PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

Brief on Eskom Annual Financial Statement and Integrated Report 2020

23 November 2020

1. Financial Results

Eskom recorded a net loss after tax of R20.5 billion for the year (2019: R20.9 billion, restated), which is in line with what the SOC had budgeted. Revenue grew to R199.5 billion due to the 13.87% tariff increase (2019: R179.9 billion). This resulted in the EBITDA margin increasing to 18.55% (2019: 17.46%, restated), with an EBITDA of R37 billion (2019: R31.4 billion, restated). The increase of R5.6 billion in EBITDA was eroded by an increase of R3.5 billion in net finance cost, resulting in an improvement of only R2.8 billion in net loss before tax of R26.6 billion (2019: R29.4 billion, restated). The unsustainable debt level of more than R480 billion has led to our gross interest cost becoming the second largest cost item after coal costs, higher than both employees benefit costs and capital expenditure.

However, sales volumes declined by 1.29% year-on year, with local sales volumes declining by 5.4TWh due to depressed economic conditions and supply constraints, with the industrial sector being the most severely affected; that was offset by international sales increasing by 2.7TWh. Furthermore, primary energy costs increased significantly, driven by an unsustainable increase in the average purchase cost per ton of coal of 16.3% (2019: 14.1%). In addition, the cost of 11 958GWh energy purchased from IPPs increased to R29.7 billion (including a capacity charge) during the year (2019: 11 344GWh at R26.7 billion), at a weighted average cost of 248c/kWh (2019: 235c/kWh). We are locked into long-term contracts from earlier bid windows at much higher rates than that applicable to new IPP generation. Nevertheless, we managed to reduce employee benefit costs through sub-inflation salary increases at managerial level coupled with headcount reduction. Other operating expenditure, including maintenance, was relatively contained at R18.7 billion (2019: R18.2 billion).

A decline of approximately 19% was achieved for the year, largely due to lower decommissioning provision costs. However, this was negated by the write-off of R4 billion of a portion of work under construction relating to potential overpayments to a number of contractors involved in the construction of Kusile Power Station. Decommissioning, mine closure and rehabilitation provision costs declined due to an increase in the long-term discount rate to 4.82% at 31 March 2020 (2019: 3.36%), with the rate change linked to the significant weakening of the Rand in March 2020. Additionally, Eskom's cost curtailment efforts have borne some results, primarily through reductions in sundry expenses. Net finance costs increased to R31.3 billion (2019: R27.7 billion, restated), due to higher levels of borrowings at a higher weighted average cost.

2. Shareholder Compact Performance

Shareholder compact performance

The table below sets out Eskom's performance measured against the shareholder compact that was reviewed by the external auditors. The external audit opinion relating to this review is detailed on page 22. All the key performance indicators (KPIs) in the compact refer to the Eskom company, with the exception of the lost-time injury rate and the finance measures which reflects the group. The 2020 targets were revised, where applicable, in accordance with the shareholder compact addendum signed by the Minister of Public Enterprises on 1 April 2019.

Actual performance against the year-end target is indicated as follows:

🟢 Actual performance for the year met or exceeded the target

🔴 Actual performance for the year did not meet the target

Key performance indicator	Ref	Unit	Target 2020		Actual 2020	Actual 2019
Focus on safety						
Lost time injury rate (employee)[1]		index	0.34	🟢	0.30	0.31
Improve plant operations						
Energy availability factor	(a)	%	71.50	🔴	66.64	69.95
Planned capability loss factor	(b)	%	9.50	🔴	8.92	10.18
Unplanned partial load losses	(c)	average MW	3 500	🔴	4 651	3 443
Unplanned automatic grid seperations trips	(d)	number of trips	560	🔴	594	517
Post philosophy outage unplanned capability loss factor	(e)	%	17.00	🔴	29.91	17.05
System minutes lost	(f)	minutes	3.53	🔴	4.36	3.16
Transmission technical energy losses savings		MWh	8 422	🟢	32 890	n/a
Payment levels excluding Soweto interest	(g)	%	96.70	🔴	96.24	95.79
Distribution total energy losses	(h)	%	8.00	🔴	8.79	8.47
Total electrification connections	(i)	number	177 000	🔴	163 613[2]	191 585
System average interruption duration index		hours	38.00	🟢	36.90	38.00
Primary energy optimisation						
Migration of coal delivery from road to rail	(j)	Mt	10.60	🔴	7.50	8.20
Coal purchase rand/ton		% increase	20.00	🟢	16.30	14.06
Reduce environmental footprint in existing fleet						
Relative particulate emissions	(k)	kg/MWh sent out	0.33	🔴	0.47	0.47
Specific water usage	(l)	ℓ/kWh sent out	1.35	🔴	1.42	1.41
Deliver capital expansion						
Generation capacity installed and commissioned (commercial operation)		MW	1 588	🟢	1 588	–
Transmission lines installed	(m)	km	155.00	🔴	127.90	378.70
Transmission transformer capacity installed and commissioned		MVA	250	🟢	250	540
Ensure financial sustainability[3]						
EBITDA		R million	34 386	🟢	36 998	31 417
Cash interest cover		ratio	0.65	🟢	0.94	0.94
Debt service cover		ratio	0.29	🟢	0.52	0.47
Disposal of the EFC	(n)	R million	6 104	🔴	–	n/a
Savings from turnaround initiatives		R million	6 213	🟢	16 287	n/a
Socio-economic impact: human capital						
Learner intake: artisans	(o)	number	92	🔴	91	–
Learner intake: engineers		number	16	🟢	16	10
Learner intake: technicians		number	11	🟢	11	3
Learner intake: sector-specific		number	–	🟢	–	8
Training spend as % of gross manpower costs	(p)	%	3.75	🔴	3.67	3.85
Industrialisation and localisation						
Preferential procurement	(q)	% of TMPS	75.00	🔴	61.57	54.41
Local content contracted (Eskom-wide)		%	80.00	🟢	92.84	91.51
Competitive supplier development programme	(r)	% of total capital procurement spend	30.00	🔴	0.03	n/a
B-BBEE score		number	8	🟢	7	–
Enterprise and supplier development	(s)	R million	5.00	🔴	4.59	n/a
Research and development		% of NERSA-allocated spend	80.00	🟢	84.94	80.31

