

# OUTA

ORGANISATION UNDOING TAX ABUSE



Eskom

Megawatt Park  
Head Office

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## **OUTA's comments on Eskom's exemption from section 55(2)(b) of the Public Finance Management Act, 1999**

**Submission to National Treasury**

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## 1. INTRODUCTION

- 1.1 By way of introduction, OUTA is a proudly South African non-profit civil action organisation, comprising of and supported by people who are passionate about improving the prosperity of our nation. We envision a prosperous country, with an organised, engaged and empowered civil society that ensures responsible use of tax revenues.
- 1.2 Part and parcel to OUTA's mission is the challenging of legislation and regulatory environment, this includes participating and engaging with government on the *"Public Finance Management Act, 1999: withdrawal of exemption in terms of section 92 and invitation for public comment – Eskom Holdings SOC Ltd"* as published in the Government Gazette on 6 April 2023 (GG No. 48406).
- 1.3 In the paragraphs below, OUTA will categorically illustrate its concerns, objections, and proposals (amendments). The decision to only temporarily rescinded this exemption whilst calling for public comment, with a view to introduce a new exemption framework for Eskom, remains of concern to OUTA.

## 2. HISTORICAL EXEMPTIONS – TRANSNET

- 2.1 While we understand that exemptions similar to the exemption in question have been granted before, such as to Transnet on 31 March 2022 – which resulted in an unqualified audit for the organisation in the 2022 financial year – we are of the opinion that such exemption did not necessarily produce any positive outcomes for Transnet's financial situation, management or performance.

- 2.2 Although Eskom's declining performance does have a significant an impact on the South African economy (and to a much greater extent than Transnet), we believe that the Eskom exemption granted in this regard should be rescinded. We contend that it does not stimulate the correct management behaviour to address the root causes of irregular, fruitless and wasteful expenditure, thereby placing the organisation in a worse off position.
- 2.3 We further believe that the utilisation of section 92 in exempting Eskom from the workings of section 55(2)(b) of the PFMA suggests an acknowledgement by government that irregular, fruitless and wasteful expenditure at Eskom, lacks the necessary controls required to contain and reduce this expenditure.
- 2.4 Instead of addressing the root causes that create the prime environment for irregular, fruitless and wasteful expenditure to multiply, government in this instance is continuing to feed the problem.

### **3. THE IRRATIONALITY BEHIND THE ESKOM EXEMPTION**

- 3.1. While we do acknowledge that the Minister has the power to grant the exemption in terms of section 92 of the PFMA, our view is that an attempt to grant such reporting exemptions of irregular, fruitless and wasteful expenditure reporting in Eskom's Annual Financial Statements ("AFS"), despite this information being made available in the Integrated Annual Report ("IAR"), is not in the interest of Eskom or the public at large, for the following reasons:

- 3.1.1. The perspectives of a financial analyst should not be confused with that of accounting and auditing principles. The analyst provides insights of the

financial statements from the perspective of an investor, which also requires the auditor's report to be accurate and complete with all the information, as opposed to the omission of selective information.

- 3.1.2. Should the accounting officers of Government institutions to be granted exemption from reporting on irregular, fruitless and wasteful expenditure, the reduced transparency will weigh negatively on the oversight roles fulfilled by various stakeholders, civil society and the Auditor General's office reporting thereof, which in turn reduces necessary sanctions (including the raising of financial capital which becomes public debt), flowing from such reporting.
- 3.1.3. The objectives of the PFMA includes transparency, accountability and sound financial management and the auditor's mandate is to act in the best interest and protect the interest of the public and investors and not the entity. It is therefore the accounting officer's responsibility to act in the best interest of the entity and thereby report on matters of irregular, fruitless and wasteful expenditure.
- 3.1.4. The auditor's role is to expresses an opinion with reasonable assurance, regarding the annual financial statements and such opinion must encompass that information is accurate, complete, etc., i.e., displays all the characteristics of the applicable financial reporting framework (which in the case of Eskom, is bound by the International Financial Reporting Standards ("IFRS")).

- 3.1.5. The fact that irregular, fruitless and wasteful expenditure information might appear somewhere in an Annual Report (also referred to as an Integrated Annual Report), this does not provide the necessary assurance on such important information, unless it is reflected in the AFS.
- 3.1.6. Furthermore, credible rating agencies and finance lending houses are not that naive to simply continue with favourable credit ratings of a state owned entity (“SOE”), on the basis of unqualified audits, knowing that exemptions to the reporting of IFWE have been granted. The ratings agencies and investment houses assess the SOE / company's ability to manage its cashflow and service its debt obligations, which is also partially demonstrated by trends of a company's ability to manage and reduce irregular, fruitless and wasteful expenditure.
- 3.1.7. By exempting to disclose irregular, fruitless and wasteful expenditure in the Financial Statements, merely sends alarm bells to ratings agencies and lending houses. It suggests that these oversight entities are stupid enough to see a “lack of reporting” as equating to the “absence of malfeasance”, which they most definitely are not.
- 3.1.8. By seeking to exempt the reporting of such irregular, fruitless and wasteful expenditure, government seems to want “dress up” the waiving of reporting on irregular, fruitless and wasteful expenditure as avoiding downgrades or covenant breaches – but hiding such data does not allay those events.

