WRITTEN NARRATIVE OF EVIDENCE TO BE PRESENTED BY ANOJ SINGH, FINANCIAL DIRECTOR OF ESKOM, AT AN OVERSIGHT INQUIRY INTO CORPORATE GOVERNANCE OF STATE OWNED ENTERPRISES, BY THE PORTFOLIO COMMITTEE ON PUBLIC ENTERPRISES OF THE PARLIAMENT OF SOUTH AFRICA, ON 5 DECEMBER 2017

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INTRODUCTION:

1. I present the evidence contained herein, at the request – and on written invitation (dated 14 November 2017) of the chairperson of the Parliamentary Committee on Public Enterprises.

2. In accordance with the invitation to present evidence, I deal with the following specific issues:

   2.1 The purchase of Optimum Coal Mine by Tegeta from Glencore:

   2.2 The pre-payment of the coal supply extension at a Board Tender Committee meeting of 11 April 2016.

   2.3 Corporate Governance at Eskom.

   2.4 The relationship between McKinsey and Trillian.

3. The version contained herein is based on the facts as they are known to me, insofar as they are – or might be relevant to the four "issues" which I have been requested to address in my evidence. However, I emphasize that I am presently on official suspension from duties, and this has hampered me in accessing information from the company, which might otherwise have offered a more full and precise exposition in respect of each issue.

4. I assure the Committee that I recognize the seriousness of this investigation, by its nature. At the same time, I align myself with the aspersions of Lynne Brown, the Honourable Minister of Public Enterprises, to the extent that she stated that she and implicated persons (which includes me) are vulnerable due to the manner and style in which the Parliamentary Committee conducts its hearing. With this in mind, I will endeavour to provide the clearest possible narrative of events as known to me and at the same time to show that my

actions as CFO were reasonable and rational, were executed with due care and skill and benefitted Eskom.

5. I have not been able to attend the entire proceedings of the Committee but have, through the record of testimony, identified certain testimonies that is at odds with the facts as they are known to me. I therefore deem it appropriate to address these aspects to the extent that I believe they will serve the best interests and purpose of the Committee in making objective findings, as it would be a serious mistake of the Committee to allow the inquiry to be hi-jacked by one narrative of one family when the enterprise focused on is an organization with deep rooted problems that have evolved over years – which is also critical to the country's success.

6. With respect to all of the allegation that have been levelled against individuals like myself in the public over the past year not a single report, leak, enquiry or investigation focussed on the granular details which directly contributed to Governance lapses at Eskom or the efforts by the Board during – my tenure - to address these issues. Consequently, I attempt to do so today.

7. In addition, I have been in contact with the relevant law enforcement authorities to provide them with all documents that have been provided to the Committee to enable them to conduct their necessary investigations in this regard.

STRUCTURE OF PRESENTATION:

8. For a proper understanding of my version and submissions pertaining to Corporate Governance at Eskom, it is important that I provide an exposition of the role and responsibilities of the CFO of Eskom. I therefore commence these written submissions with such an exposition:

9. I will thereafter deal with the issues I have been requested to address in evidence, by way of 3 sections, namely:

Section 1, - an Executive Summary dealing with the issues set out in paragraphs 2.1 to 2.4 *supra*

Section 2, (by way of a separate bundle) - Transaction level detail, including summary of timeline of events, discussions on authority, commercial rationale, commercial value/advantages of transactions and CFO observations

Section 3, (by way of a separate bundle) the exhibits referred to in section 1

10. I regard it appropriate to deal with the specific issues that the Committee has requested I deal with, by presenting an executive summary with the following topics:

Topic 1 - Governance at Eskom;
Topic 2 - Pre-purchase of coal – December 2015;
Topic 3 - Payment to Tegeta of R659 million – April 2016;
Topic 4 - Optimum Coal Mine Penalty Settlement; and
Topic 5 - Relationship between McKinsey and Trillian
("the transactions")

11. I will essentially deal with each of the transactions on the basis of the following elements:

- Approval authority;
- Financial risk management;
- Authority or mandate to execute payment or issue guarantee;
- PFMA compliance.

12. I will also, where necessary, deal with other elements of the transactions which I deem relevant. In particular, in relation to the relationship between McKinsey and Trillian, I will elaborate in more detail.

OVERVEIW OF THE ROLE AND RESPONSIBILITIES OF THE CFO OF ESKOM:

13. I explain the role of CFO of Eskom taking into account:

- the background to my appointment as such;
- the position in as far as the functionary operates within the structures of Eskom, and
- my experiences'

insofar - and to the extent that this might enable the Committee to gain proper oversight thereof.

14. I assumed my role as CFO of Eskom on 1 August 2015 on a secondment from Transnet where I held the position of CFO from July 2012 – having acted as CFO since 2009. I saw the secondment to the position of CFO at Eskom as a huge challenge, given the fact that it was the biggest burning platform, whilst I have always been driven by challenges and the opportunity to employ my skills and efforts to make a difference in our country.

15. My role of CFO at Eskom entails me performing the following main functions:

- Financial management of the Company;
- Company performance monitoring; reporting and mitigating actions;
- Funding and liquidity management – performance monitoring; reporting and mitigating actions;
- Financial risk management - performance monitoring; reporting and mitigating actions;

- Tariff and Regulatory Compliance – NERSA;
- Credit rating agency – performance monitoring; reporting and mitigating actions;
- Maintaining and monitoring the financial control environment;
- Corporate plan development and Strategic direction setting and alignment;
- Shareholder communication and alignment.

16. Bearing in mind the decisions and actions which are being reviewed by way of the Committee's investigations, it is appropriate that I provide the context and framework within which decisions were made when I assumed responsibility as CFO at Eskom in August 2015. I was greeted with the following environment and framework:

- New Board of Directors; new Chairman and new Group Chief Executive ("GCE");
- Numerous EXCO positions occupied by acting individuals;
- The organization was directionless and leaderless which was exacerbated by the poorly constructed corporate plan for 2015/16;
- Load shedding crisis;
- Poor generation of plant performance – EAF of 69%;
- Diesel usage at all-time high – approximately R1 billion per month;
- Spiralling cost of primary energy (coal cost and diesel) – 18% per annum increase;
- Liquidity crisis – Letter to the Minister of Public Enterprises declaring cash shortage in and around December 2104/January 2015;
- Credit Rating Agency Downgrade – all three rating agencies in and around February 2015;
- Tariff decision rejected by NERSA and relationship was poor – selective reopener application rejected by NERSA;
- New build program was significantly behind schedule;

- A significant portion of the new build program was unfunded due to spiralling cost increase on the projects;
- Financial performance of the organization was very poor and financial sustainability was and still is in question;
- Credibility of information provided by Eskom to stakeholder was questionable;
- Negotiations with National Treasury for the Equity injection;
- "Gun to the head" attitude of suppliers;
- Lastly, everything was needed yesterday, and everything had to be done yesterday;
- All this led to the establishment of the "war room" by Government.

17. I was literally at ransom – so was the country - in the above framework and this determined and motivated my priorities at the time, as it was evident that the organization was in a crisis. This crisis required an "all hands-on deck" approach to address the issues and stabilize the Company.

18. To the extent that the investigation conducted by the Committee is, *inter alia*, focused on the manner in which decisions were taken and the basis therefore, I believe that the Committee must have appreciation for the primary energy space, and it must be borne in mind that all of the transactions that I have been requested to cover emanates from the primary energy or coal procurement, which is a significant area for governance concerns as it is the single biggest expense of the Company and one of the most critical aspects in understanding the financial viability problems at Eskom as well as its associated impact on Eskom tariff increases;

19. Further aspects which are also of importance in order to understand matters which obviously had an effect on the basis and procedures whereby decisions affecting procurement are taken:

19.1 Eskom procures approximately 120 MT of coal per annum and is the largest purchaser of coals in South Africa;

19.2 Eskom spends R40 – R50 billion on coal per annum;

19.3 Most of the Eskom coal supply contracts were concluded without open tender processes being followed;

19.4 Approximately 40% of coal is procured from so-called cost-plus mines which are 40-year contracts and were awarded prior to procurement regulations as we know it today;

19.5 The balance of Eskom coal was procured under what was called the medium-term coal mandate or the 2008 coal mandate which was approved by the Board Tender Committee ("BTC") in 2008, following the shortage of coal in 2008;

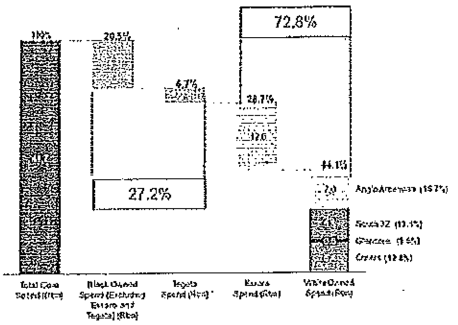
19.6 This mandate allowed for the sourcing of coal without rigorous open tender processes being followed and 33 contracts and numerous contract extensions were undertaken via this mandate;

19.7 Approximately 500 MT of coal was procured via this mandate since 2008;

19.8 Eskom's coal and logistics spend contributes 0.66% to SA's GDP;

19.9 The analysis of coal spend is as follows:

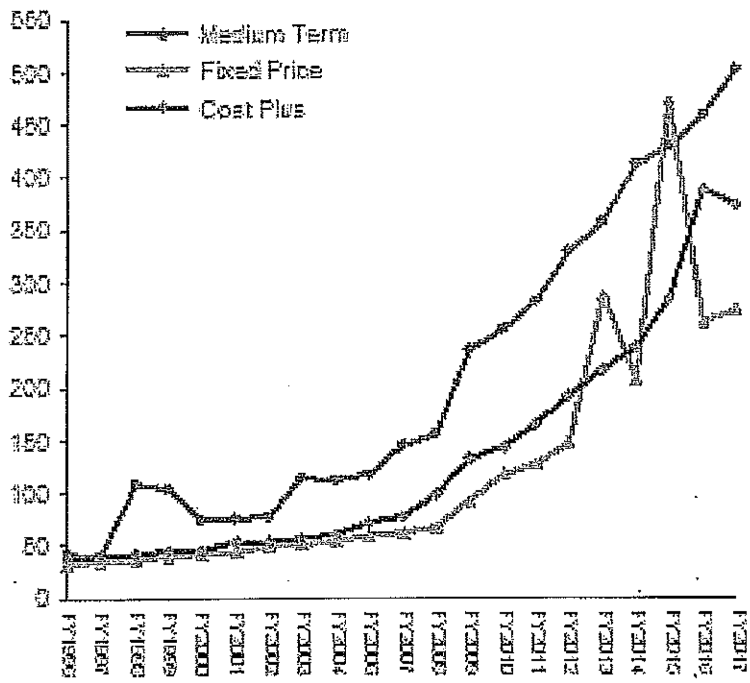
FY2017 Coal Spend Breakdown[2]



1. 73% - from major coal suppliers that are non-black owned
2. 27% - from black-owned suppliers
3. 6.7% - from Tegeta

19.10 Coal cost is ~30% of Eskom's total cost and consequently forms a large portion of the tariff increases that Eskom charges customers;

Coal costs per contract type:



19.11 As can be seen from the graph the cost of coal across all sources of coal increased dramatically post 2008, which also correlates to the tariff increases that increases that Eskom charged its customers - an average increase of 18.8% over the last five financial years;

19.12 Higher CV coal costs due to competition with export markets - major coal suppliers and change in quality specifications by Eskom;

19.13 Cost plus coal costs are much higher because of current low production volumes and excludes capital costs which are significant - significant increase in R/Ton due to poor volume performance of 15% over the last 5 years;

19.14 Major contributors: Exxaro - Arnot mine – pricing of R1132/ton and Anglo - New Denmark mine pricing of R642/ton compared to Optimum of R150/ton;

19.15 Arnot supply was between R453 – R470/Ton from Tegeta realising a saving of approximately R1.2bn;

19.16 Tegeta – no capital cost requirement - contract mix includes higher CV coal, medium Optimum term contract coal as well as one of the cheapest long-term coal contract;

19.17 The fixed price contracts include the Medupi take or pay penalties with Exarro for coal supply to Medupi power station amounting to R11.40 billion, which in my view should be fruitless and wasteful expenditure in terms of the PFMA as Eskom has paid Exarro penalties but has not taken delivery of any coal for this value paid:

- Other than the penalties paid to Exarro, Eskom has taken delivery of some coal under this contract for which Eskom has paid approximately R 8 billion
- This makes this contract one of the most expensive supply contracts for Eskom at approximately R1000/ton if penalties are included

- Effectively this contract has cost Eskom approximately R 20 billion in total which has effectively eroded the equity injection of R 23 billion provided by Government.

SECTION 1

EXECUTIVE SUMMARY:

Topic 1 - Governance at Eskom:

20. It must be borne in mind that I am not a governance expert in the true sense, and that my overview of governance at Eskom is presented from my own understanding thereof, as seen from the perspective of a Chief Financial Officer and this version will essentially be limited to what I have experienced and been exposed to in the some two (2) years that I have fulfilled the role of CFO at Eskom.

21. I believe that there are various factors which impact on governance at both a strategic – tactical – and operational level and I will deal with these in turn and provide examples thereof which I have come across, so as to demonstrate my views with regard thereto.

22. The responsibility for governance in an organisation resides with the Board of Directors ("BOD") and in Eskom it functionally resides with the Group Company Secretary ("GSC") – as I think it does in many other companies like Eskom.

23. The following factors impacted governance at a BOD level in Eskom:

Strategic Level

- The significant turnover of BOD members and Chairman's of the BOD;
- No proper consideration of BOD rotation and succession planning;
- The numerous BOD vacancies;
- The length of BOD vacancies;
- The skill mix of BOD – finance expertise; legal expertise; construction expertise; mining expertise (coal procurement); regulatory (tariff) expertise – in my view biggest risk for Eskom – IT expertise (King requirement), nuclear expertise and maybe a governance expert also.
- Stakeholder and reputation management which is a key BOD function is poorly executed in the organisation for an entity such as Eskom with its current significant problems.

24. The BOD evaluation conducted for each AGM spells out some of these issues.

25. The role of the Group Company Secretary at Eskom was combined with that of Group Legal and Compliance and this also proved to be a hurdle for two reasons – it created a segregation of duties concern and the work load on the Group Executive was too much, given the existing skill and competency base within these two departments.

26. The BOD recognised this problem and the People and Governance subcommittee of the BOD took a resolution to split the roles but was not implemented until very recently.

27. The numerous changes and turnover in leadership at an EXCO level also impacts negatively on the organisation – numerous CEO and EXCO changes in recent years.

28. In addition, given that Eskom is a state-owned company alignment between Shareholder and Policy Department of Government also plays a critical role –

renewables program; funding structure of Eskom; Eskom tariffs and closure of power stations to name but a few.

Tactical of operational level:

29. I will now turn to the tactical or operational level governance at Eskom.

30. The process and control environment within Eskom is well documented and designed, however compliance; monitoring, reporting and consequent management is lacking in the organisation.

31. In my view the above inefficiencies lead to poor accountability and responsibility amongst employees of Eskom, which is compounded by the policy that allows Eskom employees to do business outside Eskom and with Eskom itself. We attempted to review these policies, but this work is still in progress.

32. The effects of the above and other aspects discussed below have had a significant negative impact on the business which also impacted on Company performance – my first-hand experience of the effects of these factors is most evident in the procurement environment – most of the "noise" associated with Eskom in the past has always been around procurement.

33. Events that have contributed to this state of Eskom in my view is outlined below:

    33.1 Management and the BOD I would assume undertook an operating model change in 2010. This change envisaged a shift from a decentralised operating model to a matrix organisation structure.

33.2 A decentralised structure allows for full accountability and responsibility to be visible to the lowest level and enables clear performance management.

33.3 A matrix organisation is more complex and difficult to manage, and the lines of accountability and responsibility and performance management lines are blurred.

33.4 To make matters worse the organisational structure change I am given to understand was not fully implemented – only the management layer of the organisation evolved to the matrix structure and the bargaining unit employees have not been converted.

33.5 This concern was raised by myself in one of the EXCO strategic sessions and there was overwhelming support to migrate back to a decentralised organisation – an EXCO decision was taken I think to use the procurement function as a pilot to implement this decision before embarking on the rest of the organisation.

34. The next significant factor that needs to be considered was the decision taken in 2012 to re-implement SAP as part of the Back to Basics Program.

34.1 The SAP implementation follows a methodology of implementing vanilla SAP which was a basic version of SAP and did not have the required built in controls to manage a complex organisation such as Eskom – significant concerns raised by previous external auditors of Eskom in this regard.

34.2 In addition, the SAP implementation would have been designed considering the operating model change discussed above but which was not completed consequently one of the most critical IT system as no longer supporting business processes.

35. In an organisation as complex and large as Eskom it is imperative that the IT system supports business processes so that transactions are adequately controlled and executed.

36. This is still evident today as the external auditors of Eskom's only place reliance on the general controls environment but adopt a fully substantive approach on business process when conducting the external audit of Eskom – as when compared to Transnet the opposite is true except for the expenditure cycle.

37. The Back to Basics program referred to above was reported as irregular expenditure in 2015 amounting to R310 million.

38. The consequences of the above have essentially resulted in the following issues on the procurement processes:

- Poor procurement control environment;
- Poor contract management;
- Poor consequent management;
- Poor document management.

39. The aforesaid was the main reason that led to the external auditors of Eskom eventually qualifying Eskom's PFMA note disclosure in the 31 March 2017 annual financial statements.

