CONTENTS

1. Introduction 3
2. Audit opinion history 4
3. Overview of audit outcomes 4
4. Irregular, Fruitless and Wasteful expenditure 5
5. Cranbrook Group transaction 6
6. Drivers of internal control 8
1. Introduction

1.1 Reputation promise of the Auditor-General of South Africa
The Auditor-General has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, it 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 Purpose of document
The purpose of this briefing document is for the Auditor-General of South Africa (AGSA) to provide an overview of the audit outcomes of the Development Bank of Southern Africa (herein after referred to as “DBSA”) for the 2019/20 financial year.

1.3 Organisational structure

1.4 Funding
During the 2020 financial year, the DBSA has generated net interest income of R4.4 billion. Interest revenue of R8.2 billion was generated against interest costs of R3.9 billion. Additionally, the DBSA generated R458 million in fee income and investment income.

The DBSAs’ directors may in their discretion borrow or raise funding for the purposes of the operations of the entity subject to the leverage ratio not exceeding 250% of the permanent capital and accumulated reserves as per Regulation 44 of the regulations made under section 17 of the DBSA Act. An annual borrowing programme based on projections of business activity for the financial year is approved by National Treasury.

During the 2020 financial year, DBSA raised net borrowing of R5.8 billion which is within the approved programme limit of R20 billion. The overall borrowings remained within the leverage ratio limit (108%), not exceeding 250% as at 31 March 2020.

Overview of the development loan book

The gross loan book as at 31 March 2020 is R96.4 billion and the loan portfolio increased by R14.6 billion year on year. The impairment (expected credit losses) recognised on the gross loan book is R10.2 billion resulting in a net loan book of R86.2 billion.

<table>
<thead>
<tr>
<th>Category</th>
<th>31 March 2020</th>
<th>31 March 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Developmental loans</td>
<td>R96.4 billion</td>
<td>R82.0 billion</td>
</tr>
<tr>
<td>Total expected credit losses</td>
<td>R10.2 billion</td>
<td>R6.2 billion</td>
</tr>
<tr>
<td>Stage 1 expected credit loss</td>
<td>R488 million</td>
<td>R198 million</td>
</tr>
<tr>
<td>Stage 2 expected credit loss</td>
<td>R5.3 billion</td>
<td>R3.3 billion</td>
</tr>
<tr>
<td>Stage 3 (Non-performing loans) expected credit loss</td>
<td>R4.4 billion</td>
<td>R2.7 billion</td>
</tr>
<tr>
<td>Net Developmental loans</td>
<td>R86.2 billion</td>
<td>R75.8 billion</td>
</tr>
<tr>
<td>Overall expected credit loss coverage ratio</td>
<td>10.56%</td>
<td>7.55%</td>
</tr>
<tr>
<td>Stage 1 cover ratio</td>
<td>0.83%</td>
<td>0.41%</td>
</tr>
<tr>
<td>Stage 2 cover ratio</td>
<td>17.48%</td>
<td>11.11%</td>
</tr>
<tr>
<td>Stage 3 (Non-performing loans) cover ratio</td>
<td>62.04%</td>
<td>67.54%</td>
</tr>
</tbody>
</table>

The overall expected credit losses coverage ratio measures the expected credit losses as a percentage of the gross loan book. This coverage ratio increased in the current year.
compared to the prior year as can be seen in the table above which means there are more expected credit losses than the prior year. The general risk profile of the book is more concentrated and introduces volatility in the expected credit losses given IFRS 9’s expected credit loss methodology. The concentrated risk profile is expected and generally a norm for DBSA as it has large exposures to similar clients in specific sectors e.g. government loan exposures. The uncertainty of the COVID 19 pandemic together with the ailing economy resulted in a 64% increase in expected credit losses, i.e. a move of R6.2 billion to R10.2 billion.

