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**FINANCIAL OVERSIGHT OF DEVELOPMENT FINANCE
INSTITUTIONS: THE CASE OF THE LAND AND AGRICULTURAL
DEVELOPMENT BANK OF SOUTH AFRICA (LAND BANK)**

By

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Submitted in partial fulfilment of the requirement for the degree

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TSHWANE UNIVERSITY OF TECHNOLOGY

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July 2014

DECLARATION

I declare that:

This dissertation, Financial Oversight of Development Finance Institutions: The Case of Land and Agricultural Development Bank of South Africa, submitted in partial fulfilment of the Magister Technologiae: Cost and Management Accounting, at Tshwane University of Technology, is my own work; that all the sources used or quoted have been identified and acknowledged by means of complete references, and that this dissertation in its entirety has not previously been submitted by me for the purpose of obtaining any qualification.

Author: Malapateng George Teka

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DEDICATION

To Almighty God: to Him the Glory and Honour!

In memory of my late parents, Phineas Thabanetshwana and Francinah Ramatsimele Teka. My special thanks go to my parents who, under difficult and strenuous conditions managed, to put me through school and my initial tertiary studies. They also taught me throughout their life that the best way to triumph over difficulties is by going to school and by showing your faith through your deeds. Unfortunately they passed away during my studies. I know they would have loved to be at my graduation. This achievement is dedicated to you.

ACKNOWLEDGEMENTS

I would like to extend my sincere gratitude to the following people:

- I am grateful to both Prof. Dr. rer. pol. habil. Heinz Eckart Klingelhöfer and Dr Lourens J Erasmus, my supervisor and co-supervisor respectively, for their utmost honesty, patience, frankness and particularly their valuable guidance regarding this study. Their supervision of the study has been extremely thorough, leaving no room for any theoretical lacuna. Your insightful contribution to my overall purpose is much appreciated.
- I also owe a considerable debt of gratitude to my colleagues in the National Treasury for their support, advice and encouragement regarding this study.
- The research respondents, without whom this study would not have been possible.
- All my friends and family members, for their unwavering support, motivation and positive thoughts.
- My family, Atlegang, Tebogo, Moemedi, Thabiso, Tshogofatso , Tshephang and daughter Kgomotso who just makes life fun.

ABSTRACT

The Land Bank has been impacted by a steady flow of reported corruption, scandals and allegations of financial mismanagement. The government oversight responsibility has also been shifted to the National Treasury, from the Department of Agriculture, Forestry and Fisheries. Subsequently, the government saw fit to commission four forensic audits, and the resulting reports have been submitted to the Serious Economic Offences Unit of the South African Police Service, the Hawks, for further attention. This research seeks to determine, through a critical analysis of the Land Bank's financial management strategy and National Treasury oversight model, to identify more efficient and effective oversight tools. A qualitative research methodology was utilised, involving a detailed literature review, an analysis of Land Bank's financial data, and the gathering of data through interviews. The qualitative phase of the research entailed in-depth interviews with subject matter experts within the Land Bank and the National Treasury. The data obtained through these research instruments was analysed to identify factors that prevented proper oversight, to determine whether appropriate systems are in place to support the corporate planning process; and to identify a mechanism, system and/or plan which will assist the National Treasury in performing its oversight role efficiently and effectively. The results of the analysis of the data and the conclusions drawn from the literature review, revealed that the successful adoption of scientific financial oversight tools such as CAMELS and SDI are likely to assist the National Treasury in the performance of its financial oversight role.

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ACRONYMS

AFR	Annual Funding Requirement
AGRIBEE	Agricultural Black Economic Empowerment
ALM	Asset and Liability Management
BAAC	Bank for Agriculture and Agricultural Cooperatives
CAMELS	Capital, Asset Quality, Management, Earnings Liquidity and Sensitivity
CAR	Capital Adequacy Requirement
CEO	Chief Executive Officer
DAFF	Department of Agriculture, Forestry and Fisheries
DBSA	Development Bank of Southern Africa
DFIA	Development Financial Institute Act
DFI	Development Financial Institutions
FDIC	Federal Deposit Insurance Corporation
FSMP	Financial Sector Master Plan
IDC	Industrial Development Corporation
IFIS	International Finance Institutions
KPIs	Key Performance Indicators

