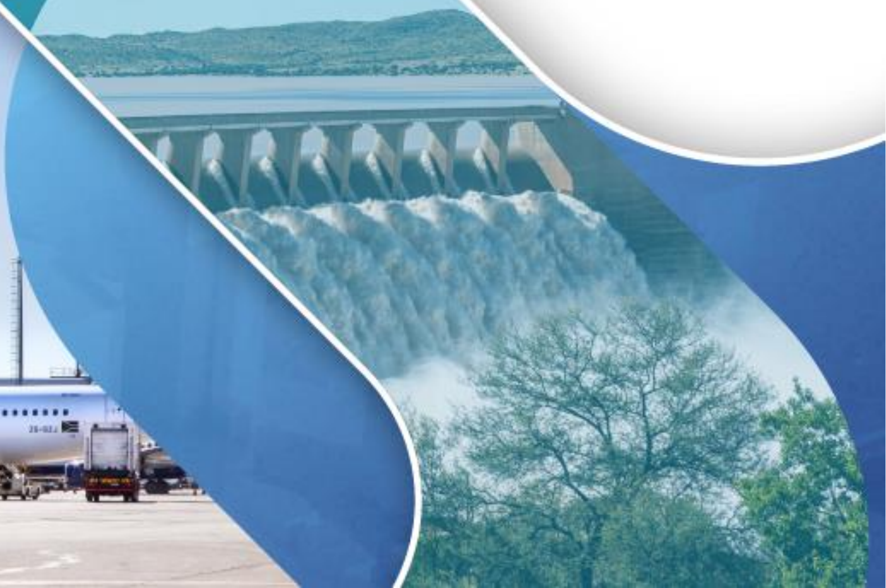
AUDITOR-GENERAL
SOUTH AFRICA

Eskom audit outcomes briefing

Portfolio Committee on Electricity and Energy



29 January 2025

Mission and vision

MISSION

The Auditor-General of South Africa has a constitutional mandate and, as the supreme audit institution of South Africa, exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence

VISION

To be recognised by all our stakeholders as a relevant supreme audit institution that enhances public sector accountability

Overall audit outcomes

Outcome area	Movement	2023-24	2022-23	2021-22
Financial statements				
• Irregular expenditure – incomplete and inaccurate		√	√	√
• Fruitless and wasteful expenditure – incomplete		√	√	√
• Losses due to criminal conduct – incomplete		√	√	√
Annual performance report				
• Generation (Improve plant operations)				
• Transmission (Improve plant operations)				
• Distribution (Improve plant operations)				
• Just energy transmission				
• Finance (Ensure financial sustainability)				
Compliance with legislation				
• Annual financial statements				
• Expenditure management				
• Revenue management				
• Procurement and contract management				
• Consequence management				
• Oversight and governance				
• Asset management				
• Liability management				
• Strategic planning				

Eskom continued to submit **financial statements for audit purposes, which contained material misstatements** in multiple account balances and disclosures. The audit process was used to improve the quality of the financial statements and avoid qualifications in areas over and above PFMA disclosures.

The **significant internal control deficiencies that resulted in negative audit outcomes** for at least the previous five years were not addressed by the accounting authority.

The reports of current and previous auditors over the same period have consistently highlighted **material breakdown in controls over compliance with applicable laws and regulations** that have hindered the entity's ability to prevent material non-compliance findings, resulting in qualified audit opinions.

Adequate action is not taken against officials who contravene the supply chain management prescripts, resulting in continued non-compliance and irregular expenditure. In certain instances, slow progress was made in the process of investigating and following through on consequence management proceedings. **Failure to implement consequence management encourages a culture where the disregard for legislation, policies and procedures thrives.**

The **commitments** made over the years by those charged with governance **to address these matters have not materialised** due to a **lack of accountability at various levels in the organisation, inadequate oversight and monitoring processes and ineffective consequence management.** The lack of group monitoring activities of compliance at component level results in matters surfacing through the external audit process.

Management should **proactively evaluate findings** by obtaining a thorough understanding of the key drivers of the audit outcomes and identify the key areas across the business that require attention.

