

# Report of the Auditor-General to Parliament on the Group Financial Statements and Performance Information of the Land and Agricultural Development Bank of South Africa (Land Bank) for the Year Ended 31 March 2008

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the accompanying group financial statements of the Land Bank which comprise the consolidated and separate balance sheets as at 31 March 2008, the consolidated and separate income statement, consolidated and separate statement of changes in equity and consolidated and separate cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 22 to 37 and pages 49 to 125.

### Responsibility of the accounting authority for the financial statements

2. The accounting authority is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA) and the Land Bank Act No. 15 of 2002 (Land Bank Act). This responsibility includes:
  - designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

## Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) and section 35(2) of the Land Bank Act, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing and General Notice 616 of 2008, issued in Government Gazette No. 31057 of 15 May 2008. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
6. An audit also includes evaluating the:
  - appropriateness of accounting policies used
  - reasonableness of accounting estimates made by management
  - overall presentation of the financial statements.



7. Except as discussed in paragraphs 8 to 16, I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### Basis for qualified opinion

8. Section 51(1)(a)(i), 51(1)(b)(ii), 55(1)(a), 56 and 57 of the PFMA states that the accounting authority and delegated employees must ensure that the public entity maintains an effective, efficient and transparent system of internal control and keep full and proper accounting records. During the period subject to audit the Land Bank experienced a significant breakdown in internal controls in specific areas. The areas affected by the breakdown in internal controls are detailed in paragraphs 9 to 16 of this report.

### Land Development Loans

9. As disclosed in the Directors' report, events occurred during the previous financial period which indicates that the land for development loans had been entered into outside the mandate of the Land Bank in terms of the Land Bank Act. Due to the nature of the uncertainties and alleged irregularities found by an independent investigation, I was unable to obtain sufficient, appropriate audit evidence that would enable me to confirm or verify by alternative means the validity of the contracts entered into, the reliability of the measurement of the expected future cash flows and consequently the valuation and rights and obligations of land for development loans valued at R231,7 million (2007: R302,4 million), net of impairments of R339,1 million (2007: R56,5 million) and the additional need for a possible onerous contract liability for approved facilities not disbursed. The loans are 59% (2007: 16%) impaired at year

end and the impairment charge in the income statement for the period under review amounts to R201,4 million (2007: R56,5 million) – refer also paragraphs 14 and 33.

### New system implementation costs

10. As reported in the Directors report, there has been a breakdown in the Land Bank's internal processes and controls in respect of new information technology ("IT") system implementations. Special investigations undertaken by the Land Bank indicate various irregularities; including possible irregular, fruitless and/or wasteful expenditure, fraud, negligence and/or gross misconduct. Disclosed on the face of the income statement is an amount of R35,2 million (2007: nil) for the full impairment of an intangible asset resulting from the discontinued implementation of a new IT system banking module. Up to 31 December 2007 the Land Bank has incurred costs of approximately R145,8 million since the inception of the implementation of new IT system modules for financial, procurement and human resources functionalities. Included in accrued expenses disclosed in note 14 to the financial statements are unpaid amounts of R25,5 million for system implementation costs. The majority of the costs incurred to date have been expensed through the income statement, including the R35,2 million impairment of the banking module costs previously capitalised.

I was unable to obtain sufficient appropriate audit evidence for the computer equipment balance of R10,5 million (2007: R14,3 million) disclosed in note 11 to the financial statements and the intangible assets balance of R11,1 million (2007: R49,7 million) disclosed in note 8. I am consequently unable to confirm or verify by alternative means the rights and obligations,

valuation and completeness of the computer equipment and intangible assets balances – also refer paragraphs 16 and 32.

## Procurement and payments

11. As reported in the Directors report, there has been a breakdown in the Land Bank's internal processes and controls in respect of procurement and payments, exacerbated by an inadequate implementation of a new procurement IT system module. Based on the breakdown in internal controls and the nature of an audit where I cannot examine every operating activity or accounting procedure in the Land Bank, my work cannot be expected to identify all weaknesses in the Land Bank's systems and procedures and/or all significant error and/or fraud. I was consequently unable to obtain sufficient appropriate audit evidence for certain transactions included in operating expense categories totaling R105,9 million forming part of operating expenditure as disclosed in note 24.1 to the financial statements. As a result I was unable to confirm or verify by alternative means the occurrence, completeness and accuracy of these expenses within operating expenses, as well as the accuracy and completeness of the related taxes.

Included in accrued expenses of R121,5 million disclosed in note 14 to the financial statements, are accruals related to the abovementioned operating expense transactions for which I was unable to obtain sufficient appropriate audit evidence. I consequently was also unable to confirm or verify by alternative means the existence, completeness and valuations of these accrued expenses – refer also paragraphs 15 and 34.