LBDF	Land Bank Development Fund
LP	Loan Portfolio
MAFISA	Macro Finance Institution of South Africa
OECD	Organization for Economic Co-operation and Development
OLP	Outstanding Loan Portfolio
PFMA	Public Finance Management Act
QCA	Qualitative Content Analysis
RFIS	Rural Finance Institutions
ROE	Return on Equity
ROI	Return on Investment
SARS	South African Revenue Services
SCI	Statement of Corporate Intent
SCOPA	Standing Committee on Public Accounts
SDI	Subsidy Dependence Index
SME	Small and Medium Enterprise
SMART	Specific, Measurable, Attainable, Realistic and Time Bound
SWOT	Strengths, Weaknesses, Opportunities and Threats
TBTF	Too Big To Fail

CHAPTER 1

BACKGROUND AND MOTIVATION

1.1 INTRODUCTION

The Land and Agricultural Development Bank of South Africa (Land Bank) is a development finance institution (DFI) whose mandate is to support, promote and facilitate the development and transformation of the agricultural sector through fulfilling the objectives stated in the Land Bank Act (Act no.15 of 2002). The Land Bank was initially established in 1912 to promote rural and agricultural development. The Land Bank is wholly owned by the South African Government and is a key financial player in the agriculture sector of the economy.

When the representative of the Land Bank appeared before the Standing Committee on Public Accounts (SCOPA) in 2008, its management came under heavy criticism from the committee, as the Land Bank's financial affairs were in a bad state (Godi, 2008:16). The chairperson of the SCOPA, observed that the bank already had a very bad reputation, and that it had been in the news for all the wrong reasons. It has since appeared before SCOPA a further three times, because the Auditor-General's reports on its finances have been "unfavourable". The Land Bank's ability to account for the money that they had, and their ability to adhere to fundamental financial management laws appeared to have been compromised. However, part of the broader problem has been a shortage of people with the skills required to run it, and this has brought the bank to the brink of insolvency.

According to Godi (2008:16), appropriate and up to date policies, procedures and control mechanisms have not been developed and implemented to ensure adherence to established directives. On risk assessment he remarked (ibid.): “Management has not always undertaken a thorough identification of risks, from both internal and external sources, that may affect the ability of the entity to meet its objectives. And mechanisms are not always in place to identify changes that may affect the entity’s ability to achieve its missions, goals and objectives.”

Management of the Land Bank was then taken over by the National Treasury on 13 July 2008. Leading up to National Treasury’s take-over, the Land Bank had been rocked by a steady flow of corruption scandals and allegations of appalling financial mismanagement.

According to a media statement on the forensic audit report into the financial management of the Land Bank (2007), the South African Cabinet made a recommendation that the forensic audit report be referred to the National Directorate of Public Prosecutions for further investigation. Other similarly drastic recommendations were also made by Cabinet after consideration of the report including one that criminal proceedings be instituted against all those employees who had been identified as having personal interests in loans issued, and those who had acted inappropriately and/or negligently.

Other Cabinet recommendations at that time included:

- that the Department of Agriculture, Forestry and Fisheries (DAFF) and the National Treasury co-operate closely in the process of turning the Land Bank around;
- that methods for recovering "undue" benefits derived by third parties, as a result of the actions of the Land Bank's management, be investigated;
- that internal disciplinary measures be taken against members of staff and management who had failed to act within the parameters of their duties;
- that all the loans that had been written-off be reviewed; and
- that there be a major review of the Land Bank's executive and non-executive management (including the composition of its board), and recommendations made as to the board's restructuring.

1.2 RESEARCH PROBLEM

The Land Bank has been receiving negative media coverage over the past decade, as a result of allegations of financial mismanagement. This has resulted in the removal of 5 board members (including two board chairpersons), and the replacement of three chief executive officers (CEOs) over a short period. A series of management challenges have contributed to the situation at the Land Bank. Towards the end of 2007/08 the acting CEO, who had been seconded from the Department of Agriculture to the Land Bank, was recalled to the department. At that point, the General Manager: Operations was appointed acting CEO of the Land Bank. Following the end of the reporting period, the acting CEO resigned (Land Bank annual report 2007/8:34). During this period the government's oversight

responsibility was also shifted to the National Treasury from Department of Agriculture, Forestry and Fisheries, at which point the government commissioned four forensic audits. These audit reports have since been completed and submitted to the Serious Economic Offences Unit of the South African Police Service, the Hawks. The Financial Intelligence Centre and the Compliance Unit at the South African Revenue Service (SARS) have also been invited to participate in these investigations.