Audit of financial statements

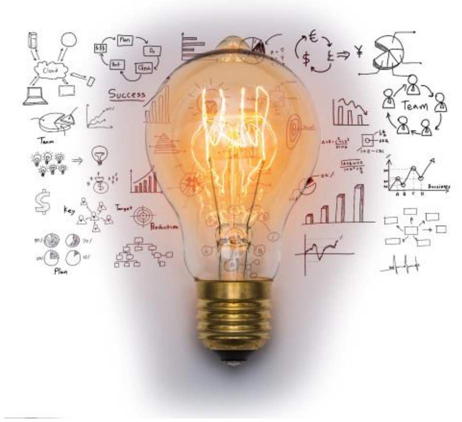
Financial year	2023/24	2022/23	2021/22
Audit outcome	Qualified with findings	Qualified with findings	Qualified with findings

2023/24 Qualifications	Reason
Irregular expenditure	• Inadequate systems of internal control to timeously detect and record irregular expenditure • Inadequate controls to ensure appropriate assessment of potential irregular expenditure arising from non-compliant supply chain management processes and various investigation reports • Inadequate tracking of forensic report findings • Abuse of deviation process with a related party • Payments on certain contracts made to parties who are not party to the original agreement.
Fruitless and wasteful expenditure	• Inadequate systems of internal control to timeously detect and record this expenditure in the financial statements • Inappropriate assessment of possible fruitless and wasteful expenditure logged • Where items were detected, such items were not recorded as fruitless and wasteful expenditure
Losses due to criminal conduct	• Inadequate systems of internal control to timeously detect and record these losses • Inventory (reworking and transfers) written off as unexplained losses.

An explanation of a qualified opinion

The financial statements contain material misstatements in specific amounts, or there is insufficient evidence for us to conclude that specific amounts included in the financial statements are not materially misstated.

The qualified audit opinion implies that the cost of primary energy could be much lower – if the losses from criminal conduct, irregular expenditure and fruitless spending could be eliminated.



Audit of financial statements – Key audit matters

These are matters that required "significant auditor attention" to audit and correct errors - mostly **due breakdown of controls in the underlying business processes**. Key audit matters are regarded as areas where there might be a higher risk of material misstatement or those where significant management or auditor judgements were involved. If the underlying controls deficiencies relating to this key audit matter are not addressed, this could have the potential of being a material issue in the future.

Key audit matter (KAM)	Related reportable irregularity	Significant control deficiencies	Current year errors
Impact of forensic investigation into the illicit creation of prepaid tokens (Illicit prepaid tokens)	No	Yes	Yes
Valuation of complex financial instruments	No	Yes	Yes
Primary energy costs and inventory management	No	Yes	Yes
Material breakdown in internal controls over financial reporting and the impact on the audit of the financial statements	Yes	Yes	Yes
Valuation of compensation events provisions relating to mega-build projects	No	No	Yes
Impairment of property, plant and equipment and indefinite useful life intangible assets	No	No	No

Illicit prepaid tokens

Eskom sells prepaid electricity tokens via the online vending system (OVS) and recognises revenue in line with IFRS 15, Revenue from contracts with customers.

In the previous financial period, management commissioned a forensic investigation, which led to the identification of unauthorised use of privileged level access within the prepaid IT ecosystem to create illicit usable prepaid tokens in the current year. The preliminary results were for the period October 2023 to May 2024.

The audit concluded that a material breakdown of internal controls within the prepaid IT ecosystem had occurred. Significant control deficiencies identified included inappropriate user access controls, dated systems with a lack of available data logs, inadequate backup procedures, and limited understanding by Eskom staff of the prepaid environment, including hardware and relevant systems.

The significant control deficiencies resulted in an inability to determine the full extent of illicit prepaid tokens created. In addition, assessing whether the illicit prepaid tokens created have been utilised by outside parties is a manual process of inspecting meters.

Performance reporting

Policy context – Energy sustainability

The NDP envisages that, by 2030, South Africa will have an energy sector that provides **reliable** and **efficient energy** service at **competitive rates**; that is socially equitable through expanded access to energy at **affordable tariffs**; and that is **environmentally sustainable** through **reduced emissions and pollution**.

