



ANNEXURE H

APPROVED INTEGRATED NATIONAL ELECTRIFICATION PROGRAMME (HOUSEHOLD): PROJECT AND CASH FLOW DETAILS FOR THE 2023/24 FINANCIAL YEAR

Project Details

Province Name:	Western Cape	Municipality Name:	Cederberg
Project Name:	Citrusdal Housing	Municipality Number:	WC012
DMRE Project ID:		Number of Connections Planned:	162
Project Part of IDP:	Yes	IDP Project Number:	
Type of Electrification:	Overhead	House Density:	Urban
Sufficient Supply Capacity:	Yes	Connection Supply Capacity:	40A
ADMD Initial:	1.5	ADMD Final:	2.4

Approved Connections and Capital Detail

Approved Capital:	R 2,997,000	Approved Connections:	162
DMRE Subsidy:	R 18,500	DMRE Suite of Supply	20A @ 2.4kVA ADMD

Detailed Cash Flow and Connections Per Month

Cash Flow

Apr:	May:	Jun:	Jul:	Aug:	Sept:	
			R 2,997,000			
Oct:	Nov:	Dec:	Jan:	Feb:	Mar:	Total Cash Flow:
						R 2,997,000

Connections

Apr:	May:	Jun:	Jul:	Aug:	Sept:	
			100		62	
Oct:	Nov:	Dec:	Jan:	Feb:	Mar:	Total Connections:
						162

**ANNEXURE I****APPROVED INTEGRATED NATIONAL ELECTRIFICATION PROGRAMME (BULK INFRASTRUCTURE): PROJECT AND CASH FLOW DETAILS FOR THE 2023/24 FINANCIAL YEAR****Project Details**

Province Name:	Western Cape	Municipality Name:	Cederberg
Project Name:	Clanwilliam Sub/S	Municipality Number:	WC012
DMRE Project ID:		Type of Infrastructure:	Bulk
Project Part of IDP:	Yes	Planned Project Output: (to be achieved in 23/24)	10MVA substation
IDP Project Number:		New/Upgrade/Refurb:	New
Name of Source Infrastructure:	Eskom supply	Project Beneficiaries:	Clanwilliam
Initial Output Status: (project state before funding)	No capacity	Final Output Status: (project state at completion)	Adequate capa

Approved Connections and Capital Detail

Approved Capital:	R 32,003,000	Approved Project Output (km/MVA):	10MVA
DMRE Subsidy:	R 32,003,000	Project Phase:	2

Detailed Cash Flow Per Month and Milestones Per Quarter**Cash Flow**

Apr:	May:	Jun:	Jul:	Aug:	Sept:	
			10,000,000			
Oct:	Nov:	Dec:	Jan:	Feb:	Mar:	Total Cash Flow:
	10,000,000			12,003,000		R 32,003,000

High-Level Project Scope of Work:

10MVA 66/11kV substation, including earth works, fencing, procurement of 66kV equipment, foundations, earthing

2022/23 Key Milestones and Planned Activities:

- Q1 Detail designs completed
- Q2 Tender process completed, contractor appoint
- Q3 Construction 50% completed
- Q4 Project fully completed



The Accounting Officer
Cederberg Municipality
Private Bag X2
Clanwilliam
8135

Date: 29 November 2023

Reference: Communication 32 of 2023

Dear Mr. Matthyse

COMMUNICATION OF FINDINGS IDENTIFIED DURING THE AUDIT OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2023

Background

1. In performing the audit of the financial statements, we identified misstatements as described in the annexure. We have recorded the internal control deficiency that gave rise to the misstatements and our recommendation for correcting the misstatements for your consideration.
2. The finding will be included in the management report including your comments and our final response.

Required

3. You are requested to indicate whether you agree with the facts stated in the annexure including whether you agree with the identified internal control deficiency. Should you disagree, please provide us with documentary evidence to the contrary within five days from the date of this communication, as agreed in the engagement letter.
4. Should you agree, you are hereby requested to make the necessary corrections.
5. Should you choose not to make the necessary corrections, kindly communicate your reasons for this within five days from the date of this communication, as agreed in the engagement letter. The remaining uncorrected misstatement will then be evaluated for reporting purposes based on materiality.
6. Should you choose to make the necessary corrections, kindly refer the point described below and provide us with the necessary information within **5 days** from the date of this communication, as agreed in the engagement letter.
7. Please provide us with copies of the proposed adjustments and the supporting documentation.
8. Once we have received this information, we will perform additional audit procedures to determine whether there are remaining uncorrected misstatements.