40. Procurement concerns relating to the poor control environment revealed by a diagnostic requested to by myself uncovered the following issues relating to 2015:

  - o Spend without a contract in place of R6 billion which equates to 5% of total spend
  - o Invoice date before good received date of R14 billion
  - o 73 % of items procured by Eskom was categorised as free text spend

- Only 33% of all procurement makes use of a purchase requisition
- Contracts are deemed unmanageable in the Eskom environment

- Procurement analysis conducted by Eskom Internal Audit of their finding since 2014 to 2017 revealed the following:

  - Only 31 % of all procurement transactions reviewed by Internal Audit did not have any issues
  - 17% had issues in the pre-tendering stage
  - 12 % had issues in tender receipt and opening stage
  - 24 % had issues in the tender evaluation stage
  - The dominant root causes of the control deficiencies are people related
  - This is supported by the fact that process improvement is required in relation to operational effectiveness and less so for design adequacy
  - The retention of critical documents was partially case in point

41 Examples of poor contract management that potentially could lead to the contravention of the PFMA would include the following:

a. Exarro take or pay contract entered into in 2008 for supply of coal to Medupi – R11,4 billion - fruitless and wasteful expenditure in my view

b. SHEQ contract entered into in 2006 resulted in irregular expenditure of R2,1 billion and fruitless and wasteful expenditure of R510 million

c. Just Coal – coal supply contract – March 2014 – valued at R6 billion – delivery of out of specification coal to power stations – contract eventually cancelled by Eskom

d. Deemed Energy Payments to Independent Power Producers – late connection by Eskom – fruitless and wasteful Expenditure in my view – R 250 million

e. I have not delved into the contract management issues experienced on the new build program at Medupi and Kusile as I don't have access to this information at the moment but is also an area of concern, but I do know that the Company has made improvements in this area

- Since April 2016 the following action points were executed by myself to improve the procurement environment:

    - Conducted maturity assessment of procurement function. This assessment was done by KPMG which indicated a basic level of maturity
    - Instituted an improvement plan (appointment of service provider took 6 months to be appointed), which caused delays in the implementation, to address the concerns identified in the assessment of the maturity of procurement, which includes but not limited to an operating model review and systems changes and enhancements.
    - Establishment of governance and compliance function within procurement.
    - Secondment of the Mr Peter Volmink to Eskom to fulfil the role in point 4 as an interim measure to stabilise and capacitate the procurement office.
    - Recommendation to recruit a specialist CPO
    - Numerous meetings held during 2016/17 to ensure procurement environment is improved
    - Consequent management improved by CFO and A & F and reported to P & G – long outstanding disciplinary enquiry and forensic investigations – 60 days
    - Procurement dash board reported at Finance Committee by CPO
    - Procurement dash board presented at EXCO and start session for procurement resolution of problems by Group Executive
    - Recommendation to Exco and BOD that procurement function and Company incentives bonuses be modified due to the PFMA violations and procurement weaknesses

- For completeness and lastly no governance discussion would be complete without a discussion on the Public Protectors Report – however I am aware that the Committee has had the benefit of discussions on this matter, so I will not delve into this matter any further.

<u>The specific transaction (approval process in general)</u>:

42 With reference to documents which evidence the veracity of my version.

43 In an organisation as large and as complex as Eskom and in fact any organisation there is significant reliance that is placed on the cross functional disciplines of the organisation. This means that when anyone in the Company approves or executes a transaction on behalf of the Company they take comfort from the roles that are played by our colleagues from other departments in the organisation – such as Operations; HR; Finance, Procurement; Legal and Compliance; Company Secretariat and many others.

44 By way of example when an invoice is paid – the buyers ensure that there is contract in place and a purchase order is placed with the supplier; the goods receiving clerk at the power station acknowledges that the goods have been delivered to site; the accounts payable clerk processes the invoice and matches the purchase order and goods received note with the invoice and then the payments clerk releases the payment to the supplier – this is also an example of segregation of duties.

45 Having said the above, I do not abdicate responsibility for my actions in any way, albeit that I believe that I have always acted within the framework and parameters of my responsibilities.

46 With the above description as CFO I now turn to my role in each of the transactions that I was requested by the Committee to cover by way of this evidence. Ultimately, it will appear from my narrative that I was not the person

that approved any transactions on my own but acted on the resolutions of the BOD or it Sub-Committees as the case may be. In particular, I will show that:

- Prepayment of R1,6 billion and the associated guarantee issued to Tegeta - was authorised by the BOD;
- Prepayment of R600 million - was authorised by the BTC;
- The transaction with McKinsey & Company and its sub-contractor (Trillian) - was approved by the BTC;
- The Optimum Coal Mine Penalty settlement of R577 million - was approved by the BTC.

47 The summary above provides you with a high-level overview of what my role was in executing the actual transactions and the role of other colleagues on whom I relied to give effect to the approvals obtained from the BOD.

48 My role in each of these transactions and those of others is elaborated in further detail in Section 2 hereunder.

49 The Audit and Forensics Function (Internal Audit) of Eskom has produced two factual findings reports that outline the exact nature of my role in each of the transactions in question and I emphasize that this internal audit clarifies that I could not have unduly influenced the outcome of these transactions. Copies of the Factual Finding Reports are appended hereto as annexures "**AS1**" and "**AS2**" respectively.

<u>Topic 2 - Pre-purchase of coal – December 2015</u>:

<u>Approval authority</u>:

50 The pre-purchase of coal was approved by the BOD by round robin resolution on 9 December 2015. I append hereto as annexure "**AS3**", a copy of the "*SUBMISSION DOCUMENT*" which formed the basis of the round robin

resolution, containing the said minutes of the round robin meeting and the resolution.

51 This was a unanimous decision by the BOD to approve the transaction other than Mr Parmensky as he recused himself due to conflict and Mr Brian Molefe who was off sick.

52 This was on recommendation of the Board Investment and Finance Committee (IFC) on 9 December 2015 (annexure "**AS4**").

53 The round robin resolution provided me with delegated authority to execute the transaction on behalf of the Company by the BOD, which I duly executed in terms of that authority of 9 December 2015.

<u>Financial risk management</u>:

54 Once the draft supply contract for the pre-purchase of coal was prepared by Ms Daniels and presented to me and Mr Koko on 10 December 2015, it became clear to me that that the Company would be exposed to significant financial risk. I append hereto as annexure "**AS5**", a copy of this agreement.

55 The contract contained several conditions precedents (suspensive conditions) that would need to be fulfilled before the coal supply agreement would become effective and bind on Tegeta to supply the coal to Eskom.

56 The financial risk exposure was the mismatch in dates of when the R1,6 billion pre-payment approved by the BOD would be done and the date on which the coal supply agreement would become effective which was anticipated to be 31 March 2016 – thus recovery of these funds during this period was of great concern to Ms Daniels, Mr Koko and myself – one of my roles as explained above is financial risk management.

57 This risk was only identified at this stage after the draft contract was prepared hence it not being included in the BOD submission for specific approval.

58 Given the significance of the risk that security of supply posed to the Company and other matters outlined in the BOD submission I decided it was still possible to implement the decision of the BOD and the directive from DMR by issuing a guarantee to Tegeta instead of physically paying R1,6 billion in cash to Tegeta until the suspensive conditions were fulfilled.

59 No objections were noted from Ms Daniels or Mr Koko in this regard.

60 This is a commercially acceptable way of mitigating this type of risk in addition it made sense and was a logical response to the problem.

61 The purpose of the guarantee was to provide assurance to Tegeta that Eskom had the required cash/funds available to make the pre-payment as approved by the BOD when the suspensive conditions contained in the coal supply agreement were met – however and more importantly without paying cash of R1,6 billion to Tegeta.

62 The Ms Daniels brought the supply contract to finality with the help of Cliff Dekker Hofmeyr attorneys ("CDH").

63 Ms Daniels was also involved in setting up the guarantee with Eskom Treasury and ABSA that was eventually issued to Tegeta - so was I. I append hereto as annexure "**AS6**", a copy of the guarantee issued by Absa on 11 December 2015.

64 It should also be noted that the guarantee issued to Tegeta contained the following conditions:

- Same suspensive conditions as the supply agreement;
- Not negotiable and not transferable;

- Expiry date of 31 March 2016.

<u>Authority to issue guarantee</u>:

65 I enquired of Ms Daniels – the Group Company Secretary if I possessed the required authority to enter in the guarantee agreement.

66 Ms Daniels assured me that the BOD had delegated the required authority to me to execute the same – this is one example of many when you are required to place reliance on the cross functional discipline as this was the accountability of Company Secretary to ensure I acted in accordance with the BOD authority confirmed upon me.

67 Ms Daniels advised me that the following portion of the BOD resolution authorised me to enter into the guarantee agreement with ABSA:

"*CFO authorised to take all necessary steps to give effect to the above including signing of any consents or any other documents necessary or related thereto*".

68 Ms Daniels again confirmed the same in an email to ABSA on 17 February 2016, when she provided an extract of the above BOD resolution to the Bank when requested to provide evidence of my authority to enter in to the guarantee agreement. I append hereto as annexure "**AS7**", a copy of an extract from the Resolution as certified by Ms Daniels as company secretary on 17 February 2016.

69 ABSA and their compliance department was satisfied with the authority furnished to them.

70 I have obtained a Senior Counsel opinion regarding my authority to issue the guarantee – the conclusion of which concurs with that of Ms Daniels. I append hereto a copy marked annexure "**AS8**".

PFMA compliance:

71 The supply contract with Tegeta made provision for Eskom to obtain the necessary PFMA approval for the transaction if required per clause 6.8.

72 I engaged with the Group Compliance Manager Mr Aziz Laher on 23 February 2016 regarding the PFMA consequences of this transaction. Ms Daniels provided the supply agreement to Mr Laher via email on the same day.

73 Mr Laher, on 24 February 2017, informed both Ms Daniels and myself via email that the Minister of Public Enterprises must be informed of the transaction in terms of the Materiality and Significance Framework – table on page 15 para 3.2 of no.4. A copy of which is annexed as annexure "**AS9**".

74 I stress again, that the Minister only be informed, and no approval of the Minister was required.

75 I immediately instructed Mr Laher by return email to prepare the necessary documents to inform the Minister accordingly – Ms Daniels was also copied in this correspondence – Mr Laher confirmed via email that he will attend to my request.

76 Between the 24 February 2016 and 29 February 2016 various other emails on this subject circulated between various people within Eskom legal and primary energy departments.

77 Mr Laher, on 29 February 2016, addressed an email to Mr Vusi Mboweni Senior General Manager – Primary Energy that stated the following:

"*Dear Vusi – I trust you are well. The correspondence below (copied to you) refers. Please can you urgently comment on the draft letter to the Minister (attached), including the status of the conditions precedent? The CFO wants* *the finalised letter (and attachments) to be ready for signature by tomorrow 1 March 2016 and – Maya will take it with her to Cape Town tomorrow."*

78 Ms Terressa Micheal from my office followed up with Mr Laher on 17 March 2016 regarding the PFMA submission he replied and stated that she must check with Ms Bhana as the file was with me. Ms Bhana replied stating that I had checked with Mr Koko and that the guarantee will not be used and will lapse on 31 March 2016. Mr Laher replies and says: "*thanks for clarifying*".

79 I would assume that Mr Laher's view after that was that there was no need for a PFMA submission any more as there was not going to be a transaction any more – I did not have the opportunity to confirm the same with Mr Laher however.

<u>Reporting of the Guarantee to the BOD</u>:

80 The responsibility to report guarantees issued by the Company to the BOD falls with the Eskom Treasury department as this aspect is covered in their quarterly reports to the IFC.

81 The value of guarantees issued by Eskom at 31 December 2015 was R1,5 billion - according to the Eskom Treasury report.

82 The issuance of this guarantee was brought to the attention of various treasury officials via emails – Mr Marius Homewood and Dr Vincent Makhuva (18 December 2015) Andre Pillay (18 December 2015) Ms Suki Laher (18 December 2015) who all thus had knowledge that the guarantee was issued. This is over and above Ms Caroline Henry the Head of Eskom Treasury – by and large this was the Treasury EXCO.

83 This evidences the fact that the issuing of the guarantee was not concealed or kept from the site of the responsible officials in any way.

84 I inspected the quarterly reports and Treasury did not report the issuance of this guarantee to the IFC.

85 In my mind, the guarantee contained suspensive conditions and was not effective and consequently there was no need to report it until the guarantee became effective.

86 I can assure the Committee that I did not interfere in any way in the duties of the Treasury to report the same to IFC if they believed it needed to be reported.

87 The BOD is required to ratify any round robin resolution taken by the BOD at its next meeting in terms of its mandate.

88 The responsibility for this reporting lies with Ms Daniels as Group Company Secretary.

89 The BOD did not ratify its round robin resolution at its next meeting which was on 19 April 2016.

90 Ms Daniels however did table the ratification of the round robin resolution at the BOD meeting of 19 April 2016.

91 In addition, if the round robin resolution was placed before the BOD for ratification any other matters of importance relating thereto which the Company Secretary would have been aware of would have been brought to the BOD attention, such as issuing the guarantee.

92 I have been brought to understand that Ms Daniels did not bring this matter to the BOD attention at the meeting of 19 April 2016. I am not aware of the reasons therefore.

<u>Commercial value/benefits to Eskom:</u>

93 Potential security of supply risk was mitigated.

94 Potential socio-economic risk was mitigated – job losses.

Topic 3 - Prepayment to Tegeta of R659 million – April 2016:

Approval authority:

95 The pre-purchase of coal was approved by the BTC at its meeting on 11 April 2016.

96 I did not attend this meeting nor was I aware of the meeting taking place as I am not a member of the BTC.

97 I was informed by Ms Daniels on 12 April 2016 of the meeting and that the meeting had resolved that the CFO is required to perform the following:

- Negotiate a discount with Tegeta;
- Obtain adequate security for the pre-purchase;
- Ensure that the transaction made commercial sense for Eskom;

98 I duly executed and complied with the resolution of the BTC and concluded the following:

- Negotiated a 3,5% discount with Tegeta;
- Obtained adequate and appropriate security for the transaction;
- Provided a rationale for the commercial value that the transaction would have for Eskom.

99 These findings were reported back to and approved by the BTC at its meeting of 13 April 2016, which then delegated me the authority to enter into the security agreement with Tegeta. It is not required that I attend BTC meetings.

Financial risk management:

100 The security agreement with Tegeta was drafted by Ms Daniels with the assistance of CDH.

101 The security package consisted of the entire issued share capital of Tegeta and lien over inventory.

102 This means that if Tegeta defaulted on the prepayment agreement with Eskom then Eskom would own Tegeta and all its associated mines as Eskom held all its shares.

103 The security package was valued more than R4 billion due to the underlying contracts Tegeta had with Eskom, compared to the exposure of R600 million – almost seven times the value required.

104 I requested the head of Audit and Forensics (Eskom Internal Audit) to verify that the Tegeta share certificates that were delivered to Eskom and was in Eskom's possession to ensure that if Eskom had to perfect the security package it had the ability to do so.

105 This was duly executed by Eskom Internal Audit and no exceptions were reported to me.

106 In addition, I was also brought to believe that the external auditors also inspected the Tegeta share certificates in Eskom's possession at the time.

Mandate to execute prepayment transactions:

107 Prepayment of this nature is not unique and was done in the past and will continue to be done going forward as they form part of the following arrangements:

- It was part of the procurement mandate approved by the BTC in 2008;
- long-term 40-year coal supply contracts with cost plus mines.

108 Prepayments to mines in terms of the 2008 mandate amounted to approximately R115 million in the past and was provided to three other companies namely Isambane; Liketh and Silver Unicorn.

109 Pre-payment to cost plus mines in the past amounted to R11,3 billion and over the next five years are projected to be an additional R17,5 billion.

110 These cost-plus contracts have been awarded to Anglo (coal volumes 61%); South 32 - formerly BHP (coal volumes 22%) and Exarro (coal volumes 17%).

111 Coal purchased from these mines over the last five (5) years have amounted to R74 billion.

PFMA Compliance:

112 Preliminary legal opinion obtained by Eskom from Senior Counsel briefed by CDH on this transaction indicates that Eskom was not in contravention of the PFMA in executing this transaction as it relates to irregular and fruitless and wasteful expenditure.

113 I believe this is the position adopted by Eskom's external auditors, as well, since I do not recall any adverse findings being reported to the Audit Committee of Eskom in this respect for the year ended 31 March 2017.

114 I can also only assume that Auditor General would have concurred with this view as they were part of the Audit Committee Meetings and the audit of Eskom is performed on their behalf by Sizwe Ntsaluba Gobodo.

115 **Commercial value benefits to Eskom**

Issues	Value derived	Real benefit R billion
Prepayment for Arnot coal	The financial benefit of this transaction is compared to the export parity price of coal delivered to the Arnot power station	0.1
Prepayment for Arnot coal	Had Eskom's anticipated risk materialized, and should Eskom not have purchased the 1.26Mt coal, the extreme worst case would have been to run OCGTs to make up for the production shortfall of 2.2 million MWh	5.5

<u>**Topic 4 - Optimum Coal Mine Penalty Settlement**</u>:

<u>Approval authority</u>:

116 The Optimum coal mine penalty settlement was approved by the BTC at its meeting on 8 February 2017.

117 The assessment and outcomes of the arbitration process was presented to the BTC by Ms Daniels.

118 The BTC resolved the following:

- That Ms Daniels to conclude the negotiations with Tegeta at a settlement value of not less than R500 million.
- That the CFO is delegated the authority to execute the transaction on behalf of the Company.

Financial risk management:

119 The negotiation was conducted by Ms Daniels which took the form of an arbitration between the parties – Advocate RA Solomon SC presided over the proceedings.