MTSF: SUBOUTCOME: SECURE SUPPLY OF ENERGY		
Intervention	Indicator	Target 2024
Improve energy availability factor to ensure constant supply of electricity	Energy availability factor	80% (not achieved) Eskom reported 54.46 (2023: 56.03)
Increase reserve margin to counter load shedding	Increased electricity reserve margin	15% (not achieved – due to low EAF)
Explore embedded generation options to augment Eskom's capacity	Additional megawatts commissioned	1000MW by 2024 – not measured as an KPI
Separation and unbundling of Eskom to eliminate cross subsidisation and improve efficiency	Independent transmission company under Eskom Holdings Established	Transmission company established by 2024 **(achieved)**

For the period ended March 2024, the targets that government had set for themselves regarding availability of electricity were not achieved. The challenges were so serious that while the MTSF set a target of 80% EAF, Eskom's target was set at a low 65%, which they also could not achieve.

The MTSF also provided for a planned reserve margin of 15% to create space for maintenance. The low EAF meant there is no reserve margin available.

The unbundling of Transmission Company was finalised by 31 March 2024.

Energy challenges – 2023-24

Deterioration in plant availability resulted in severe capacity constraints leading to:
329 days of load shedding, 2023: (280 days)

Extremely high usage of OCGTs *(Open Cycle Gas Turbines - power stations that use **diesel** as their primary resource)*:
OCGT load factor 17% (2023: 14,3%)

EAF *(Energy availability factor which denotes power station availability)* **dropping to 54,56% (2023: 56,03%)** record low.

Post-philosophy outage unplanned capability loss factor remains high at 31,61% (2023: 35,75%) – raising questions about the effectiveness of the maintenance programme.

Post-year-end plant performance improvement (no loadshedding since 26 March 2024) – may improve these stats for 2024-25 financial year

Audit of performance information

While the audit process does not review the performance of Eskom, audit work provides insight into weaknesses within the entity that will remain obstacles to the achievement of the entity's performance objectives.

Reported performance for the 2023-24 financial year indicated that **Eskom achieved only 17 of the 40 KPIs – translating to a 42,5% achievement.**

Material findings on performance information				
KPA	**Indicator**	**Target**	**Actual**	**Audit finding**
Finance	Savings from turnaround initiatives	R22,4 bn	R9,9 bn	The auditors could not verify a portion of the reported achievement (R1,3 billion) relating to costs incurred on uncontracted coal, as they were to substantiate the estimates and judgements applied in management's estimation of the baseline.
Distribution	**Missing indicator:** An indicator to measure performance on the progress of Eskom Distribution infrastructure expansion and the conversion from conventionally billed post-paid customers to prepaid customers and Smart grid technologies was omitted from the approved planning documents. Consequently, progress towards the achievement of this mandate was not reported on in the shareholders compact performance section of the directors' report.			

These material findings requires urgent intervention as they directly relate to key initiatives from the strategic turn around plan and the corporate plan. Weaknesses in planning and monitoring of and reporting on performance on these KPAs may hinder the board's and shareholders' ability to monitor progress on key initiatives.

Financial management and compliance

Financial management and compliance

Compliance Subject Matter	Audit report paragraph	Findings reported in the prior year
Expenditure Management	Resources of the public entity were not utilised economically.	**No**
Revenue Management	Effective and appropriate steps were not taken to collect all revenue due from local large power users (municipalities) and local small power users. Not all contractual agreements were concluded with large power users to enable the public entity to bill and collect the revenue due where the supply of electricity took place.	**Yes**
Procurement and Contract Management	We were unable to obtain sufficient appropriate audit evidence that, in all instances, contracts and quotations were awarded in accordance with the legislative requirements, as proper record keeping was not maintained.	**Yes**
Procurement and Contract Management	Some of the goods, works and services were not procured through a procurement process that is fair, equitable, transparent and competitive, as required by section 51(1)(a)(iii) of the PFMA.	**Yes**
Procurement and Contract Management	We were unable to obtain sufficient appropriate audit evidence that some contracts and quotations were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the PPPFA and Preferential Procurement Regulation 2017.	**Yes**
Procurement and Contract Management	Some of the contracts and quotations were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of PPPFA and Preferential Procurement Regulation 2017 and/or 2022.	**Yes**
Procurement and Contract Management	Tenders for contracts above R30 million, which had a condition for mandatory subcontracting to advance designated groups, were awarded to bidders who did not submit evidence of subcontracting agreements, in contravention of the 2017 Preferential Procurement Regulation 9(1). This non-compliance was identified in the procurement processes for coal contracts amounting to R16 billion.	**Yes**

