 55(2)(b), was not complete and accurate.	Action discussed in reportable irregularity number 6 below.	6
<b>Reportable irregularities – 31 March 2021</b>		
3. Eskom failed to effect corrective action for identified non-compliance to the National Environment Management Act (NEMA) thereby breaching fiduciary duties.	Action discussed in reportable irregularity number 4 below.	6

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Extract from Eskom's AFS for the year ended 31 March 2022.

# RATIONALE FOR THE EXEMPTION (cont.)

## *Prior exemptions – was transparency and accountability achieved?*

- Similar conditions and reporting requirements were granted to **Transnet**
- Permitted disclosure of irregular, fruitless and wasteful expenditure in the annual report
- Consultation with the AGSA on audit implications and type of assurance to be provided
- Performance of agreed upon procedures by the AGSA
- Tabling of annual report, audited AFS to Parliament which enabled for oversight and accountability by Parliament

# TRANSPARENCY AND ACCOUNTABILITY TEST TRANSET CASE STUDY

# Information reported in the integrated report of the entity

## Reported information was subject to audit

## Integrated report tabled in Parliament on 16 August 2022

The Irregular Expenditure Framework requires the accounting authority of the public entity to disclose in their AFS, any irregular and fruitless and wasteful expenditure incurred in the current and previous financial years. The period of how far back the entity must disclose the irregular or fruitless and wasteful expenditure is not defined nor provided for in the framework.

The Minister of Finance considered granting an exemption to Transnet as follows:

- Approval of an exemption from section 55(2)(v)(i) & (ii) of the PFMA for a period of three (3) years starting from 2021/2022 to 2023/2024 to allow Transnet, to develop and implement internal controls measures in ensuring accurate and complete reporting of irregular and fruitless and wasteful expenditure.
- Report irregular and fruitless and wasteful expenditure confirmed for the current and previous financial year (one year comparative) in the annual report of the entity;
- Report irregular and fruitless and wasteful expenditure for the current and previous financial year (one year comparative) in the annual report, those transactions that are -
  - under assessment, determination and/or investigation;
  - not condoned by the relevant authority (not applicable to fruitless and wasteful expenditure);
  - transferred to recoverables for recovery;
  - written off if irrecoverable and/or
  - not condoned and removed (not applicable to fruitless and wasteful expenditure).
- Report quarterly in terms of the Irregular Expenditure Framework to the National Treasury.

### Legislative Framework in relation to condonation of irregular expenditure

Chapter 1 of the Irregular Expenditure Framework defines relevant authority as - (i) The National Treasury, in the case where an employee or the accounting authority of a Schedule 2, public entity, was responsible for irregular expenditure.

The definition of the relevant authority means that all irregular expenditure incurred by PFMA institutions must be considered for condonation by the National Treasury, in the case of a national department or national public entities.

The criteria for condonation of irregular expenditure is that irregular expenditure incurred must (i) not have resulted in any losses, (ii) be free of corrupt, fraudulent and other criminal acts, and (iii) be accompanied by consequence management process followed by the institution. If the National Treasury does not condone the irregular expenditure, then, section 59 of the Framework permits the accounting authority to remove such irregular expenditure upon satisfying the provisions of section 59 of the Framework.

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- under assessment, determination and/or investigation.
- not condoned by the relevant authority (not applicable to fruitless and wasteful expenditure).
- transferred to recoverables for recovery.
- written off if irrecoverable and/or
- not condoned and removed (not applicable to fruitless and wasteful expenditure).

(d) Report quarterly in terms of the Irregular Expenditure Framework to the National Treasury.

### Agreed Upon Procedures

Transnet and AGSA, with the support of National Treasury, agreed that AUPs would be performed by the AGSA on the reportable items that are disclosed in the integrated report. The responsibilities relating to AUPs do not constitute an assurance engagement and accordingly auditors do not express an audit opinion on any form of assurance thereon.

Progress on the PFMA remedial plan focus areas

- Governance** - Implementation of Combined Assurance Project in Supply Chain Management (SCM) and established PFMA governance structures.
- Procurement** - In an effort to automate its procurement practices and in line with Transnet's digitalisation strategy, a new electronic tender submission system was launched in October 2021. The system aims to ensure that Transnet tenders are submitted via a secure e-Tender Submission Portal replacing manual publications.
- Contract management** - Automated controls have been activated and there is a continuous process to enforce compliance across the organisation.
- Systems and reporting** - System enhancements are underway to ensure accuracy and completeness of reporting.
- People Management and Learning** - Improved consequence management process in place with low enforcement agencies assisting with previously reported PFMA violations.

