## DPE Stationery:DPE logo.jpg INFORMATION MEMORANDUM

**TO : Mogokare Richard Seleke**

**DIRECTOR-GENERAL**

**FROM : Justin De Allende**

**RE :** **PARLIAMENTARY QUESTION NO 2161**

# DATE : 4 August 2017

**================================================================**

To provide the Minister with a response to Parliamentary Question Number 2161

|  |  |  |
| --- | --- | --- |
| **COVER MEMO AND THE PACKAGING OF PQ BY:**  **Department of Public Enterprises** | | |
| **……………………………….**  **Acting Deputy Director-General**  **Date:** | | **COMMENTS:**  **………………………………………..** |
| **…………………………………**  **Mogokare Richard Seleke**  **Director-General**  **Date:** | **APPROVED/DECLINED/COMMENTS**  **…………………………………………..**  **…………………………………………..**  **………………………………………….** | |



**DEPARTMENT: PUBLIC ENTERPRISES**

**REPUBLIC OF SOUTH AFRICA**

**NATIONAL ASSEMBLY**

**QUESTION FOR WRITTEN REPLY**

**QUESTION NO.: PQ 2161**

**DATE OF PUBLICATION: 4 August 2017**

Mr E J Marais (DA) to ask the Minister of Public Enterprises: Given the qualified audit opinion of R 2996 million in irregular expenditure shown on page 22 of Eskom’s 2016/17 annual financial statements, (a) what is the itemised cost breakdown of this irregular expenditure with supplier names for each item, (b) how was the R2996 million expenditure processed without supporting documentation given that the systems do not allow it, (c) what disciplinary measures have been instituted against individuals implicated in this irregular expenditure and (d) what measures is Eskom implementing to prevent this from reoccurring?

**REPLY:**

**(a)**

Eskom has provided this detail in the Annual Financial Statements issued for the year ended 31 March 2017. Please refer to Note 52 on page 113.

**(b)**

Please refer to the attached note for details of the irregular expenditure.

**(c)**

A recovery plan has been developed, which includes instituting disciplinary measures and is in the process of execution.

**(d)**

Eskom has developed an improvement plan with the aim of addressing PFMA compliance. Please refer to Directors report on Page 13 to 14 of the Annual Financial Statements issued for the year ended 31 March 2017.

**Remarks: Reply: Approved / Not Approved**

**Mr. Mogokare Richard Seleke Ms. Lynne Brown, MP**

**Director-General Minister of Public Enterprises**

**Date: Date:**

**Annexure to PQ 2162 (B)**

**52. Information required by the Public Finance Management Act**

Any losses due to criminal conduct or irregular or fruitless and wasteful expenditure that individually (or collectively where items are closely related) exceed R25 million must be reported in terms of the significance and materiality framework agreed with the shareholder.