The Land Bank's challenges have far-reaching ramifications as they pose a risk to the entire country's food security. This research commences with a review of currently successful financial oversight models of similar institutions internationally, and compares them with that used by National Treasury, in order to make recommendations for possible improvements to the current financial oversight regime.

1.3 SIGNIFICANCE TO THE ACADEMIC KNOWLEDGE BASE

This research is intended to contribute to the identification of warning signs of an institution's non-adherence to good financial management practices, and to identify possible ways for improving the adherence to best practices in banking, in order to ensure accountability by those entrusted with the responsibility of using government resources wisely and appropriately.

1.4 OBJECTIVES OF THE RESEARCH

1.4.1 Primary objective

This research aims to investigate successful financial oversight tools/models of similar institutions to the Land Bank, internationally, for comparison to the system applied by the National Treasury. Arising from this a more efficient and effective oversight tool/model is proposed.

1.4.2 Secondary objectives

To achieve the primary objective the secondary objectives are:

- To perform a review of literature on the oversight tools/models employed at international institutions similar to the Land Bank;
- To gain the perceptions of selected National Treasury and Land Bank officials with regard to the oversight role and model applied by the National Treasury;
and
- To perform an analysis of the Land Bank's financial information using the identified international oversight tools.

1.5 RESEARCH METHODOLOGY

1.5.1 Primary sources

The researcher was granted approval by the Director: Investment Analysis at National Treasury to access Land Bank information that is at the disposal of the National Treasury, but which is not yet available to the public. Semi-structured interviews were convened with the senior management at the Land Bank, as well as with senior officials within the Asset and Liability department of the National Treasury. A qualitative content analysis was applied to the transcriptions of these interviews and the findings presented through narrative descriptive interpretation.

1.5.2 Secondary sources

Current South African legislation and regulations, as well as documents and guidelines issued by the South African National Treasury, that are relevant to this field of study, were reviewed in order to understand and take note of the legislative environment in which the Land Bank operates. International and local academic literature in this field of study was reviewed. Sources include academic textbooks, articles, papers and dissertations obtained through library searches and the World Wide Web, to gain an understanding of international best practice and the research already concluded in the field.

To assess the Land Bank's performance over the period 2006 to 2010, the annual reports, and particularly the data on actual performance against the corporate plan,

were reviewed. In addition, the Auditor General's reports, the Audit Committee's reports and the annual financial statements were scrutinized to assess the Land Bank's performance. The data obtained was processed and analysed to understand the modus operandi of the current financial management at the bank, as well as to identify gaps that might exist in its performance management. International DFIs were then studied and compared. This phase commenced with Thailand's Bank for Agriculture and Agricultural Cooperatives (BAAC) (one of the biggest names and among the most successful rural finance institutions (RFIs)). BAAC was established in Thailand under the Bank for Agriculture and Agricultural Cooperatives Act in 1966 as a government-owned bank with a mandate to stimulate agriculture by extending financial services to that sector. The second major international DFI studied was the Land Bank of the Philippines, which, in addition to being the largest government-owned bank in that country, is also the fourth largest bank in terms of assets in the Philippines. It is also one of the biggest government-owned or controlled corporations in the Philippines. The Philippine's Land Bank has an extensive rural branch network. It serves many rural sector clients in areas where banking is either limited or is non-existent. This bank's performance has been remarkable and it has continued to serve a large and diverse rural clientele successfully for 45 years.