The enhancement of the PFMA remedial plan remains a key priority for the Company. The lessons learned and challenges have been clearly defined and placed the organisation in a much better position to speedily implement initiatives that drive PFMA compliance across Transnet.

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### PFMA reportable items for the year ended 31 March 2022

Transnet disclosed R105 billion of PFMA reportable items in its prior year AFS, which included R104 billion of irregular expenditure and R28 million of fruitless and wasteful expenditure. These amounts were inclusive of the prior year's opening balances.

The details below reflect current year actual and potential PFMA reportable items and the related one-year comparative.

#### 1. Irregular expenditure

(a) Details of current and previous year irregular expenditure (confirmed and under assessment)

	2022 R million	2021 R million
Irregular expenditure confirmed	1140	3 869
Non-compliance with the Construction Industry Development Board regulations	—	24
Non-compliance with the Basic Conditions of Employment Act	136	—
Non-compliance with the National Treasury requirements	151	1 141
Non-compliance with the Preferential Procurement Policy Framework Act	211	781
Other (N1)	642	1 923
Irregular expenditure under assessment	32	—
<b>Total</b>	<b>1 172</b>	<b>3 869</b>

N1: Other matters include:

- Services rendered/good received prior going through procurement processes and issuing purchase orders;
- Tenders issued to the market without stipulating mandatory local content requirements; and
- Contraventions of other applicable legislation, which resulted in irregular expenditure.

(b) Details of current and previous year irregular expenditure (under determination and investigation)

	2022 R million	2021 R million
Irregular expenditure under determination	58	—
Irregular expenditure under investigation	—	—

(c) Details of current and previous year irregular expenditure condoned

	2022 R million	2021 R million
Irregular expenditure condoned	—	—

(d) Details of current and previous year irregular expenditure removed by the Board - (not condoned)

	2022 R million	2021 R million
Irregular expenditure removed	—	—

(e) Details of current and previous year irregular expenditure recovered

	2022 R million	2021 R million
Irregular expenditure recovered	—	—

(f) Details of current and previous year irregular expenditure written off (irrecoverable)

	2022 R million	2021 R million
Irregular expenditure written off	—	—

(g) Details of current and previous year disciplinary or criminal steps taken as a result of irregular expenditure

	2022 R million	2021 R million
Disciplinary steps taken	—	—
Matters where no action was taken or required (N1)	224	147
Counselling	1	—
Training	1	304
Verbal warnings	—	—
Written warnings	—	8
Suspensions without pay	—	—
Dismissal	—	217
In progress (N2)	27	870
Not started (N3)	888	2 323
<b>Total</b>	<b>1 140</b>	<b>3 869</b>

N1: Matters where no action was taken or required include cases where line management had addressed a transgression by taking action that did not constitute disciplinary action; and cases where disciplinary action could not be instituted as the responsible persons had already left the employ of Transnet.

N2: Cases in progress include cases where line management or the Employee Relations (ER) function is in the process of disciplining the employee(s) responsible.

N3: Cases not started refer to matters that ER has received from line management/PFMA champions but has not started with the process of disciplinary action; and those matters for which determination tests have not yet been performed.

#### 2. Fruitless and Wasteful Expenditure

(a) Details of current and previous year fruitless and wasteful expenditure (confirmed and under assessment)

	2022 R million	2021 R million
Disciplinary steps taken	—	—
Fruitless and wasteful expenditure confirmed*	3	120
Poor contract management	—	83
Redundant assets and stock	—	11
Fines and penalties	1	5
Other (N1)	2	21

	2022 R million	2021 R million
Fruitless and wasteful expenditure under assessment (N2)	183	—
<b>Total</b>	<b>186</b>	<b>120</b>

\* Rounding off of fractions

N1: The FY 2021/22 are before net recoveries and write-offs, which have been separately presented below. The nature of these transactions amongst others include negligence, poor management oversight and settlement paid.