120 I was not part of the negotiations at any stage.

121 The letter of demand that was issued to OCM was a measure taken to prevent the claim that Eskom had against OCM from prescribing as these claims related to 2012 – prescription occurs after a period of three years.

122 The fact that Eskom issued the letter of demand does not automatically guarantee Eskom that the value of the demand will be awarded by a court of law. Eskom would need to still prove its claim in a just and fair way based on the contractual terms and conditions.

123 Ms Daniels did from time to time provide me with updates on the status of the negotiations.

124 Ms Daniels decided and obtained authority for me to be delegated to sign the settlement agreement.

125 Ms Daniels felt it would be inappropriate for her to sign given that she was negotiating the settlement it would be better to have someone other than her to sign the settlement – segregation of duties.

126 In addition to the process undertaken Ms Daniels, I conducted some of my own analysis and review of the claim that Eskom had against Optimum due to the high-profile nature of the claim.

127 These included a review and analysis of the following.

- Glencore Annual Financial Statements – no mention of the claim no contingent liability or provision made in financial statements – external auditors – Deloitte;
- Optimum Annual Financial Statements – no mention of the claim other than when the business went into business rescue – directors denied liability – claim not disclosed as liability or contingent liability – external auditors – Deloitte;
- Opening Balance Sheet for Optimum provided by Business Rescue Practitioners (BRP) to Tegeta – no provision made for the claim by BRP – external audit – Deloitte;
- Commercial viability of business to Tegeta – would not make business sense for Tegeta to acquire OCM thinking it had a R2,1 billion penalty to settle with Eskom and then pay a purchase price of R2,1 billion for the business meaning a purchase price of R4,2 billion – the underlying cash flows of the business would not support this valuation;
- Discussion with Eskom Project Manager – he indicated that there were justifiable reasons for the claim to be much lower than the R2,1 billion.

128 This in-depth analysis and my deductive reasoning led me to believe that for all intent and purposes the parties external to Eskom believed that the value of the claim was zero.

Commercial value/benefit to Eskom:

129 Commercial value derived by Eskom was R577 million.

130 It is my view that Eskom got a good deal in this respect and this contrary to media headlines that Eskom granted Tegeta a 75% discount on the claim – an alternative perspective could be said to be that Eskom increased the claim from zero to R577 million.

Issues	Value derived	Real benefit R billion
Hendrina Optimum BRP	The benefit of the Tegeta owned Optimum Colliery compared to the Glencore owned Optimum Colliery is calculated based on the difference between the Tegeta real coal price and the revised Glencore offered price for the period from 1 April 2016 until the contract expiry period on 31 December 2018	3.4

Topic 5 - Relationship between McKinsey and Trillian:

Approval authority:

131 The BTC, as appears from the transaction level detail contained in section 2.

132 As evident in the timeline, I arrived at Eskom on 1 August 2015 by which time the BTC had already awarded a Mandate to Negotiate with McKinsey on the MSA.

133 I was not the delegated Authority to conduct the negotiations with McKinsey nor conclude the contract. The delegated authority was the GE for Technology and Commercial. However, I from time to time provided input

134 My role began with the Chairing of the Steercom that the BTC approved be set up to implement the MSA

135 Consequently, I inherited the program, managed it, identified risks, managed them and ultimately recommended the termination of the MSA.

Financial Risk Management:

136 As part of the termination process with McKinsey I requested the following to be done

137 An internal audit review relating to the procurement and contracting process. See paragraphs 210, 211 and 212 below.

138 An external review be conducted on MSA relating to value derived. See paragraphs 170, 171 and 172 below.

139 A legal review of the MSA process be conducted. See paragraphs 213 onwards.

Commercial value to Eskom:

140 Table 1: Benefits table showing impact to Eskom's turnaround strategy and corporate plan:

	FY 2015/16 Annual Results	**FY 2016/17 Annual Results**	**Link to McKinsey MSA work stream**
Financial Performance			
EDITDA	R32 billion, representing an increase of 37.4%	R38 billion, representing an increase of 14.4%	Procurement and primary energy cost savings and generation turnaround (EAF improvement)
Cost Savings	R17.5 billion achieved against a target of R13.4bn including reduced OCGT usage	Cost savings of R20 billion achieved against a target of R17billion. Own generation cost	Procurement and primary energy cost savings and generation

		decreased by 8.5% to R60 billion, with primary energy costs down by 2.3%	turnaround (EAF improvement)
Cash Generated from Operations	Increased by 36.4% to R37.2 billion	Increased by 23.1% to R46 billion	Procurement and primary energy cost savings and generation turnaround (EAF improvement)
Funding	57% of funding secured for 2016/2017	53% of funding for 2018 financial year has been secured	Cash locking in particular treasury initiative linked to the corporate plan
Operational Performance			
Generation Energy Availability Factor (EAF)	71.1%. No load shedding from September 2015	Improved significantly to 77.3%	Generation turnaround
Capital Delivery	Medupi Unit 6 in commercial operation on 23 August 2015, adding 720MW of generating capacity	Medupi unit 5 achieved commercial operation on 3 April 2017 Medupi unit 4 synchronized to the grid on 26	Project Delivery and claims management,

		December 2016 Kusile unit 1 synchronized to the grid on 26 December 2016	

141 At a high level the program delivered the following capability building outcomes:

- 31 new Top Consultants enrolled to the program in 2016. This was in addition to the 22 consultants that were already in advanced stage of development from previous, 2013/2014, engagement with McKinsey. This brought the total consultants-in-training on the program to 53.
- Top Consultants are currently working on initiative stemming from the program that will lead to further impact over next 3 years and supporting Group Executives with their individual priority programs.
- Launched 12-month Top Buyer capability building program with initial cohort of 40 people from across Eskom business.
- At Majuba, trained 30 managers in leadership coaching and revived technical training programs.
- More than 280 ideas captured in Wave (auditable tracking tool for MSA initiatives). More than 75 Eskom users live and trained to use the tool.

142 A summary of the key impact achieved in the 4 targeted areas is as follows:

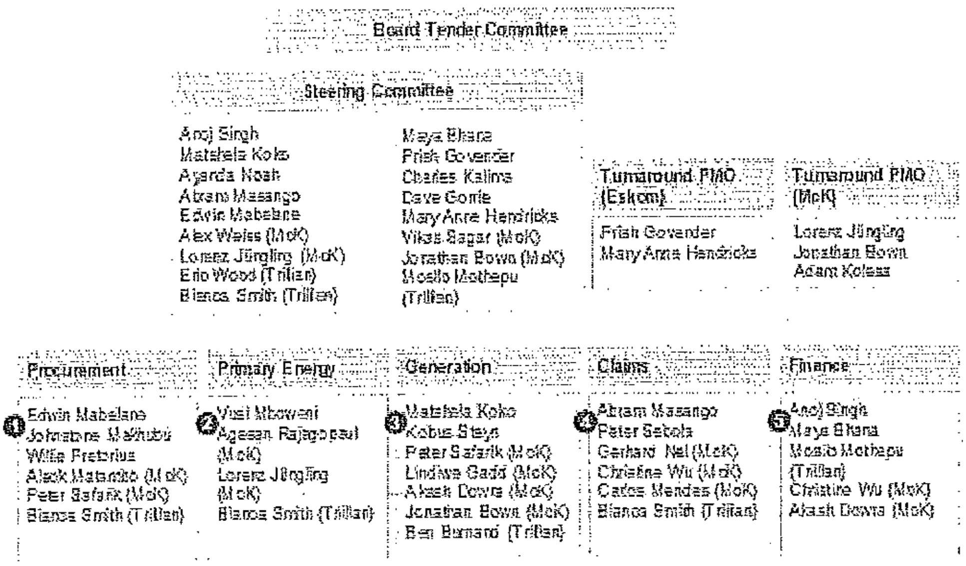
- In Generation, the first six months of the Majuba turnaround program (code-named "Sakhasonke") have reduced 12-month moving average unplanned capability loss factor (UCLF) by 4.97pp and the support of the Unit 6 GO has helped limit work to a single outage and avoid a further 4.5pp of planned capability loss factor (PCLF) in for Unit 6.
- In Procurement, average savings of 15% have been attained, a Spend Control Tower has been implemented and the Top Buyer training program have been launched. Spend Control Tower program through

which each purchase order generated by the business was reviewed by an independent team to determine whether the stated need could not be met through other means other than an external purchase or varied downwards given past consumption patterns.

- In Primary Energy, new medium term fixed price coal contracts price has reduced by 2.5 - 15% through focused fact-based negotiations
- Whilst at Medupi the stockpile height and geometry have been extended to allow additional coal to be received thereby mitigating the impact of the Medupi take or pay penalty which could have had R3.2billion EBITDA impact for Eskom.
- In Claims, at Medupi MHPS claimed R3,054bn and this was settled at R362m during the DAB (Dispute Arbitration Board) process resulting in a saving of R2,692m for Eskom, at Kusile MHPS claimed R2,67Bn and this was settled at R1,013bn resulting in a saving of R1,657bn for Eskom.
- Furthermore, initiatives on Project Delivery at Medupi and Kusile, contributed to Eskom removing R 14bn from the capital requirement for the 5-year period as initiatives carried out lead to an acceleration of the project schedule and a reduction of the claims as described above.
- Initiatives under the MSA have achieved more than R18.6 billion of annualised impact for Eskom (R34,9 billion over a five-year basis) – this impact is a combination of capital and operational cost savings and improvements in revenue potential.

143 The program has also identified a further R29 billion of initiatives that can be delivered over the next three years, covering key aspects of the Corporate Plan like external spend, coal procurement, employer claims at new build sites and improved EAF in Generation plants.

<u>**Figure 2: Governance Structures of MSA**</u>:



NB The governance structure does not show all of the core team members and Top Engineers involved in the MSA. In total more than 150 Eskom employees were involved in the MSA

144 The MSA was operationally implemented by a BTC approved steering committee. The steering committee was made up of Eskom EXCO members, Senior individuals from McKinsey and Trillian and other Eskom senior officials.

145 Over 150 Eskom employees were directly involved in the MSA, supported by their respective delivery teams, on the implementation of more than 280 initiatives.

146 I requested the Head of Auditing Forensics to conduct an assessment to ensue the prepayment was fully recovered through the delivery of coal by Tegeta. This was done and no exceptions were reported to me.

147 The membership was finalised in January 2016, as per one of the conditions precedent in the contract signed between McKinsey and Trillian in January 2016.

148 A summary of the terms of reference for the MSA Steerco were as follows:

- When considering submitted Work Package Initiatives:
- In advance, apply its mind to the recommendations presented before it;
- Ensure that the approved savings and the Eskom commercial processes are in accordance with the Services Level Agreement and Eskom policies;
- Ensure the integrity of Eskom's commercial processes;

Provide approvals:

- Approve the Work Package Initiative as submitted;
- Approve the Work Package Initiative conditionally;
- Approve an alternative Work Package Initiative as submitted;
- Approve an alternative Work Package Initiative conditionally;
- Support the Work Package Initiative, with a referral to a higher Delegated Approval Authority, where applicable;
- Reject the Work Package Initiative, with reasons.

149 When considering Eskom Top Engineers:

- Direct, guide and support Programme team to implement a programme within Eskom's policies and procedures, with a strong focus on skills development;
- Direct the participation of the Eskom Top Engineers in all Work Package Initiatives;
- Assess the SD&L value creation as agreed by the parties;
- Monitor Eskom's progress on the program; provide guidance when needed;
- Provide feedback to required parties including EXCO and Board;

150 Shall:

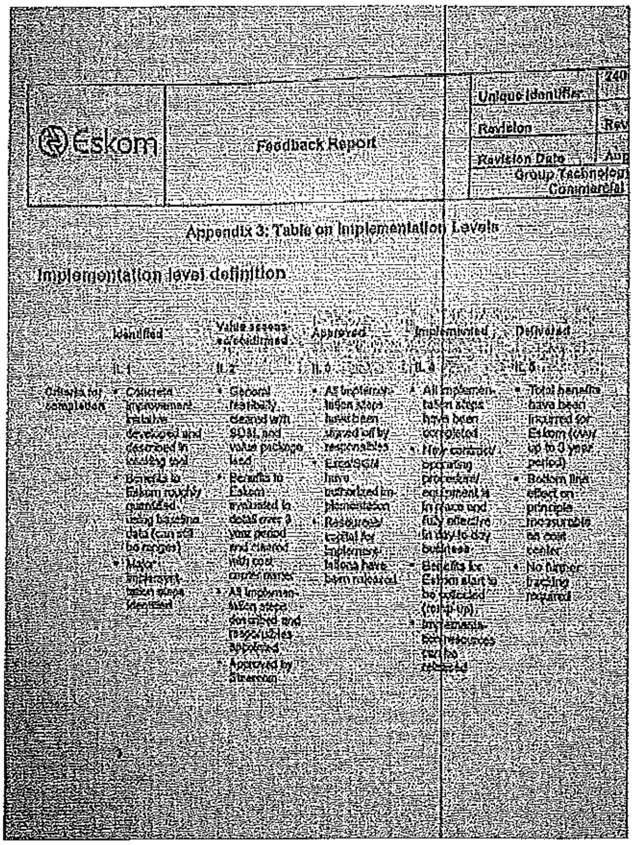
- Consider any complaints raised by Eskom or McKinsey & Co;

- Be responsible for escalation or implementation of corrective actions;

151 Authorised to:

- Investigate any matter brought before it for approval;
- Request other Eskom employees to attend the Committee meetings;
- Consult with and seek any information it requires from any Eskom employees;
- Obtain independent professional advice as it deems necessary.

152 The approval of all initiatives and associated payments followed a strict stage gate approval process indicated below.



Eskom | Feedback Report

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Group Technology Commercial	

Appendix 3: Table on Implementation Levels

Implementation level definition

	Identified	Value assessed/confirmed	Approved	Implemented	Delivered
	IL 1	IL 2	IL 3	IL 4	IL 5
Criteria for completion	• Concrete improvement initiative developed and described in tracking tool • Benefits to Eskom roughly quantified using baseline data (can still be ranges) • Major implementation steps identified	• General feasibility cleared with SGAL and value package lead • Benefits to Eskom evaluated in detail over 3 year period and cleared with cost centre owner • All implementation steps described and responsibles appointed • Approved by Steercom	• All implementation steps have been signed off by responsibles • Exco/SGM have authorized implementation • Resources/capital for implementations have been released	• All implementation steps have been completed • New contract/operating procedure/equipment is in place and fully effective in day to day business • Benefits for Eskom start to be collected (ramp up) • Implementation resources can be released	• Total benefits have been incurred for Eskom (over up to 3 year period) • Bottom line effect on principle measurable on cost center • No further tracking required

153 An auditable tracking tool (WAVE) was used to capture all of the initiatives and track the maturity of the initiatives through the IL stage gates. Moving from

one stage gate to the next required combined sign off from Eskom and the consultants.

154 The stage gates called implementation levels (ILS) together with the payment percentage due was finalised during the negotiation process and approved by the BTC in October 2015. At IL1 initiatives were classified as having once off or recurring benefits. The success fees for once off and recurring benefits were 10.8 and 10.55% respectively and was approved by the BTC in October 2015. At the time of negotiations these success fee percentages were tested with external organisation and were found to be within benchmarks.

155 As the initiatives progressed along the implementation levels the amounts payable by Eskom escalated as follows; at IL2 55% of the fee was due, at IL3 70% of the fee was due and for any initiative that progressed beyond IL3 90% of the fee was due.

156 The full payment trigger point was agreed, at the negotiations with McKinsey, to be between IL3 and IL4. This point was agreed on because it balanced the level of work done with the success fee payment. If a higher implementation level was agreed on then the success fee percentage would have been higher.

157 Bearing in the mind the MSA contract period was for three years. For recurring benefits Eskom agreed a payment plan so as to minimise the cash flow impact of the payments due. 60% of the payment would be due in year 1, 30% of the payment would be due in year 2 and 10% of the payment would be due in year 3.

158 **<u>Table 3: List of payments made to the MSA</u>**:

See list of payment made to the MSA below, I have also appended the list hereto as annexure "**AS10**".

List of Payments	Payment Amounts (Rmn Excl Vat)	IL1	IL2	IL3	Payment Trigger	Approval Authority	Internal Audit Sign-off	Internal Legal Sign-off	Invoice Date	Payment Date
Mckinsey 1 Progress Payment (Project delivery claims, Gx Turnaround, Primary energy, procurement)	597	✓	✓	✓	✓	BTC	No sign off at the time of payment but procurement and contracting process was deemed to be acceptable in December 2016	✓	11-Aug-16	15-Aug-16
Trillian 1 Progress Payment(Project delivery claims, Gx Turnaround, Primary energy, procurement)	107.2	Received Trillian invoice for progress payment for work done on Finance stream R107.2m. TSince finance stream allowed for an alternative payment mechanism to risk based contracting, Eskom insisted that the finance work streams were invoiced on a time and material basis. The hourly rate was in line with National treasury rates. Had the initiatives been invoiced on a success fee basis, as originally negotiated, the quantum of fees could have been materially larger.				BTC	No sign off at the time of payment but procurement and contracting process was deemed to be acceptable in December 2016	✓	10-Aug-16	12-Aug-16
Trillian 2 Progress Payment (Finance stream)	99.3	✓	✓	✓	✓	BTC	No sign off at the time of payment but procurement and contracting process was deemed to be acceptable in December 2016	✓	10-Aug-16	12-Aug-16
Trillian 3 Payment shortfall relating to payment 1 (Project delivery claims, Gx Turnaround, Primary energy, procurement)	134	✓	✓	✓	✓	BTC	✓	✓	14-Dec-16	20-Dec-16
Mckinsey 2 Termination Payment (Project delivery claims, Gx Turnaround, Primary energy, procurement)	305.3	✓	✓	✓	✓	BTC	✓	✓	17-Feb-16	22-Feb-16
Trillian 4 Termination payment(Project delivery claims, Gx Turnaround, Primary energy, procurement)	154.7	✓	✓	✓	✓	BTC	✓	✓	15-Feb-16	22-Feb-16
Total	1,397.5 (Excl Vat) 1,419 (Incl VAT)									

159 **<u>Table 4: Summary of Oliver Wyman Report Findings:</u>**

Claimed by Consultants	2,839
Could not be paid, not within process nor approved by steerco (not paid)	1,052.5
Remaining value	1,786.5
Technical grounds to question payment (not paid)	387.5
Process follow steercom approved	1,398.96

160 From table 3 and 4 Eskom total payments to McKinsey and Trillian were within the findings made by Oliver Wyman.

161 An example of a McKinsey invoice is attached as Annexure "**AS11**". It illustrates how payments due were calculated given the above parameters.