1.6 ETHICS STATEMENT

Research participants were made fully aware that they participated voluntarily, and were informed about the rules and procedures involved in gathering responses and data for the study. Additionally, participants' human rights were recognised and respected at all stages of the research. These rights include privacy, non-disclosure

of personal information, dignity, freedom of association, and freedom of choice. Participants' rights to privacy, anonymity, confidentiality and fair treatment were protected. Primary materials and confidential research data are being kept in secure storage. Audio recorded interviews were transcribed and the recordings will be destroyed after the postgraduate degree process has been concluded. Particular care must be exercised when confidential data are made available for discussion. Bless and Higson-Smith (1995:102), state that researchers must respect participants' right to refuse to participate in some or all aspects of the study. However, researchers must still possess skills to persuade the participants to participate in the study voluntarily in order to protect the relevance of the research.

Participants were required to provide their written consent to participate before they were interviewed. Burns and Grove (1993:776) define informed consent as the prospective subject's agreement to participate voluntarily in a study, which is only given after assimilation of essential information about the study. The subjects were informed of their right to participate voluntarily or to decline to participate and to withdraw from the process at any time, without penalty. The Faculty of Economics and Finance Research Ethics committee of the Tshwane University of Technology also granted the researcher permission in principle to conduct the study.

The researcher observed scientific honesty by striving for objectivity at all times, and by avoiding plagiarising other people's works and results. Lastly, information was provided about the researcher, and how to contact him in the event of there being further questions or complaints.

1.7 DISSEMINATION OF RESEARCH

The results of the research will be made available to the identified stakeholders. The researcher will present a copy of this dissertation to each of the offices of the various government departments, agencies and institutions that participated in the research. Finally, the researcher plans to publish an extract from or condensed version of this research in an accredited academic journal, and to deliver papers at academic conventions on this topic.

1.8 BREAKDOWN OF CHAPTERS

CHAPTER 1: BACKGROUND AND MOTIVATION

This chapter locates and introduces the study and provides the understanding of the Land Bank mandate. It gives the overview of the problem statement and provides the motivation for the study thereof. It focuses on the primary objective which is to investigate successful financial oversight tools/models of similar institutions to the Land Bank, internationally, for comparison to the system of oversight applied by the National Treasury.

CHAPTER 2: FINANCIAL OVERSIGHT OF DFI's: LITERATURE REVIEW

This chapter presents a comparative analysis of how the financial oversight is conducted by Organisation of Economic Co-operation and Development (OECD) countries. It focuses on the role and the mandate of the DFIs. The Capital

adequacy, Asset quality, Management, Earnings, Liquidity and Sensitivity (CAMELS) rating system which is used for supervision purposes as an internal tool to measure risk and allocate resources was reviewed. A SDI as the financial oversight tools being employed by the OECD countries was also reviewed. It reveals the costs and benefits of the DFIs. The chapter investigate the way in which the best practice oversight principles applied in other countries could be implemented by the National Treasury for the betterment of the oversight model.

CHAPTER 3: FINANCIAL OVERSIGHT OF LAND BANK: A LITERATURE REVIEW

In this chapter a review of how financial oversight is being conducted for DFIs in South Africa is presented. It reveals the role playing by the different organs of the state regarding the financial oversight of the Land Bank. It also explores the reasons for and different aims of financial oversight functions for DFIs and their managements in South Africa.

CHAPTER 4: RESEARCH METHOD AND DESIGN

This chapter explores the methodology used to collect data. It concentrates on the aims and purpose of interviews for this research study, how participants were selected for interviews, how letter of informed consents were distributed to the participants. It also addresses the ethical considerations that were observed by the author. The qualitative content analysis as the main data analysis research methodology was explored.

CHAPTER 5: ANALYSIS AND INTERPRETATION OF RESEARCH RESULTS

This chapter presents the results of the analysis and interpretation of the data which was analysed from the interviews and literature review. The data was collected and processed in support of the objectives presented in Chapter 1 of this dissertation.

CHAPTER 6: RECOMMENDATIONS AND CONCLUSIONS

This chapter concludes the study by providing the findings of the study, together with the conclusions drawn from the study, and the resultant recommendations. In addition, this chapter describes the obstacles encountered in conducting this study, and mentions possible avenues for future research. The chapter closes with a summary and an assessment of the value of this research study.