## Payroll

12. As reported in the Directors report, there has been a breakdown in the Land Bank's internal processes and controls in respect of human resources, exacerbated by the failed implementation of a new human resources IT system module. I was consequently unable to obtain sufficient appropriate audit evidence of certain transactions included in personnel costs totaling R216,1 million disclosed in note 24.1 to the financial statements. As a result I was unable to confirm or verify by alternative means the occurrence, completeness and accuracy of certain personnel costs, as well as the accuracy and completeness of the related taxes.

Included in accrued expenses of R121,5 million disclosed in note 14 and employee related payables and provisions of

R23,1 million (2007: R24,5 million) disclosed in note 17 to the financial statements, are accruals and provisions related to the payroll transactions for which I was unable to obtain sufficient appropriate audit evidence. I consequently was also unable to confirm or verify by alternative means the existence, completeness and valuation of the accrued expenses and provisions - refer also paragraph 16 and 34.

## Funds administered on behalf of the Department of Agriculture (DoA)

13. Included in funds under administration disclosed in note 18 to the financial statements are balances of funds administered on behalf of the DoA totaling R752,1 million (2007: R475,9 million). Payments out of these funds of R71,5 million (2007: R37,1 million) were made by the Land Bank during the period subject to audit. As reported in the Directors report, there has been a breakdown in the Land Bank's internal processes and controls in respect of funds administered on behalf of the DoA. A special investigation has commenced subsequent to year end into allegations regarding certain payments out of these funds as well as other governance allegations. Owing to the nature of the uncertainties and the break down in processes and controls, I was unable to obtain sufficient, appropriate audit evidence that would allow me to confirm or verify by alternative means the occurrence of payments during the year and consequently the rights and obligations, existence, completeness, valuation and disclosure of the balances at year end as well as the existence and completeness of a possible contingent liability in respect of non-compliance with the memorandum of understanding that governs the fund administration responsibilities of the Bank – refer also paragraph 34.

## Material non-compliance with applicable legislation

- **Land Bank Act**  
**Lending transactions outside the mandate of the Bank**
14. The core mandate of the Land Bank as contained in the Land Bank Act is to focus on agricultural development. To support its core business, the Land Bank entered into non-agricultural land development transactions which fall outside of the core mandate of the bank as contained in the Land Bank Act. Appropriate approval was not obtained by the Bank to enter into non-agricultural activities. On 22 February 2007, a moratorium was placed on the approval of any new Land Development

Loans which was subsequently lifted and again implemented in October 2007. Impairment on these loans amounted to R257,9 million (2007: R56,5 million).

- **PFMA**

- **Procurement-irregular expenditure**

15. Linked to the new IT system implementation as disclosed in paragraphs 10 and 11, numerous instances were noted during the audit of non-adherence to the approved policies and procedures to ensure that procurement is fair, equitable, competitive, transparent and cost-effective in terms of section 51(1)(a)(iii) of the PFMA. Furthermore the accounting authority could not provide appropriate audit evidence that it took effective and appropriate steps to prevent irregular expenditure as required by Section 51(1)(b)(ii) of the PFMA and could not quantify irregular expenditure for disclosure in the financial statements. As a result I was unable to confirm or verify by alternative means the occurrence of all expenditure incurred by the Land Bank and consequently the completeness of irregular expenditure as defined by the PFMA – refer also paragraphs 11 and 34.

Pertinent findings are:

- Procuring from numerous single source suppliers, where the policy restricts this to “rare circumstances” and valid single source suppliers (section 51(1)(a)(iii) of the PFMA).
- Procurement of goods in the absence of a binding contract (section 51(1)(a)(iii) of the PFMA).
- Not following the approved tender processes in terms of the Land Bank policies and procedures to facilitate equitable and transparent transactions (section 51(1)(a)(iii) of the PFMA).
- Numerous transactions were approved outside the approved delegation of authority matrix (section 56 and 57 of the PFMA).
- Fraudulent behavior by employees of the Bank resulted in irregular procurement (section 51(1)(a)(iii), 56 and 57 of the PFMA) in certain aspects of IT system procurement.
- Settlement payment of R4,7 million to the former CEO that required Ministerial approval (section 17(2) of the Land Bank Act).