2. Audit opinion history

The audit outcomes for the previous three years have been summarised below:

<table>
<thead>
<tr>
<th>DESCRIPTION</th>
<th>2019/20</th>
<th>2018/19</th>
<th>2017/18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit opinion</td>
<td>C</td>
<td>U</td>
<td>C</td>
</tr>
<tr>
<td>Compliance with legislation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Procurement and contract management</td>
<td></td>
<td>✔️</td>
<td></td>
</tr>
</tbody>
</table>

**AUDIT OPINION**

- **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 overall audit outcome of the DBSA for the 2019/20 financial year is financially unqualified with no material findings on compliance with legislation and predetermined objectives. The audit outcome improved compared to the prior year where material findings were noted on compliance with legislation. The details of the audit outcome and improvement is covered in the next section.

3. Overview of the audit outcomes

- The audit outcome improved in the current year, as management implemented the commitments made on the audit recommendations on material findings made in the prior year, which contributed to the entity regaining its clean audit status.
- The DBSA is an implementing agent of a number of government departments and entities, through its Infrastructure Delivery Division (IDD). They perform various infrastructure procurement activities for these government entities. The majority of the compliance findings raised for the DBSA, was with regards to these IDD procurement activities. In the prior year, in the IDD, we identified material non-compliance with the provisions of the Preferential Procurement Regulations as well as National Treasury instruction notes, with regards to the requirements of Local Content provisions.
• The Supply Chain Management (SCM) policy and procurement processes were revised in line with the recommended best practice including the Preferential Procurement Regulations, National Treasury instruction notes and guidelines.
• Furthermore, management enhanced their review controls around the annual performance report which had material changes that were identified during the audit process for one indicator. This control includes the use of internal audit to review the annual performance report which improved the consistency of reporting actual achievement of planned indicators and targets compared to the corporate plan.

4. Irregular, Fruitless and Wasteful expenditure

(a) Irregular expenditure:

<table>
<thead>
<tr>
<th>No</th>
<th>RFP No</th>
<th>Description</th>
<th>Contract Amount</th>
<th>Payments</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>RFP001/2019</td>
<td>Appointment of a preferred tenderer to provide fully equipped early childhood development centers'</td>
<td>R2 012 651</td>
<td>R2 215 889</td>
<td>R 203 238</td>
</tr>
<tr>
<td>2</td>
<td>RFP062/2015</td>
<td>Access controls</td>
<td>R1 398 697</td>
<td>R1 764 483</td>
<td>R365 786</td>
</tr>
</tbody>
</table>

DBSA’s Irregular expenditure increased by R2.3 million compared to the prior year. The irregular expenditure incurred was as a result of contravention of procurement and contract management legislative prescripts for DBSA and not the Infrastructure Delivery Division which functions as a service to other government departments and entities.

The increase in irregular expenditure is attributable to contract payments that continued post their expiry date and contract price variations that were not approved by the delegated authority. The instances of irregular expenditure highlight the internal control deficiencies around contract management within DBSA. These are the contracts affected, identified during the audit:

The remainder of R2.1 million was identified by the auditee (includes amounts identified through the audit):
Due to lack of oversight the Corporate Services Division did not implement adequate monitoring controls to ensure that payments being made to the suppliers do not exceed the original contract price.

(b) Fruitless and wasteful expenditure:

<table>
<thead>
<tr>
<th>Supplier Name</th>
<th>Description</th>
<th>Original Contract Amount</th>
<th>Irregular Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. GERMP</td>
<td>Laundry Services</td>
<td>R 443 313.00</td>
<td>R 99 821.34</td>
</tr>
<tr>
<td>2. Empact Group</td>
<td>Catering Services</td>
<td>R 4 161 647.88</td>
<td>R 629 727.88</td>
</tr>
<tr>
<td>3. Blue Apple</td>
<td>Annual Report</td>
<td>R 472 574.73</td>
<td>R 281 503.94</td>
</tr>
<tr>
<td>4. Mangwajane Logistics</td>
<td>Kitchen consumable</td>
<td>R 396 043.29</td>
<td>R 881 904.95</td>
</tr>
<tr>
<td>5. Internet Solutions</td>
<td>Hosting and Cloud protection</td>
<td>R 9 564 256.68</td>
<td>R 214 620.44</td>
</tr>
<tr>
<td>6. IDTEK</td>
<td>Security access and surveillance</td>
<td>R 1 398 697.24</td>
<td>R 365 785.97</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td><strong>R 2 473 364.52</strong></td>
<td></td>
</tr>
</tbody>
</table>

DBSA has not incurred any fruitless and wasteful expenditure in the past two years. The fruitless and wasteful expenditure incurred during the 2017/18 financial year related to interest on late payments and theft of foreign currency used on an international travel trip.