N2: The National Treasury issued reporting guidelines as part of the PFMA exemption requirements that Transnet must follow when reporting PFMA matters in its integrated report. These new guidelines required the entity to report both confirmed and under assessment PFMA reportable items starting from 31 March 2022 financial year up to the end of the PFMA exemption period, in the 2024 financial year.

A total of R3.83m, fruitless and wasteful expenditure under assessment includes, R1.48m (R1.36) relating to TFR's proactive approach to remove electrical overheads equipment on railway lines that are susceptible to theft. TFR considered this approach to be a potential fruitless and wasteful exercise and the related determination process to confirm was in progress at year-end.

(b) Details of current and previous year fruitless and wasteful expenditure (under determination and investigation)

	2022 R million	2021 R million
Fruitless and wasteful expenditure under determination	—	—
Fruitless and wasteful expenditure under investigation	—	—

(c) Details of current and previous year fruitless and wasteful expenditure recovered

	2022 R million	2021 R million
Fruitless and wasteful expenditure recovered	—	—

(d) Details of current and previous year fruitless and wasteful expenditure written off - (not recovered)

	2022 R million	2021 R million
Fruitless and wasteful expenditure written off	—	—

(e) Details of current and previous year disciplinary or criminal steps taken as a result of losses and fruitless and wasteful expenditure

	2022 R million	2021 R million
Disciplinary steps taken	—	—
Matters where no action was taken or required (N1)	1	6
Counselling	—	—
Training	—	—
Verbal warnings	—	—
Written warnings	2	2
Suspensions without pay	—	—
Dismissal	—	—
In progress	—	106
Not started	—	7
<b>Total</b>	<b>3</b>	<b>120</b>

0 - rounded off figures.

N1: Matters where no action was taken or required include cases where line management has addressed a transgression by taking action that does not constitute disciplinary; and cases where disciplinary could not be instituted as the responsible persons had already left the employ of Transnet.

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N3: Cases not started referring to matters that ER has received from line management/PFMA champions but has not started with the process of disciplinary; and those matters for which determination tests have not been performed.

#### 3. Details of material losses through criminal conduct

(a) Details of current and previous year material losses through criminal conduct

	2022 R million	2021 R million
Disciplinary steps taken	—	—
Material losses through criminal conduct	4	—
Theft (N1)	4	—
Written off	—	—
Recovered	—	—
<b>Total</b>	<b>4</b>	<b>—</b>

N1: Material losses through criminal conduct relates to criminal matters where Transnet employees were involved. These include theft of scrap wheels amounting to over R3 million.

(b) Other material losses

	2022 R million	2021 R million
Nature of other material losses	—	—
Other material losses	—	—

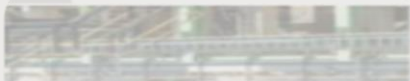
(c) Material losses written off

	2022 R million	2021 R million
Nature of losses	—	—
Material losses written off	—	—

(d) Material losses recovered

	2022 R million	2021 R million
Nature of losses	—	—
Other material losses	—	—

# Transnet post exemption and Audit outcome



## The outcome of the external audit

Over the past four years, we have received qualified audit opinions due to misstatements identified in the Company's irregular expenditure. In 2022, Transnet approached the National Treasury to request a departure from disclosing amounts as required by specific provisions of the PFMA and related instruction notes in the Annual Financial Statements. These included irregular, fruitless and wasteful expenditure (IFWE) and non-condoned historical irregular expenditure as required by the Irregular Expenditure Framework.

Accordingly, Transnet received an exemption from disclosing the particulars required by sections 55(2)(b)(i), (ii) and (iii) of the PFMA in the AFS for three years, starting from 2022 to the 2024 financial year. The extent of the exemption has been limited to the disclosure of the confirmed and under assessment IFWE in this integrated report, together with one comparative year. National Treasury granted the exemption to enable us to develop and implement more rigorous internal control measures to ensure we report accurately on IFWE disclosures in the future.

I am encouraged to report that Transnet has received an unqualified audit for the 2022 financial year. That said, we need to continue to close the governance gaps that still prevent us from receiving a fully positive audit report from the AGSA<sup>2</sup>. On behalf of my colleagues on the Executive Leadership Team, I wish to thank the AGSA for its support and encouragement during the audit.



