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Our Ref: DEM16/0914/ELZANNE JONKER/ks | Your Ref: | Date: 18 April 2023

THE MINISTER OF FINANCE

PER EMAIL: OAGqueries@treasury.gov.za

Dear Sir,

IN RE: COMMENT BY THE DEMOCRATIC ALLIANCE ON THE PROPOSED ESKOM EXEMPTION

I INTRODUCTION

1. We represent the Democratic Alliance (**DA**).
2. On 31 March 2023, the Minister of Finance exempted Eskom from reporting in its annual financial statements on any irregular expenditure and fruitless and wasteful expenditure that occurred during the financial year. The Minister's exemption was for three financial years.
3. On 6 April 2023, after widespread outcry and backlash, the Minister withdrew his exemption, and invited public comment on a proposed exemption identical to the withdrawn exemption.
4. This letter constitutes the DA's comment.
5. The DA opposes the proposed exemption.

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6. The proposed exemption is irrational. The means selected by the Minister—an exemption from reporting on irregular expenditure—bears no link to a legitimate government purpose.
7. For one, audits are one of the few brakes on the rampant corruption crippling Eskom. Removing that brake will only jeopardise Eskom's financial feasibility, encourage more corruption and irregular expenditure, and leave the public in the dark as to the extent of that irregular expenditure.
8. Moreover, no bank, investor, or financial institution will loan Eskom money knowing that Eskom has not reported on irregular expenditure. No one would give Eskom money (with the hope of making a return) without knowing—at least—the amount and extent of irregular expenditure at the entity.
9. But the rationality does not end there. The proposed amendment, as the DA understands it, requires that Eskom will still have to report on its irregular expenditure. The catch is that Eskom needs to report on irregular expenditure in Eskom's *annual reports*—not Eskom's *annual financial statements*. The difference: annual reports are not audited, while annual financial statements are audited.
10. The irrationality worsens. The proposed exemption says Eskom does not need to provide audited statements on irregular expenditure to create a mirage of financial



viability. But in the same breath, the exemption still requires Eskom to report, without an audit, on irregular expenditure. So, investors will still know of Eskom's irregular expenditure; except they will know that the reporting on irregular expenditure in Eskom's annual report is *unaudited*.

11. There is simply no point to the proposed exemption. Without the proposed exemption, investors are given audited statements of irregular expenditure at Eskom. With the exemption, investors have *unaudited* reports of irregular expenditure at Eskom. If an *audited* statement of irregular expenditure harmed Eskom's financial prospects, an *unaudited* report can do no better.
12. The proposed exemption does not achieve or link to the purpose for which it was taken. It is irrational. If affected, the proposed exemption will be inconsistent with the Constitution of the Republic of South Africa, 1996 and invalid.
13. Alternatively, even if providing only unaudited reports (instead of audited financial statements) somehow secures Eskom credit or avoids breaches of loan agreements, the proposed exemption is unreasonable. The gain to Eskom is far outweighed by the harm caused to Eskom and the constitutional principles of responsiveness, accountability, and openness. The benefits to Eskom cannot justify the corruption, illegality, and irregular expenditure precipitated by the proposed exemption. The



financial advantage gained by Eskom cannot justify the shroud of secrecy the proposed exemption will set over Eskom's inner workings.

II THE ENERGY CRISIS AND CORRUPTION AT ESKOM

14. Since 2007, there have been widespread, national blackouts. These have euphemistically become known as "load shedding".
15. With few exceptions, these blackouts effect all users of electricity, including residences, small businesses, large, electricity-intensive businesses, government departments, hospitals, public buildings, courts, and schools.
16. Loadshedding has increased over the years, with last year (2022) being the year with the most loadshedding on record.
17. The reduced access to electricity occasioned by load shedding has a deleterious effect on the rights of South Africans and the functioning of the South African economy.
18. Load shedding has become necessary more and more frequently to prevent the total collapse of the grid. Why does Eskom increasingly face the dilemma between load shedding and a national grid collapse? The energy crisis was caused in no small part by widespread, deeply entrenched bad faith, fraud, deliberate illegality, crime, and corruption.