5. Cranbrook Group transaction

5.1 Background

The AGSA received a protected disclosure memorandum from a whistle blower, on the 17 July 2020. This was raising concerns relating to a request submitted to the Audit and Risk Committee (ARC) of DBSA by management to write-off the Cranbrook Group related loans that were issued between 2007 and 2009, amounting to R259 million.
We inspected the related memo submitted to the ARC and we determined the following with regards to these transactions:

- In March 2008, the DBSA Board Credit and Investment Committee approved a R124 million loan to Blue Horizon Investments 11 (Pty) Ltd (BH11) (a subsidiary of the Cranbrook Group) for the development of the Ledibeng Eco Estate in Lephalale. The project involved the installation of internal reticulation of phases 1 and 2, of a 6 phased development. The phased 1 and 2 developments consisted of 2 453 stands. The Ledibeng Eco Estate project was developed to complement an increase in housing demand in Lephalale. The region was experiencing above average economic activity and attraction generated by coal mining and the Eskom Medupi Power Station construction projects.

- Further loans were issued by DBSA to both Proline Trading 60 (Pty) Ltd (PT60) (a subsidiary of the Cranbrook Group) for the development of the Spekboom River Estate in Burgersfort for R125 million which was restructured in September 2011 and a R10 million loan to Moeparutsi Properties (Pty) Ltd (Moeparutsi). Whereas Proline and Blue Horizon are subsidiaries of Cranbrook, the Moeparutsi loan was to two Limpopo based individuals to acquired shares in Cranbrook Property Projects (Pty) Ltd as part of BEE and empowerment activities of Cranbrook. Moeparutsi was dependent upon dividend income from Cranbrook Property Projects (Pty) Ltd in order to repay its debt obligations to DBSA. Per the request submitted to ARC, BH11 is said to have repaid approximately 65% of the loan.

The allegations on the above mentioned loans, was around the write-off report included for these loans, that the submission itself was not properly supported by due process before it could be tabled at the ARC meeting, and also the complainant felt that all steps to recover the outstanding loan amount were not appropriately actioned by management according to the DBSA’s policies and processes. The whistle blower highlighted concerns on the write-off request which included the following:

- The debt had never been actively recovered for a period of over 10 years after it was classified as a non-performing loan,
- The write-off report was presented undated and it was not accompanied by the usual Investment Committee (IC) report and minutes as evidence that the report served in that committee and was duly approved and recommended to the ARC,
- None of the 10 designated executive signatures had been appended on the report; meaning that no executive was prepared to own it under such circumstances,
- The loans have been restructured in the past,
- The group of companies are under liquidation and DBSA does not appear to be preference creditors,
- Evidence of various breaches of the DBSA’s internal processes, procedures and Delegation of Authority; and
- Contravention with various provisions of the PFMA in particular section 51 (1) (a) (i).

As an audit office we are mandated to respond to any allegations brought to our office through the available channels by the public or anyone related to our auditees. We
assessed these allegations concerned and their impact on our audit and we resolved to consider the allegations through our normal audit process which did not constitute an investigation.

5.2 Audit findings

We then have, as part of our normal audit process of development loans, assessed the origination, the monitoring, the write-off process and financial reporting of the Cranbrook Group loan transactions. We further assessed management’s conduct relating to this transaction to confirm they had fulfilled their fiduciary duties in line with the provisions of the PFMA. Below are the specific areas where we provide further detail on the outcome of our testing.