52.1 Irregular expenditure

**Group and company**

|  |  |  |
| --- | --- | --- |
| Note | 2017  Rm | 2016  Rm |
| Balance at beginning of the year | 348 | 418 |
| Current year expenditure | 4 043 | 106 |
| Amounts condoned | (1 084) | (146) |
| Amounts not recoverable (not condoned) | (311) | (30) |
| Balance at end of the year | 2 996 | 348 |
| Age analysis | 2 996 | 348 |
| Current year | 2 992 | 38 |
| Prior years | 4 | 310 |
| Comprising | – | 310 |
| B2B engineering tools expenditure incurred without PFMA approval (a) |
| Balance at beginning of the year | 310 | 310 |
| Amounts not recoverable (not condoned) | (310) | – |
| Purchase of land without investment committee approval (b) | – | – |
| Balance at beginning of the year | – | 108 |
| Amounts condoned | – | (108) |
| Breach of PPPFA: monetary thresholds – incorrect tender process applied (c) | 92 | 11 |
| Balance at beginning of the year | 11 | – |
| Current year expenditure | 95 | 41 |
| Amounts condoned | (13) | – |
| Amounts not recoverable (not condoned) | (1) | (30) |
| Breach of the NEMA (d) | – | 7 |
| Balance at beginning of the year | 7 | – 7  – |
| Current year expenditure | – |
| Amounts condoned | (7) |
| Use of labour broker – internal processes not followed (e) | – | 10 |
| Balance at beginning of the year | 10 | – |
| Current year expenditure | – | 10 |
| Amounts condoned | (10) | – |
| Professional services contract – internal processes not followed | – | – |
| Current year expenditure | – | 36 |
| Amounts condoned | – | (36) |
| Tender processes not adhered to – commitments made before approval (f) | 56 | 1 |
| Balance at beginning of the year | 1 | – |
| Current year expenditure | 549 | 3 |
| Amounts condoned | (494) | (2) |
| Procurement of services – incorrect classification as an emergency (g) | 8 | 4 |
| Balance at beginning of the year | 4 | – 4 |
| Current year expenditure | 4 |
| Quality management – tender process not followed and insufficient delegation of authority | 1 560 | – |
| Current year expenditure (h) |
| Breach of PPPFA – tax clearance certificates (i ) | 987 | – |
| Current year expenditure | 1 453 | – |
| Amounts condoned | (466) | – |
| Non-compliance with CIDB regulations ( j) | 8 | – |
| Current year expenditure | 97 | – |
| Amounts condoned | (89) | – |
| Breach of PFMA – use of sole source | 96 | –  – 5 |
| Current year expenditure (k) |
| Breach of PFMA – tender processes not adhered to |  |
| Current year expenditure (l) | 189 |
| Various other instances | – |
| Balance at beginning of the year | 5 | – 5  – |
| Current year expenditure | – |
| Amounts condoned | (5) |

* 1. Irregular expenditure (continued)

1. B2B engineering tools expenditure incurred without PFMA approval

The matter regarding the expenditure incurred on the B2B Engineering Tools project of R310 million before PFMA approval was reported in 2015. The expenditure was subsequently derecognised by the board in accordance with the National Treasury Guideline issued on 19 April 2016.

1. Purchase of land without investment committee approval

The matter regarding the purchase of land without investment committee approval was reported in 2015. The irregular expenditure incurred has been condoned by the relevant authority and has therefore been removed from the register of irregular expenditure.

1. Breach of PPPFA: monetary thresholds – incorrect tender process applied

Irregular expenditure of R95 million was incurred in breach of the Preferential Procurement Policy Framework Act (PPPFA) as follows:

* + the PPPFA requires that monetary thresholds to determine the appropriate point-scoring criteria applicable to specific transactions be considered inclusive of VAT. Eskom erroneously applied the thresholds exclusive of VAT. Certain procurement was therefore done using the incorrect point-scoring criteria and resulted in a breach of PPPFA. Irregular expenditure incurred on affected transactions amounted to R95 million (2016: R11 million) of which R13 million was condoned in 2017, including R11 million reported in 2016. An amount of R92 million was awaiting condonation at 31 March 2017. Eskom is ensuring that regular reviews are conducted and that buyers are made aware and retrained on the supply chain management procedure
  + Eskom’s exemption from the PPPFA expired on 7 December 2012. Eskom paid R0.4 million (2016: R30 million) during the year on contracts that were entered into between 8 December 2012 and 31 March 2013 that were inconsistent with the requirements of the PPPFA. These contracts were not recalled or corrected at the time and Eskom continued to meet its obligations in terms of these contracts. All the affected transactions took place in the normal course of business and were subject to Eskom’s approved procurement policy in force at the time

1. Breach of NEMA

Eskom unlawfully commenced with construction activities for a 132 kV power line in the Eastern Cape Province along a route that was not authorised by the Department of Environmental Affairs (DEA). An amount of R7 million was incurred on the portion of the line constructed in contravention of the National Environmental Management Act (NEMA). Eskom rectified the breach and received the required authorisation from DEA on 2 September 2016. Eskom paid a penalty of R1 million imposed by DEA. Disciplinary action was concluded against three employees involved.