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19. The DA refers the Minister to the proceedings and affidavits in three matters pending before the High Court of South Africa, Gauteng Division, Pretoria: *DA v NERSA* case no. 2023/003615, *Tebeila Institute v NERSA* case no. B38/23, and *UDM v Eskom* case no. 2023-005779.
20. In these matters, Eskom, the National Energy Regulator of South Africa (**NERSA**), and the President all accept the role corruption has played in causing the energy crisis.
21. Eskom makes numerous allegations on oath that the energy crisis was caused in no small part by corruption.
 - 21.1. Eskom says corruption “has had a profound effect on Eskom”. It describes itself as “under siege”.
 - 21.2. Corruption caused the dysfunctional Medupi and Kusile plants, the decision to end agreements with independent power producers, the “hollowing” of Eskom’s finances and experienced personnel, the sabotage and violence at Eskom’s sites, stage 6 load shedding, and various unlawful agreements with suppliers including the Guptas.
 - 21.3. Eskom says that corruption has cost Eskom more than R14.7 billion.
 - 21.4. We can but quote Mr De Ruyter:



“Corruption has compromised Eskom's financial position, board, and management structures; reduced its coal supply security; degraded its power stations through the use of out-of-specification coal; and there by negatively impacted its generation capacity.”.

22. Eskom, in its 2035 Corporate Strategy, writes:

*During the previous financial years, various assurance service providers identified non-compliance with Eskom policies and procedures as the key root cause for misconduct uncovered during assurance reviews, internal audits, or investigations concluded. Themes such as employees doing business with Eskom indirectly, conflicts of interest, fraudulent contract management and procurement irregularities were also identified during the same period. Some of these challenges have been driven by poor governance and flouting of organisational governance standards. **Fraud and corruption caused by unethical business practices and collusion in procurement lead to financial losses and reputational damage.**”*

23. The President accepts that corruption has led to the energy crisis. The President has described how criminal syndicates are “well-organised” and “destroying the utility”.

24. NERSA, in its reasons for the tariff hike decision of 21 January 2023, has a section headed “Eskom's fraud, fruitless and wasteful expenditure”. NERSA lists around 17 ongoing investigations into alleged corruption and fraud at Eskom. The cost of these investigations alone amounts to R9.6195 billion.



25. The Zondo Report is damning in its findings of fraud and corruption at Eskom. The DA does not repeat those findings here. In the Report's Key Findings and Recommendations, the Commission finds numerous instances of apparent fraud and corruption, which it refers to prosecution.
26. The DA has seen a presentation by National Treasury giving the background to the exemption. In this presentation, National Treasury accepted that corruption is "ENTRENCHED" in Eskom.
27. The corruption about which we know appears only to be the tip of the iceberg.
28. Mr De Ruyter, in an interview aired on 24 February 2023, unveiled further corruption at Eskom, including allegedly by a person high up in government. Mr De Ruyter further explained how criminal syndicates, linked to coal and procurement, have infiltrated officials at all levels of the state. These syndicates, using violence and fraud, secure themselves sham government tenders often after orchestrating sabotage at Eskom's facilities.
29. Mr De Ruyter has not named the corrupt officials and criminals involved in these furtive, illegal schemes. The country does not know who is involved personally. The corrupt cannot, at this stage, be separated from the good.

30. The rampant, profound corruption surrounding Eskom necessitates audited reporting on irregular expenditure. The corruption is so widespread, operates at so many levels (including the highest level), and exists to unknown extents, that accurate reporting and monitoring can only be guaranteed with the imposition of an independent auditor.

V THE BACKGROUND TO THE PROPOSED EXEMPTION

(A) ESKOM'S REQUEST FOR AN EXEMPTION

31. On 9 March 2023, Eskom applied to the Minister for an exemption under section 92 of the Public Finance Management Act 1 of 1999 (**DA1**).
32. Eskom applied to be exempt from including in its financial statements (i) material losses due to criminal conduct, (ii) irregular expenditure, (iii) fruitless and wasteful expenditure, and (iv) any losses recovered or written off. Eskom sought the exemption for FY22/23, FY23/24, and FY24/25. The DA will refer to all four of these as "irregular expenditure", unless indicated to the contrary.
33. Eskom's motivation for the request is clear.
- 33.1. Disclosures of irregular expenditure are subject to "full statutory audit" by the Auditor General of South Africa (**AGSA**).

- 33.2. Irregular expenditure disclosed in a financial statement result in a qualified audit for Eskom.
- 33.3. A qualified audit increases the cost of borrowing for Eskom, breaches Eskom's debt covenants, and risks a downgrade for Eskom's rating by credit rating agencies.
- 33.4. Eskom, given the ongoing energy crisis, cannot afford these increases in the cost of borrowing and needs access to financing to recover.
34. Eskom explains that it will report on irregular expenditure in its annual report. Eskom even proposes that AGSA provides an "assurance audit or review" on irregular expenditure reported in annual reports. Eskom says it "has every intent to continue investigating and determining irregular expenditure and fruitless and wasteful expenditure and will continue with appropriate consequence management proceedings".
35. Eskom's request comes off the back of a qualified audit for FY21/22. The auditors for that financial year returned a qualified audit for reasons relating to Eskom's inability to establish control systems for irregular expenditure.
36. The auditors' reasons reveal the extent to which Eskom is incapable of preventing, detecting, and responding to irregular expenditure. These reasons include—