9. If the results of these procedures are satisfactory, we will accept the proposed adjustments and you may make the adjustments.
10. If the results of these procedures are not satisfactory or there are remaining uncorrected misstatements, we will evaluate these for reporting purposes based on materiality.

Yours sincerely

Sebulon Afrika
Acting Senior Manager: Western Cape

Enquiries: Sikululwe Ndamase
Telephone: 021 528 4129
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Acknowledgement of receipt by management:

Received by

Date

Integrated National Electrification Programme (INEP)

INEP conditional grant allocation incorrectly accounted

Audit finding

Requirements

Section 122 (1) (a) of the Municipal Financial Management Act 56 of 2003 states that “every municipality must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year’.

GRAP 1 paragraph.17 states that financial statements shall present fairly the financial position, financial performance, and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events, and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses. The application of Standards of GRAP with additional disclosures, when necessary, is presumed to result in financial statements that achieve a fair presentation.

In terms of GRAP 11 paragraph.08 Construction contract is a contract, or a similar binding arrangement, specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

GRAP 23.06 defines control of an asset as “*rising when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit.*”

Background

Integrated National Electrification Programme (INEP) is an initiative of government to provide capital subsidies to municipalities and Eskom to address the electrification backlog in order to provide access to electricity to households. The INEP capital subsidies are allocated through schedule 5B and 6B Division of Revenue Act (Dora) grants. The capital subsidies referred to in this communication of audit finding are schedule 5B Dora allocations.

In terms of the Dora, the purpose of a schedule 5B allocation is _ “*To implement the Integrated National Electrification Programme by providing capital subsidies to municipalities to address the electrification backlog of all existing and planned residential dwellings (including informal settlements, farm dwellers, new and existing dwellings) and the installation of relevant bulk infrastructure*”. Schedule 6B grants are paid to Eskom for a similar purpose.

It is our understanding from the above, that schedule 5B INEP grants are paid to the municipality for constructing electrification infrastructure assets (or to appoint a contractor to do it on its behalf) and by inference the municipality should ordinarily account for the infrastructure assets construction cost during the construction phase unless there is other evidence to the contrary.

The responsibilities for constructing the electrification infrastructure assets is bestowed to the municipality in terms of the schedule 5B INEP grants and by inference the municipality should report on that responsibility in their financial statements unless there is other evidence to the contrary.

A memorandum of agreement (MOA) has been concluded between the Department of Minerals and Energy (DOE) and Cederberg Municipality, in respect of the funding and implementation of the Integrated National Electrification Programme (INEP), for the “10MVA 66/11kv Clanwilliam substation” project.

Memorandum of Agreement entered into between the Department of Mineral Resources and Energy and the municipality clause states that the municipality;

- 6.2.... “shall not spend any allocated funds in areas where they are not licensed to distribute electricity unless prior arrangements are made and approved through a signed Service Level Agreement (SLA) with a licensed entity”.
- 6.23.....“Ensure that all assets created under schedule 5b, Eskom area of supply, should be handed over to Eskom for operations and maintenance. A Service Level Agreement (SLA) should be in place before any transfer of funds could be affected”.

Self-Build Agreement with Eskom

The municipality entered into a self-build agreement (i.e. *contract conditions for the self-build of Eskom distribution connection assets by customers*) with Eskom for the project.

The agreement specifically states that the assets constructed will be transferred to Eskom upon completion as per the following clauses;

3. INTRODUCTION

3.1 The CUSTOMER has applied for the Connection of the Facility and additional load at / Electrical Installation situated at Clanwilliam substation (as further described in Annexure A) to the Distribution System (as defined below) including the option for the CUSTOMER to undertake the financing, insuring, land rights acquisition, design, engineering, procurement, supply, fabrication, construction, erection, installation, inspection, pre-commissioning, testing, completion, all activities ancillary to these, and such other specified portions of the Connection Works for the CUSTOMER’s own risk and cost (the ‘**Contract Works**’ as described in Annexure B) and on completion of the Contract Works to effect the handover of the plant, facilities, equipment, assets and related designs, material guarantees/warranties, deeds and other documentation to ESKOM as described herein.

