AUDITOR-GENERAL
SOUTH AFRICA

SCOPA BRIEFING NOTE

PFMA 2021-22

LAND AND AGRICULTURAL
DEVELOPMENT BANK OF SOUTH AFRICA

08 February 2023

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1. Introduction

1.1. Reputation promise of the Auditor-General of South Africa

The Auditor-General of South Africa (AGSA) has a constitutional mandate and, as the supreme audit institution (SAI) of South Africa, exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

1.2. Role of the AGSA

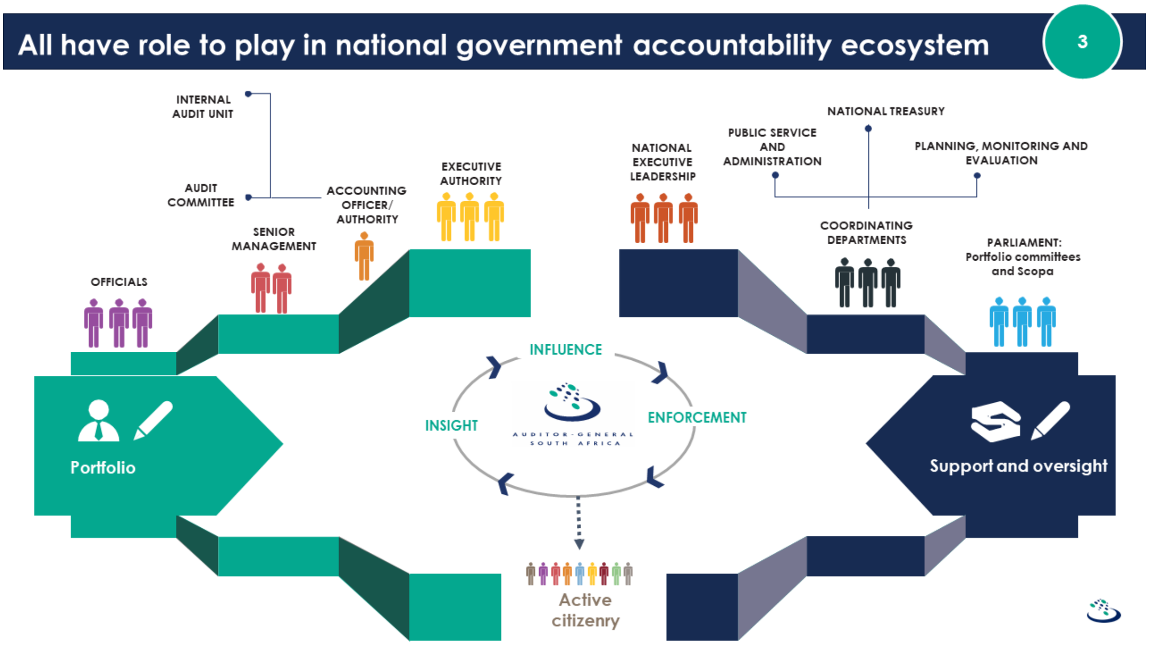
Our role as the AGSA is to reflect on the audit work performed to assist the committee in its oversight role of assessing the performance of entities.

1.3. Purpose

The purpose of this briefing document is for the AGSA to provide an overview of the audit outcomes and other findings in respect of Land and Agricultural Development Bank of South Africa (Land Bank, also referred to as "the bank" in this report) for the 2021-22 financial year.

1.4. Accountability ecosystem

Accountability ecosystem



The accountability ecosystem is the network of stakeholders that have a mandate and/or responsibility, whether legislative or moral, to drive, deepen and/or insist on public sector accountability.

A more active and engaged accountability ecosystem would add to the much-needed effort to shift public sector culture and would alleviate the overreliance on the AGSA to assume responsibility for improving audit outcomes and enforcing consequences.