- 36.1. inadequate systems of internal control to timeously detect and record irregular expenditure, and fruitless and wasteful expenditure;
- 36.2. 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;
- 36.3. some incidents that were previously logged for assessment were removed without tests being adequately conducted;
- 36.4. expenditure amounts not always corresponding with underlying supporting documentation; and
- 36.1. 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.
37. Eskom complains that section 55(2) requires the disclosure of all irregular expenditure, including irregular expenditure that does not result in loss. Eskom makes the allegation, difficult to believe, that “[i]t 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”. The



allegation is difficult to believe, because Eskom can explain to investors the difference between immaterial and material irregular expenditure (if that distinction even exists). There is no reason to think commercially experienced lenders cannot understand this difference.

(B) THE MINISTER'S REASONS

38. On 31 March 2023, the Minister partially granted Eskom the exemption sought. He published the exemption as Notice No. 3247 GG 48354 of 31 March 2023.
39. The decision reveals that the Minister exempted Eskom from reporting on (i) irregular expenditure and (ii) fruitless and wasteful expenditure (as defined in the PFMA) in Eskom's financial statements. Eskom is still obliged to include material losses due to criminal conduct and any losses recovered or written off in its financial statements. The exemption, as requested by Eskom, is for FY22/23, FY23/24, and FY24/25.
40. The Minister's decision, with respect to FY22/23, was at the eleventh hour. He decided, on the last day of the financial year, that Eskom does not need to include irregular expenditure in its financial statements for that year. This notwithstanding Eskom's duty under section 55 to submit its financial statements *within two months after the end of the financial year* to auditors and National Treasury.



41. On 31 March 2023, the Minister wrote a letter to Eskom containing the reasons for and details of his exemption (**DA2**).
42. The Minister wrote that he makes his decision “after due consideration of the risk of a possible negative outlook on Eskom’s corporate rating and credit assessment with the credit rating agencies”. This is the only reason the Minister gives for his decision.
43. The Minister qualified the exemption with conditions. Eskom must—
 - 43.1. still include any material losses through criminal conduct, any criminal and disciplinary steps taken as a consequence of such losses or irregular expenditure, or fruitless and wasteful expenditure, and any losses recovered and written off in Eskom's financial statements;
 - 43.2. develop an action plan to address weaknesses mentioned in the FY21/22 qualified audit report;
 - 43.3. report material losses, criminal conduct identified and irregular and fruitless and wasteful expenditure for the current and previous financial year in its annual report of the entity for the periods starting from 2022/23 to 2024/25 as prescribed in chapter 8 of Note 4;



- 43.4. report quarterly on progress made on irregular and fruitless and wasteful expenditure that is under assessment, determination or investigation and any historical amounts in progress “in line with the framework”;
- 43.5. engage AGSA on an agreed upon procedures on items to be disclosed in the annual report of Eskom due to challenges raised in the tracking of internal audit and forensic report findings. The objective is to enhance accountability and oversight by the Board.

(C) TREASURY’S MEDIA STATEMENT

44. The media reacted strongly to the Minister's decision. There was all-round condemnation of the decision by unions, opposition parties, and civil society.
45. On 3 April 2023, in what appears to be an exercise in public relations and damage control, National Treasury issued a media statement on the Minister's decision (**DA3**).
46. The statement confirms that public “institutions are required, by law, to report irregular as well as fruitless and wasteful expenditure in the annual report and the annual financial statements”.
47. The statement mainly echoes the Minister's reasons. The statement repeats the concern that requiring an audit of Eskom's irregular expenditure undermines its



credibility for financing. The statement emphasises how Eskom must still report its irregular expenditure in annual reports.

VI THE EXEMPTION WILL BE IRRATIONAL AND UNREASONABLE

48. On 6 April 2023, without providing reasons, the Minister reversed his exemption of 31 March 2023. He still proposes to proceed with the exemption, but seeks comments thereon.

49. The proposed exemption will be irrational and unreasonable.

(A) IRRATIONALITY

50. The purpose behind the Minister's proposed decision is to increase Eskom's ability to obtain loans, avoid costs of borrowing, and prevent breaches of Eskom's existing loans.

51. The means chosen by the Minister is to exempt Eskom from submitting irregular, fruitless, and wasteful expenditure for audits, but simultaneously requiring Eskom to report on such expenditure with the "assurance audit" of AGSA.

52. The means bears no rational connection to the purpose for four reasons.

53. **One.** Audited statements act as an important safeguard against and indicator of irregular expenditure. Removing this safeguard will only increase the corruption and



irregular expenditure at Eskom. This irregular expenditure, on top of Eskom's already debilitating woes, will harm Eskom, its feasibility, and undermine its ability to secure financing.