Origination

Due to the unavailability of documented credit policies applicable at that time (2007), we were unable to audit the origination process that was followed for the Cranbrook Group loans, whether it was approved within the requirements of the then applicable credit policy. Our audit of the origination was then limited in this regard and we then raised a limitation of scope finding to management to this effect with a recommendation that the origination of the loans be investigated. (see the internal control deficiencies findings issued to management listed below under “Monitoring”. The audit team was not able to confirm the loan origination process followed for approval of the Cranbrook group loans as the earliest credit policy provided to the audit team was dated October 2008, whilst the loans relating to the Cranbrook group were all approved prior to that period, from 2007 up to and including August 2008.

Monitoring

We were not provided with a complete set of supporting evidence of how these loans were monitored prior to them being transferred to the Business Support Recovery Unit (BSRU) in 2012 nor after this period. We noted some evidence of monitoring over the years, however we could not validate the consistency thereof, and whether the under performance of the loans were escalated to the relevant governance committees. This relates to either issuing letters of demand or updating surety and borrower information. Our audit scope was limited in this regard. We thus raised internal control deficiencies with the monitoring process of these loans. The internal control deficiencies were identified as follows and relate to both limitations under origination and monitoring:

- Management did not implement proper record keeping to ensure that complete, relevant and accurate information is accessible and available to support financial reporting.
- Management did not ensure that the credit policy applicable at the time of the approval of Cranbrook related loans was available for audit.
- Management also did not ensure that proof of monitoring Cranbrook related loans prior and post to being transferred to the BSRU was available for audit.

These internal control deficiencies identified were followed through to the current monitoring processes and the policies and procedures in BSRU.
We were also unable to confirm the repayments made for these loans due to the unavailability of supporting bank statements. We could only confirm receipt of R4.4 million in total received from all the respective entities as follows:

<table>
<thead>
<tr>
<th>Total repayments received on all Cranbrook related loans subsequent</th>
<th>R 4 460 584.99</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proline Trading 60 (PTY) Ltd - 07/06/2019</td>
<td>R 1 867 956.53</td>
</tr>
<tr>
<td>Blue Horizon Investments 11 Pty (Ltd) - 08/02/2017</td>
<td>R 231 035.90</td>
</tr>
<tr>
<td>Moeparutsi Properties (Pty)Ltd - 18/10/2011</td>
<td>R 2 079 853.43</td>
</tr>
<tr>
<td>Proline Trading 60 (PTY) Ltd - 01/07/2020</td>
<td>R 281 739.13</td>
</tr>
</tbody>
</table>

We were able to observe some monitoring activities of these loans, for instance, the loans for Moeparutsi and Proline were restructured however we were unable to test the governance process that was followed to approve these restructures as the documents submitted to governance committees and their approvals for restructuring were not provided. The latter mentioned would have been required to validate the signed new loan agreements we were provided. We further attempted to test this restructure against the credit policy at the time, however, the credit policy of 2008 is silent on how restructures were to be performed. Therefore, we could not test whether this restructuring was performed in accordance with DBSA policies and procedures.

**Write-off**

We confirmed through our audit process that the write off request in a form of a client status report was approved and recommended for ARC approval in line with the DBSA’s delegation of authority by the Investment Committee. The client status report issued by the BSRU recommended the write-off of the exposure to the Moeparutsi Property Project loan (R10.6 million) and in-duplum interest in arrears on the Proline (R61.5 million) and Blue Horizon (R11.7 million) loans. Therefore, the total write-off requested amounted to R83.3 million in total. The DBSA write-off policy states that the “Facilities may only be written-off when they are considered uncollectable and worthless, that is, action for recovery has been exhausted or it is no longer worthwhile in the foreseeable future.”

We found through inspection of the write-off memo submitted to the ARC the following considerations by management through the BSRU unit; that supports the write off.