162 An example of a Trillian invoice for the work jointly performed with McKinsey is attached as Annexure "**AS12**".

163 A key observation to note is that the invoice provided by Trillian is on a high-level line item basis. Eskom then requested a detailed reconciliation from McKinsey to verify the exact values due to Trillian before final payments were made.

164 A final observation associated with <u>table 3</u> above is closeness of the invoice submission date and the payment date for both the McKinsey and Trillian invoices. This can be explained by the fact that the consultants had performed close to 10 months of work without having received any payments and requested a quick turnaround in the payments process to assist with cash flow requirements post the approval of the BTC. This motivation is then assessed by the Head of Shared Services in Eskom, prior to releasing the payment.

Steerco: Recommendation to BTC to cancel MSA:

165 In June 2016 the Steerco recommended to the BTC the cancellation of the MSA for the following key reasons:

- The questions raised in Eskom's letter to McKinsey dated 19 Feb 2016 had not been fully and satisfactorily addressed. An example of this would be how McKinsey was going to fulfil the Board approved SD&L requirement given the fact that McKinsey had decided not to go forward with Trillian. McKinsey had been given the opportunity by Eskom between April 2016 and June 2016 an alternative plan to meet the SD&L requirements and this was not forthcoming.
- The payments accruing to McKinsey and Trillian, which could not be envisaged at the time of concluding the contract with McKinsey, was increasing at a rapid scale from a quantum perspective. The steerco raised concerns as to the eventual contract value that could be payable for the entire duration of the MSA.
- The new requirements for National Treasury, sole source contracts, would have attracted greater scrutiny albeit that the new requirements were not in place at the time of concluding the MSA.
- With the above in mind the BTC was approached to cancel the MSA and engage in an open tender process to contract with other participants in the market, which may or not may have included McKinsey.
- The increased number of participants would have also had the effect of increasing the SD&L impact of the project. Opportunity for further BBBEE participation could be increased if more than one company was involved.

166 A settlement was thereafter followed to terminate the MSA with McKinsey. The settlement process was supported by Eskom Internal Audit, Internal Legal, External Review by Oliver Wyman and External Legal by Cliff Dekker

Hofmeyer (CDH). Furthermore, all payments associated with the settlement process was approved by the BTC.

167 A detailed timeline with supporting documents that fully describe the MSA from initiation to termination has been provided in "Timeline of events" including herein. The supporting documents are not exhaustive, and any document requested by the Committee can be made available if required.

Legal and PFMA Considerations:

168 Certain key issues have dominated the Public space regarding the MSA. The issues together with responses are detailed as follows:

Legal issues:

169 Fruitless and wasteful expenditure:

- Defined as "***expenditure** which was made in vain and would have been avoided had reasonable care been exercised*";
- The organisational performance was significantly improved as a result of the MSA.
- The WAVE tool contains baseline signoffs by the consultants and Eskom employees per initiative. This was measured against actual achieved results and again validated and signed off by consultants and Eskom employees.
- 280 initiatives were captured in the WAVE tool and allocated to consultants and Eskom employees. Over 150 Eskom employees were directly involved in heading up these initiatives. They in turn had numerous teams to implement the initiatives jointly with the consultants.
- The steering committee made up of Group Executives and General Managers were accountable for approving the various initiatives on recommendation from the implementation teams.

- Based on steerco minutes, at no point did any steerco member or any other members involve in the project raise a concern regarding the value delivered by the program, other than those initiatives that were contested between the consultants and Eskom employees – these were never approved by the steerco as a consequence.
- As an added measure to validate the value that management believed to have been derived by the programme, the CFO requested an independent review, which was conducted by Oliver Wyman (Annexure "**AS13**").

170 The context of the work as stated by Olivier Wyman was as follows:

- *"The objective of the assignment was to produce an independent peer review with regards to the reasonableness of the conditions, performance measurement and remuneration of the consultant and its subcontractor.*
- *Two separate pieces of work are also being conducted independently by Eskom including an internal audit review of the contract and a legal review of the MSA and split of fees between the consultant and the BBBEE partner".*
- Oliver Wyman did not categorically state that no value was derived by Eskom as a result of the MSA.
- They concluded that the process set up by Eskom and the consultants was an indicator of value derived.
- The report indicates that consultants have claimed an amount of R 2,839 billion for the services rendered under the MSA.
- Firstly, the report indicates an amount of R1,052.5 bn could not be paid to the consultants as it did not follow the above process and was never approved by the steerco.

171 The resultant R1,785.5 bn can be summarised as follows:

- R1,398.96 bn followed the outlined process and was consequently paid.

- R387.5 m of the R1,786.5 bn was questioned by Oliver Wyman on technical grounds but was due and payable in terms of the process followed.
- Through the settlement negotiation process the consultants accepted the recommendation of Eskom on the basis of the Oliver Wyman report and consequently this amount of R387.5 m was never paid also.
- In addition, Oliver Wyman conducted a benchmarking on the various work streams of the MSA and found some work streams to be over-valued and some undervalued. But the overall fee was within the allowed benchmarks – R 1270bn vs R1290 bn excluding the finance stream.

172 Therefore, it is my contention that:

- The Oliver Wyman "confirmed a payment of R1,398.96 bn" (excl VAT) to the consultant based on work conducted which was then the amount paid to the consultant and its sub-contractors.
- Given the work done by in access of 150 Eskom employees, the signoff of this work by various Eskom employees and consultants, the capturing of the work in an auditable tracking and monitoring tool (WAVE), the approval of the initiatives by the steerco, further recommended to the BTC for approval and lastly the independent external verification by Oliver Wyman leads us to conclude that there is no fruitless and wasteful expenditure relating to the MSA.

Payment without a direct contract with Trillian:

173 During the contract negotiation phase McKinsey agreed to the development of a SD & L partners. It was agreed that up to 50% on average of the contract value would be sub-contracted to an SD&L partner.

174 Eskom had entered into a contract with McKinsey called the Master Services Agreement. A Letter of Acceptance was issued in December 2015 and the

contract subsequently signed in January 2016, wherein contained the above obligation.

175 The contract makes clear reference to a McKinsey Partner defined by the contract to include the contractor to McKinsey. Furthermore, in the SD&L annexure of the contract clear work split percentages are defined per work stream.

176 McKinsey introduced Trillian as their SD&L partner in October 2015 to Eskom and continued to work with Trillian even after the letter that Eskom received on 30 March 2016 till August 2016. This is evidenced the Steering Committee records and was done to ensure that all activities were brought to a logical conclusion and to minimise any loss of value.

177 All initiatives were jointly approved by Eskom, McKinsey and Trillian at the steercos.

178 McKinsey provided communication to pay Trillian directly in February 2016. It is a McKinsey policy, as stated by McKinsey in the parliamentary enquiry, that any subcontractor fees due are paid directly to the subcontractor.

179 Furthermore, McKinsey provided reconciliations to confirm the amounts due to the SD&L partner in November 2016 and February 2017.

180 Trillian was registered on the vendor database by the Eskom Vendor Management function.

181 Eskom's procurement and vendor payment practices allows for the direct payment to sub-contractor even if a contract exists only with the main contractor in the following circumstances:

- A main contract is in place with the main contractor;
- Agreement of the subcontractor is obtained to be paid directly;

- Agreement is obtained from the main contractor to pay the sub-contractor directly.

182 This practice dates back as fa as 2011 and was adopted to facilitate Eskom's compliance to pay BBBEE vendors within a period of fourteen (14) days and also enable it to claim these payments as BBBEE accreditation points.

183 Vendors that have benefitted from this practice to name a few are:

- Tubular Construction Projects, Zakhele Electrical, M-Power, GWL Chemicals, Eagle Lifting Equipment, Matz Electrical, Cosira, Gambu Projects, NTP Logistics, Sebenzana.

Allocating work to Trillian without a contract:

184 Given the urgency to gain traction on the Eskom turnaround strategy, the consultants began work in October 2015, post approval by the BTC to conclude a contact with McKinsey for the MSA.

185 Trillian was introduced to the Eskom procurement and project management team by McKinsey as a SD&L partner on the MSA in October 2015.

186 It was McKinsey's decision to deploy Trillian at Eskom without a sub-contract being concluded between the parties as the SD&L obligation was with McKinsey.

187 It is our understanding that both McKinsey and Trillian were working at risk which both entities accepted. At no point time did Eskom instruct McKinsey to deploy or use Trillian.

188 The above is further evidence by the fact that McKinsey used Trillian for the Corporate Plan contract before deploying Trillian as a SD&L partner on the MSA.

189 McKinsey's vetting process of Trillian was taking place in parallel as is evidenced in the Letter from McKinsey dated 25 February 2016 (annexure "**AS14**").

<u>Irregular expenditure</u>:

190 *"Defined in section 1 of the Public Finance Management Act (PFMA), 1999 as 'expenditure other than unauthorised expenditure, incurred in contravention of or that is not in accordance with a requirement of any applicable legislation, including:*

i. (a) this Act; or

ii. (b) the State Tender Board Act, 1968 (Act No. 86 of 1968), or any regulations made in terms of that Act; or

iii (c) any provincial legislation providing for procurement procedures in that provincial government".

191 McKinsey stated clearly in this parliamentary enquiry that they had a valid contract in place with Eskom thus the conclusion that can be drawn is that the contract was enforceable.

192 Eskom signed a binding letter of acceptance with McKinsey in December 2015. One of the conditions precedent was the use of risk based contracting and the continued validity thereof.

193 Eskom had received external legal advice from McKinsey that was sourced from Ledwaba and Mazwai Attorneys (annexure "**AS15**"). The conclusion of the external legal advice sought by McKinsey was that the risk based contracting methodology will not offend National Treasury Regulations as it was allowed for in terms of SCM Practice Note 3 of 2003/4.

194 Eskom was not satisfied with this advice and decided to approach Senior Counsel (SC). SC contended that SCM Note 3 cannot be relied upon as it has either been implicitly or explicitly repealed OR superseded by Instruction Note 2013/14. He advised that an exemption be sought from National Treasury as per applicable provisions of the Instruction Note (annexure "**AS16**").

195 Eskom signed a binding letter of acceptance with McKinsey. One of the conditions precedent was the use of risk based contracting and the continued validity thereof.

196 It is important to note that both legal advices relied on the status of SCM Practice Note 3 of 2003 for their conclusion. It was therefore logical for management to seek clarity on this matter from National Treasury before embarking on the longer process of seeking exemption which could delay the program quite considerably.

197 Eskom engaged National Treasury on 04 February 2016, as National Treasury is the regulator and ultimate authority on the said issue. This approach was further supported by Eskom Group Compliance. The engagement resulted in a confirmation by National Treasury that SCM Practice Note 3 of 2003 was still applicable and in force (annexure "**AS17**"). Eskom then concluded that the legal advice by Ledwaba Mazwai Attorneys prevails and there was therefore no need to amend the contracting terms and conditions with McKinsey or seek a deviation.

198 On the 7th January 2016, Eskom signed a contract with McKinsey. There were two conditions precedent to the contract namely:

199 The first condition precedent was the auditors confirming in writing that the tracking tool (WAVE) incorporates the necessary controls to allow a reasonable audit of the data.

200 McKinsey dealt directly with the Internal Audit function at Eskom to ensure that the WAVE tool approval was in place.

201 McKinsey provided to Eskom Internal Audit and independent audit assurance report from Ernest & Young to demonstrate the suitability of the tool (annexure "**AS18**").

202 Furthermore, Eskom Group IT was asked by Eskom Internal Audit to review the suitability of the WAVE tool from an IT Architecture perspective. The Group IT review was completed in January 2016 and the use of the tool was approved (annexure "**AS19**").

203 The Group IT report also stated the following from an audits findings perspective; *"**Audit Findings** – From the ISAE 3000 opinion report produced by EY there were a few deficiencies identified and through discussion these deficiencies have been rectified or control has been implemented to rectify them."*

204 The second condition precedent was the Employer constituting the Steering Committee and grating such Steering Committee the respective roles, responsibilities and powers to give effect to the relevant provisions of the agreement.

205 Approval for the Steering Committee constitution was given by the BTC in October 2015.

206 The members of the Steering Committee were finalised in January 2015.

207 In October 2015 advice was sort from Eskom Group Compliance regarding the PFMA implications of the MSA.

208 Feedback received from Group Compliance was as follow:

"There is no basis within the Significance and Materiality Framework to make an application to the Minister of Public Enterprises – regardless of the value. i.e. under the PFMA, DPE approval is not required, and likewise, nor are we required to inform our Minister of the transaction".

209 It should be noted that in terms of the Significance and Materiality Framework, the Minister of Public Enterprises must be informed of any procurement of goods/services in excess of one-and-half billion Rand (R1 500 000 000) from a foreign (non-South-African) supplier. The total payment to McKinsey alone amounted to R902.2million (excl. VAT).

210 Eskom Internal Audit conducted a review of the MSA.

211 The final Internal Audit review report was completed on 12 December 2015 (Annexure "**AS20**"). The conclusions of the report as follows:

i. "The procurement process followed by Eskom to appoint McKinsey complied with applicable Eskom policies, procedures and processes and the National Treasury guidelines, instructions and practice notes.

ii. The contracting with McKinsey followed Eskom policies, procedures and processes and National Treasury guidelines, instructions and practice notes.

iii. We could not determine whether the contract was terminated in accordance with the termination clauses as contained in the contract or was in fact terminated at all.

iv. We could not conclude whether the payments made were in accordance with the settlement terms between Eskom and McKinsey as no written settlement agreement signed by both parties were presented."

212 Management comments as noted in the conclusions of the Internal Audit review were as follows:

i. *"The settlement agreement will be established between the parties and the payments to date will be dealt with on the same basis of that agreement. A Board mandate will be requested for the same*

ii. *The request to Board was to have the contract with McKinsey terminated and the work be put back into the panel of strategic management for all panel members to tender for it."*

iii. The termination agreement between Eskom and McKinsey was signed in February 2017.

<u>My interaction with internal legal: Ms Suzanne Daniels:</u>

213 As part of the termination process, I asked the team to engage internal audit, internal legal and to source an external review of the fees payable.

- At the time of the engagements with Internal Legal listed in the table below Ms Daniels was the Head of Internal Legal and the Company Secretary
- Below is a detailed account of the interaction with internal legal as provided above for internal audit and the external review done by Oliver Wyman

Date	Timeline: Description of events
Aug 16	Before progress payments were made to McKinsey and Trillian, I consulted Ms Daniels who confirmed that the payments to Trillian without a subcontract being in place as this was a progress billing and the issue will be resolved when the termination agreement is put in place. This was again confirmed by Ms Daniels in the Draft BTC submission of 8 Dec 2016 and the Final BTC submission of 12 Dec 2016. This was also confirmed by the Internal audit report of 12 December 2016.
07-Dec-16	Draft BTC submission for 13 December 2016 sent to Internal Legal for review. (Annexure "**AS21**")
08-Dec-16	Confirmation from Internal Legal Ms Daniels that external legal input for the draft BTC submission is being acquired from Cliff Dekker Hofmeyer. (Annexure "**AS22**")
09-Dec-16	Draft BTC submission for 13 Dec 2016 submitted again to Internal Legal Ms Daniels for review and input. Preliminary Oliver Wyman Report also submitted (Annexure "**AS23**")

12-Dec-16	Final BTC submission received from Internal Legal Ms Daniels with input that said the following: *"Cliff Dekker Hofmeyr (CDH) was retained to conduct a review and the conclusion is that Eskom need to enter into a termination agreement with the parties to bring the matter to finality. This will absolve Eskom from any further liability once the termination agreement was place."* (Annexure "**AS24**")
08-Feb-17	Feedback to BTC on conclusion of termination negotiation process. BTC notified that Eskom had settled on final payment of R460m including the BBBEE partner portion and after the signing of a termination agreement, Eskom will be in a position to close the matter. The submission was supported by Internal Legal Ms Daniels, who was present at the BTC. The BTC resolved that the feedback on the settlement reached with McKinsey and the payment of R460m by Eskom as part thereof in full and final settlement of all claims in terms of the MSA is noted and supported.
15-Feb-17	Draft Settlement Agreement from CDH. Internal Legal Ms Daniels copied.
	Final Settlement Agreement from CDH. Internal Legal Ms Daniels copied. (Annexure "**AS25**")
17-Feb-17	A memo was sent to the Interim Group Chief Executive from The Chief Procurement Officer titled "The Final Settlement Risk Based Contract Mckinsey and Co. The memo was a request to pay the final amount of the McKinsey MSA in line with the approval from the BTC and the provision amount for the amount payable in October 2016. From a legal perspective the report noted that the settlement agreement was drawn up by CDH and there were no major findings. The memo was dated 17 February 2017 and was supported and signoff by Internal Legal Ms Daniels before payment were made on 22 February 2017 (Annexure "**AS26**")

<u>TENDER TO PRESENT ADDITIONAL EVIDENCE:</u>

214 I hereby unconditionally tender my cooperation to provide whatever additional evidence might be available to me, which the Committee might require me to present; and to present further evidence regarding facts which might become known to me or with which I might be in a position to deal after having considered such facts and/or having been given the opportunity to inspect

documents and records which are presently not available to me, but might be made available to me.