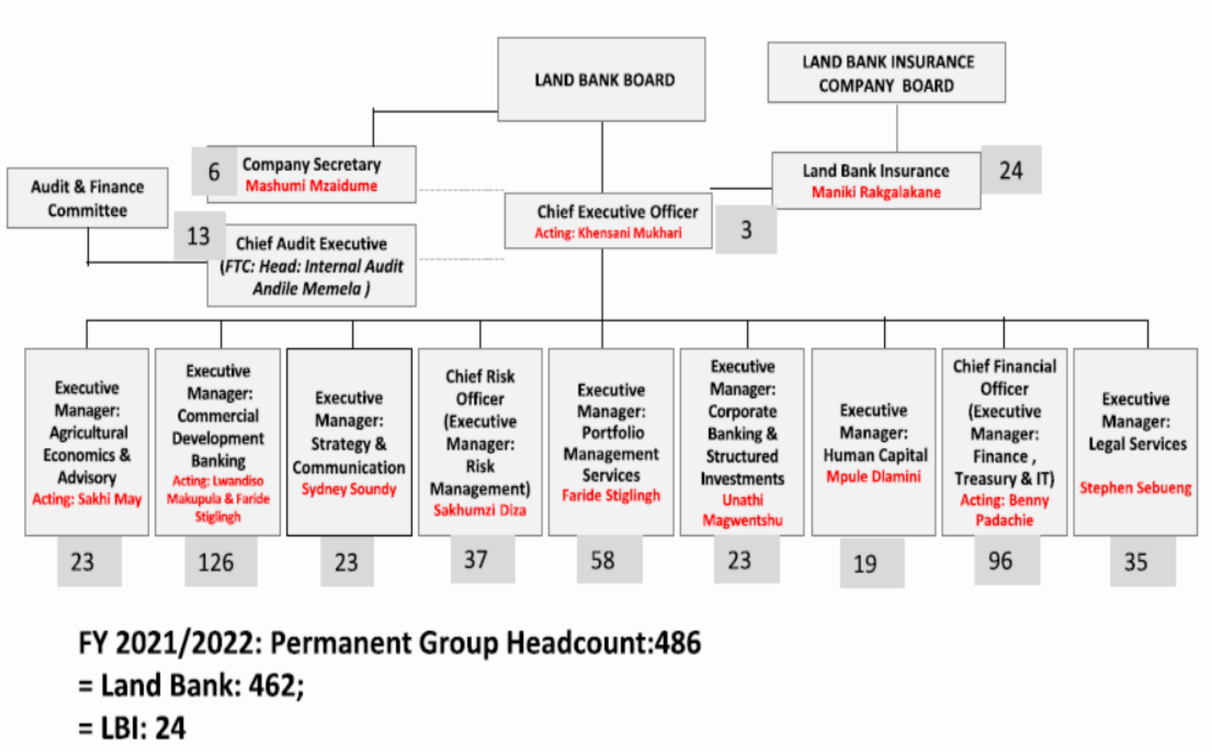
Shifting the public sector culture towards one that is characterised by performance, accountability, transparency and integrity can only be accomplished if all roleplayers in the broader accountability ecosystem fulfil their respective responsibilities and mandates.

Given the nature of the AGSA's mandate, by the time that we audit the financial statements of auditees and report on adverse findings, multiple failures have already occurred along the accountability value chain. After our audits, other steps are required to complete the accountability cycle.

Improvement in sound financial management to enhance the lives of citizens does not only reside within the domain and responsibility of the accounting officer or authority and the auditors. It depends on the entire accountability ecosystem to enable a culture of accountability in a sustainable and meaningful way.

1.5. Organisational structure

Organisation structure of Land Bank



1.6. Funding

Land Bank obtains its funding from interest income charged on loans, which is mainly driven by the size of the gross loan book. The bank earned R2, 61 billion (2020-21: R3, 03 billion) from interest income in the 2021-22 financial year.

The bank also generated an investment revenue of R357 million (2020-21: R204 million) in the 2021-22 financial year.

In 2021, the bank also received a capital injection of R3 billion from the shareholder, the National Treasury.

The shareholder committed a capital injection of R7 billion over three years (R5 billion in the 2021-22 financial year, R1 billion in the 2022-23 financial year and R1 billion in the 2023-24 financial year). This commitment, however, comes with the condition to re-establish/re-entrench the development and transformation mandate of the bank.

2. Audit opinion history

Audit outcomes explained:

	Unqualified opinion with no findings: The ideal – a clean audit – everything has been done the way it should be. There are no material misstatements in the financial statements and the auditee has complied with the law and reported properly on its performance objectives. A clean audit means the *money has been used ideally and for the intended purpose*. A clean audit also confirms that those charged with service delivery have created a solid foundation for delivering services and that finances are unlikely to be the cause for delayed service where things are going wrong.
	Unqualified opinion with findings: Not bad, but not ideal – here, the information in the financial statements is correct and complete, meaning there are no material misstatements. But there are 'material findings': problems with the auditee's performance reporting or non-compliance with the law, or both. This could compromise the auditee's accountability.
	Qualified opinion with findings: The situation is worrying – the auditee did not manage and account for its finances to achieve the best results. The financial statements contain material misstatements about specific amounts, or there is insufficient evidence for the AGSA to conclude that the amounts are not materially misstated.
	Adverse opinion with findings: Lots of problems everywhere – the auditee has not followed the correct rules and procedures and has not provided complete, correct information to account for its spending. There are a lot of material misstatements.
	Disclaimed opinion with findings: The worst outcome – the finances are so badly managed that the auditee cannot even produce evidence (documentation) to support its financial statements.