- **Moeparutsi Properties (Pty) Ltd**

  The write-off of the total obligation outstanding is substantiated by the fact that no repayments were made towards the loan subsequent to 2012. As per the BSRU report, there was no contact between DBSA and the directors / shareholders of Moeparutsi subsequent to disbursement. The original loan documents were poorly drafted with no registration numbers or ID numbers for individual sureties and a legal name which do not appear to exist on the CIPC. The DBSA also holds no financial or contact information on either the borrower, nor any of the sureties. In addition,
the loan was provided in 2007 and has therefore prescribed with DBSA not having the ability to prove otherwise given the lack of interaction between DBSA and the directors of the entity.

- **Blue Horison Investments 11 (Pty) Ltd and Proline Trading 60 (Pty) Ltd**

  The write-off of in-duplum interest is appropriate due to the prescripts by law that arrear interest may not exceed the unpaid principal amount of debt. In the light of the above, it is therefore also reasonable for future interest charges to be suspended given that in-duplum was reached and that the counterparty is in the process of liquidation.

  The principal amount of the debt has not been recommended for write-off by ARC as payment from the selling of collateral held on the loan may still result in receipts on the loan.

  As part of our audit we confirmed that the process that the DBSA BSRU unit followed was in line with the current write-off policy of the DBSA. We also noted that the ARC recommended write-offs for approval by the board and approval had not been granted at the time of conclusion of the audit in September 2020.

  Based on the BSRU status report for the current financial year, the DBSA is still trying to recover the loans to BH11 and PT60 through the collateral they hold over the loans, and are in constant discussions with the liquidators of BH11 and the attorneys & directors of PT60. They are continuing sending letters of demand, hence they are not requesting write-off of the full loan balance, but rather the in-duplum interest they are not entitled to by law. This is evidenced only in the recent years (2014-2020), as there was no evidence provided for the monitoring of these loans prior to those years, and hence our limited scope findings raised above.

**Compliance**

Due to lack of evidence, we could not identify any non-compliance with the provisions of the PFMA sections 51 and 83 as alleged, by the concerned complainant, relating to this transaction. Our process of assessing compliance included assessing whether the decisions made by management and those charged with governance was reasonable, was in accordance with the relevant policies and procedures applicable at that time, and whether those charged with governance exercised their fiduciary duties. Our basis of the assessment of compliance, was limited to the documentation provided to us by management. Therefore, we could not conclude whether there was any non-compliance with laws and regulations as a result of the internal control deficiencies we identified in the origination and monitoring process of the Cranbrook transaction for the periods between 2007 – to date as our audit scope was limited. The internal control deficiencies are, as follows:

- Management did not implement proper record keeping to ensure that complete, relevant and accurate information is accessible and available to support financial reporting.
Management did not ensure that the credit policy applicable at the time of the approval of Cranbrook related loans was available for audit.

Management also did not ensure that proof of monitoring Cranbrook related loans prior and post to being transferred to the BSRU was available for audit.

As indicated above under monitoring of the loans, although there was evidence of monitoring in some years during the life cycle of these loans, we could not conclusively validate that these were consistently performed due to the limitation in the documentation we were provided by management.

The possible instances of non-compliance may have occurred during that period where these loans were originated and monitored before the year 2014, but this could not be confirmed as we were not provided the supporting information to validate this. And the resultant limitations of scope findings were thus raised to management.

**Financial reporting**

We have confirmed through our audit process that the Cranbrook Group loans have defaulted and have been correctly classified as non-performing loans during the 2019/20 financial year. The loans were fully provided for in the current year, as non-performing loans, which assumes a 100% probability of default, and losses limited to the collateral held.

The loans are currently held as follows for the 2019/20 financial year per the loan status report of BSRU:

<table>
<thead>
<tr>
<th>Counterparty</th>
<th>Initial loan approved R'000</th>
<th>Initial loan disbursement R'000</th>
<th>Gross loan book (including interest) R'000</th>
<th>Expected credit losses R'000</th>
<th>Carrying amount R'000</th>
<th>Requested write-off R'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blue Horison 11</td>
<td>124 000</td>
<td>124 000</td>
<td>117 690</td>
<td>110 315</td>
<td>7 375</td>
<td>11 668</td>
</tr>
<tr>
<td>Proline Trading 60</td>
<td>125 000</td>
<td>125 000</td>
<td>311 472</td>
<td>304 514</td>
<td>6 958</td>
<td>61 471</td>
</tr>
<tr>
<td>loan 1 and 2 (restructured)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Moeparutsi</td>
<td>10 000</td>
<td>10 000</td>
<td>10 614</td>
<td>10 614</td>
<td>0</td>
<td>10 614</td>
</tr>
<tr>
<td>Total exposure</td>
<td><strong>259 000</strong></td>
<td><strong>259 000</strong></td>
<td><strong>439 776</strong></td>
<td><strong>315 553</strong></td>
<td><strong>14 333</strong></td>
<td><strong>83 753</strong></td>
</tr>
</tbody>
</table>

DBSA has collateral:
- market value of R11.9 million on Portion 2 of the farm Paarl 522, Registration Division LQ, Limpopo Province Measuring 653,7615 hectares Deed of Transfer T101773/2007 for the BH11 loan,
- market value of R12.9 million on Portion 10 of Farm Mooifontein 313, Registration Division KT, Limpopo Province Measuring 509,4172 hectares Deed of Transfer T40717/2007 on the PT60 loan, and
• no collateral on the Moeraputsi loan.

The write-off articulated above was not approved by ARC and the board of directors, at the time of conclusion of the audit in September 2020. As a result, a write-off on the Cranbrook transactions was not reported in the annual financial statements of the DBSA for the 2019/20 financial year.

**Conclusion/Recommendation**

We communicated to management the limitation of our audit scope relating to this transaction. We further recommended to management and the ARC to verify the processes followed for origination and monitoring for all the Cranbrook Group loans through the ongoing forensic investigation being performed by the internal audit unit. DBSA is currently performing a forensic investigation on the life cycle of these Cranbrook transactions and the investigation was still in progress at the conclusion of our audit in September 2020.

We will conduct a follow up on these matters in the following audit cycle, and once the investigation is concluded, we shall review the outcomes and its impact on the audit of DBSA.

6. **Drivers of internal controls**

<table>
<thead>
<tr>
<th>Entity</th>
<th>Leadership</th>
<th>Financial and performance management</th>
<th>Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Oversight responsibility</td>
<td>Effective leadership culture</td>
<td>HR Management</td>
</tr>
<tr>
<td>DBSA</td>
<td>[Diagram showing drivers for DBSA]</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Legend Drivers**

- Good
- Causing concern
- Intervention required

We evaluated the drivers of internal controls for the DBSA as a whole, and did not identify any significant internal control deficiencies. The DBSA has established governance structures which exercise oversight controls. There are various executive management and board oversight committees’ setup at the DBSA, with terms of reference, approved policies and procedures that govern how transactions and operations ought to be performed. These committees include, among others, the audit committee, asset liability committee and the board credit and investment committee.

Although, there were no significant internal control deficiencies that were escalated to the audit report; there are controls deficiencies over compliance that we raised with management to
implement the audit recommendations. These controls are to ensure they do not result in significant internal control deficiencies in future.

The DBSA is an implementing agent of a number of government departments and entities, through its Infrastructure Delivery Division (IDD). They perform various infrastructure procurement activities for these government entities. The majority of the compliance findings raised for the DBSA, was with regards to these IDD procurement activities.

Financial and performance management

Compliance monitoring – Procurement and contract management

Management did not implement adequate internal controls to ensure compliance with the preferential procurement requirements and CIDB requirements relating to procurement and contract management.

Contract extensions as a result of poor planning and control deficiencies on monitoring of contracts, which also resulted in the R2.7 million irregular expenditures above. We noted that; there is no centralised contract management system whereby the contract spend is monitored by the Finance Department while the actual project monitoring is performed by business.

An isolated case of a bid that did not follow the competitive bidding process was identified relating to a contract awarded in the previous years for recruitment services of the IDD unit. We evaluated the non-compliance and found it not to be material.

Proper record keeping – Annual performance reporting

Management did not perform adequate reviews to ensure the annual performance report is supported by evidence that agrees to the reported achievements and evidence that is within the reporting period.

The end