# Research conducted by National Treasury

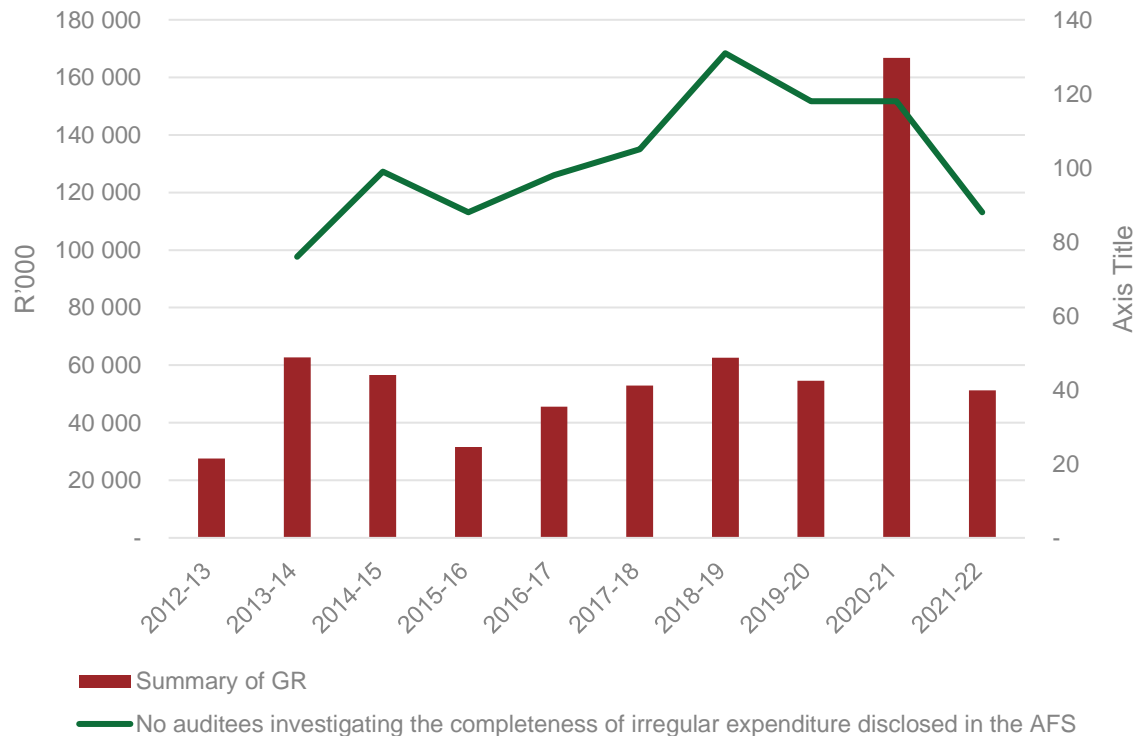
- Over the past decade, irregular expenditure (IE) has increased significantly with an average annual growth rate of 36%, often for procedural reasons
- The rise in IE has become a major concern for government, particularly given the widely held public perception that IE is equivalent to fraud, and makes accounting authorities and officers risk-averse, and avoid being problem-solvers
- The definition of IE is broad and captures any spending emanating from a transgression of any applicable legislation, irrespective of the nature and amount of the transgression
- For example, the 2020/2021 FY was significantly affected by the R77 billion recorded by the NSFAS for disbursing bursaries without a **gazetted funding guideline** (a procedural non-compliance)

# Research conducted by National Treasury

- The increase in legal prescripts has a direct impact on the compliance universe and the scope of IE
- In the UK, entities report on losses where public resources have been lost or wasted. However, in South Africa IE focuses on the value of the transgression rather than the resulting loss (if any) to the state

# NT research conducted (cont.)

Irregular expenditure per year



- In South Africa, the irregular expenditure figures in Annual Reports include **both procedural and deliberate non-compliance**.
- Frequently, procedural non-compliance **does not lead to any losses for government**. It is simply about a process that was not followed.
- The reporting on procedural IE **adds little value but imposes significant compliance costs** on government in identifying, detecting, assessing, addressing, reporting on and condoning IE