SECTION 2

OF

WRITTEN NARRATIVE OF EVIDENCE TO BE PRESENTED BY ANOJ SINGH, FINANCIAL DIRECTOR OF ESKOM, AT AN OVERSIGHT INQUIRY INTO CORPORATE GOVERNANCE OF STATE OWNED ENTERPRISES, BY THE PORTFOLIO COMMITTEE ON PUBLIC ENTERPRISES OF THE PARLIAMENT OF SOUTH AFRICA, ON 5 DECEMBER 2017

SUMMARY WITH TIMELINES OF EVENTS:

1. Without detracting from the aforesaid narrative, I provide for the benefit of the Committee, and in respect of each of the transactions, a summation of what I have stated above, together with a timeline of events.

2. What is contained hereunder is merely a summary of the aforesaid, for the convenience of the Committee.

Pre-purchase of coal: December 2015:

3. Upon recommendation from Investment and Finance Committee of the Board, the Board of Directors approves the following resolution:

4. Request from DMR is noted:

   - Group Chief,Executive; Group Executive Generation and Chief Financial Officer authorised to negotiate and conclude a pre-purchase of coal agreement with proposed owners of OCM;
   - The agreement will be subject to regulatory approvals having been obtained by Eskom and the Supplier as necessary;

- CFO authorised to take all necessary steps to give effect to the above including signing of any consents or any other documents necessary or related thereto.

Insurance of Guarantee:

5. CFO authorized to take all necessary steps to give effect to the above including signing of any consents or any other documents necessary or related thereto.

Commercial Rationale for Executing the Transaction:

6. Compliance with mandate and instruction per DMR.

7. Ensuring security of energy supply and avoiding load shedding.

8. Empowerment by increasing shareholding to 51%.

9. Avoiding job losses by preventing closure of OCM which is in business rescue.

Cross Functional Responsibilities and Accountability of Transaction per DOA:

10. Mitigated financial risk to Eskom by reducing – pre-payment risk by issuing a bank guarantee which contained suspensive conditions.

Identification of Business Need	- Primary Energy and Generation
Initiation of Transaction	- Primary Energy and Generation
Financial and Funding	- Finance
Financial Risk Management	- Finance
PFMA and Governance	- Legal and Compliance
Approvals and Authorization	- Legal and Compliance
Contract Approval	- Legal and Compliance
Contract Management	- Primary Energy and Generation

Sequence of event of the transaction:

Date	Details of the transaction
6 December 2015	• Group Executive Generation submits letter to DG DMR • Letter highlights security of energy supply and asks for intervention from Department to mitigate risk identified • Business rescue proceedings at the Optimum Coal Mine (OCM) impacts negatively on Hendrina power station - 2000MW • Also impacting Komati power station as it receives 180 000 tons of coal from Koornfontein Mine • In parallel Arnot power station supply was also at risk due to the Exarro contract coming to an end on 31 December 2015 - cost per ton of R1132/ton • Contract extension with Exarro not acceptable to Eskom – cost of R1400/ton • Optimum could also not supply Arnot as the RFP process did not yield required volumes
Undated	• Letter from Dr T Ramontja Director General Department of Mineral Resources (DMR) in response to Group Executive Generation letter o Highlights department will fast track competition commission approval and mining rights due to consequences for the country o identifies a financial provision of R1,7billion relating to historical liabilities at Optimum Coal Holdings o Requests Eskom to play an active role in providing support for the project to proceed o Proposes that for new owners of the mine to continue with the current contract up to 2018 and to drive transformation that a pre-payment up to one-year coal supply be undertaken by Eskom o Basis for this is the upfront capital requirements to ramp up production to meet coal supply requirements o suggests that every possible angle must be considered and offered to ensure supply is guaranteed at contracted prices for all critical mines • This will avert a national crisis that the country can ill afford
8 December 2015	• Group Executive Generation prepares a round robin submission to the Board of Directors for the approval of pre-purchase of Coal from OCH • Also signed by the CFO • 5,5 MTPA of coal supply risk identified at Hendrina PS • Business Rescue Practitioners proposal and supported by DMR is a possible solution to mitigate this risk • Solution pre-purchase of coal 1,68 billion which mitigates supply risk • Counter party risk mitigated by cession of coal to Eskom • Funding for the pre-purchase reduce inventory coal days from 54 to 40 days which power station • NPV benefit to Eskom of R238.9m • Proceeds of R1,68 billion will be used by OCM to settle existing liabilities to ensure business is a going concern • Proposed purchaser will increase empowerment ownership from 30% to 51% • OCM close will result in job losses
9 December 2015	• At 08h30 the BOD Investment and Finance Committee (IFC) has a telecon to consider the above submission • IFC resolves to recommend that the Board approve the transactions as set out in the submission
9 December 2015	• BOD approves the following resolution by round robin • Request from DMR is noted • Group Chief Executive; Group Executive Generation and Chief Financial Officer authorised to negotiate and conclude a prepurchase of coal agreement with proposed owners of OCM

Date	Details of the transaction
	• The agreement will be subject to regulatory approvals having been obtained by Eskom and the Supplier as necessary • CFO authorised to take all necessary steps to give effect to the above including signing of any consents or any other documents necessary or related thereto
9 December 2015	• Email from Company Secretary Ms Daniels confirming the decision taken by the Board is valid and effective

10 December 2015	• Draft Agreement for the prepurchase of coal from OCM circulated by Ms Daniels to CFO and Group Executive Generation for review and comment
	• Draft agreement drafted by Cliff Deker Hofmyer attorneys
	• Draft Agreement contains suspensive conditions which increased pre-payment risk – meaning if Eskom pays the R1,6billion and the conditions are not fulfilled then how does Eskom get its money back
	• Discussion with Ms Daniels regarding the authority of the CFO to issue a bank guarantee is held and confirmation is obtained by the current resolution issued by the BOD is sufficient to issue bank guarantee
	• Agreement for the prepurchase of coal from OCM signed by CFO and Tegeta
	
	• Agreement suspensive on following conditions (Clause 5)
	  o Approvals in terms of MPDRA required for share transfer
	  o Approvals from the Competition Commission
	  o Confirmation that shares in OCM has been transferred to Tegeta
	  o Confirmation from Eskom legal advisors that conditions precedent have been fulfilled
	• Agreement makes provision for the issuance of a bank guarantee in favour of Tegeta to secure the payment of the advance payment (clause 6.2)
	• Agreement also makes provision that the bank guarantee will be subject to the same conditions precedent as above (clause 6.2)
	• Agreement also makes provision for a special notarial bond over coal to be issued in favour of Eskom as security (clause 6.7)
	• Agreement makes provision to the extent required Eskom will need to obtain PFMA approval (clause 6.9)

10 December 2015	• Memorandum signed by CFO to authorise Eskom Treasury to give effect to the above bank guarantee requirement
	• Memorandum prepared by Group Treasurer – Ms Caroline Henry and set out the reason for the issuance of the guarantee and other approvals required to give effect to the pre-payment agreement
	• Reasons outlined as limiting credit risk to Eskom or recovery of funds in the case suspensive conditions are not met
	• No issues raised by Treasury regarding authority of the CFO to issue guarantee following BOD resolution
	• Memo quotes authority as per BOD resolution - "CFO authorised to take all necessary steps to give effect to the above including signing of any consents or any other documents necessary or related thereto
	• Treasury would have provided all necessary documents and approval that would have been required by ABSA to affect the guarantee
	• ABSA legal and compliance department would have the reviewed and approved the issuance of the Guarantee ensuring adequate authority existed to issue the guarantee.
	• Approval provided to Eskom Treasury to
	  o Issuance of a guarantee in favour of Tegeta
	  o ABSA as a counterparty to issue the guarantee
	  o counterparty concentration limit excess for ABSA until 31 March 2016

Date	Details of the transaction
10 December 2015	• Application to ABSA for guarantee signed by CFO
10 December 2015	• Various emails from ABSA and Eskom Treasury and Company Secretary Ms Daniels - mechanics of how the guarantee will operate - form of the guarantee - requirements to issue the guarantee • Bank account details of the beneficiary provided by GE Generation and Company Secretary to Eskom Treasury
11 December 2015	• ABSA Bank Issues a performance guarantee: 175-02-0132113-G • Subject to the same suspensive conditions as per the supply agreement (claus 2) • Expiry date was recorded as 31 March 2016 (clause 6) • Guarantee was not negotiable nor transferable (clause 7)
18 December 2016	• Various emails circulated to Eskom Treasury staff • These include Mr Marius Homewood, Mr Vincent Makhuva, Ms Suki Laher and Mr Andre Pillay
17 February 2016	• Group Company Ms Daniels issues an extract of the Board Resolution to ABSA indicating the CFO authority to execute the guarantee
23 February 2016	• CFO engages Senior Manager regarding PFMA implications of the transactions
24 February 2016	• Senior Manager Legal and Compliance responds with his assessment – PFMA approval not required but Minister of Public Enterprises must be informed in terms of Significance and Materiality Framework (SMF) • Company Secretary copied in correspondence • CFO instructs Senior Manager Legal and Compliance to prepare documents to inform Minister
24 – 29 February 2016	• Mr Laher engages with various Eskom employees to finalise the letter to the minister • Employees include – Ms Ayanda Nteta; Mr Dale Sicard; Ms Maya Bhana; Neo Tsholanku; Rakgomo Setshedi; Mr Vusi Mboweni
17 March 2016	• Ms Teressa Micheals follows up the status of the letter PFMA to the Minister with Mr Laher • Concludes that no need to send letter as transaction longer going to be effective
31 March 2016	• Guarantee expired without being utilised • Prepayment agreement still not unconditional condition 3 not yet fulfilled
15 April 2016	• Business Rescue Practioners announce sale of OCH to Tegeta • Suspensive condition 3 of the supply agreement and the guarantee would only have been fulfilled on this day • However important to note the guarantee expired on 31 March 2016 • Also, important to note if the pre-payment was affected as per the BOD approval Eskom would have been exposed to Tegeta credit risk for a period of 4 months at least • During a period when the 4 major banks in SA were in the process of closing all Oakbay related bank accounts

<u>Optimum Coal Mine Penalty Settlement:</u>

Optimum Coal Mine Penalty Negotiation

11. Authority to enter into the Transaction – Delegation of Authority

- The Optimum coal mine penalty settlement was finally approved by the BTC at its meeting on 8 February 2017
- The BTC resolved the following in previous meetings:
  - That the Acting Head of Legal and Compliance to conclude the negotiations with Tegeta at a settlement value of not less than R500 million
  - That the CFO is delegated the authority to execute the transaction on behalf of the Company

12. Commercial Rationale for Executing the Transaction

- Successfully enforced Eskom existing contractual rights as contained in the contract between Eskom and Optimum
- This right would have been forfeited had the initial process that Eskom embarked upon with Glencor been successful as this process would have not yielded any settlement of the penalty and granted a higher price of coal to Glencor
- Increased shareholder value by R577million.

Cross Functional Responsibilities and Accountability of Transaction per DOA

Identification of Business Need	-	Primary Energy and Generation
Initiation of Transaction	-	Legal and Compliance
PFMA and Governance	-	Legal and Compliance
Approvals and Authorization	-	Legal and Compliance
Contract Approval	-	CFO
Contract Management	-	Legal and Compliance

Background

13. The settlement was part of an arbitration process as provided for by the contract between Eskom and Optimum Coal Mine.

14. Advocate Solomon SC was appointed as the arbitrator for the process.

15. Miss Daniels as head of Legal and Compliance was the lead negotiator on behalf of Eskom.

16. Eskom had external lawyers CDH were advisors during this process.

17. The CFO was not in any way involved in the arbitration process as merely the delegated authority appointed by the Board Tender Committee to sign the documentation

CFO Observations and Independent Analysis

18. Given the high-profile nature of this transaction I decided to conduct an analysis of certain information to support by signing of the contract post BTC approval

19. A review of the Glencor Annual Financial Statement which are publicly available indicates that the Eskom penalty of R2,1billion was never raised as a provision or disclosed as a contingent liability. Neither was it disclosed in their Directors Report. These financial statements were audited by Deloitte in London.

20. This indicates that the Directors of Glencor and their auditors did not believe that the claim will be awarded in Eskom favour - mean they never intended to pay Eskom

21. A review of the Optimum Coal Mine Annual Financial Statement indicates that the Eskom penalty of R2,1billion was never raised as a provision or disclosed as a contingent liability

22. The Directors Report contained in the latest AFS refers to the penalty but disputes that Eskom has any rights to claim the penalty as it had used the coal. These financial statements were audited by Deloitte SA – again saying nothing was due to Eskom

23. The Eskom Project Manager discussion with me also indicated that the value of the claim for the penalty would likely be much smaller and that Glencor and Eskom identified the cause of the reject coal consequently Eskom should not be too optimistic regarding its chances of claiming the full 2,1billion penalty

24. The commercial rationale for Tegeta to purchase the business would not make sense if the seller in their due diligence declared a R2,1billion penalty payable to Eskom. This would have made the purchase price R4,2 billion being R2,1billion the price for the mine and Tegeta would then incur a further R2,1billion for the penalty making the business case commercially unviable

25. This is again confirmed by the opening balance sheet provided to Tegeta by the BRP as it does not reflect any potential claim that is payable to Eskom within one year. This balance sheet was audited by Deloitte.

26. The BRP release Optimum coal mine from business rescue in September 2016 and this was done on a going concern basis which means that they were satisfied that Optimum has sufficient cash resources and facilities to continue operating for the foreseeable future. In their word the Eskom penalty was the main reason for the BRP so how did they release it from BRP if they still had an unresolved claim of R2,1billion from Eskom. This would only have been possible if they believed that the claim was not significant

SUMMARY: PRE-PAYMENT TO TEGETA OF R659 MILLION – APRIL 2016:

Prepayment to Tegeta of R659 million – April 2016

Authority to enter into the Transaction – Delegation of Authority

27. Eskom Board Tender Committee approved the pre-purchase of coal at its meeting of 11 April 2016

28. Eskom Board Tender Committee approved the following at its meeting of 13 April 2016:

    - That the CFO conclude a share pledge agreement with Tegeta which will be effective for a period of 14 days as security for the upfront payment as previously approved
    - The share pledge agreement to be replaced by an alternative, acceptable security agreement after 14 days

29. Commercial Rationale for Executing the Transaction

30. Compliance with mandate and instruction per DMR

31. Ensuring security of energy supply and avoiding load shedding

32. Empowerment by increasing shareholding to 51%

33. Avoiding job losses by preventing closure of OCM which is in business rescue

34. Commercial benefit to Eskom of between R61 million and R5,5 billion

35. Adequate security was obtained for the prepayment in the form of shares in Tegeta

36. Pre-payment transactions for coal was in terms of Eskom policy and existing contracts

Cross Functional Responsibilities and Accountability of Transaction per DOA

Identification of Business Need	-	Primary Energy and Generation
Initiation of Transaction	-	Primary Energy and Generation
Financial and Funding	-	Finance
Financial Risk Management	-	Finance
PFMA and Governance	-	Legal and Compliance
Approvals and Authorization	-	Legal and Compliance
Contract Approval	-	Legal and Compliance
Contract Management.	-	Primary Energy and Generation

Mandate and Policy for Pre-payment

37. The procurement of 2 million tons of coal from Tegeta and Umsimbeti was executed under the 2008 mandate.

38. This mandate allowed for procurement of coal without and open RFP and allowed for pre-payments to coal suppliers. 33 coal contracts were awarded under this mandate and 500 MT was purchased using this mandate

39. The 2008 mandate and the rationale for the mandate:

a. The medium-term mandate was sought in 2008 after the declaration of an emergency at affected power stations – coal crisis in 2008

b. The mandate was sought to mitigate the occurrence of another emergency.

c. The supply and demand for future coal supplies was assessed at the time and it was identified that a shortfall of coal existed when comparing the burn requirements to the existing and planned long term supply contracts and this gap was to be covered by Medium term supplies

d. To mitigate risk and to prevent any such emergencies in future, a long-term strategy was formulated to assess the impact of future supplies to Eskom.

e. Based on this it was proposed that a mandate be approved for the short and medium-term procurement.

f. The medium-term Mandate was approved by Board Tender Committee on 11 September 2008

g. No open tender process was required

h. This mandate was terminated by the Board in September 2017 and now all coal procurement must be procured via a competitive tender process

40. To ensure security of supply and to prevent load shedding during winter, an assessment of the winter supply plan was conducted, and this indicated a shortfall of 2 million tons of coal to meet production requirements at Arnot

41. Time and quality of coal were the overriding factors that would have determined the successful suppliers

42. Only two suppliers namely Tegeta and Umsimbithi were able to increase volumes and meet the time and quality requirements