1.9 CHAPTER SUMMARY

The Land Bank is a development finance institution (DFI) whose mandate is to support, promote and facilitate the development and transformation of the agricultural sector through fulfilling the objectives stated in the Land Bank Act (Act no.15 of 2002). Management of the beleaguered Land Bank was then taken over by the National Treasury on 13 July 2008 from the DAFF. Leading up to National Treasury's take-over, the Land Bank had been rocked by a steady flow of corruption scandals and allegations of appalling financial mismanagement. According to Godi (2008:16), when the representative of the Land Bank appeared before the Standing Committee on Public Accounts (SCOPA) in 2008, its management came under

heavy criticism from the committee, as the Land Bank's financial affairs were in a bad state. Chapter 3 presents a comparative analysis of how the financial oversight is conducted by OECD countries and Malaysia.

CHAPTER 2

FINANCIAL OVERSIGHT OF DFIs: A LITERATURE REVIEW

2.7 INTRODUCTION AND BACKGROUND TO DFIs

Chapter 1 explained the research problem and the objectives of the research. This chapter presents a comparative review of how financial oversight is being conducted internationally. It reveals the effect of financial oversight on the management and administration of DFIs. It also explores the reasons for and different aims of financial oversight functions for DFIs and their managements in different countries. A comparative review of systems in place internationally also forms part of this chapter. The comparative review focuses specifically on China, Malaysia, Sweden, France, UK and Japan, all countries that have much experience of financial oversight in the management of their DFIs. The researcher also reviewed literature sources and previous studies addressing this research topic.

According to Kritzinger (2002), the term "development finance" is usually applied to investments in revenue-generating enterprises, projects or ventures in both the public and private domains. The type of projects being financed fall into one or more of the following categories: commercially profitable; financed by full-cost recovery autonomous to the enterprise; or financed by partial cost recovery, with an explicit

subsidy being provided by government. Application is generally confined to the initial capital outlay (and/or first cycle of working capital).

Schreiner and Yaron (2001) describes the DFI as a financial intermediary that aims to improve social welfare, and that it receives some resources from governments or donors. A DFI may be owned by the state and thus receive public resources as equity, but it may also have private owners (or no owners at all) and receive public resources as gifts or loans. Public funds allocated to a DFI are subsidized, as the unfettered market would charge rates at market related prices, thus potentially negating the benefits to the DFI and/or its clients. If no subsidization is provided, then logically the DFI should refuse public funds and go straight to the market on its own. By the same logic, a DFI subsidizes its clients. If services from a public DFI were costlier than identical services from the market, then clients would avoid the DFI.

Levere (2006) provides a broader perspective which maintains that the term DFI is generic and refers to a range of alternative financial institutions, including microfinance institutions, formal DFIs, and revolving loan funds. These institutions fulfil a crucial role in providing credit in the form of higher risk loans, equity positions and risk guarantee instruments to private sector investments in developing countries. DFIs are almost all backed by states with developed economies. This perspective is particularly relevant to this research in that it links to the objective of the research the requirement that management information systems and effective financial reporting frameworks exist, in order to manage risks.

Manyathi (2011), who conducted a case study on DFIs in South Africa, recorded that the DFIs were established to accelerate sustainable socio-economic development through provision of affordable funding. The purpose of DFIs is to ensure investment in areas where the market fails to invest sufficiently. He further stated that DFIs have an essential role to play in realising government's key priority areas. As South Africa's government has embarked on a new economic growth path in an effort to improve the lives of all its citizens, it is institutions such as the DFIs that will increasingly have to contribute the money and easier credit that will bring this about.

Apart from national DFIs there are also DFIs such as the International Finance Corporation (IMF) that functions between specific groups of countries, and even globally, regardless of national designations. These are referred to as bilateral DFIs and multilateral DFIs. Bilateral DFIs are majority-owned by national governments and have historically served to implement and sustain governments' foreign development and co-operation policies. Multilateral DFIs, also known as international finance institutions (IFIs), usually have greater financing capacity and provide a forum for close co-operation between governments. Both types of institution retain operational independence from their funding governments. Backed by government funds and guarantees ensuring their credit-worthiness, DFIs can raise large amounts of funds on international capital markets with which to provide loans for local development. The relevance to this research of this set of overlapping relationships is supported by the fact that the World Bank has indicated that because the DFIs receive backing from their governments it is therefore necessary to identify a mechanism, system or plan which will assist the government to curb the strain to

the fiscus inevitably caused by unbudgeted financial undertakings and expenditure (Dickinson, 2008:25).