Financial management and compliance

Compliance Subject Matter	Audit report paragraph	Findings reported in the prior year
Procurement and Contract Management	We were unable to obtain sufficient appropriate audit evidence that procurement requirements on some commodities designated for local content and production, were procured from suppliers who complied with the requirements of the 2017 Preferential Procurement Regulation 8(2).	**Yes**
Consequence management	We were unable to obtain sufficient appropriate audit evidence that disciplinary steps were taken against officials who had incurred irregular and fruitless and wasteful expenditure, as required by section 51(1)(e)(iii) of the PFMA. This was due to investigations into irregular and fruitless and wasteful expenditure not being performed. This limitation resulted in a reportable irregularity, as reported in 2022, 2023 and 2024 on the report on other legal and regulatory requirements.	**Yes**
Consequence management	Where investigations were performed, disciplinary steps were not taken against the officials who had permitted irregular and fruitless and wasteful expenditure, as required by section 51(1)(e)(iii) of the PFMA. This non-compliance resulted in a reportable irregularity, as reported in 2022, 2023 and 2024 on the report on other legal and regulatory requirements.	**Yes**
Consequence management	Disciplinary hearings were not held for confirmed cases of financial misconduct committed by officials, as required by treasury regulation 33.1.1. The non-compliance was reported as a reportable irregularity in 2022, 2023 and 2024 in the report on other legal and regulatory requirements.	**Yes**
Consequence management	Due to inadequate processes of management of cases and investigations, we are unable to obtain sufficient evidence that allegations of corruption or theft, fraud, extortion, forgery, uttering a forged document, which exceeded R100 000, were reported to the South African Police Service (SAPS), as required by section 34(1) of the Prevention and Combatting of Corrupt Activities of South Africa. This limitation is included in a reportable irregularity, as reported in 2022, 2023 and 2024 on the report on other legal and regulatory requirements.	**Yes**
SOE oversight and governance	The annual return and the latest approved audited financial statements were not filed timeously, as required by section 33(1)(a) of the Companies Act and 30(2) of the Companies Regulation.	**Yes**

Reportable irregularities

We assessed laws and regulations for instances of non-compliance. Where non-compliance was identified, we evaluated the impact of each non-compliance on the financial statements and responded in terms of our responsibility to report unlawful matters to the relevant authorities in line with section 45 of the Auditing Professions Act (Act 26 of 2005). The below reportable irregularities (RI) remained open at the date of our audit report.

Reportable irregularity	**Non-compliance identified in the current year**
Non-compliance with environmental laws and regulations: National Environmental Management Act, National Environment Management: Air Quality Act and National Water Act.	Yes
Backlog of forensic cases – breach of section 33.1.2 of the Treasury Regulations, which resulted in the accounting authority not being in a position to confirm that all relevant matters are reported in terms of section 34(1) of Prevention and Combating of Corrupt Activities Act.	Yes
Certain financial records not complete or accurately maintained in terms of PFMA and Companies Act	Yes
Breach of section 51(1)(e)(iii) and section 55(1)(a) of the PFMA due to delays in investigations into instances of irregular and fruitless and wasteful expenditure to determine if disciplinary steps needed to be taken against liable officials, as well taking the required disciplinary actions against responsible official(s).	Yes
Non-compliance with Privileges and Immunities of Parliaments and Provincial Legislatures Act regarding misleading information provided to the Standing Committee on Public Accounts (Scopa).	No
Management did not discharge their fiduciary duty as they failed to ensure that the entity's complete and accurate financial statements were submitted to National Treasury and the auditors on 31 May as required by PFMA.	Yes
Eskom Transmission and Distribution large power user power purchase agreements – appropriateness of delegation of authority in lieu of end customer agreement not entered into for specific power purchase agreements	Yes