1. *Includes occupational disease.*
2. *Includes 45 292 rollover connections.*
3. *Prior year information has been restated. Refer to note 50 in the annual financial statements.*

3. Independent Audit Report to Parliament

Eskom received a qualified audit opinion. The basis for the opinion includes irregular expenditure. The irregular expenditure includes amounts emanating from the modifications to contracts which were not conducted as required in terms of the PFMA. In addition, irregular expenditure was not fully recorded in the notes to the financial statements. The auditors were unable to determine the full extent of the understatement of the irregular expenditure disclosed in terms of section 55(2)(b)(i) of the PFMA stated at R33 055 million (2019: R22 111 million) and R23 429 million (2019: R14 688 million) in the consolidated and separate financial statements respectively, as it was impractical to do so.

4. Report on the audit of compliance with legislation

4.1 Introduction and scope

In accordance with the PAA and the general notice issued in terms thereof, the auditors have a responsibility to report material findings on the public entities' compliance with specific matters in key legislation. The auditors performed procedures to identify findings but not to gather evidence to express assurance.

The material findings on compliance with specific matters in key legislations are as follows:

4.2 Annual financial statements

The financial statements submitted for auditing were not prepared in accordance with the prescribed financial reporting framework and/or supported by full and proper records, as required by section 55 (1)(a) and (b) of the PFMA. Material misstatements of non-current assets, current assets, liabilities and expenditure identified by the auditors in the submitted financial statements were corrected and the supporting records were provided subsequently.

4.3 Expenditure management

Effective and appropriate steps were not taken to prevent irregular expenditure, as required by section 51(1)(b)(ii) of the PFMA. As reported in the basis for the qualified opinion the full extent of the irregular expenditure could not be quantified. Most of the irregular expenditure disclosed in the financial statements was caused by modifications to contracts. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R2 868 million, as disclosed in note 53.2 to the annual financial statements, as required by section 51(1)(b)(ii) of the PFMA. Most of the fruitless and wasteful expenditure was caused by the poor facilitation of project management. Fruitless and wasteful expenditure amounting to R840 million was incurred on the construction of residential flats to accommodate artisans for the Kusile project as the building cannot be utilised for the intended purpose and R1 247 million was incurred due to shortcomings in project management.

4.4 Procurement and contract management

Sufficient appropriate audit evidence could not be obtained that all awards to suppliers on established panels were in accordance with legislative requirements, as proper record keeping of such awards was not maintained. Similar limitations were also reported in the prior year. Some of the goods, works or services were not procured through a procurement process which is fair, equitable, transparent and competitive, as required by section 51(1)(a)(iii) of the PFMA. Similar non-compliance was also reported in the prior year. Some of the contracts and quotations were awarded to bidders based on preference points that were not allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations. Similar non-compliance was also reported in the prior year.