Musasike (2004:2) further highlights that in most developing nations there was no dividing line between public finance and development finance, with governments often using DFIs as conduits for fiscal transfers; and in reverse they used them as sources of funding for budgetary deficits. The result was that over time many DFIs became a drag on the fiscus of their governments, and were finally left to disappear. The demise of many DFIs at national and even sub-regional level was precipitated by structural reforms within governments' fiscal management policies, effected during the 1980s and 1990s (as dictated by the Bretton Woods institutions, essentially the IMF and the World Bank). The privatisation trends, which began in the mid-1980s in developed nations, and mismanagement and corrupt practices there and elsewhere, concluded the process. As the role of the state was reduced, so did the influence of DFIs, with the exception of those deemed to be of strategic importance to the well-being of the state. The following section will discuss the mandate of DFIs.

2.2 MANDATE OF DFIs

Rudolph (2010:4) stated in his 12th policy briefs on the state financial institution crisis that because DFIs are typically required to address market failures by providing financial support to sectors inadequately served by private institutions, they must have a clear public policy mandate. The mandate should include at least three elements. Firstly, to avoid the involvement of state financial institutions in the purely

commercial (and most profitable) parts of the market, the mandate should define target sectors where the market has failed to address their needs, such as a lack of finance for infrastructure, or for small and medium-size enterprises.

Rudolph (2010:5) went further to emphasise that the mandate should establish a role for DFIs that complements that of commercial banks, and should formalise rules of cooperation with them. This is particularly important when DFIs receive funding through government lines of credit at subsidized rates, which may then be used to under-price products that directly compete with commercial banks.

Finally, the mandate should require financial sustainability by specifying a minimum rate of return on capital. But while the mandate should request a positive rate of return, the board of directors or the shareholders should specify the exact figure. In general, it is difficult to justify a target rate that is much higher than the cost of funding for the government (Rudolph, 2010:5).

2.3 ROLES AND FUNCTIONS OF DFIs

As purpose-specific institutions, DFIs provide a range of specialised financial products and services to suit the frequently unique needs of the targeted strategic sectors. Ancillary services, in the form of consultation and advisory services, are also provided by DFIs to nurture and develop the identified sectors. DFIs therefore complement the private sector banking institutions and act as a strategic conduit to bridge the gaps in the supply of financial products and services to the identified strategic areas of the economy for the purpose of long-term economic development.

The DFIs have, to a large extent, successfully contributed to the development and growth of the targeted sectors.

Fundira (2009) stated that the DFIs have focused mainly on infrastructure development, both at national and regional levels. In many countries the transport, telecommunications and energy infrastructures are seen as natural monopolies, with individual governments owning and operating these networks. Specialized distribution networks, such as roads for transport, satellites for communication and pipelines for energy, are needed to deliver these services efficiently. These primary sources of infrastructure may be politically sensitive and highly regulated at a national level. An effective infrastructure development strategy, involving cooperation among DFIs and other regional and national institutions, is essential to promote development. This strategy must be embedded in a larger regional and national development strategy, with an integrated infrastructure development plan supported by appropriate policy and regulatory reform. Policy and regulatory harmonisation is needed to promote efficient use of infrastructure services, to promote technology transfer, increase production efficiency, lower the transactions costs of intra-regional trade, and to improve macro-economic policies and national institutions. This assertion is particularly relevant to this research, which posits that the DFIs should promote effective, efficient and economical utilisation of the government's limited resources. A discussion of the vision and objectives of DFIs follows next.

2.4 VISION AND OBJECTIVES OF DFIs

The Bank of Negara Malaysia's annual report (2002:88) indicated that DFIs should continue to progress and assume an increasingly significant role in addressing the development strategies of the different nations by complementing the established banking institutions so that together they meet all the financing requirements of the changing economy. Under this complementary partnership scenario, the DFIs would continue to provide financing to support the industrial sector, the services sector, and the modernisation of the agriculture sector, thus supporting the development of these sectors.