Auditor's steps once a RI has been identified

In terms of section 45 of the Auditing Profession Act, the process that the auditor must follow when a potential RI is discovered is as follows:

1. Once we have reason to believe that a reportable irregularity has taken place or is taking place, we must send a report to our regulator.
2. Within three days, after writing to the regulator, we must notify members of management that we have sent such a report.
3. Thereafter, we will take reasonable measures to discuss the matters with the members of the management board, obtaining representations from them, and thereafter, we are also required to send a second report to the regulator, within 30 days from the date on which the initial report was sent. This report should contain a statement that we are of the opinion that:
   a) no reportable irregularity has taken place; or
   b) the suspected reportable irregularity is no longer taking place and that adequate steps have been taken for the prevention or recovery of any loss as result thereof, if relevant; or
   c) the reportable irregularity is continuing.

   If the Independent Regulatory Board for Auditors (IRBA) receives a report that a reportable irregularity is continuing, they are required to notify any appropriate regulator of the details of the reportable irregularity to which the report relates and provide the regulator with a copy of the report.

Going concern and financial viability

Going concern and financial viability

OVERVIEW

The audit included an evaluation of the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements and whether any material uncertainties exist about the entity's ability to continue as a going concern.

Conclusion: Eskom is a going concern BUT there are various dependencies and internal and external uncertainties which could impact Eskom's ability to continue as a going concern in the future (**material uncertainties**). These risks and management's strategies to address them have been disclosed in the AFS.

Key viability risks

- Operating losses reported in current and prior years: R57 billion (2023: R26 billion)
- Current liabilities exceed current assets at year-end by R50 billion (2023: R51 billion)
- Debt-reliant liquidity position – with continued support from government.
- Extent of requirements in the capital programme to increase and replace generating and transmitting capacity.
- There is uncertainty around the timing of price rulings on separate licences by the National Electricity Regulator of South Africa (Nersa) and the continued application of the current methodology.
- The continuous increase in overdue electricity receivables primarily from municipalities. This position has deteriorated more than expected in 2024 and after the end of the financial year.
- The going concern assumption remains fully dependent on the ongoing positive and incremental impact of the generation recovery programme.
- Significant electricity losses (for reasons such as illegal connections, ghost vending, selling of illegal tokens, etc.), which results in an increase in Eskom's current and future cost to produce such energy, with no related billings and cash collections for these production volumes.

Key strategies

- Engagement with NT & the shareholder to ensure that the challenges are addressed – this includes the need to develop a long-term strategy to fully optimise the group and company's balance sheet.
- Eskom is working with the National Treasury and the shareholder representative regarding Eskom's ongoing compliance with the conditions of the debt relief arrangement to enable the conversion of the loan to equity.
- Implementing various strategies to recover overdue trade receivables;
- Working with the minister leveraging the National Energy Crisis Committee structures to ensure that the Electricity Action Plan is implemented expeditiously to resolve the electricity crisis.
- The cost structures and capital programme of the group are continuously reviewed to extract cost savings and improve cash flows.
- The group will only engage on large capital projects in compliance with the conditions attached to the Eskom Debt Relief Act and with full disclosure and approval by the minister of Finance and the shareholder.

Going concern and financial viability – cont.

Eskom's Strategic Turnaround Strategy includes "improve finance" as one of the pillars. The long-term strategic objective of this pillar is to pursue financial and operational stability. Below is a highlight of factors that may hinder the successful implementation of some of the key turnaround initiatives in this pillar:

Strategic initiative	Risks/ factors hindering success
Reduce costs	Eskom targets to save R4,95 billion in 2024-25 and R5,17 in 2025-26. The current and historical audits found that Eskom does not have appropriate systems, processes and controls to quantify irregular expenditure, fruitless and wasteful expenditure, as well as losses due to criminal conduct. These are indicative of areas of significant financial drain through which Eskom continues to lose money and fail to quantify how much was lost. Therefore, the targeted savings will not be impactful or sustainable for as long as there is still a culture of non-compliance and continued struggle in dealing with irregular expenditure, fruitless and wasteful expenditure and losses due to criminal conduct.
Increase revenue, cost-reflective tariffs	Increasing revenue is dependent on efficient performance of the generation plants, efficient distribution infrastructure and Nersa's decision on Eskom's Sixth Multi-Year Price Determination (MYPD6). The NDP envisaged electricity supply as a public function that is socially equitable through expanded access at affordable tariffs. While the cost-reflective model may increase revenue for Eskom, it may come with further social and economic challenges – due to affordability challenges for majority of the users of electricity. This may further fuel a demand for illegal electricity connections and illicit prepaid tokens, enabled by unscrupulous conduct by Eskom officials. Therefore, there is a need for strengthening the implementation of government policies aimed at protecting vulnerable consumers (poor) to cushion them from inflationary impact of future Eskom tariff increases. Audit of municipalities by the AGSA found instances of abuse of indigent policies that are meant to protect the poor through access to free basic services. The AGSA identified municipalities where households received free basic services despite not meeting as set by the municipality. Some people that were registered as indigent were deceased or employed at government institutions. Some municipalities did not have controls in place to check when indigent households had reached their limit for free basic services.

Going concern and financial viability – cont.

Strategic initiative	Risks/ factors hindering success
Reduce municipal debt	Municipal debt remains one of the biggest viability risks to Eskom, after debt service costs. The audit found that "effective and appropriate steps were not taken to collect all revenue due from local large power users (municipalities) and local small power users." Interventions implemented by Eskom and government to address municipal and Soweto receivables have been ineffective. As at 31 March 2024, Eskom was owed R86 billion rands by municipalities. The following are some of the key factors that adversely affect the recoverability of these debtors: • As reported in the directors' report, there has been a low level of compliance with the municipal debt relief programme. Sustainability of the programme is therefore at risk. • R45,2 billion was owed by 34 municipalities that have been categorised as "dysfunctional" by the Department of Cooperative Governance and Traditional Affairs (Cogta). These are municipalities that are characterised by instability in the council, poor governance and administration, financial mismanagement and failure to manage service delivery. • Of the 34 dysfunctional municipalities, 32 are on debt relief programme – owing a total of R44,7 billion. The dysfunctional state of these municipalities could also be a contributing factor to the high level of non-compliance by municipalities in the debt relief programme. The increasing municipal debt shows that municipalities are struggling to collect electricity revenue from their customers. The AGSA General Report on Municipal Audit Outcomes for 2022-23 noted that "Municipalities lost revenue because they were not billing and collecting revenue, and due to electricity losses as a result of infrastructure neglect. Of the 163 municipalities that provide electricity, 148 (91%) lost a combined R19,12 billion, and 108 (66%) had an average electricity loss above the 10% norm." Increasing tariffs without addressing Eskom and municipal distribution infrastructure and revenue management challenges will therefore not address Eskom's viability challenges. We will likely have an Eskom that is supplying electricity, only for that electricity to be lost through bad debts and non-technical losses (illegal connections).

Conclusion and recommendations

Overall message

The audit outcomes showed that there is very little progress in implementing recommendations made by auditors over the years – to address the underlying root causes.

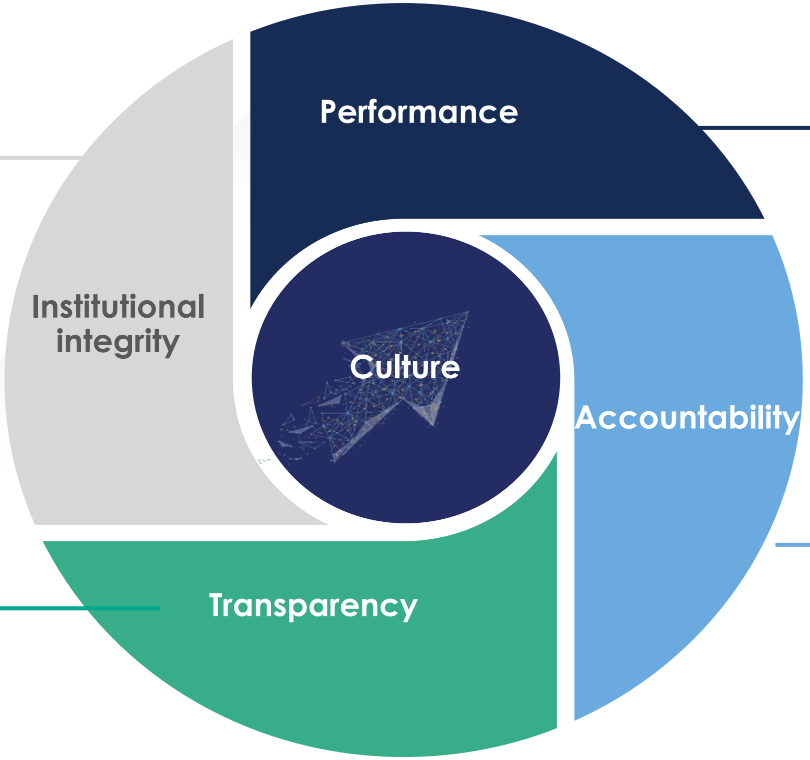
The board has a responsibility to build an entity that is characterised by a culture of performance, accountability, transparency and institutional integrity, which will ultimately result in a sustainable delivery against the mandate.