3.2 ESKOM has accepted the CUSTOMER’s Application subject to:

3.2.1 ESKOM’s receipt from the CUSTOMER of its written acceptance of ESKOM’s Budget Quote for the works and services to be undertaken by ESKOM to connect the Facility / Electrical Installation to the Distribution System in the form as prescribed in ESKOM’s Budget Quote (ESKOM’s Budget Quote as so accepted being the ‘**Accepted Budget Quote**’) and the fulfilment of all conditions for the coming into full force and effect of the Budget Quote; and

3.2.2 the conclusion and coming into effect of this Agreement between the Parties in respect of the undertaking by the CUSTOMER of the Contract Works and the transfer of the Contract Works Equipment (as defined below) to ESKOM, the terms and conditions of which are contained herein together with Annexures A to H and annexes to these Annexures (**this Agreement**).

9. OWNERSHIP

9.1 ESKOM shall only take ownership of and obtain right and title to the Contract Works Equipment or part thereof with effect from the completion of the transfer procedures described in this Agreement on the Hand-over Date.

9.2 The Parties acknowledge and agree that none of the performances required under this Agreement, including the payment by the CUSTOMER of charges or fees, shall confer on the CUSTOMER any right of ownership or Lien in, over or to any asset to which those charges or fees may relate, including the Connection Works and Connection Equipment.

SC306 DX SELF BUILD AGREEMENT (SBA) FOR IPPS AND LOADS (HV CONNECTIONS)

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ESKOM’S RESPONSIBILITIES	SELF-BUILD CUSTOMER’S RESPONSIBILITIES
<ul style="list-style-type: none"> - Contract Works via Asset Acquisition Journal • Ensure adherence to the requirements of the applicable self-build Standard 	
<p>Project Support Services</p> <ul style="list-style-type: none"> • Confirm the transfer of assets created from both the Contracts Works as well as the Eskom Works to the assets register 	

3.7 Transfer of Ownership and the Capitalisation of Assets

3.7.1 Transfer of Ownership

The Customer shall, after successful commissioning, transfer full ownership of the contract works equipment to Distribution, including all environmental authorisations, approvals and approved permits. The assets shall be transferred to Eskom at cost and in accordance with the guideline in Annexure F. The self-build Customer retains the defects liability and construction warranty for the transferred assets in line with the terms and conditions of the construction contract.

Considerations and conclusion

It is our view that the accounting treatment of the electrification infrastructure assets should be dependent on who has ownership control of the infrastructure assets and/ or work in progress, based on an analysis of the terms and conditions of the arrangement(s). If the municipality undertakes the construction of the infrastructure asset that it will eventually control, maintain and operate it applies GRAP 17, and revenue is recognised per GRAP 23 on Revenue from Non-exchange Transactions. If the municipality is appointed to undertake the construction of the bulk electrification infrastructure to supply electricity in an Eskom licensed area and the assets will eventually be controlled, maintained and operated by ESKOM, then the municipality is appointed as a contractor and should apply GRAP 11.

GRAP 23 paragraph 06 clarifies that “*Control of an asset arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit*”. Our reading of the clauses in the MOA) between the DOE and the municipality, it is clear that, when the asset is in an Eskom distribution area, the assets must be transferred to Eskom for operations and maintenance. It is further stated that a SLA should be in place before the funds are transferred and we are assuming that the mentioned SLA is the “Self-Build Agreement” signed between the municipality and Eskom. From the Self-Build agreement, it is stated that Eskom accepts the municipality’s application on condition that the municipality undertakes the contract works and transfer the works to Eskom on completion.

Based on the above the municipality is constructing the 10MVA 66/11kv Clanwilliam substation for Eskom to control, maintain and operate. The municipality should therefore apply GRAP 11 in accounting for the attributable construction contract costs and construction revenue.

Internal control deficiency

Financial and performance management

Prepare regular, accurate, and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not ensure that the principals of GRAP 11 accounting for revenue and costs related to construction contracts and principles of GRAP 23 Revenue from non-exchange are applied correctly. In addition, the National Treasury guideline (issued 21 August 2023) on accounting for Integrated National Electrification Programme were not applied. To note that the guidance from NT is providing clarification to already existing accounting principles that the affected municipalities ought to have been applying already without the recently issued guidance.

Recommendation

Management should make an assessment of the above and process the relevant corrections to the financial statements to ensure the grant revenue, assets and construction contract are accounted for in accordance with the GRAP requirements.