The audit outcomes for the current period and the past three years have been summarised below:

Summary of audit outcomes for current period and previous four years

DESCRIPTION	2021-22	2020-21	2019-20	2018-19
Audit opinions	C	Q	D	U
Areas of modification				
Loans and advances		✔		
Net impairment charges, claims and recoveries and modification gains or losses			✔	
Collateral held as security			✔	
Risk management- credit risk			✔	
Going concern and change in accounting policy disclosure note			✔	
Other findings				
Compliance with legislation				
Material misstatements in the submitted financial statements		✔	✔	✔
Expenditure management				
Procurement and contract management			✔	
Audit of predetermined objectives				
Material findings on usefulness and reliability of reported performance information				

Audit opinions legends:

C	*CLEAN AUDIT OPINION: No findings on PDO and Compliance*
U	*UNQUALIFIED with findings on PDO and Compliance*
Q	*QUALIFIED AUDIT OPINION (with/without findings)*
D	*DISCLAIMER/ADVERSE AUDIT OPINION*

The bank's audit outcome for the current audit cycle has improved to an unqualified opinion with no findings.

3. Overview of 2021-22 audit outcomes

3.1. Overall message

The overall audit outcome of the bank has improved when compared to the prior year, from a qualified audit opinion with findings to an unqualified audit opinion with no findings. The qualified opinion from the prior year was due to a material limitation of scope in testing of the gross loan book as the AGSA was unable to obtain sufficient appropriate audit evidence on repayments and disbursements by one of the service-level agreement (SLA) partners. This was mainly due to one of the SLA partners refusing to provide the supporting documents for auditing. As part of testing opening balances in the current year audit, the bank was able to reach an agreement with the SLA partner and the audit team had access to the supporting documents. We were able to obtain supporting documents for both the prior year and the current year, and are satisfied that the prior qualification has been resolved.

There were no material adjustments in the 2021-22 audit; however, going concern remains uncertain as the bank has not been able to finalise the liability solution.

During our review of the expected credit loss (ECL) model, we did not identify material misstatements or areas of International Financial Reporting Standards (IFRS) 9 non-compliance on the overall ECL figure presented in the annual financial statements. We made management aware of the findings identified in the components of the ECL model and that the incremental impact of these findings on the overall ECL was not material. We recommended that management keeps track of these findings, how they were addressed and also conduct a review of the updates prior to adjusting the implemented models.

The bank's underperforming loans decreased from R11, 33 billion (2021) to R4,99 billion (2022), which resulted in an impairment release of R800 million of the reported R1,3 billion. The profits reported in the current year mainly relate to this accounting adjustment and may not be sustainable in the future. As discussed with management, the decrease mainly results from the bank’s customers that have moved their loans to other banks. The bank appears to be losing part of the book that is performing better and might be left with underperforming loans, which may cause sustainability challenges.

We encourage the bank to consider rehabilitation and recovery of the non-performing loans to improve the quality of the loan book. We also recommended that the bank work on a strategy focusing on its new business model, which will enable recognition of new business to improve performance and financial viability of the bank.

Although we did not audit predetermined objectives, we noted as part of our audits of the financial statements that the bank had limited activity in the lending business and no new loan facilities have been approved. This was due to the current default position which the bank is working on curing. We do note, however, that the bank continues to support existing clients with their production loans and working capital facilities. It is important that the bank finds a sustainable liability solution in order to continue with the activities that relate to the achievement of its mandate. As it stands, the bank is not fully focused on achieving its mandate.

3.2. Going concern

The bank is still operating under a state of default which occurred during April 2020. It is unfortunate that the liability solution intended to cure the default has taken longer to conclude than initially anticipated. However, with the support of the shareholder, the bank and its advisors continue to work together with lenders to find a solution that is suitable for all stakeholders.

As part of the auditor’s responsibility, the AGSA assessed the financial viability of the bank by considering the following favourable and unfavourable factors:

a. The bank managed to service its operational costs during the year.
b. The bank managed to make payments to the lenders over the three-year period, which reduced funding liabilities from R41 billion in 2020 to R36 billion in 2021andto R29 billion in 2022.
c. Although there is no firm commitment from the lenders not to call upon their debt, the bank received a letter from the lawyers representing some of the lenders indicating their support for the finalisation of liability solution.
d. The minister/shareholder indicated support to the Land Bank by committing to inject an equity contribution.
e. The bank is in a net asset position and thus remains solvent.