Some of the tenders which failed to achieve the minimum qualifying score for functionality criteria were not disqualified as unacceptable in accordance with Preferential Procurement Regulations 5(6). Some of the tenders which achieved the minimum qualifying score for functionality criteria were not evaluated further in accordance with Preferential Procurement Regulations 5(7). Sufficient appropriate audit evidence could not be obtained that construction contracts were awarded to contractors that were registered with the Construction Industry Development Board (CIDB) and qualified for the contract in accordance with section 18(1) of the CIDB Act, CIDB regulations 17 and 25(7A). Similar non-compliance was also reported in the prior year.
Sufficient appropriate audit evidence could not be obtained that some of the bid documentation for procurement of commodities designated for local content and production, stipulated the minimum threshold for local production and content, as required by the 2017 Preferential Procurement Regulation 8(2).
Sufficient appropriate audit evidence could not be obtained that some of the commodities designated for local content and production, were procured from suppliers who submitted a declaration on local production and content as required by the 2017 Preferential Procurement Regulation.
Sufficient appropriate audit evidence could not be obtained that commodities designated for local content and production, were procured from suppliers who met the prescribed minimum threshold for local production and content, as required by the 2017 Preferential Procurement Regulation 8(5).
Sufficient appropriate audit evidence could not be obtained that members of the accounting authority whose close family members, partners or associates had a private or business interest in contracts awarded by the entity disclosed such interest, as required by PFMA section 50(3)(a).
Sufficient appropriate audit evidence could not be obtained that persons in service of the entity who had a private or business interest in contracts awarded by the entity had not participated in the process relating to that contract as required by PFMA section 50(3)(b).

4.5 Consequence management

The auditors were unable to obtain sufficient appropriate audit evidence that disciplinary steps were taken against officials who had incurred irregular expenditure as required by section 51(1)(e)(iii) of the PFMA. This was due to investigations not being initiated and failure to maintain proper and complete records as evidence to support that investigations were initiated. Disciplinary steps were not taken against the officials who had incurred and/or permitted fruitless and wasteful expenditure, as required by section 51(1)(e)(iii) of the PFMA. The auditors were unable to obtain sufficient appropriate audit evidence that allegations of financial misconduct committed by members of the accounting authority and officials were investigated as required by treasury regulation 33.1.3 and 33.1.1 respectively. This was due to a failure to maintain proper and complete records as evidence to support the investigations into allegations of financial misconduct committed by members of the accounting authority and officials.

The auditors were unable to obtain sufficient appropriate audit evidence that allegations of theft/fraud/extortion/forgery/uttering a forged document which exceeded R100 000 were reported to the South African Police Service, as required by section 34(1) of the Prevention and Combatting of Corrupt Activities Act. Similar limitation was also reported in the prior year.

4.6 Governance and oversight

The company secretary did not ensure that the minutes of all shareholders' meetings, board meetings and the meetings of any committees of the directors, or of the company's audit committee, were properly recorded, as required by section 88(2)(d) of the Companies Act. Similar non-compliance was also reported in the prior years.

4.7 Internal control deficiencies

The auditors considered internal control relevant the audit of the consolidated and separate financial statements, reported performance information and compliance with applicable legislation; however, our objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion and the findings on compliance with legislation included in this report. The accounting authorities' initiatives implemented during the year to provide effective leadership based on a culture of honesty, ethical business practices and good governance, protecting and enhancing the interests of the entity are in progress and have not, in all circumstances, resulted in the intended outcomes.

The accounting authority did not exercise adequate oversight responsibility regarding compliance with applicable legislation and related internal controls that resulted in the lack of proper procurement and contract management processes as well as effective consequence management practices. Action plans developed to address internal control deficiencies were not, in all instances, adequate. Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial reporting. The accounting authority did not fill the vacancy of a chairperson of the audit and risk committee, who resigned during the year, with a member that has the requisite financial skills, as there was no member appointed to the accounting authority by the executive authority, who possesses the requisite skills.

5. Issues for Consideration

Eskom achieved two targets against the shareholder compact on improved plant operations with nine targets not being achieved.
On primary energy optimisation Eskom could not achieve the target on migration of coal delivery from road to rail.
The reduction of environmental footprint in the existing fleet could not be achieved.
Deliver on capital expansion: Installation of transmission lines not achieved
Financial sustainability, the disposal of EFC was not achieved
Socio-economic impact: human capital, targets on learner intake artisans and percentage spend of gross manpower costs were not achieved.
Industrialisation and localisation: preferential procurement, competitive supplier development programme and enterprises and supplier development were not achieved.

- What was the reason for non-achievement of these targets?
- How is Eskom addressing the findings by the independent auditors?
- What is the impact on NERSA tariff determination on Eskom?
- What is Eskom's plan in dealing with unstainable debt level which has an impact on its financial performance?
- How long is Eskom going to be treated as a going concern is there a plan for future sustainability?
- Has there been a change in timelines of maintenance since planned and opportunity maintenance was conducted during lockdown? Are we likely to see changes in timelines?
- What levels of inefficiencies in the supply chain which are delaying the procurement process and hampering delivery on the maintenance programme?
- Can Eskom elaborate on higher costs of primary production including the use of OGCT and IPP production?