While noting that Eskom is not the only key roleplayer in the energy value chain, its role is the most critical one in the ecosystem as a producer and supplier of electricity. Historical performance as reported in the directors' report shows that generation continued to under-perform for the 2023-24 financial year. However, the post year-end generation performance shows great signs of improvement and evidence that the implementation of the Generation Recovery Plan is bearing fruits.

Characteristics of an effective public sector culture

Implement and maintain **institutionalised controls** to ensure leadership and officials **behave ethically, comply with legislation and act in best interest** of institution, **avoiding conflicts of interest**

Provide public, oversight, auditors and other stakeholders with **timely, relevant and reliable information on institution's finances, performance, use of resources and compliance with legislation**



Demonstrate commitment to improving lived realities of South Africans by **delivering on legislated mandate and strategic objectives aligned to people's needs**, being **financially sustainable**, and **avoiding harm to public and public sector institutions**

Be responsive to public, oversight and other stakeholders through **reporting and providing answers on mandated responsibilities fulfilled, actions taken and decisions made**; ensure **swift consequences** for transgressions and poor performance

Recommendations to Eskom

Accountability is enabled through credible financial statements and performance reports that provide a transparent account of an auditee's performance, finances and compliance with legislation.

Legislation and policies are in place to regulate responsible and effective financial and performance management; the protection of public funds and resources; and the fiduciary duties of leadership and officials to behave ethically and act in the best interest of the state, and to ensure that there are consequences for transgressions and poor performance – these must just be implemented.

The following are our main recommendations to address the identified root causes:

- The board should assess progress in implementation and impact of measures aimed at strengthening internal capacity, consequence management and the control environment – specific structures responsible for the compliance management function, loss control function and controls relating to significant weaknesses highlighted by the auditors;
- Measures implemented to address the internal control deficiencies around SCM and the implementation of proper record keeping process should be assessed for effectiveness. The continued deficiencies in the SCM process hinder accountability and implementation of effective consequence management practices. They further limit economical utilisation of funds.
- Audit action plan should be enhanced to ensure that it addresses the root causes of the repeat material misstatements in the annual financial statements, findings in performance planning and reporting as well as weaknesses in the compliance management systems.
- The action plans must be monitored by internal audit and the audit committee should play an oversight role in ensuring effective implementation and monitoring thereof.
- A plan to respond to each area of drivers or root causes of material weaknesses should be allocated to key individuals to drive, implement and monitor preventative controls. Clear key performance indicators should be assigned to ensure there is appropriate, effective and sustained change.

Recommendations to the portfolio committee

The portfolio committee is a key roleplayer in strengthening the accountability ecosystem and enabling a culture of accountability at Eskom that will ultimately improve service delivery.

Monitoring and regular follow-up with the executive authority and the accounting officer/ authority on:

1. Measures that have been implemented to address matters identified from the audit, in addition to matters raised by the portfolio committee in previous engagements.
2. Progress made on strategic initiatives as per the Eskom Strategic Turn Around Plan, as well as related risks and dependencies outside Eskom.
3. Progress by the board in addressing the reportable irregularities.

THANK YOU

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