43. Based on information provided the price of coal was bench-marked and found to be commercially acceptable

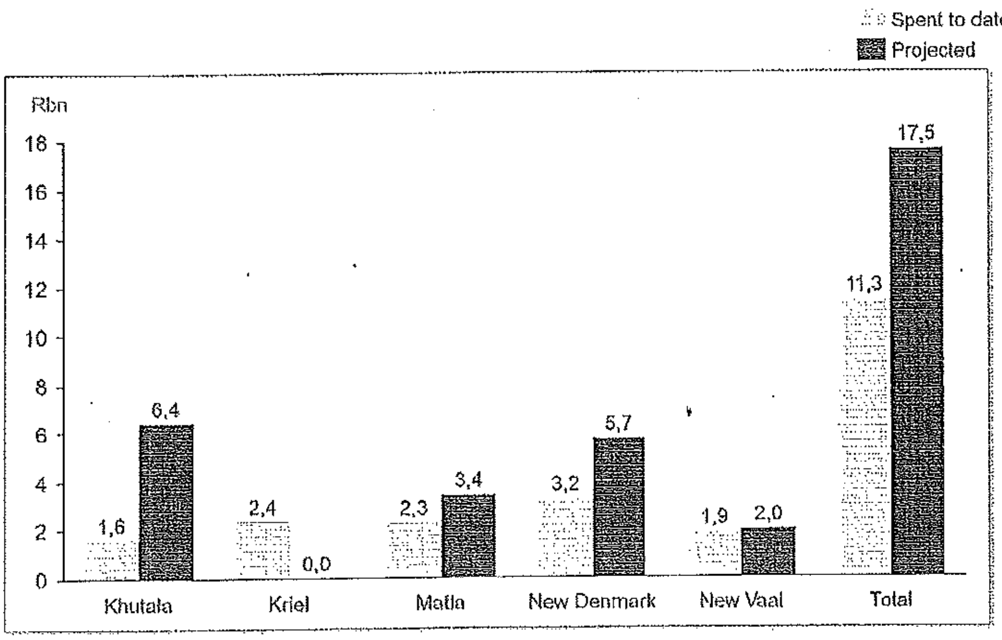
44. The prepayment was made in terms of the Board approved 2008 mandate in respect of coal prepayments - R659 million (incl. VAT)

45. Several other prepayments to suppliers have been made since 2008 in terms of the approved medium-term mandate:

	Prepayments made	Prepayment Conditions	Benefits to Eskom
Isambane	Isambane received three prepayments for the following amounts:	The conditions were:	• Beneficiation of Eskom Coal

	Prepayments made	Prepayment Conditions	Benefits to Eskom
	• R10m • R33m • R31m	• 15% interest and payable over 12 months • 0% interest and payable over 24 Months • 0% interest and payable over 24 Months	
Liketh	Liketh received R42.89M	• 15% interest and payable over 12 months	• Beneficiation of their Coal to increase volumes supplied to Eskom
Silver Unicorn	Silver Unicorn received R3.59M	• 0% interest and payable over 6 months	• Beneficiation of their Coal to increase volumes supplied to Eskom
Tegeta	Tegeta received R659m (including VAT)	• 3.5% discount negotiated for early payment (5 months) • Total time value of money impact is 9,5% compared to prime overdraft rate of 9.75% at the time	• Security of supply

46. Cost plus mines also enjoy prepayment of capital into their mining operations - Future investment requirement R 17,5 billion for next five years and investments to date amount to R11,3 billion. Consequently, total prepayments will be R28,8 billion.



Based on Corporate Plan until FY2022 and internal analysis for the remainder of the contractual duration. This value will increase to R28.15bn if the Cost-Plus contracts are extended beyond the original duration. This excludes land and water costs

- Eskom has spent a total of ~R12bn on capital projects at cost plus mines – effectively is prepayments for coal purchases – no interest charged

- The latest cost-plus request for capital approval by the Board on 27 September 2016 was for Exarro – Matla mine – R1.8 billion

47. Other than coal prepayments, Eskom had prepaid other suppliers an amount of R3.9 billion at 31 March 2016, details of which are as follows:

Division	**March 2016 (R'm)**	**Explanation**
Capital & Properties	2,421	Comprise mainly of payments made to suppliers for manufacturing capacity for the future construction of assets such as Ingula project (CMI - Main underground works contract), Kusile project (Alstom - turbine contract) and Medupi project (Hitachi and Cylde Bergerman)
Distribution	340	Mainly due to payments made to suppliers for the purchase of transformers
Generation	586	Payments made for coal supplies, critical & strategic spares
Technology	274	Payments made for modular spares
Group Customer Services	39	Payments mainly for the DoE solar water heating rebate programme
Group IT	215	Payments made for software licenses
Strategic Functions	55	Relates mainly to payments for membership fees to Electrical Power Research Institute (EPRI)
Other	23	
	3,953	

Financial Considerations

48. The coal purchased was budgeted for and in line with the Corporate Plan;

49. Liquidity risk was mitigated by available cash and the future liquidity risk was assessed in terms of the available cash flow forecasts and associated funding plans.

50. Eskom does not agree that the prepayment should be recognized as a loan and this treatment has been agreed with its external auditors and is in terms of international financial reporting standards. It is my understanding that this treatment has also been accepted by the Auditor General of SA

51. In addition, Eskom does not believe that interest should be calculated in terms of Section 80 of the PFMA as asserted by National Treasury CPO, as Section 80 is applicable to debts and loans payable into the National Revenue Fund

- Although Section 80 of the PFMA is not applicable, the comparison to interest charged per Section 80 of the PFMA is used to confirm that even if Section 80 were applicable, Eskom would not be in breach of compliance as Eskom was better off by R4,7 million.

	Rands	Advance Payment	S80 of PFMA	Difference
Monthly cash flows	Deemed Interest charged for the period (5 months)	23,921,796	17,105,663	6,816,132
Daily cashflows	Deemed interest charged for the period (5 months)	23,921,796	19,193,255	4,728,541

52. A 3.5% discount was negotiated with Tegeta for early payment of 6 months which translates into a 7% annual discount;

53. A 4% negative cost of carry benefit accrued to Eskom due to the surplus cash on hand for 6 months effectively yielding a 2% benefit to Eskom;

54. The total time value of money (interest) impact is thus 9% compared to prime overdraft rate of 9.75% at the time;

55. The next best option to acquiring coal would be to burn diesel to ensure no load shedding in winter. This option would have been the most expensive option as the cost of production of coal is R277/MWh and the cost of diesel is R2,245/MWh;

56. Had Eskom's anticipated risk materialized, and should Eskom not purchase the 1.26Mtons of coal the extreme worst-case scenario would have been to run OCGT and burn diesel to make up the production shortfall of 2.2MW. This equates to a saving of R5.5 billion by avoiding the use of diesel.

57. A further consideration was the record of decision issued by NERSA on Eskom's 2013/2014 Revenue claw back application in which the Regulator completely disallowed costs of diesel used to generate electricity as a cost recoverable from the consumer. Consequently, the use of diesel had to be the last option;

58. Adequate and appropriate security had been provided by Tegeta in the form of a lien over inventory and pledge of the issued shares of Tegeta;

59. This was accepted after careful consideration of the net asset value of Tegeta as contained in their latest approved annual financial statements and a review of their latest management accounts;

60. Additional security was derived from the underlying coal supply contracts from the coal supply of Tegeta with Eskom – e.g. Brakfontein contract over 10 years approximately R4 billion compared to the exposure of R600 million

61. An internal audit verification conducted revealed that the quantum of the prepayment was fully recovered by coal delivered by Tegeta by 31 August 2016

Legal opinion on fruitless and wasteful and Irregular expenditure

62. The board obtained a legal opinion relating to the various transactions with Tegeta however the legal opinion with respect to prepayment states the following:

   a. in respect of the price difference of R18.68/GJ as opposed to R19.69/GJ for coal from Tegeta only an expenditure that was "without value" or "without substance" not yielding the desired result is considered to be in vain.
   b. In that regard, fruitless and wasteful expenditure no reference was made by National Treasury to any particular contravention by Eskom of applicable legislation in making the advance payment of R659 558 079.
   c. Without any clear contravention of the PFMA read with Treasury Regulations, the medium-term mandate and Eskom SCM Policy it cannot simply be concluded that it was an irregular expenditure

63. Both National Treasury and the Public Protector have inconsistent views on the nature of the expenditure for the advance payment.

64. The Public Protector observed that the advance payment might be fruitless and wasteful expenditure whereas National Treasury maintains that it amounts to irregular expenditure.

65. The Public Protector recorded with reference to an argument for irregular expenditure that "after evaluating the responses received from Eskom, it is clear that they do have the requisite policies in place which provide for a prepayment of coal to be made. This is in line with various agreements put in place by Eskom after the energy crisis in 2008". The conclusion of the Public Protector is in line with our assessment that the expenditure cannot be irregular if there was compliance with Eskom's policies.

66. However, it also does not mean that the expenditure is fruitless and wasteful expenditure when applying the test aforesaid without demonstrating that an employee or official of Eskom contravened legislation, including the Eskom SCM policies, made or permitted expenditure inconsistent with the PFMA or Eskom's internal control systems it cannot be concluded that any financial misconduct was made either wilfully or negligently.

67. A copy of the preliminary Report is annexed hereto marked "**AS27**"

SUMMARY AND TIMELINE OF EVENTS – McKINSEY (MSA):

Timeline: Dates	Timeline: Description of events
2012	▪ Eskom had implemented a successful Top Engineers Development Program (later to be called the Top Consultants Program during the MSA) that was initiated in 2012. The program was done in collaboration with McKinsey, who was the preferred service provider. The primary objective of this program was to develop future engineering leaders with a broader skill set including core problem solving skills.
2013	The Top Engineers Development Programme stalled in 2013 due to funding constraints, as the program was executed on a fixed fees basis.
2014	In 2014 EXCO resolved that the overall strategy of developing a permanent Top Engineers Program is valid and should be pursued. However, no clear solution existed at the time for funding the program.
2014/2015	▪ Requirement for turnaround strategy by the Board linked to Denton's Report. The organisation needed improvement in 4 key areas: o Financial sustainability o Primary energy costs o Generation performance o New build delivery and costs
Jul-15	▪ Mandate to negotiate on a sole source basis was approved by the EXCO Procurement Committee and the BTC in June and July respectively. The key elements included: o Initiative is self-funding o Performance initiatives will be paid out of realised savings to a maximum value of 12% per project o Exit period of 12 months from start of contract if no benefits are realised

Timeline: Dates	Timeline: Description of events
	• The sole source was motivated in line with Eskom's procurement procedures on the following basis: o Assets, good or services being procured under a new contract/project is a repetition of similar/identical assets, goods or services procured against contracts that form part of a programme/project for which an initial contract was awarded using tendering procedures, and where Eskom indicated, in the notice of intended procurement or in the enquiry or tender documents for the initial procurement of goods/services, that further contracts may be awarded using negotiated contracting procedures • Further motivation for the sole source was as follows: o McKinsey developed the original Top Engineers Programme and has intellectual property in the design of the programme that Eskom cannot re-create in respect of: ▪ Content of classroom training programmes ▪ Reverse secondment approach to include Eskom employees as trainees on McKinsey's engagements with Eskom and other clients ▪ Specific mentorship methodology to fast track development ▪ Specific evaluation schemes to assess consulting readiness of engineers in trainings ▪ McKinsey is the largest global consulting house ▪ McKinsey has the largest knowledge development spent in the industry ▪ McKinsey is the only global consulting company with a local presence of over 20 years, having transformed to a level 1 BBBEE contributor ▪ Eskom has completed the majority of its management consulting projects with McKinsey support, giving McKinsey privileged insight into the business, culture, processes, and people of Eskom.

Timeline: Dates	Timeline: Description of events
	▪ Signoff received from Acting CFO (Nonkululeko Valeti) for Top Engineers Development Programme later called Top Consultants Programme
	▪ Unsolicited Proposal from McKinsey to Eskom included elements and Approach for a rapid turnaround of Eskom Generation
	▪ Proposal by McKinsey to Eskom. To develop the current Top Consultants Programme into a consulting unit that can provide world class management consulting services capable of resolving emergency company-wide risks by driving savings and unlocking cash. A proposal to continue with certain activities envisaged to be implemented as part of the MSA while the MSA was being negotiated. Down payments were required that would cover McKinsey's immediate cash flow and would be reconcilable to the success based compensation mechanism of the MSA.
	▪ The proposals were never accepted by Eskom, instead they were used as input into the negotiation process for the MSA.
July to Oct 2015	▪ Negotiations with McKinsey for the MSA
Oct-15	▪ Feedback report to the BTC and approval from the BTC to proceed with contract with the following key elements: o Acceptance of feedback with McKinsey o Contract period of three years o Option to terminate after 12 months o Self-funding principle of contract o Down payments to be made and McKinsey Bank Guarantee to secure down payments (It should be noted that the down payments were never made) o Payment trigger points regime (see diagram below)
Nov/Dec-15	▪ Trillian was introduced to the Eskom procurement and project management team by McKinsey as a SD&L partner on the MSA. It should also be noted that Trillian was also a SD&L partner to McKinsey on the Corporate plan contract. This contract was approved by the Board and awarded to McKinsey in September 2015. It was understood that Trillian was being formed by members of Regiments and the move to Trillian was being done through section 197 of the Labour Relations Act. Both McKinsey and Trillian continued to perform work on all streams at risk
	▪ Eskom signed a binding letter of acceptance with Mc Kinsey. One of the conditions precedent was the use of risk based contracting and the continued validity thereof.
	▪ Eskom had received external legal advice from McKinsey, that was sourced from Ledwaba and Mazwai Attorneys. The conclusion of the external legal advice sought by McKinsey was that the risk based contracting methodology will not offend National Treasury as it was allowed for in terms of SCM Practice Note 3 of 2003/4.

Timeline: Dates	Timeline: Description of events
	▪ Eskom was not satisfied with this advice and decided to approach Senior Counsel (SC). SC contended that SCM Note 3 cannot be relied upon as it has either been implicitly or explicitly repealed OR superseded by Instruction Note 2013/14. He advised that an exemption be sought from National Treasury as per applicable provisions of the Instruction Note. ▪ Whilst going through the implications of the legal advices, Eskom signed a binding letter of acceptance with McKinsey. One of the conditions precedent was the use of risk based contracting and the continued validity thereof. ▪ It is important to note that both legal advices relied on the status of SCM Practice Note 3 of 2003 for their conclusion. It was therefore logical for management to seek clarity on this matter from National Treasury before embarking on the longer process of seeking exemption which could delay the program quite considerably. ▪ Eskom engaged National Treasury on 04 February 2016 as National Treasury is the regulator and ultimate authority on the said issue. The engagement resulted in a confirmation by National Treasury that SCM Practice Note 3 of 2003 was still applicable and in force. Eskom then concluded that the legal advice by Ledwàba Mazwai Attorneys prevails and there was therefore no need to amend the contracting terms and conditions with McKinsey or seek a deviation.
Jan-16	▪ Contract signed with McKinsey. ▪ There were two conditions precedent to the contract namely: o The auditors confirming in writing that the tracking tool (WAVE) incorporates the necessary controls to allow a reasonable audit of the data ➢ McKinsey dealt directly with the Internal Audit function at Eskom to ensure that the WAVE tool approval was in place ➢ McKinsey provided to Eskom Internal Audit and independent audit assurance report from Ernest & Young to demonstrate the suitability of the tool ➢ Furthermore, Eskom Group IT was asked by Eskom Internal Audit to review the suitability of the WAVE tool from a IT Architecture perspective. The Group IT review was completed in January 2016 and the use of the tool was approved

Timeline: Dates	Timeline: Description of events
	➢ The Group IT report also stated the following from an audits findings perspective; *"**Audit Findings** – From the ISAE 3000 opinion report produced by EY there were a few deficiencies identified and through discussion these deficiencies have been rectified or control has been implemented to rectify them."* o The Employer constituting the Steering Committee and granting such Steering Committee the respective roles, responsibilities and powers to give effect to the relevant provisions of the agreement ➢ Approval for the Steering Committee constitution was given by the by the BTC in October 2015 ➢ The members of the Steering Committee was finalised in January 2015
Feb-16	▪ Communication from McKinsey, *"In line with the contractual arrangement agreed in our MSA and per Trillian's request, we attach the authorisation to pay Trillian directly"*
	First Steerco Purpose of steercos: o When considering submitted Work Package Initiatives: o In advance, apply its mind to the recommendations presented before it o Ensure that the approved savings and the Eskom commercial processes are in accordance with the Services Level Agreement and Eskom policies o Ensure the integrity of Eskom's commercial processes o Provide approvals o Approve the Work Package Initiative as submitted o Approve the Work Package Initiative conditionally o Approve an alternative Work Package Initiative as submitted o Approve an alternative Work Package Initiative conditionally o Support the Work Package Initiative, with a referral to a higher Delegated Approval Authority, where applicable o Reject the Work Package Initiative, with reasons o When considering Eskom Top Engineers: o Direct, guide and support Programme team to implement a programme within Eskom's policies and procedures, with a strong focus on skills development o Direct the participation of the Eskom Top Engineers in all Work Package Initiatives

Timeline: Dates	Timeline: Description of events

	○ Assess the SD&L value creation as agreed by the parties
	○ Monitor Eskom's progress on the program; provide guidance when needed
	○ Provide feedback to required parties including EXCO and Board
	○ Shall:
	○ Consider any complaints raised by Eskom or McKinsey & Co
	○ Be responsible for escalation or implementation of corrective actions
	○ Authorised to:
	○ Investigate any matter brought before it for approval
	○ Request other Eskom employees to attend the Committee meetings
	○ Consult with and seek any information it requires from any Eskom employees
	○ Obtain independent professional advice as it deems necessary
	○ The **WAVE tool** was used manage, report and formed the database for tracking initiatives associated with the MSA
	○ Eskom and McKinsey agreed to use the WAVE tool to track all of the initiatives undertaken that progressed through the various implementation levels. The tool was also deemed to be appropriate because of the necessary controls and was also suitable from a IT architecture perspective.
	○ All initiatives were recorded and tracked on the WAVE tool as per the contract requirement.
	○ The wave tool was frozen as of the 15 July 2016 as agreed in the fourth Steerco. The wave tool recorded over 280 initiatives.
	○ Each initiative was fully described and classified in terms of its implementation level
	○ Each initiative had an Eskom owner and core team assigned to it. Eskom had over 96 individuals directly involved in the program that were made up of General Managers, Senior Managers and Middle Managers. This number was over and above the Top Engineers Group.
	