Based on the above considerations, the AGSA concluded that the bank is a going concern, but a material uncertainty exists due to the liquidity challenges.

4. Key focus areas

4.1. Audit of the annual performance report

In the current financial year, the Minister of Finance exempted the Land Bank from submitting a corporate plan in terms of section 92 of the Public Finance Management Act 1 of 1999. The exemption applies until the bank has cured its default position. In this context, the bank did not have an approved annual corporate plan for the 2021-22 audit as a result of the exemption, and] the audit team could not perform the audit of predetermined objectives.

4.2. Compliance

No material non-compliance findings were identified during the audit.

Below is the irregular expenditure that was reported in the annual financial statements. Most of this irregular expenditure relates to previously reported non-compliance.

Irregular expenditure reported in annual financial statements

Auditee	Irregular expenditure (Balance)		
	Amount 2022	**Amount 2021**	**Amount 2020**
Land Bank Group	R975 million	R986 million	R766 million

Key contributors to opening balance of irregular expenditure

Incident	Amount
SLAs were extended without the prior approval of the National Treasury, as required in terms of National Treasury supply chain management (SCM) Instruction Note 3 of 2016-17. R310 million was incurred in 2010 and R200 million was incurred in 2019.	R510 million

Incident	Amount
Extension of contract was treated as a single-source deviation in line with treasure regulation 16.A6.4 and the SCM Guideline for Accounting Professionals, which allows for single-source deviations on the basis of continuation of consulting services to be approved internally by the accounting authority.	R18 million
In May 2019, Land Bank procured the services of a temporary employee from an audit firm to fill the vacancy for the head of Internal Audit. Investigations have revealed that not all procurement processes were correctly followed in the filling of this vacancy.	R1.5 million

During the year under review, the entity incurred irregular expenditure amounting to R8 million, which was disclosed in the financial statements. The expenditure is broken down below:

Description of irregular expenditure	Irregular expenditure amount R'	Category of Impact of irregular expenditure
Irregular expenditure incurred amounting to R7,6 million. This related to an expiration of the contract where management applied for approval from the National Treasury to grant an extension for three years. The National Treasury did not approve the three-year contract in full, and only approved two years to allow Land Bank Insurance to follow and finalise competitive bidding processes in acquiring this service.	7 650 000	Procurement process compromised one or more pillars of section 217 of the constitution.
Expenses were incurred on a single source in contravention of SCM Instruction Note 3 of 2016-17 due to the extension of a contract without the approval of the National Treasury, as well as the deviation from the procurement process without the approval of the National Treasury.	685 900	Procurement process compromised one or more pillars of section 217 of the constitution.

5. Drivers of internal control

The overall control deficiencies are summarised as follows:

Leadership Financial and performance Governance

Leadership	Financial and performance management	Governance
Management did not implement effective human resource management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored.	Management did not design and implement formal controls over information technology (IT) systems to ensure the reliability of the systems and the availability, accuracy and protection of information.	Management did not ensure that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action effectively.

6. IT performance

6.1. Cybersecurity reviews

Land Bank only has a senior information technology (IT) security specialist who looks after the bank's entire IT infrastructure in terms of cybersecurity. This raises an issue in terms of capacity.

In addition, the senior IT security specialist does not have tools to enable the bank to scan the network environment to identify and assess vulnerabilities. This was found to be inadequate in terms of capability.

Lack of appropriate capacity and capability to deal with cybersecurity incidents could result in delayed or no response to incidents of security breach that can negatively expose the bank's reputation.

6.2. General control review

There was no security awareness communication and training to educate the users on information and cybersecurity risks in the 2021-22 financial year.

This was because the IT security specialist who was responsible for security awareness communication and training resigned and there were delays in the recruitment and appointment of a replacement.

6.3. SAP software licences

The Information and Communication Technology (ICT) department was not regularly monitoring SAP software licences to ensure that licences are not over- or underutilised.

7. Key recommendations to the committee

- Follow up with the executive authority on progress on the liability solution and actions to be taken to ensure this solution is concluded.
- Enhance your oversight on Land Bank and follow up with the bank's board on the permanent appointment of the chief executive officer.
- Engage the executive authority and Land Bank's accounting authority on actions to be taken to ensure that the internal audit unit is capacitated with the appropriate skills and resources to provide adequate assurance to the bank.
- Engage the accounting authority on progress made to resolve external audit findings in the IT area.
- Even though the bank has been able to provide loans to its existing customers during the period of liquidity challenges, more effort needs to be made to ensure that the bank places more focus on functions that are core to its mandate.

Ends