

Mr. Enoch Godongwana,
Minister of Finance
Private Bag X115
Pretoria, 0001
Per email: minreg@treasury.gov.za

Dear Minister Godongwana

REQUEST FOR EXEMPTION FROM SECTION 55(2)(b) OF THE PUBLIC FINANCE MANAGEMENT ACT, NO 1 OF 1999 AND APPROVAL TO DEPART FROM NATIONAL TREASURY REGULATIONS, INSTRUCTIONS AND CONDITIONS ISSUED IN TERMS THEREOF

PURPOSE

1. The purpose of this letter is to request in terms of section 92 of the Public Finance Management Act, No. 1 of 1999 (**PFMA**), for Eskom Holdings SOC Ltd ("**Eskom**") to be exempt specifically from section 55(2)(b)(i), (ii) and (iii) of the PFMA, as to permit Eskom to include material losses due to criminal conduct, irregular expenditure and fruitless and wasteful expenditure, as well as any losses recovered or written off in its annual report and not in its annual financial statements.
2. Eskom requests that the period of this exemption covers each of the 2022/23, 2023/24 and 2024/25 financial years.
3. Together with the exemption described above, Eskom requests approval to depart, in terms of section 79 of the PFMA, from Treasury Regulation 28.2.1 which requires that the disclosures made in terms of section 55(2)(b) of the PFMA are recorded as a note to the annual financial statements. As stated above, Eskom would make the necessary disclosures in its annual report and not in its annual financial statements, thus its obligation of accountability and transparency will be satisfied.
4. The effect of such exemption and departure approval, collectively, is that material losses due to criminal conduct, irregular expenditure and fruitless and wasteful expenditure, and appropriate consequence management (including criminal prosecutions, disciplinary charges and losses recovered or written off), will continue to be reported by Eskom. However, those particulars will no longer be subject a to full statutory audit by the Auditor-General South Africa. **As such, the threat of a qualified audit for reasons relating to PFMA non-compliance will be alleviated.** This will provide relief to Eskom in circumstances where its financial position is constrained and the cost of borrowing is a major concern in its financial recovery efforts. As may be agreed with the Auditor-

General of South Africa, the disclosures in the annual report could still be subject to an assurance audit or review.

5. In addition to the above, Eskom requests approval to depart, in terms of section 79 of the PFMA, from those paragraphs of National Treasury Instruction No. 4 of 2022/23 (PFMA Compliance and Reporting Framework) which require disclosure to be made in its annual financial statements. This new reporting framework was published on 10 January 2023.

INTRODUCTION

6. Eskom has been engaging with various stakeholders from National Treasury and the Department of Public Enterprises on its proposal to seek the Minister's approval and support in relation to this exemption and departure application. Eskom requests the Minister's support for a timely consideration of Eskom's requests for exemption and departure, so that the approval, if granted, can be applied by Eskom in preparation of its financial reports for the 2022/2023 financial year.
7. Exemptions are provided for in section 92 of the PFMA which permits the Minister of Finance, by notice in the *Government Gazette*, to exempt an organ of state from any provisions of the PFMA for a period determined in the notice. Section 79 of the PFMA provides for departures from Treasury Regulations, National Treasury Instructions, or any condition imposed by PFMA, by approval of the National Treasury.
8. At a meeting held on 26 October 2022, the Energy Procurement and Finance Workgroup of the National Joint Operational and Intelligence Structure supported Eskom's intent to request the exemption departure and to request approval thereof from the Honourable Minister.
9. Eskom will continue to respect and co-operate with supervisory authorities including the Minister of Public Enterprises as its Executive Authority, the National Treasury, the Auditor-General of South Africa and Parliament, and will continue to report on material losses, irregular expenditure and fruitless and wasteful expenditure in accordance with the new Instruction. The difference is that disclosure will be made in the Eskom's Annual Report, as opposed to its Annual Financial Statements.
10. We set out below the background to this application and, the details of and grounds for Eskom's application for
 - 10.1. partial exemption in terms of section 92 of the PFMA from the requirements of section 55(2)(b)(i) to (iii) (paragraphs 19 to 24 below);
 - 10.2. departure in terms of section 79 of the PFMA, from the requirements of Treasury Regulation 28.2.1 (paragraphs 19 to 28 below);so as to permit Eskom to report on current year material losses, irregular expenditure and fruitless and wasteful expenditure in its annual report and not in its annual financial statements.

11. Eskom has every intent to continue investigating and determining irregular expenditure and fruitless and wasteful expenditure and will continue with appropriate consequence management proceedings.