- 3.1.9. It is our belief that ratings agencies and investment houses will actually provide a more favourable outlook toward an organisation that receives a qualified audit based on historic reports of irregular, fruitless and wasteful expenditure, and who have displayed improvements (reductions in irregular, fruitless and wasteful expenditure) in the current financial reporting period, along with an improved financial position and outlook of the organisation. Under such circumstances, rating agencies and investment houses will most likely acknowledge this situation more favourably than one granted exemption from reporting on this information and receiving an unqualified audit.
- 3.1.10. By not reporting on irregular, fruitless and wasteful expenditure in the AFS of each financial year and comparisons thereof to the prior financial year, we believe this is a display of a lack of confidence in Eskom's management to address these serious issues and merely perpetuates poor financial management performance into the future. By seeking to not disclose this information, National Treasury and the SOE are sending the wrong message to not only the financial markets, but to civil society and the public as well.
- 3.1.11. It is well known that despite the fact that irregular, fruitless and wasteful expenditure will still be reported in Eskom's Integrated Annual Report ("IAR") rather than as part of the AFS, the IAR data is not audited, and the reliability of this information will always remain in doubt.
- 3.1.12. Furthermore, it is important to note that in National Treasury's own instruction Note #4 of 2022/23, relating to PFMA compliance and

reporting framework, it has made it clear for the need for the reporting of such irregular, fruitless and wasteful expenditure information in the financial statements of all entities and departments.

3.1.13. We are also concerned that an exemption of this nature will now become a precedent for more reporting exemption requests from other entities and municipalities for similar reasons proposed by Eskom, which in turn will disable and reduce oversight bodies and authorities to hold the respective accounting officers/authorities to account for irregular, fruitless and wasteful expenditure.

3.1.14. We believe that the majority of the reasons presented in Eskom's letter to the Minister of Finance (dated 9 March 2023), requesting exemption from reporting as per Section 55(2)(b) of the PFMA were largely flawed and weak. Paragraph 12 of the letter contains a list of these reasons provided, most of which acknowledge Eskom's lack of adequate systems and controls to detect irregular, fruitless and wasteful expenditure, or an inability to assess supply-chain violations and testing or substantiation of transgressions. These issues and reasons speak to poor leadership and mismanagement, and are inadequate to grant exemption from such reporting. In fact, it is our opinion that this poor rationale provides the Minister with reasons to call on Eskom's management to get their controls, systems and financial management house in order, and to do so within a period of six months to one year. There are many professional organisations that can be called on to assist Eskom to get this work done.



#### **4. LEGAL CONCERNS**

- 4.1. We contend that granting the exemption in question will fall short of the basic values and principles that govern our public administration as enshrined in the Constitution of the Republic of South Africa (“the Constitution”), and in particular section 195 thereof.
- 4.2. There is a significant potential that the exemption will be unconstitutional as the exemption is in contrast with section 195 of the Constitution in that:
- 4.2.1. The effect of the exemption will not maintain and promote a high standard of professional ethics.
  - 4.2.2. Efficient economic and effective use of resources will not be promoted.
  - 4.2.3. The exemption does not promote for Eskom to be development-oriented.
  - 4.2.4. The exemption hinders services by Eskom to be provided impartially, fairly, equitably and without bias.
  - 4.2.5. The exemption creates an environment for Eskom to be unaccountable for irregular, fruitless and wasteful expenditure.
  - 4.2.6. Transparency is utterly diminished as the public will be deprived of timely, accessible and accurate information, in particular relation to Eskom’s irregular, fruitless and wasteful expenditure.
  - 4.2.7. The exemption does not cultivate good human-resource management and career-development practices, maximise human potential and would likely achieve the opposite result.
- 4.3. Furthermore, section 215 of the Constitution is clear that national, provincial and municipal budgets and budgetary processes must promote transparency,

accountability and the effective financial management of the economy, debt and the public sector.

4.4. We contend that the exemption will have the opposite effect in relation to Eskom's budgeting. Removing the obligation from Eskom to submit crucial information such as irregular, fruitless and wasteful expenditure will skew the budgeting process by diminishing transparency, accountability and the effective financial management of the economy, debt and the public sector.

4.5. Should the exemption be granted, it has the potential to be challenged on a constitutional basis in a court of law. Furthermore, we contend that section 92 of the PFMA may in itself may be unconstitutional. We therefore reserve our rights to take the appropriate recourse should the exemption be granted.

## **5. CONCLUSION**

5.1. In closing, we believe that Eskom's request for this reporting exemption and the Minister's support thereof, can be construed as a rather embarrassing approach that hints at a level of depravity about the lengths our government will go to, in order to hide information that exposes mismanagement, maladministration and even corruption.

5.2. We therefore respectfully propose that any plan to negate or reduce the full reporting of irregular, fruitless, and wasteful expenditure be disbanded and that all SOEs and government departments continue to report in the manner that has been carried out in the past.

5.3. We may however concede to a variation of this reporting, should the Auditor General's Office and National Treasury seek to introduce a "dual" reporting that qualifies the audit of the current financial reporting period separately to the historic periods, in such a way to indicate the organisation's current period management conduct of the irregular, fruitless, and wasteful expenditure categories (which may attract an unqualified audit outcome), whilst displaying the qualified position for prior financial year periods (should these exist). However, such a proviso of the current period "unqualified outcome" must depend on a display of how accounting officers have meaningfully addressed the prior period "qualified matters" raised.