- **Fruitless and wasteful expenditure**

16. As outlined in the paragraphs 10 to 12 above, the Land Bank had a significant breakdown in the internal control environment

which has resulted in possible fruitless and wasteful expenditure. The accounting authority could not provide appropriate audit evidence that it took effective and appropriate steps to prevent fruitless and wasteful expenditure as required by Section 51(1)(b)(ii) of the PFMA and could furthermore not quantify fruitless and wasteful expenditure for disclosure in the financial statements. Consequently due to the deficiencies noted above, I could not perform alternative procedures to determine the completeness of the fruitless and wasteful expenditure incurred by the Bank – refer also paragraphs 10, 12, 32 and 34.

Pertinent findings are:

- Expenditure incurred on a new IT banking module for which implementation has been discontinued with uncertainty in respect of its future use. The IT banking model impairment of R35,2 million is disclosed in note 8 to the financial statements.
- Payment of salaries to suspended employees for an extended period as a result of drawn out disciplinary procedures.
- Payment of subsistence and travel allowances for employees in acting positions for an extended period of time.
- Penalties and interest on late payment of taxes relating to PAYE, UIF and SDL. The payments of R0,87 million were not recovered from the employees.
- Expenditure of R7,8 million for a special forensic investigation completed during September 2007 on Land for Development Loans on which investigation no further actions have been taken to date.

### Qualified opinion

17. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of Land Bank and the group as at 31 March 2008 and its financial performance and cash flows for the year then ended, in accordance with International Financial Reporting Standards and in the manner required by the PFMA.

## OTHER MATTERS

I draw attention to the following matters that relate to my responsibility in the audit of the financial statements:

### Internal controls

18. Section 51(1)(a)(i), 51(1)(b)(ii), 56 and 57 of the PFMA states that the accounting authority and delegated employees must ensure that the public entity maintains and has maintained

an effective, efficient and transparent system of financial and risk management and internal control. Without providing any assurance over the effectiveness of the internal control, the table below depicts my initial assessment of the root causes that gave rise to the inefficiencies in the system of internal control, which lead to the qualified opinion. The root causes are categorized according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Land Development Loans	X	X	X	X	X
New system implementation	X	X	X	X	X
Procurement and payment	X	X	X	X	X
Human resources	X	X	X	X	X
Funds administered on behalf of the DoA	X	X	X	X	X
Irregular and fruitless and wasteful expenditure	X	X	X	X	X

#### Control environment:

Establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

#### Risk assessment:

Involves the identification and analysis by management of relevant financial reporting risks to achieving predetermined financial reporting objectives.

#### Control activities:

Policies, procedures and practices that ensure management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

#### Information and communication:

Supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.

#### Monitoring:

Covers external oversight and internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customized procedures or standard checklists, by employees within a process.

### Internal control

#### – information and communication

#### Banking module deficiencies and shortcomings in financial reporting information

19. As previously reported, there are still deficiencies in the historical banking loan module, as well as certain inadequacies in either logical or manual mitigating controls, which remain unresolved. Historical loan module and financial reporting information shortcomings give rise to certain accounting work being performed outside the loan system in order to comply with the requirements of accounting standards, specifically IAS18: Revenue and IAS39: Financial instruments – Recognition and Measurement. The deficiencies extend to the application of significant judgments and estimates in the calculation of loan impairment numbers and the recognition of notarial bond and mortgage bond fees. Critical accounting judgments and key sources of estimation are disclosed in note 2.26 to the financial statements.

## Non compliance with applicable legislation

### • Corporate Governance

20. In terms of section 49 of the PFMA, each public entity should have an accounting authority. From 13 November 2007 to 4 March 2008 the Land Bank did not have a board of directors (accounting authority in terms of the PFMA) as required by section 4 of the Land and Agricultural Development Bank Act, 2002. In the absence of the Board, the Land Bank was unable to submit documentation approved by the accounting authority as required by the PFMA and was therefore in breach of section 51(1)(f), section 54 (1) and section 51(2). This includes failure to approve corporate plans, shareholders' compact and other required documents. The Land Bank has subsequent to the appointment of the new Board rectified the non-compliance and the approved documentation has been submitted on 5 May 2008.

### • Declaration of interests

21. In terms of section 50(3)(a) of the PFMA and section 21 of the Land Bank Act, the accounting authority and employees are required to declare their business interests. The Land Bank did not have an effective and appropriate system in place to ensure that all business interests have been duly declared. Audit procedures revealed instances where Land Bank employees have interests in companies and close corporations which have not been declared.

### • Moratorium on collection of debtors

22. The Land Bank, on instruction from the former CEO, has placed a moratorium on the collection of loans made to emerging farmers. In terms of section 51(1)(b)(i) of the PFMA, the accounting authority must take effective and appropriate steps to collect all revenue due. I have not been provided with appropriate, documentary evidence that the Board and the Minister of Land Affairs and Agriculture can and did approve this moratorium. I am therefore unable to confirm or verify by alternative means whether the Land Bank has taken effective and appropriate steps to collect all revenue due as required by the aforementioned section of the PFMA. The gross development loan book amounted to R813 million (2007: R777 million) at year end with a related impairment raised of R434 million (2007: R301 million).