BACKGROUND TO THIS APPLICATION

12. Eskom has published its consolidated and separate financial statements for the year ended 31 March 2022. The independent external auditors issued a qualified audit opinion due to:
 - 12.1. inadequate systems of internal control to timeously detect and record irregular expenditure, and fruitless and wasteful expenditure;
 - 12.2. inadequate controls to ensure appropriate assessment of expenditure arising from violations of supply chain management processes, investigations, and tracking of internal audit and forensic report findings;
 - 12.3. some incidents that were previously logged for assessment were removed without tests being adequately conducted;
 - 12.4. opening balance adjustments were made which could not be substantiated by supporting evidence;
 - 12.5. expenditure amounts not always corresponding with underlying supporting documentation;
 - 12.6. primary source registers tracking cases contained missing numbers in the sequence;
 - 12.7. use of an outdated methodology for estimating non-technical revenue losses;
 - 12.8. inability to obtain sufficient and appropriate evidence that the losses reported due to criminal conduct were completely and accurately recorded – this is due to inadequate systems of internal control to detect and record these losses; and
 - 12.9. potential losses associated with fuel oil usage and losses arising from poor coal quality were not assessed due to inadequate systems of internal control to evaluate, investigate and monitor unusual fluctuations in fuel oil and coal usage.

IMPLICATIONS FOR ESKOM OF EXISTING REGULATORY REQUIREMENTS

13. The consequences of a qualified audit for Eskom are severe. It could possibly include a downgrade of Eskom's corporate rating and baseline credit assessment by credit rating agencies, and breaches of Eskom's debt covenants.
14. Sections 55(1) and (2) of the PFMA regulate, *inter alia*, financial record keeping and reporting of the annual financial statements and annual reports of public entities. Sub-section 55(1)(d) provides for the submission of annual reports and annual financial statements to the relevant treasury, the responsible Executive Authority and, if the Auditor-General did not perform the audit of the financial

statements, to the Auditor-General. Treasury Regulation 28.2.1 requires material losses, irregular expenditure and fruitless and wasteful expenditure to be reported in the annual financial statements.

15. These instruments have the effect of requiring disclosure by Eskom, in the public domain, of matters that extend far beyond what Eskom is required to disclose in accordance with International Financial Accounting Standards (**IFRS**), and the JSE Debt Listing Requirements to which Eskom is bound. This expansion beyond the “ordinary” financial reporting standards applies both as regards the extent / materiality of the impact of such expenditure on Eskom’s financial position, and the duration of the continued obligation to report on historical losses, irregular expenditure and fruitless and wasteful expenditure several years beyond the financial year in question. Disclosures made in the annual financial statements, by implication, are subject to full statutory external audit. **Even if the past is resolved, there remains a significant risk for a qualification because of the very onerous financial accounting compliance requirements.**
16. The effect of relevant provisions of section 55 of the PFMA, read with Treasury Regulation 28.2.1 and National Treasury Instruction No. 4 of 2022/23 is that even cases of administrative or non-substantive non-compliance with legislation, which caused no loss to the State, must be reported in the annual financial statements.
17. Eskom has made huge strides in the past three financial years to establish systems, procedures and checks, balances designed to reduce the extent and risk of fraud, corruption and irregular expenditure. A summary of the various measures Eskom has put in place to address these risks is contained in paragraphs 4 to 7 of **Annexure A** hereto.
18. Notwithstanding the efforts to implement consequence management in relation to historic irregular expenditure and fruitless and wasteful expenditure, and to reduce the extent and risk of ongoing irregular expenditure, the sheer breadth of the disclosure requirements which Eskom is subject to, and the broad historical reach thereof, creates ongoing negative perceptions of Eskom’s financial position amongst its stakeholders, which has a continuing impact on its ability to attract funding and investment.

REQUEST FOR EXEMPTION AND DEPARTURE APPROVAL

Exemption from section 55(2)(b)(i) to (iii) of the PFMA and departure from Treasury Regulation 28.2.1

19. Section 55(2)(b) of the PFMA states that the annual report and financial statements must include particulars of (amongst other matters):
 - 19.1. any material losses through criminal conduct and any irregular expenditure and fruitless and wasteful expenditure that occurred during the financial year;
 - 19.2. any criminal or disciplinary steps taken as a consequence of such losses or irregular expenditure or fruitless and wasteful expenditure; and
 - 19.3. any losses recovered or written off.