A good corporate governance structure has to be embedded in the legislation to enhance the performance of the DFIs. This would be demonstrated through the appointment of a qualified and experienced board of directors, and reinforced with proper checks and balances through an effective audit function. Furthermore, the accountability of DFIs should be enhanced by a legal framework in terms of which the institutions are required to disclose their financial performance, and to identify the activities they have supported, to the relevant oversight authorities and to the public, (The Bank of Negara Malaysia annual report, 2002:88). The Land Bank does appear to comply with the requirements of legislation, submitting their financial information to the appropriate oversight bodies (more or less) on time. Thus, this research study aims to identify the facts and to achieve an understanding of the issues that inhibit the National Treasury's efforts to accurately anticipate the Land Bank's financial assistance requests, despite having all the necessary information available.

2.5 THE COSTS AND THE BENEFITS OF DFIs

The taxpayers in a country collectively bear the cost of public DFIs. Subsidies to one person are taxes on another. Furthermore, funds spent on a DFI are funds not spent to improve the nation's collective welfare in some other way. The direct or primary benefits of a public DFI accrue to its clients. Although the indirect or secondary costs and benefits that accrue to non-clients and to the employees of the DFI, to governments, and to donors may be large, they are also very difficult to measure.

In the research of Stiglitz (1998) and Tollison (1984) it was found that financial oversight and cost benefit analysis is warranted because the group that bears the costs is not the group that receives the benefits. Worse, the choice to subsidize DFIs may be the responsibility of the very same employees who stand to gain from the subsidies, as more funds for DFIs guarantee their jobs, fosters promotions, and expands their influence. Each member may have much to gain from channelling more subsidies to DFIs.

Already in the 1980s, Adams, Graham and Von Pischke (1984) contended, that the subsidies linked to loans from DFIs may attract rich people. If the loans being made available to the DFIs are substantial so that subsidies can be big, wealthier people (at the top end of the eligibility range) may find it worthwhile to press for more public funds for DFIs. For example, wealthy farmers and their lobbies have sought and received big subsidies from agricultural DFIs all over the world.

In contrast, the groups that bear the brunt of the costs of DFIs are taxpayers and would-be clients left unassisted when the DFIs' funds dry up and projects are left unfunded. These groups are big, but fragmented, dispersed, and silent. The small

cost to each member of the group means that it is not worth the effort to press for cuts in public support for DFIs.

Because changes in personal welfare enabled by public support for DFIs are not perfectly aligned with changes in social welfare, industry lobbies and employees of governments, donors, and DFIs may be tempted to crusade for DFIs even if DFIs are not the best solution to improve social welfare. Alternatively, policy makers may lack the tools or the data to check whether a DFI improves social welfare in the manner intended. The decision makers must therefore be monitored, as they may receive unearned and undeserved benefits (Schreiner & Yaron, 2001:11).

2.5.3 Government subsidy to DFIs

According to Stiglitz and Tollison (cited by Schreiner & Yaron, 2001:11), if there are no externalities, then there is no need to measure social costs and benefits when private people transfer their own funds to a DFI. It is safe to assume that private individuals protect their own interests and thus weigh benefits and costs before proceeding. In contrast, there is a need to measure costs and benefits when governments and public institution donors transfer funds to DFIs. Public servants do not always protect the public interest.

According to Yaron, Benjamin, and Gerda (1997), society subsidizes DFIs to improve the overall social welfare of the population. The social benefit is the extra utility that clients have access to when compared to the situation where subsidies and DFIs are absent. The social cost is the benefit lost, as a result of the DFI being

funded instead of the funds being allocated to another deserving cause. Yaron, *et al.* (1997) observes furthermore, that a market failure is required in order for DFIs to improve social welfare. A market failure occurs when competition fails to lead to a socially beneficial outcome (Besley, 1997). This happens when a movement from the *status quo* would improve social welfare, but no private entity can capture enough of the gains or benefits to recoup its costs. The market fails because the best private choice is not also the best social choice. In principle, if DFIs are correctly funded, someone should be rendered better off, and no one is left worse off.