54. In other words, corruption is one of the reasons Eskom is failing; audited statements combat corruption; so, removing auditing increases corruption and undermines Eskom's feasibility. The means—exemption from audit—harms Eskom's financial credibility. The exemption does not promote credibility.
55. **Two.** Potential creditors will not loan Eskom money without knowing the extent to which Eskom's expenditure is irregular. This is true as a matter of commercial common sense.
56. Eskom's audits will only be "clean" because those audits do not consider any of the dirty laundry. The Minister's decision does not nothing to reduce irregular expenditure at Eskom. It only removes that irregular expenditure from the purview of auditors.
57. Even if, in "ordinary" circumstances, potential creditors do not require audited statements of irregular expenditure, they certainly will not be encouraged by a deliberate absence of such statements from Eskom. Eskom has a long history of irregular expenditure. To take away auditing, against a backdrop of rampant irregular expenditure, will not reduce the cost of borrowing. On the contrary: it will



deter investors from investing in a company that has no independent assessment of the regularity of its expenditure and when there is ample evidence of chronic irregular expenditure.

58. **Three.** No doubt Eskom breaches agreements when it fails to prevent irregular expenditure; and furtively excluding irregular expenditure from audited statements will not change that. If anything, the Minister's decision will cause breach. The contracts with Eskom in all probability *require* audited statements of financial regularity.
59. **Four.** Even if the Minister is right, that audited disclosures of irregular expenditure harm Eskom's financial credibility, then the Minister ought not to require Eskom to report on irregular expenditure in its annual reports as reviewed by AGSA. The Minister's proposed decision, read with the Minister's previous conditions, is self-destructive. It requires Eskom nonetheless to "harm" its financial credibility by revealing its irregular expenditure in its annual report, and to obtain an audit by AGSA on those disclosures. The exemption furthermore does not affect Eskom's statutory and regulatory duties to identify and report on irregular expenditure. In the context of a decision which assumes that audited disclosures of irregular expenditures *harm* Eskom, this is inexplicable.



60. Put differently, the Minister intends to have Eskom's irregular expenditure and eat it. He intends to assist Eskom by exempting audited reporting of irregular expenditure. But he sees the obvious problems with that exemption. So, at the same time, he requires an audit—through the back door—of all expenditure irregularly incurred as reported in Eskom's annual report. This is irrational.

(B) UNREASONABLENESS

61. The Minister's decision is simply disproportionate. Assuming Eskom achieves some form of financial credibility for not auditing irregular expenditure, that credibility is minimal. Eskom is still a notoriously corrupt, dysfunctional state entity with little to no hope of recovery. Its audits may now be "clean", but that is only because the auditors did not consider irregular expenditure. Very few investors will be comforted by these "clean" audits, if any.

62. The cost to Eskom and the public interest, on the other hand, is immense.

63. Corruption and irregular expenditure at Eskom, already rampant, can only increase with the removal of auditing. There will simply be no telling how much irregular expenditure occurs at Eskom, since the very people compiling the annual reports may be complicit in the irregular expenditure. No one will ever check whether they properly record Eskom's irregular expenditure.



64. In turn, corruption will continue to cause Eskom's woes, demise, and inability to provide South Africans with electricity.
65. There is also a huge moral and principled cost. Responsiveness, openness, and accountability are founding values in section 1 of the Constitution. These values are echoed in section 195 of the Constitution. The Minister's decision retrogresses from those values. His decision results in less transparency, less accountability, and less responsiveness at Eskom.
66. The decision sets and entrenches a dangerous precedent. The Minister appears willing to exempt any state-owned entity from auditing its irregular expenditure when that entity has too much irregular expenditure. Eskom is now the second, after Transnet. More may follow suit, resulting in the worst SOEs, from an irregular expenditure perspective, not reporting, in audited statements, on that irregular expenditure.
67. There are obvious alternatives to securing energy stability and resolving the energy crisis. Government is already exploring some of those alternatives, including unbundling Eskom and allowing local government to procure electricity from independent providers. A more obvious solution is to address the irregular expenditure at Eskom directly, through new personnel, anti-corruption policies, and



effective prosecution. There is no need to exempt Eskom from providing audited statements of irregular expenditure.

VII CONCLUSION

68. The Minister's proposed decision is like a bad magic trick. He intends to attempt, with the financial world as his audience, to make irregular expenditure at Eskom disappear by excluding that expenditure from Eskom's audited financial statements. No bank, investor, or financial institution will fall for this trick.
69. On the contrary, the decision will only undermine Eskom's credibility and ability to procure funding. The irregular expenditure still exists. But now there is no independent audit of its extent.

Yours faithfully

MINDE SCHAPIRO & SMITH INC.

per: 