20. Eskom requests to be exempt from the above provisions which would enable it to record material losses due to criminal conduct, irregular expenditure and fruitless and wasteful expenditure that occurred in the relevant financial year in question (and for the comparative year as per National Treasury Instruction No. 4 of 2022/23) in its annual report (or in an appendix thereto) and not in its annual financial statements.
21. Eskom requests that the period of this exemption covers each of the 2022/23, 2023/24 and 2024/25 financial years.
22. If the exemption requested above is granted, Eskom seeks approval to depart from Treasury Regulation 28.2.1, which provides that any material losses through criminal conduct and any irregular and fruitless and wasteful expenditure must be disclosed as a note to the annual financial statements of the public entity.
23. In support of this application for exemption and departure we highlight that:
- 23.1. while section 55(2) of the PFMA identifies those matters to be reported in the annual report and financial statements, it does not specify whether those matters must be addressed in both or either the financial statements and the annual report. Applying the ordinary rules of interpretation, the statement that the “*annual report and financial statements ... must*” contain certain information means that taken together, they must contain that information. It does not mean that both the annual report and the financial statements must contain all of that information. That leads to purposeless duplication;
- 23.2. section 55(2)(b)(i) of the PFMA, which requires disclosure of material losses, irregular expenditure and fruitless and wasteful expenditure, is limited to those losses and that expenditure “that occurred during the financial year;
- 23.3. the consequences of having to report ALL irregular expenditure and ALL fruitless and wasteful expenditure in the annual financial statements, are severe and in most cases entirely disproportionate to their relevance to Eskom’s financial position. Given the wide definition of irregular expenditure (“*expenditure ... incurred in contravention of or that is not consistent with a requirement of any applicable legislation...*”), even administrative non-compliance, which may not result in any loss and which has no adverse effects on Eskom’s financial position, becomes auditable by virtue of section 55 and must be quantified and reported. It is difficult for investors, lenders and other stakeholders to distinguish between irregular expenditure which should be of concern, and irregular expenditure which is immaterial for their purposes; and
- 23.4. a qualified audit opinion is hugely detrimental to Eskom’s attempts to reduce and refinance its debt, and to attract new funding; and impacts directly on the cost of funding, which in turn has an adverse impact on the public through electricity tariffs and on the fiscus through the increasing necessity for government guarantees and bail-outs.

24. Eskom is of the view that the constitutional requirements of accountability and transparency can be satisfied by disclosure of material losses from criminal conduct, irregular expenditure and fruitless and wasteful expenditure in its annual report, rather than as a note to its annual financial statements.
25. Disclosure in the annual report rather than in the annual financial statements would also:
 - 25.1. be consistent with generally accepted accounting practice;
 - 25.2. remove issues pertaining to non-material irregular expenditure and fruitless and wasteful expenditure from the ambit of the audit performed by the Auditor-General of South Africa or other external auditors, thereby releasing Eskom from the risk and threat of possible audit qualifications arising from compliance-related matters as opposed to financial matters; and
 - 25.3. be familiar to investors and lenders, who regularly question the reasons for and the relevance of reports on irregular expenditure and fruitless and wasteful expenditure.
26. The disclosures in the annual report could still be subject to an assurance audit or review, as may be agreed with the Auditor-General of South Africa.
27. In summary, Eskom's proposal, in the event that its exemption from section 55(2)(b) and departure approval from Treasury Regulation 28.2.1 is granted, is for Eskom to report on material losses from criminal conduct, and any irregular expenditure and fruitless and wasteful expenditure in its annual report (or in an appendix thereto) and not in its annual financial statements. This request is made in respect of the financial years 2022/23, 2023/24 and 2024/25.
28. Eskom assures National Treasury that it will continue to implement its consequence management procedures in respect of non-condoned irregular expenditure and unrecovered fruitless and wasteful expenditure which occurred in prior financial years.

Conclusions

29. Accordingly, we humbly request that for the financial years 2022/23, 2023/24 and 2024/25 Eskom be granted:
 - 29.1. exemption from the requirements of section 55(2)(b)(i), (ii) and (iii) of the PFMA, to the extent that it requires material losses due to criminal conduct, irregular expenditure and fruitless and wasteful expenditure to be disclosed in its annual financial statements;
 - 29.2. approval to depart from the requirements of Treasury Regulation 28.2.1, to the extent that it requires material losses due to criminal conduct and all irregular expenditure and fruitless and wasteful expenditure to be disclosed as a note to its annual financial statements;
30. Eskom will report material losses due to criminal conduct, irregular expenditure and fruitless and wasteful expenditure which was incurred in the relevant financial year (and comparative period), in its annual report (or in an appendix thereto).

31. The requests for exemption and departure approval summarised in paragraph 29 above are shown in the table below for ease of reference.

<i>Specified provision of Public Finance Management Act and regulations or instructions issued in terms thereof</i>	<i>Extent of exemption or departure approval</i>	<i>Period of exemption / departure approval</i>
Section 55(2)(b)(i), (ii) and (iii) of the Act and Treasury Regulation 28.2.1 made in terms of section 76 of the Act	Recording of material losses from criminal conduct, any irregular, fruitless and wasteful expenditure and any losses recovered or written off in the annual report (or in an appendix thereto)	Financial years 2022/23, 2023/24 and 2024/25
National Treasury Instruction No. 4 of 2022/2023	Recording of any irregular expenditure and fruitless and wasteful expenditure in the annual financial statements, is to be made in the annual report (or in an appendix thereto)	Financial years 2022/23, 2023/24 and 2024/25

32. We request your urgent attention to this request and confirm our availability to discuss and address any concerns.

Yours sincerely



Mpho Makwana

CHAIRMAN

Date: **09 March 2023**

Cc: Mr Pravin Gordhan, Minister of Public Enterprises