1. Use of labour broker – internal processes not followed

Eskom processes were not followed for the procurement of certain goods and services through a labour broker. The senior managers concerned were disciplined and the labour broker instructed to discontinue sundry payments. The expenditure was condoned and no further action is required.

1. Tender processes not adhered to – commitments made before approval

Irregular expenditure of R549 million comprising 245 incidents was incurred as a result of non-adherence to internal procurement processes and employees contravening the Eskom Delegation of Authority. Incidents totalling R56 million are awaiting condonation.

1. Procurement of services – incorrect classification as an emergency

Services procured to the value of R4 million (2016: R4 million) were incorrectly classified as an emergency in the procurement process. This matter will be submitted for condonation in 2018.

1. Quality management – tender process not followed and insufficient delegation of authority

Irregular expenditure estimated at R1 560 million was incurred because of the placement of contracts without proper delegation of authority or without following established processes during the 2008-2015 financial years.

Multi-disciplinary investigations were conducted into indications of mismanagement and allegations of irregularities in the quality management department. Possible fruitless and wasteful expenditure of R886 million regarding this matter was reported in 2016.

A further investigation was recently finalised by an independent external company with the following outcome:

* + identification of irregular expenditure of R1 560 million because of the placement of contracts without proper delegation of authority or without following established processes during the 2008-2015 financial years with the bulk of the payments made on these contracts occurring in the 2013 and 2014 financial years
  + estimated fruitless and wasteful expenditure of R510 million compared to the original estimate of R886 million reported in 2016. Refer to 52.2(a)
  + losses due to criminal conduct of R2 million. Refer to 52.3(b)

Actions taken to date include the following:

* + two employees have been dismissed (one is a senior manager)
  + a criminal case was opened with the South African Police Service to investigate possible fraudulent transactions
  + civil action against Eskom by one of the main suppliers is being defended
  + a fidelity claim has been lodged in terms of a commercial crime insurance policy with a cover limit of R3 billion for losses arising from fraudulent or dishonest acts committed by employees. This claim will be concluded once the legal matters have been finalised

Further disciplinary, civil and/or criminal action as appropriate will be considered against other parties involved, including action to recover losses.

The following contract management process improvements have been implemented:

* + improvement in the monitoring of performance by the SHEQ panel service providers with regular inspections and enforcement of consequence management for poor or ineffective delivery
  + effective segregation of duties
  + reconciliation of task orders to scope, budget, timesheets, invoices and payments, with approval of timesheets by project managers on site
  + limiting of long-term task orders and close monitoring of performance to ensure resources are not idle nor unproductive
  + training of employees on effective electronic documentation management

1. Breach of PPPFA – tax clearance certificates

PPPFA regulations require that tenders may only be awarded to a person whose tax matters have been declared to be in order by SARS. SARS only issues such a confirmation to a person registered as a taxpayer. Three contracts with an award value of R340 million were reported as being under investigation in 2016. A further R126 million was incurred on these contracts during the year. They were confirmed as irregular in 2017 since no SARS declaration was found to be obtained at the time of award and were condoned during the year. There were 59 contracts that were similarly affected during 2017. Irregular expenditure of R987 million was incurred on these contracts during the year and is awaiting condonation.

1. Non-compliance with CIDB regulations

Construction Industry Development Board (CIDB) regulations specify the different levels of grading that contractors must have based on the value of the contracts to be awarded (not a requirement for World Bank-funded contracts). Expenditure of R89 million was identified and condoned during the year on two foreign contracts awarded in terms of World Bank funding where the grading level was not in line with CIDB regulations. A further R8 million was incurred on a contract for which tender invitations were not advertised on the CIDB website as per the CIDB Regulation 24.

1. Breach of PFMA – use of sole source

There were three incidents of irregular expenditure totalling R96 million where the use of sole sources could not be adequately justified.

1. Breach of PFMA – tender processes not adhered to

There were 11 incidents of irregular expenditure totalling R189 million where approved supply chain management processes were not adhered to.