	• The first steerco covered the following agenda items:
	    ○ Mechanics of the contract,
	    ○ Progress on work packages
	    ○ Additional points of discussion.
	    ○ The Steerco raised some concerns and this was noted
	
	MEMBERS
	Mr Anoj Singh Chief Finance Officer ("CFO") Chairman
	Mr Matshela Koko

Timeline: Dates	Timeline: Description of events
	Mr Abram Masango Mr Edwin Mabelane Mr Willie Majola **OFFICIALS** Mr Prish Govender Ms M A Hendricks Committee Secretary **IN ATTENDANCE** Mr Kobus Steyn Mr Vusi Mboweni Mr Dave Gorrie Mr Willie Pretorius Ms Unathi Hlalele Mr Jonathan Brown McKinsey & Company Mr Alexander Weiss McKinsey & Company Mr Lorenz Jungling McKinsey & Company Mr Vikas Sagar McKinsey & Company Mr Eric Wood Trillian Ms Bianca Smith Trillian Ms Mosilo Mothepu Trillian
	▪ Letter to McKinsey re confirmation of BBBEE partner, allegations regarding Mr. Bobat in Financial Mail, Alignment of MSA to Corporate Plan, Lessons learnt from BPP and back to basics, development of BBBEE partner, Top consultants programme, Inclusion of contract management in MSA.
	▪ Letter from McKinsey stating that they were busy with review process regarding Trillian as a BBBEE partner. ▪ Also provide a written methodology on how some of the other concerns could be addressed in the MSA process.
Mar-16	▪ Letter from McKinsey stated the following. "*In light of the previously envisaged relationship with Trillian which, under the current conditions, will not be possible. We would appreciate an opportunity to develop options with Eskom to ensure that we meet our supplier development obligations*"
	Second Steerco ▪ Covered the following topics amongst others: 1. Concerns raised from previous Steerco, 2. Programme alignment and Governance, 3. Top consulting update, 4. Role of partners (Trillian), 5. Programme Mechanics, 6. Work packages approvals. **MEMBERS** Mr Anoj Singh Chief Finance Officer ("CFO") Chairman Mr Matshela Koko Mr Willie Majola **OFFICIALS**

Timeline: Dates	Timeline: Description of events
	Mr Prish Govender Ms M A Hendricks Committee Secretary **IN ATTENDANCE** Mr Kobus Steyn Mr Peter Sebola Mr Johnston Makhubu Ms Maya Bhana Mr Vusi Mboweni Mr Jonathan Brown McKinsey & Company Mr Alexander Weiss McKinsey & Company Mr Vikas Sagar McKinsey & Company Ms Bianca Smith Trillian Ms Mosilo Mothepu Trillian **APOLOGIES** Mr Abram Masango Mr Edwin Mabelane
April 2016-May 2016	▪ Following the letter from McKinsey on 30 March 2016, Eskom engaged in discussions with McKinsey on the following: 1. Plan to demobilize existing BBBEE partner and mobilise new partner, 2. How issues raised in the letter of 19 Feb 2016 will be addressed with new partner. ▪ It should be noted that McKinsey continued to work jointly with Trillian during this period as it was agreed by all parties that no further work streams would be added and that the current initiatives will be taken to a logical conclusion so that the value was maximised for Eskom. ▪ Eskom was also clear with McKinsey that it is not going to influence the selection of a BBBEE partner as McKinsey would be fully liable for the delivery of the work as per the contract.
Jun-16	**Third Steerco - Eskom in committee meeting** • Decided the following, 1. Approach BTC to reconsider MSA 2. The payments accruing to McKinsey and Trillian, which could not be envisaged at the time of concluding the contract with McKinsey, was increasing at a rapid scale from a quantum perspective. The steerco raised concerns as to the eventual contract value that could be payable for the entire duration of the MSA. 3. The new requirements for National Treasury, sole source contracts, wold have attracted greater scrutiny albeit that the new requirements were not in place at the time of concluding the MSA 4. With the above in mind the BTC was approached to cancel the MSA and engage in an open tender process to contract with other participants in the market, which may or not may have included McKinsey.

Timeline: Dates	Timeline: Description of events
	5. The increased number of participants would have also had the effect of increasing the SD&L impact of the project. opportunity for further BBBEE participation could be increased if more than one company was involved **(Closed Meeting)** **MEMBERS** Mr Anoj Singh Chief Finance Officer ("CFO") Chairman Ms Maya Bhana Mr Abram Masango Mr Edwin Mabelane **OFFICIALS** Mr Prish Govender Ms M A Hendricks Committee Secretary
	Third Steerco - Full committee • The following was discussed: 1. Update on finance stream initiatives by Trillian, 2. Change management, 3. Wave tool update, 4. Top consulting group update, 5. Steerco governance, 6. SD&L update, 7. approval of initiatives, 8. Communication update. **(Open Meeting)** **MEMBERS** Mr Anoj Singh Chief Finance Officer ("CFO") Chairman Mr Abram Masango Mr Edwin Mabelane Mr Willie Majola Mr Andre Pillay MS Maya Bhana **OFFICIALS** Mr Prish Govender Ms M A Hendricks Committee Secretary

Timeline: Dates	Timeline: Description of events
	IN ATTENDANCE Mr Kobus Steyn Mr Peter Sebola Mr Johnston Makhubu Ms Maya Bhana Mr Jonathan Bown McKinsey & Company Mr Alexander Weiss McKinsey & Company Mr Vikas Sagar McKinsey & Company Mr Eric Wood Trillian Ms Faheema Badat Trillian Mr Ben Burnand Trillian Mr Arvn Babu Deloitte Ms Sihle Mdluli Deloitte
	BTC approved the following resolutions: 1. Approval to cancel MSA, 2. Allow all costs to be negotiated and finalized, to be approved by the BTC, 3. Approval for all activities to be redirected to existing contracts were appropriate, with incorporation of similar SDL objectives and option of contracting risk based approach.
Jul-16	**Fourth Steerco** ▪ Both McKinsey and Trillian were informed about the Board Decision of 21 June 2016 to terminate the MSA process. ▪ It was decided that all work would stop and analysis of all costs would be done up until the 15 July 2016. ▪ It was also decided and agreed that consultants will remain on the ground until a proper handover was done. ▪ The presentation covered progress on the MSA and impact created as well as the next steps to wind down the MSA. **MEMBERS** Mr Anoj Singh Chief Finance Officer ("CFO") Chairman Mr Abram Masango Mr Edwin Mabelane Mr Willie Majola Mr Andre Pillay Mr Matshela Koko MS Maya Bhana **OFFICIALS** Mr Prish Govender Ms M A Hendricks Committee Secretary **IN ATTENDANCE** Mr Vusi Mboweni Mr Johnston Makhubu Ms Masedi Skosana Mr Dan Mashigo

Timeline: Dates	Timeline: Description of events
	Mr Snehal Nagar Mr Pieter Le Roux Mr Mandla Gobinca Mr Jakobus Cilliers Mr Ash Sookun Mr Jonathan Bown Mckinsey & Company Mr Alexander Weiss Mckinsey & Company Mr Vikas Sagar Mckinsey & Company Ms Faheema Badat Trillian
Aug-16	**Fifth Steerco** ▪ The following items were discussed: 1. Update from top consulting group, 2. Finalisation of initiatives on all work streams, 3. Both McKinsey and Trillian raised a concern that no payments have been made to date, despite agreed down payments. Cash flow was a concern for Trillian being a new company. **MEMBERS** Mr Edwin Mabelane Chairperson **OFFICIALS** Mr Prish Govender Ms MA Hendricks Committee Secretary **IN ATTENDANCE** Mr Charles Kalima Ms Jainthree Sankar Ms Vonani Ntlhabyane Mr Dan Mashigo Mr Andre Pillay Mr Dunn Mukosa Mr Kobus Steyn Ms Lynelle Singh Mr Kobus Cilliers Mr Ash Sookun Mr Jonathan Bown McKinsey & Company Mr Vikas Sagar McKinsey & Company Mr Eric Wood Trillian Ms Faheema Badat Trillian Mr Ben Burnand Trillian **APOLOGIES** Mr Anoj Singh Chief Finance Officer ("CFO") Chairman Mr Matshela Koko Mr Vusi Mboweni Mr Abram Masango Mr Willie Majola MS Maya Bhana Mr Peter Sebola
Aug-16	BTC submission following was noted:

Timeline: Dates	Timeline: Description of events
	▪ Initiatives under MSA have achieved more than R18.6bn of annualised impact for Eskom, ▪ Applying the termination clauses of the MSA, Eskom may need to pay up to R2.84bn (inclusive of payment to BBBEE partner) for value to date. The following was approved: ▪ An already negotiated lower settlement value of R1.8bn (inclusive of payment to BBBEE partner), ▪ R800m to cover utilisation of consultants' resources to date, ▪ Six months transition period. ▪ During this period consultants will be reimbursed on rates basis (this was not executed)
	▪ I consulted Ms Daniels who confirmed that the payments to Trillian without a subcontract being in place as this was a progress billing and the issue will be resolved when the termination agreement is put in place. This was again confirmed by Ms Daniels in the Draft BTC submission of 8 Dec 2016 and the Final BTC submission of 12 Dec 2016. This was also confirmed by the Internal audit report of 12 December 2016.
	▪ Received McKinsey invoice for progress payment R596.9m. ▪ It should be noted that McKinsey only invoiced for the main contractor portion and not the BBBEE supplier portion.
	▪ Received Trillian invoice for progress payment for work done on Finance stream R107.2m. Since finance stream allowed for an alternative payment mechanism to risk based contracting, The finance work streams were invoiced on a time and material basis. The hourly rate was in line with National treasury rates. Had the initiatives been invoiced on a success fee basis, as originally negotiated, the quantum of fees could have been materially larger. ▪ Received Trillian invoice for progress payment for work done on other streams R99.3m.
	▪ Letter from Trillian claiming that the risk based portion of the payment associated with the work done together McKinsey was not settled in full.
	▪ Eskom continued with the handover process with McKinsey and Trillian. However no transition fees were paid as approved by BTC 8 August 2016
Nov-16	▪ Eskom engaged Oliver Wyman to undertake a technical review of the performance of the MSA, in terms of the associated payments. o The context of the work as stated by Oliver Wyman was as follows ➢ *"The objective of the assignment was to produce an independent peer review with regards to the reasonableness of the conditions, performance measurement and remuneration.* ➢ *Two separate pieces of work are also being conducted independently by Eskom including an internal audit review of the contract and a legal review of the MSA and split of fees between the consultant and the BBBEE partner"*
	▪ Eskom audit requested to undertake a review of the McKinsey MSA process
	▪ Eskom eventually received a recon from McKinsey of the total payment due to the BBBEE partner in terms of the invoice submitted McKinsey on 11 August 2017. ▪ The recon confirmed that Trillian has been short paid as per their letter of 27 August 2016.

Timeline: Dates	Timeline: Description of events
	▪ Oliver Wyman was also asked to include the likelihood of the payment shortfall into their analysis of the MSA.
Dec 16	▪ Draft BTC submission for 13 December 2016 sent to Internal Legal for review.
	▪ Confirmation from Internal Legal Ms Daniels that external legal input for the draft BTC submission is being acquired from Cliff Dekker Hofmeyer.
	▪ Draft BTC submission for 13 Dec 2016 submitted again to Internal Legal Ms Daniels for review and input. Preliminary Oliver Wyman Report also submitted
	▪ Final BTC submission received from Internal Legal Ms Daniels with input that said the following: *"Cliff Dekker Hofmeyer (CDH) was retained to conduct a review and the conclusion is that Eskom need to enter into a termination agreement with the parties to bring the matter to finality. This will absolve Eskom from any further liability once the termination agreement was place."*
	▪ Final internal audit review report received with the following conclusions: 1. The **procurement** process followed by Eskom to appoint McKinsey complied with applicable Eskom policies, procedures and processes and the National Treasury guidelines, instructions and practice notes, 2. The **contracting** with McKinsey followed Eskom policies, procedures and processes and National Treasury guidelines, instructions and practice notes, 3. We could not determine whether the contract was terminated in accordance with the termination clauses as contained in the contract or was in fact terminated at all, 4. We could not conclude whether the payments made were in accordance with the settlement terms between Eskom and McKinsey as no written settlement agreement signed by both parties were presented. ▪ Management comments were as follows: 1. The settlement agreement will be established between the parties and the payments to date will be dealt with on the same basis of that agreement. A Board mandate will be requested for the same, 2. The request to Board was to have the contract with McKinsey terminated and the work be put back into the panel of strategic management for all panel members to tender for it.
	BTC submission approved the following: ▪ A mandate to negotiate and conclude the remaining portion of the settlement up to R849m, based on a total value of R18bn communicated to the Board Tender in August 2016, noting the legal, internal audit and external benefits review of the contract once the negotiations is complete, the necessary feedback will be provided to the BTC, ▪ For a payment of R134m to finalise payments up to August 2016 to the BBBEE partner that was due as per the work split agreed with McKinsey (supported by McKinsey recon 29 November 2016 and verification by Oliver Wyman). ▪ It should be noted that the internal audit and preliminary reports were attached to the submission to BTC. ▪ Internal legal input to the BTC submission was obtained and read as follows, *"Cliffe Dekker Hofmeyer (CDH was retained to conduct the review and the conclusion is that Eskom needs to enter into a Termination agreement with the parties to bring the matter to finality. This will absolve Eskom from further liability once the termination agreement is in place."*

Timeline: Dates	Timeline: Description of events
	▪ Invoice from Trillian for shortfall in payment associated with 8 August 2016 payment
	▪ Received Final Oliver Wyman Report, key findings were as follows: o *Payments* ▪ R 2,839 billion (claimed by McKinsey) ▪ R 1,052.5 billion (not approved by Steerco, and this amount was never paid ▪ R 1,786.5 billion (Was approved by Steerco and could possibly be paid) • R 937.63 million paid as a progress payment in line with the MSA • R 848.83 million was negotiated with McKinsey and R 460 million was the settlement reached, in line with the maximum remaining amount indicated by Oliver Wyman that Eskom should pay ▪ Of a potential payment of R1,786.5 billion, Eskom finally paid R 1,397.63 billion (excl VAT) o *Benchmarking* ▪ From the payment benchmark estimate of R 1,270 billion (excl VAT), Eskom paid R 1,290 billion (excluding the finance stream initiative as this was not part of the benchmarking study)
Jan-17	▪ Settlement negotiations with McKinsey
Feb-17	▪ Feedback to BTC on conclusion on negotiation process. Minutes attached as ▪ BTC notified that Eskom had settled on final payment of R460m including the BBBEE partner portion and after the signing of a termination agreement, Eskom will be in a position to close the matter. ▪ The submission was supported by Eskom legal. ▪ The BTC resolved that the feedback on the settlement reached with McKinsey and the payment of R460m by Eskom as part thereof in full and final settlement of all claims in terms of the MSA be noted and support by the BTC.
	▪ Draft settlement agreement for CDH, internal legal copied ▪ Final Settlement agreement by CDH, internal legal ▪ Internal audit acceptance of settlement agreement
	▪ Memo issued to Interim GCE supported by internal legal. ▪ The interim CE was advised of the Board approval of 8 August 2017, the signing of the settlement agreement and that the amount payable was provided for in October 2016.
	▪ Settlement agreement signed between McKinsey and Eskom. The final payment due was inclusive of the SD&L partner portion
	▪ Invoice from McKinsey for R460m showing split between itself and BBBEE partner i.e. R305.3m to McKinsey and R154.6 to BBBEE partner
	▪ Invoice from Trillian for R154.6m

Corporate Plan Contract with McKinsey

Timeline: Dates	Timeline: Description of events
Sept 2015	▪ Submission made to the Eskom Board of Directors ▪ Strategy to appoint McKinsey as a strategic partner to Eskom on the emerging work around financial and strategic topics that do not fit under the currently negotiated performance based MSA ▪ BOD resolved the following: o The appointment of McKinsey & Company as the sole partner for the financial and strategic topics of: cash flow and profitability targets for FY16; updating the business cases for Medupi and Kusile; further developing and disseminating Eskom's new design to cost strategy; and adapting Eskom's governance model to ensure delivery of the new strategy. o McKinsey & Company be contracted on a fixed cost basis with a total contract value of R 101, 733, 124.80 for an effective duration of 8 months

	▪ After negotiations a Letter of Acceptance was issued to McKinsey ▪ The negotiated contract value was R 98, 461, 228.27 (excl VAT) ▪ McKinsey further agreed to 30% subcontracting to an SD&L partner
	▪ A contract was signed between McKinsey and Eskom
Oct/Nov-15	▪ Eskom received invoices from McKinsey for their portion of the contract value.
Jan-16	▪ Eskom received an invoice from Trillian for their portion of the contract value.
Feb-16	▪ Eskom received authorisation from McKinsey to pay Trillian directly.
April-16	▪ Eskom paid Trillian only after all of the Vendor Management processes were completed.