### • Payment of Chief Executive Officers' Remuneration

23. In terms of Section 17(2) of the Land Bank Act, the Minister of Land Affairs and Agriculture, after consultation with the Minister of Finance and the Board, should determine the remuneration, allowances and other service benefits of the CEO of the Bank. I was unable to confirm or verify by alternative means that the Minister of Land Affairs and Agriculture or the Minister of Finance had approved the following payments:

- The termination package of R4,7 million paid to the former CEO.
- Remuneration paid by the Land Bank to a former acting CEO.

## Matters of governance

24. Section 55(1) of the PFMA requires that the financial statements be prepared in accordance with generally recognised accounting practice. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
<b>Audit committee</b>		
• The public entity had an audit committee in operation throughout the financial year.		X
• The audit committee operates in accordance with approved, written terms of reference.	X	
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 77 of the PFMA and Treasury Regulation 27.1.8.		X
<b>Internal audit</b>		
• The public entity had an internal audit function in operation throughout the financial year.	X	
• The internal audit function operates in terms of an approved internal audit plan.	X	
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in Treasury Regulation 27.2.		X
<b>Other matters of governance</b>		
• The annual financial statements were submitted for audit as per the legislated deadlines (section 55 of the PFMA).		X
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		X
• No significant difficulties were experienced during the audit concerning delays/unavailability of expected information and/or senior management.		X
• The prior year's external audit recommendations have been substantially implemented.		X
• SCOPA resolutions have been substantially implemented.		X

## OTHER REPORTING RESPONSIBILITIES

### Report on performance information

25. I was engaged to review the performance information as set out on page 33 in the annual report.

### Responsibilities of the accounting authority

26. The accounting authority has additional responsibilities as required by section 55(2)(a) of the PFMA to ensure that the annual report and audited financial statements fairly present the performance against predetermined objectives of the public entity.

### Responsibilities of the Auditor-General

27. I conducted my engagement in accordance with section 13 of the PAA read with General Notice 616 of 2008, issued in Government Gazette No. 31057 of 15 May 2008.

28. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

29. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

### Audit findings (performance information) No set targets for non-financial key performance indicators

30. The Land Bank has not set targets for non-financial key performance indicators against which performance is measured and consequently not reported this in the annual report.

### Non-compliance with regulatory requirements: Incomplete quarterly reporting of performance information

31. In the quarterly reports submitted to the Minister of Land Affairs and Agriculture, the Land Bank only reports on the performance information on certain financial indicators i.e. growth in the loan book, loan book quality, capital adequacy. No reporting is performed on the non-financial indicators. It was also noted that the Land Bank does not report on all the financial indicators as set out in the Corporate Plan in the quarterly reports.

## OTHER REPORTS

### Special investigation completed Suspension and dismissal of senior members of IT management

32. As reported in the Directors report, a special investigation was undertaken during the period under review that included, but not limited to, gathering evidence for disciplinary proceedings and subsequent dismissal of senior management in IT. The findings from the investigation indicate possible irregular, fruitless and/or wasteful expenditure, fraud, negligence and/or gross misconduct around the implementation of a new IT system – refer also 10 and 16.

### Land Development Loan irregularities

33. A special investigation was conducted by independent forensic investigators and concluded in September 2007. The Board indicated in the 2007 annual report that in terms of the conclusion and recommendations made by the forensic auditors, the Board will assess all issues that have been identified and take necessary corrective actions. No actions have been taken to date on the recommendations from the investigation – refer also paragraph 9 and 14.

### Preliminary special investigation in progress

34. As reported in the Directors report, a preliminary special investigation has commenced subsequent to year end into allegations made to the ethics line and in a governance allegations letter received by the Bank and myself. The specific areas covered by the investigation relate to the Agri BEE and other funds administered on behalf of the DoA, recruitment and promotion of staff, forced suspension, dismissal and resignations, irregular salary payments, appointment of consultants, entertainment of senior members of management and leaking of information to the media. The purpose of the preliminary investigation is to advise the Land Bank on interim actions to be taken and to advise of further detailed forensic investigations which may be necessary, if any are required – refer also paragraph 11, 12 and 13.

## APPRECIATION

35. The assistance rendered by the staff of the Land Bank during the audit is sincerely appreciated.



Auditor-General

Pretoria

28 August 2008



A U D I T O R - G E N E R A L