1. Irregular expenditure under investigation

There are numerous additional instances of procurement that are subject to investigation, namely:

* + tender processes not adhered to including breaches of delegation of authority
  + incorrect PPPFA points thresholds applied
  + non-compliance with CIDB regulations
  + lack of supporting documentation including tax clearance certificates
  + award made to a company on a sole source basis which might not comply with the criteria of sole source and contract amount determined on a contingency fee basis
  + non-declaration of conflicts of interest by employees and tenderers giving rise to a risk of undue influence
  + contract information not reflected correctly in the reporting system

These matters are being investigated and will be disclosed in a subsequent period should they prove to be irregular.

1. Relevant authority for condonations

Condonations are currently approved by the relevant internal governance committee unless it is specifically required to be approved by National Treasury. Eskom is awaiting clarification from National Treasury on whether a relevant government department responsible for a particular piece of legislation must approve condonation of a breach relating to that legislation.

* 1. Fruitless and wasteful expenditure

1. Incidents of fruitless and wasteful expenditure above the materiality threshold

There was one (2016: one) major incident of fruitless and wasteful expenditure incurred by the group during the year that exceeded the materiality threshold of R25 million. This matter is carried forward from 2016.

Fruitless and wasteful expenditure incurred by the quality management department

An investigation by an independent external party confirmed fruitless and wasteful expenditure estimated at R510 million compared to the original estimate of R886 million reported in the previous financial year. Refer to 52.1(h).

1. Incidents of fruitless and wasteful expenditure below the materiality threshold

Total fruitless and wasteful expenditure which individually or collectively (where items are closely related) were below the materiality threshold was R37 million (2016: R93 million) comprising 210 (2016: 655) incidents of which 10 incidents accounted for R22 million. Management continues to institute preventive and corrective measures, including disciplinary action, as considered appropriate.

1. Fruitless and wasteful expenditure under investigation

There are currently 84 incidents of alleged fruitless and wasteful expenditure under investigation, of which none is expected to exceed the materiality threshold of R25 million. The nature and extent of potential losses incurred cannot be reasonably ascertained at this stage. It is important to note that these are allegations and many of these occurrences may not qualify as fruitless and wasteful expenditure upon conclusion of the investigations.

* 1. Criminal conduct

1. Theft of conductors, cabling and related equipment

Losses due to conductor theft, cabling and related equipment totalled R70 million (2016: R85 million), involving 5 734 incidents (2016: 5 161 incidents). Actions to combat these losses are managed by the Eskom Network Equipment Crime Committee in collaboration with other affected state-owned companies and the South African Police Services. The combined effort resulted in 235 (2016: 229) arrests and R5 million (2016: R5 million) worth of stolen material was recovered.

1. Fraud

Eskom concluded 15 (2016: 14) investigations into fraud during the reporting period involving R24 million (2016: R33 million), including a R2 million loss due to criminal conduct on the quality management matter. Refer to note 52.1(h). The existing internal control measures in the affected areas as well as similar areas have been reviewed and enhanced. Disciplinary, criminal as well as civil proceedings have been instituted against those involved.

1. Non-technical revenue losses

Non-technical losses are estimated at R1.3 billion (2016: R1.2 billion). These arise mainly from meter tampering and bypasses, illegal connections to the electricity network and illegal vending of electricity.

Interventions to reduce non-technical energy losses:

* + implementation of technologies in the form of smart/split meters with protective enclosures to prevent access to the meter
  + disconnection of illegal connections, meter tampers and imposition of penalties (tamper fines)
  + estimation and recovery of revenue for historic unaccounted energy where tampered metering installations are encountered
  + revision of supply group codes on prepaid meters to prevent the use of illegal prepaid vouchers
  + investigations and prosecution of criminals perpetrating electricity theft through the sale of illegal prepaid vouchers, illegal electrification and meter tampering services
  + customer education, social mobilisation and partnership campaigns to drive behaviour change