Annexure E

"AS1"

Eskom

CONFIDENTIAL

MEMORANDUM

FACTUAL FINDING REPORT OF INTERNAL AUDIT ON THE NATURE AND EXTENT OF THE GROUP CHIEF FINANCIAL OFFICER INVOLVEMENT IN TRANSACTIONS BETWEEN ESKOM AND TEGETA

ESKOM HOLDINGS SOC LTD

ASSURANCE AND FORENSIC

Eskom

MEMORANDUM

To : Johnny Dladla (Interim Group Chief Executive); Anoj Singh (Group Chief Financial Officer)

From : Molefi Nkhabu – Senior General Manager (Assurance and Forensic)

SUBJECT :FACTUAL FINDING REPORT OF INTERNAL AUDIT ON THE NATURE AND EXTENT OF THE GROUP CHIEF FINANCIAL OFFICER INVOLVEMENT IN TRANSACTIONS BETWEEN ESKOM AND TEGETA

1. Introduction

Acceding to the request received, Assurance and Forensic (A&F) conducted a factual finding review to establish the extent of involvement of the Group Chief Financial Officer (GCFO) in contracts relating to Tegeta and identify the extent and nature of that involvement, if any. Where the records indicate the involvement of the GCFO, comment on governance process (including segregation of duties) followed or not followed.

2. Factual finding procedures

The procedures performed by A&F were designed to find factual and objective evidence regarding the involvement or otherwise of the GCFO in the list of transactions provided by management and where the GCFO was involved determine the extent of the GCFO's involvement. To that end, A&F sought to rely on the review and inspection of documentary evidence as determined and requested by A&F and provided by management.

The responsibility to compile an exhaustive list of relevant transactions and submission of related documentary evidence was that of management, A&F's responsibility was to verify and validate the information against the list as well as management comments made on the list.

Because the above procedures do not constitute an audit, and investigation nor any assurance engagement in terms of International Standards for the Professional Practice of Internal Auditing, A&F does not express any opinion other done indicate factual findings. Had we performed additional procedures or an audit or review, or other assurance engagement, other matters might have come to our attention and would have been reported.

3. Scope

The procedures performed are limited to the list of relevant transactions provided by management to A&F. A&F assumed the completeness of the transactions and no attempt was made to determine the completeness thereof. We confined our review to the records that are reasonably expected to provide evidence to the objective of the review. We did not and it was not our intention to perform additional procedures beyond the inspection of the records because of the nature of the engagement.

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Eskom Holdings SOC Ltd Reg No 2002/015527/30

We draw attention to the following factors that influenced the procedures performed by A&F in this regard. We considered that the most critical aspects of the transactions are the approval of the transactions and the signing of the contracts. The approval being the point at which the authority is granted to enter into a transaction with a third party (Tegeta) and signing of the contract being the point at which Eskom is officially committed and the obligations and duties against Eskom being raised including the right and privileges in favour of Eskom being created. The other two aspects of importance but of little consequence were considered to be the support for and the recommendation of the transactions. The reason these were considered of little consequence is hat these are subject to being vetoed by the higher authority or functionary.

4. Disclaimer

This report is intended solely for the GCFO for the purpose for which it was requested. This report may not be suitable for any other purpose as it was compiled solely for the purpose of which it was intended. Neither this report in its entirety or parts thereof may be distributed, discussed with, or otherwise disclosed to, any third party without prior consent of Eskom management and A&F. Eskom management and A&F accepts no liability to any third party who gains access to this report and who of his/her own volition in reliance thereon may decide to to act or refrain from action in any particular to his or her detriment.

5. Executive Summary

Executive Summary of the results of the factual findings from procedures performed by A&F are set out below

Number of transactions	Results	Rating
2	These transaction were concluded before the CFO appointed (n/a)	
7	Evidence of the CFO's involvement could ***not*** be found	
1	The CFO's involvement was limited to ***supporting*** the transaction	
1	The CFO's involvement was limited to **recommending** the transaction	
1	The CFO **signed** the contract / agreement	
0	The CFO **approved** the transaction	

Legend: rating

	No concern
	Discussion may be required
	Issue of concern

Please refer to the attached schedule for detailed comment regarding the results of the factual finding procedures performed by A&F on the list provided by management.

6. Appreciation

A&F would like to express its appreciation for assistance and cooperation during the assignment. Should you have any queries or comments with regard to matters contained in this audit report, please do not hesitate to contact me in this regard.

Name: Molefi Nkhabu
Chief Audit Executive: Eskom Holdings SOC Ltd
2017/07/04

CONTRACTING PARTY	CONTRACT TYPE	POWER STATION	CSA START	CSA END	APPROVAL AUTHORITY	APPROVAL (SIGNED BY)	MANAGEMENT COMMENTARY / RESPONSE	A&F COMMENT
Tegeta Exploration and Resources (Pty) Ltd - Bra[illegible]	Medium Term	Majuba	01-Apr-16	30-Sep-25	BTC 2008 Mandate	Signed – Head of Primary Energy	• CFO's date of appointment was 1 August 2016. • The signing date of the contract was March 2016. The CFO could not have influenced the outcome of this contract.	The procurement process, contract negotiations and signing thereof was finalised prior to the appointment of the CFO
Tegeta Exploration and Resources (Pty) Ltd - Optimum (Jan)	Short Term	Arnot	14-Jan-16	31-Jan-16	BTC 2008 Mandate	Signed – Head of Primary Energy	• Contract awarded in terms of the existing Delegation of Authority • The CFO not involved in procurement process • Contract not signed by the CFO. • The CFO could not have influenced the outcome of this contract	A&F confirmed through inspection of records that the contract was signed on the 13 Jan 2016 by the Head of Primary Energy. The other details provided are in line with signed CSA Approval is in line with the 2008 mandate *No evidence came to our attention indicating the CFO's involvement in authorising the transaction*
Tegeta Exploration and Resources (Pty) Ltd - Optimum	Short Term	Arnot	16-Feb-16	15-Apr-16	BTC 2008 Mandate	Signed – Head of Primary Energy	• Contract awarded in terms of the existing Delegation of Authority • The CFO was not involved in procurement process. • Contract not signed by the CFO. • The CFO could not have influenced the outcome of this contract.	A&F confirmed through inspection of records that the contract was signed on the 16 February 2016 by the Head of Primary Energy. The other details provided are in line with signed CSA Approval is in line with the 2008 mandate

CONTRACTING PARTY	CONTRACT TYPE	POWER STATION	CSA START	CSA END	APPROVAL AUTHORITY	APPROVAL (SIGNED BY)	MANAGEMENT COMMENTARY / RESPONSE	A&F COMMENT
								No evidence came to our attention indicating the CFO's involvement in authorising the transaction
Tegeta Exploration and Resources (Pty) Ltd - Optimum (2nd Addendum)	Short Term	Arnot	16-Apr-16	15-Sep-16	BTC resolution April 2016	Approval by the Board Tender Committee (BTC) and signed by GE Generation	• CFO not involved in submission to BTC • However the BTC on 11 April 2016 requested the CFO to o Negotiate a discount o Obtain adequate security o Confirm the economic viability of the transaction • At the BTC meeting on 13 April 2016, CFO provided feedback relating to the above which was acceptable to BTC • The CFO could not have influenced the outcome of this contract.	A&F confirmed through inspection of the records that Contract start date is 15 Feb 2016 as per CSA Approval in line with the BTC resolution April 2016 *No evidence came to our attention indicating the CFO's involvement in authorising the transaction*
Koornfontein Mines (Pty) Ltd – Koornfontein mines contract and m[illegible]tions	Medium Term	Komati	01-Apr-12	31-Mar-16	BTC 2008 Mandate	Signed – Head of Primary Energy	• Contract awarded in terms of the existing Delegation of Authority • Mr Singh not involved in procurement process • Contracts not signed by the CFO. • The CFO could not have	Provided details in line with signed CSA Approval in line with the 2008 mandate *No evidence came to our attention indicating the CFO's involvement in authorising the*

CONTRACTING PARTY	CONTRACT TYPE	POWER STATION	CSA START	CSA END	APPROVAL AUTHORITY	APPROVAL (SIGNED BY)	MANAGEMENT COMMENTARY / RESPONSE	A&F COMMENT
							influenced the outcome of this contract.	*transaction*
K[illegible]ntein Mines (Pty) Ltd [illegible]oornfontein (1st Addendum)	Medium Term	Komati	01-April-16	30-April-16	BTC 2008 Mandate	Signed – Head of Primary Energy	• Contract awarded in terms of the existing Delegation of Authority • The CFO was not involved in procurement process. • Contract not signed by the CFO. • The CFO could not have influenced the outcome of this contract.	Provided details in line with signed CSA Approval in line with the 2008 mandate *No evidence came to our attention indicating the CFO's involvement in authorising the transaction*
Koornfontein Mines (Pty) Ltd - Koornfontein (2nd Addendum)	Medium Term	Komati	01-May-16	31-May-16	BTC 2008 Mandate	Signed – Head of Primary Energy	• Contract awarded in terms of the existing Delegation of Authority • Mr Singh not involved in procurement process. • Contract not signed by Mr Singh. • The CFO could not have influenced the outcome of this contract	Provided details in line with signed CSA Approval in line with the 2008 mandate *No evidence came to our attention indicating the CFO's involvement in authorising the transaction*
Koornfontein Mines (Pty) Ltd - Koornfontein (3rd Addendum)	Medium Term	Komati	01-Jun-16	31-Jul-16	BTC 2008 Mandate	Signed – Head of Primary Energy	• Contract awarded in terms of the existing Delegation of Authority • Mr Singh not involved in procurement process. • Contract not signed by the CFO. The CFO could not have	Provided details in line with signed CSA Approval in line with the 2008 mandate *No evidence came to our attention indicating the CFO's involvement in authorising the transaction*

CONTRACTING PARTY	CONTRACT TYPE	POWER STATION	CSA START	CSA END	APPROVAL AUTHORITY	APPROVAL (SIGNED BY)	MANAGEMENT COMMENTARY / RESPONSE	A&F COMMENT
							influenced the outcome of this contract.	
O[illegible]m Coal Holdings - K[illegible]ontein - (4th Addendum)	Medium Term	Komati	01-Aug-16	01-Jul-23	BTC resolution August 2016.	Approval by the (BTC) - 11 April 2016 Signed: GE Generation	• The CFO supported the submission, prepared by line management, to BTC • Contract approved by BTC • National Treasury also provided approval on this contract • Contract not signed by the CFO. • The CFO could not have influenced the outcome of this contract.	Provided details in line with signed CSA. Approval in line with the BTC resolution August 2016. *The CFO was involved in supporting the transaction.*
Optimum Coal Holdings – Optimum'	Fixed Price	Hendrina	01-Jan-93	31-Dec-10	Assumed Mandate at the time.		• The CFO's date of appointment was 1 August 2016. • The signing date of the contract was January 1993. • The CFO could not have influenced the outcome of this contract.	Provided details in line with signed CSA. Could not establish the Eskom representative who signed the CSA in 1993. *The procurement process, contract negotiations and signing thereof was finalised prior to the appointment of the CFO.*

CONTRACTING PARTY	CONTRACT TYPE	POWER STATION	CSA START	CSA END	APPROVAL AUTHORITY	APPROVAL (SIGNED BY)	MANAGEMENT COMMENTARY / RESPONSE	A&F COMMENT
Optimum Coal Holdings - Optimum	Optimum Coal Penalty	Hendrina	Not applicable – Arbitration settlement completed in March 2017		BTG	• The settlement was part of an arbitration process • Miss Daniels as head of legal was the lead negotiator • The CFO was not involved • Eskom had external lawyers advising during this process	• The CFO and the group Company secretary recommended the settlement agreement and the Interim GCE, at the time, approved the settlement • The CFO signed aligned to the existing delegation of authority (DoA) after input from legal • After making appropriate enquiries, the CFO signed the contract	The Board Tender Committee approved the granting of a mandate to negotiate and conclude a settlement in respect of the claim against Optimum, and a full report on the final settlement figure to be applied is to be tabled before the Board Tender Committee The CFO and the Group Company Secretary recommended the settlement and the Interim Group Chief Executive approved the settlement The GCFO signed the settlement agreement on the 14 Marchg 2017 as per approval authority in accordance with Clause 8 2 of the Delegation of Authority Framework The settlement agreement has been assigned by all parties

"AS2"

Eskom

CONFIDENTIAL

MEMORANDUM

FACTUAL FINDING REPORT OF INTERNAL AUDIT ON THE NATURE AND EXTENT OF THE GROUP CHIEF FINANCIAL OFFICER'S INVOLVEMENT IN TRANSACTIONS RELATING TO AN MSA BETWEEN ESKOM AND MCKINSEY & COMPANY

ESKOM HOLDINGS SOC LTD

18 July 2017

ASSURANCE AND FORENSIC

Eskom

MEMORANDUM

To : Johnny Dladla (Interim Group Chief Executive); Anoj Singh (Group Chief Financial Officer)

From : Molefi Nkhabu – Senior General Manager (Assurance and Forensic)

SUBJECT :**FACTUAL FINDING REPORT OF INTERNAL AUDIT ON THE NATURE AND EXTENT OF THE GROUP CHIEF FINANCIAL OFFICER'S INVOLVEMENT IN TRANSACTIONS RELATING TO AN MSA BETWEEN ESKOM AND MCKINSEY & COMPANY**

1. Introduction

Acceding to the request received, Assurance and Forensic (A&F) conducted a factual finding review to establish the extent of involvement by the Group Chief Financial Officer (GCFO) in the transaction relating to a Master Service Agreement (MSA) between Eskom and McKinsey & Company, and identify the nature of that involvement, if any. Where the records indicate the involvement of the GCFO, comment on governance process (including segregation of duties) followed or not.

2. Factual finding procedures

The procedures performed by A&F were designed to find factual and objective evidence regarding the involvement or otherwise of the GCFO in the McKinsey & Company MSA based on chronology of events as provided by management and where the GCFO was involved determine the extent of the GCFO's involvement. To that end, A&F sought to rely on the review and inspection of documentary evidence as determined and requested by A&F and provided by management.

The responsibility to compile an exhaustive chronology of events with relevant transactions and submission of related documentary evidence was that of management, A&F's responsibility was to verify and validate the information against the chronology of events with accompanying management comments made on the schedule depicting chronology of events.

Because the above procedures do not constitute an audit or investigation nor any assurance engagement in terms of International Standards for the Professional Practice of Internal Auditing, A&F does not express any opinion other than indicate factual findings. Had we performed additional procedures or an audit or review, or other assurance engagement, other matters might have come to our attention and would have been reported.

3. Scope

The procedures performed are limited to the schedule depicting chronology of transactions in relation to the McKinsey & Company Master Service Agreement (MSA) provided by management to A&F. A&F assumed the completeness of the events and no attempt was made to determine the completeness thereof.

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Eskom Holdings SOC Ltd Reg No 2002/015527/30

We confined our review to the records that are reasonably expected to provide evidence to the objective of the review. We did not and it was not our intention to perform additional procedures, other than the inspection of the records because of the nature of the engagement.

We draw attention to the following factors that influenced the procedures performed by A&F in this regard. We considered that the most critical aspects of the transactions are the approval of the transaction, the signing of the contract and the approval of the cancellation and payments.

The approval being the point at which the authority is granted to enter into a transaction with a third party (McKinsey & Company), signing of the contract being the point at which Eskom is officially committed and the obligation against Eskom is raised including the right in favour of Eskom are created and cancellation of the contract being the point at which Eskom is officially released and the obligation against Eskom is withdrawn, including the right in favour of Eskom.

The other two aspects of importance but of little consequence were considered to be the support for and the recommendation of the transactions. The reason these were considered of little consequence is that these are subject to being vetoed by the higher authority or functionary.

Specific Scope exclusion

The review of the validity, accuracy and completeness of payments, the contract terms and conditions and contract management was specifically excluded from the review.

4. Disclaimer

This report is intended solely for the Eskom Interim Chief Executive Officer for the purpose for which it was requested. This report may not be suitable for any other purpose as it was compiled solely for the purpose of which it was intended. Neither this report in its entirety or parts thereof may be distributed, discussed with, or otherwise disclosed to, any third party without prior consent of Eskom management and A&F. Eskom management and A&F accepts no liability to any third party who gains access to this report and who of his/her own volition in reliance thereon may decide to act or refrain from action in any particular to his or her detriment.

5. Executive Summary

Executive Summary of the results of the factual findings from procedures performed by A&F is set out below:

5.1 There is no evidence to indicate that the GCFO was involved in: -

- Seeking a mandate from the Board to negotiate with McKinsey.
- Negotiation with and seeking approval from the Board Tender Committee to approve the outcome of the negotiation with McKinsey.
- Signing the letter of intent from Eskom to McKinsey.
- Signing the final MSA with McKinsey.
- The **actual** negotiation and signing of final settlement with the McKinsey.
- Approving any payments.

5.2 There is evidence of the GCFO's involvement to a *more or lesser degree* in the following instances: -

- The GCFO was the chair of the Top Consulting Steering Committee.
- The GCFO wrote the letter to McKinsey requesting formal response on the role to be played by the BBBEE partner amongst others.

- Requesting cancellation of the MSA from the BTC.
- The endorsement of the request to the BTC to approve the settlement terms and the first payment.
- The GCFO's involvement was limited to requesting the appointment of the assurance provider to validate the payment.

Please refer to the attached schedule below for detailed comment regarding the results of the factual finding procedures performed by A&F on the list provided by management.

6. Appreciation

A&F would like to express its appreciation for assistance and cooperation during the assignment. Should you have any queries or comments with regard to matters contained in this audit report, please do not hesitate to contact me in this regard.

Name: Molefi Nkhabu
Chief Audit Executive: Eskom Holdings SOC Ltd

Timeline for the Master Services agreement with McKinsey & Company