Management response

Management comment on the audit finding:

1. The Clanwilliam bulk project consists of the new 66kV line between Graafwater and Clanwilliam, and the new 66/11kV substation in Clanwilliam
2. The main purpose of the project is to create more capacity in Clanwilliam, thereby allowing developments, including low cost housing projects, to continue. Due to the lack in adequate capacity there has been an embargo on new developments for quite some time.
3. Application has been made to Eskom in 2018 for additional capacity, but at the time Eskom indicated that they did not have any indication when the bulk project will be funded from their side and accordingly be rolled out.

4. Discussions with several other stakeholders started in 2019, including Dept Rural Development, Dept Water and Sanitation, Dept Mineral Resources and Energy (DMRE) and others regarding possible funding of the project.
5. Successful discussions with DMRE whereby they confirmed full funding of the project kick started the project. The contribution from DMRE was based on Cederberg implementing the project with funding provided as grants through DORA. First funding was allocated for the 2019/20 year.
6. Discussions between Cederberg, Eskom and DMRE led to the signing of a self-build agreement between Cederberg and Eskom. The self-build agreement dictates that the project will be constructed by Cederberg as “implementing agent”, utilising DMRE’s grant funding, until completion whereafter the project will be handed over to Eskom for operation and maintenance. The benefit to Cederberg at that stage will be the increased capacity in Clanwilliam.
7. For the time period till the project is completed the asset will belong to Cederberg Municipality as work-in-process, however contractually it will stay under the Contractor’s liability in terms of their contract with Cederberg. Once the project is fully completed, line and substation, the total asset will be handed over to Eskom.
8. Part of the upgrading project are new supply cables from the new substation to the existing municipal network. (This portion of work will stay with Cederberg) (±R0.6m in value)

Management comment on the root cause identified within the audit finding:

Management comment on the recommendation:

Reason for non-compliance:

Remedial action:

What actions will be taken:	By whom:	By when:
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If the above findings affect an amount (s) disclosed in the financial statements:		
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Please give an indication of whether the correcting journal entry shall be processed:			
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If yes, please indicate the accounting entry:

If no, please provide the reason why such a conclusion:

Auditor's conclusion

Management's response is noted.

We draw management's attention to the requirements of the Standard of Generally Recognised Accounting Practice – Construction Contracts (GRAP 11), in relation to the accounting for the Integrated National Electrification programme.

Paragraph 8 of GRAP 11 includes the following definitions:

*"A **binding arrangement** is an arrangement that confers enforceable rights and obligations on the parties to the arrangement as if it were in the form of a contract. It includes rights from contracts or other legal rights.*

***Construction contract** is a contract, or a similar binding arrangement, specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.*

***Contractor** is an entity that performs construction work pursuant to a construction contract."*

In terms of paragraph 11 of GRAP 11:

"An entity assesses the terms and conditions of each contract concluded with customers to establish whether the contract is a construction contract or not. In assessing whether the contract is a construction contract, an entity considers whether it is a contractor, as described in paragraph .16..."

Paragraph 16 of GRAP 11 states:

"A contractor is an entity that enters into a contract to build structures, construct facilities, produce goods, or render services to the specifications of another entity either itself or through the use of sub-contractors. The term "contractor" thus includes a general or prime contractor, a subcontractor to a general contractor, or a construction manager."

As the municipality has entered into a contract with Eskom specifically for the construction of a combination of assets that are closely interrelated in terms of their use, the binding arrangement would meet the definition of a construction contract and should be accounted for in terms of GRAP 11, where the ownership of the assets will vest in Eskom.

Paragraph 15 of GRAP 11 states:

"Sometimes one entity may construct assets for another entity without recovering the cost of construction directly from the recipient entity. Rather, the construction activity is funded indirectly by way of a general appropriation or other allocation of general government funds to the contractor, or from general purpose grants from third party funding agencies or other governments. These are classified as fixed price contracts for the purpose of this Standard."

The construction activity is funded by the DMRE and the contract should therefore be classified as a fixed price contract in terms of GRAP 11. The contract revenue and contract costs associated with the construction contract must be recognised as revenue and expenses respectively, with reference to the stage of completion of the contract activity at the reporting date.

For the current year audit, this matter will be reported in the management report as an emerging risk so as to afford management an opportunity to update their internal processes to appropriately account for the construction contracts (construction funded through the INEP grant and all other construction contracts). The accounting will be assessed during the audit performed for the 2023-24 financial year. Any material misstatements identified in this area which is not corrected by management, will result in a modification of the audit opinion in that year.

The audit finding remains and will be reported in the management report "*annexure D: Summary of detailed audit findings*" as part of matters that should be addressed to prevent material misstatements of the financial statements in future.