# NT research conducted (cont.)

- The requirement to disclose irregular expenditure in the notes to the financial statements triggers the auditing obligation
- This means that the auditors must obtain sufficient and appropriate audit evidence to support their opinion on the financial statements
- This disclosure requirement creates the risk of qualification on the basis of irregular expenditure, over and above what is expected of listed companies.
  - For SOEs, the higher risk of qualification adversely impacts on their ability to borrow, and greater reliance on the fiscus
- Irregular expenditure is assessed twice in the audit cycle:
  - In the audit of **compliance** with laws and regulations – the auditors test for violations of laws and regulations
  - In the **financial** audit – the auditors test the completeness and accuracy of the numbers reported on irregular expenditure in the notes to the financial statements

# National Treasury Instruction 04 of 2022/23

- Requirement for institutions (subject to the PFMA) to disclose in their financial statements, unauthorised, irregular and fruitless and wasteful expenditure that occurred in the financial year with comparative amounts
- Information required to be disclosed in the annual report is as follows:
  - unauthorised, irregular and fruitless and wasteful expenditure under assessment, determinations and investigations
  - information on irregular expenditure condoned, not condoned and removed
  - Losses recovered
  - Losses written off
  - unauthorised expenditure approved with or without funding
  - criminal and disciplinary steps take as a consequence of losses and IE&FWE

# How is the government restoring Eskom's long-term financial sustainability?

- There are several reasons why government has proposed a more optimal solution to Eskom's debt:
  1. Since 2008/09, government has provided the utility with R263.4 billion in bailouts.
  2. These allocations have failed to stem the collapse of Eskom's balance sheet and operations.
  3. The utility imposes an enormous drain on the economy and its debt stands at an unsustainable R423 billion.
  4. Government guarantees R350 billion of this debt, which is at risk of default – a contingent liability that raises South Africa's risk premium and borrowing costs.
- An optimally designed debt solution, with conditions, can strengthen the utility's balance sheet, enabling it to restructure and undertake the investment and maintenance needed to support security of electricity supply.

# What are the key features of government's approach?

- The Minister of Finance announced a debt relief arrangement of R254 billion (about R168 billion in capital and R86 billion in interest) over the next three years to restore Eskom's financial sustainability.
- The National Treasury will advance a loan to Eskom that will be converted to equity as Eskom meets the conditions outlined by the Minister of Finance.
- Strict conditions have been developed to safeguard public money, including limitations on new borrowing. The Minister of Finance will enforce these conditions, and upon compliance, will allow the entity to convert the loan to government-owned equity.
- Quarterly meetings between the National Treasury, the Department of Public Enterprises and Eskom will take place to discuss progress made in achieving conditions.
- Additional reporting obligations will be imposed onto Eskom to ensure that the funds allocated for the debt relief arrangement are used for that purpose and that all broader governance challenges at the utility are addressed.

# Why is it important for Eskom to be on a sound financial footing?

- With a sound balance sheet, Eskom can undertake the investments needed to resolve loadshedding through the maintenance of its existing fleet and investment in transmission, distribution and other infrastructure.
- While Eskom's guarantee portfolio will be reduced as its debt is settled through the debt relief arrangement, its large guaranteed debt remains a significant contingent liability and therefore a fiscal risk.
- Any event that triggers loan covenants between Eskom and their lenders will put Eskom's balance sheet under further pressure, will likely increase Eskom's cost of borrowing and may result in additional fiscal pressure should the entity be unable to negotiate lender waivers for these covenants.
- Over the next three years, the National Treasury, Department of Public Enterprises and Eskom will implement the debt relief arrangement to relieve extreme pressure on the utility's balance sheet, enabling it to undertake the necessary maintenance and investment.
- In addition, the National Treasury has appointed an international consortium with extensive experience in the operations of coal-fired power stations to review all plants in Eskom's coal fleet and advise on operational improvements.

# CONCLUSION AND WAY FORWARD

- **Key SOEs have to deal with historical IF&W expenditure**, which cripples the process to reverse the effects of state capture, how do we assist honest officials to fix an entity that has suffered from corruption?
- The three year exemption provides the basis for Eskom/Transnet to break from its recent past, and reduce the scope for qualified audits due to historical IF&W expenditure, what other reporting to oversight structures would be required?
- What further reporting or governance arrangements can be introduced to reduce the scope for corruption in SOE's?
  - Treasury is open to any further measures to strengthening any exemptions, to ensure that we reduce the scope for further abuse and corruption