Yaron (2004:7) (quoting the work of Stiglitz, 1993) concurs by stating that failures plague financial markets. But a market failure, though needed to justify public intervention, is not enough. DFIs can be justified only if they mitigate a market failure so effectively that the benefits arising from the intervention exceed the costs. Even in the absence of market failure, a DFI might be the best way to reach a social goal, for example, if no other financial tools address an important social concern as efficiently (Yaron, Benjamin & Gerda, 1997:20).

DFIs venture in where the market has failed to tread, and to find good borrowers amongst those shunned by private lenders is a difficult task. Through adjustments to the process by which they judge and control risk, some DFIs have found profitable avenues to award loans and to collect the return without the presence of traditional collateral. Often, the most successful DFIs are those most concerned about the measurement (and containment) of their costs.

According to Schreiner and Yaron (2001) (quoting the work of Devarajan, Squire, & Suthiwart-Narueput, 1997), some DFIs are successful and do mitigate market failures. But some DFIs may waste scarce funds or exacerbate market failures. The theory is clear: if there is a market failure, then a DFI may have scope to improve social welfare. In practice, however, market failure alone is not enough to justify a DFI because DFIs themselves have costs and can disrupt markets. Government's failure may wreck attempts to fix market failure, and a DFI may be inefficient. This research recognises the widely-acknowledged view that the DFIs exist to mitigate market failures. This point is aligned to the objective of the research which endeavours to examine the financial management systems and operating model of the Land Bank (as an organisation attempting to mitigate the failure of commercial banking with respect to the need for loans for agricultural purposes), in order to make recommendations about increasing its effectiveness.

To choose well between competing needs amongst the different strata of society, government must measure costs of DFIs, and perhaps also the benefits that accrue to the recipients of credit (Devarajan, Squire & Suthiwart-Narueput, 1997). A DFI is only one of a number of competing and complementary possibilities to improve welfare through reducing poverty and increasing incomes. Lipton and Ravallion (1995:2630) argue that chronic poverty does not appear to be primarily due to the market's failure to grant credit, but rather to a low productivity factor, and a low endowment of non-labour factors per person. Having identified that measuring the benefits of DFIs is a very difficult task, the theory thereof will be discussed.

2.5.4 Measurement of benefits of DFIs

Heckman and Smith (1995) deepen the argument by asking what would have happened without the DFI - the standard counter-factual problem. This requires a control group: individuals who cannot choose to have access to DFI instruments but who are similar in terms of standard of living conditions to those individuals who can choose to utilise DFI instruments. Forming a control group usually requires random assignment of access to a DFI (or random assignment of qualified applicants), but such social experiments consume large amounts of funds, time, and expertise and are still subject to potentially debilitating critiques.

Moffitt (1991) argues that in the absence of random assignment, the measurement of the benefits of a DFI is similar to program evaluation with non-experimental data. Econometricians have grappled with this problem for at least 30 years. Without random assignment, a good control group is hard to find. Among the individuals who have access to a DFI, the individuals who choose to make use of DFI instruments are not the same as the individuals who choose not to apply for the DFI instruments; the users are more likely to do well regardless of the DFI, perhaps because they work more or accept higher risks. In contrast, the non-users would in all likelihood not do as well, regardless of the DFI. Thus, simple comparisons of users to non-users may overestimate the impact of the DFI. Although the measurement of benefits is improving all the time, credible measures are still incomplete and require an extended period of measurement, much skill, and a large budget. Thus, it is too expensive to measure the benefits of all public DFIs (Yaron, *et al.* 1997:24).

In contrast, it is less expensive to measure costs. In most cases, the measurement of costs (but not benefits) is a better use of resources than the measurement of both costs and benefits. This is the basic premise behind cost-effectiveness analysis (Garber & Phelps, 1997:25). This research aims to explore and examine mechanisms employed by the National Treasury to ensure effective financial oversight.

2.6 FINANCIAL OVERSIGHT TOOLS

2.6.1 The Subsidy Dependence Index (SDI)

The then former Deputy Minister of Finance, Nhlahla Nene (Nene, 2010) indicated during his budget vote speech that the Government was continuously being confronted by the question of how best to position our DFIs in order to enhance their capacities to effectively and efficiently deliver significant and tangible developmental results to all the qualifying needy individuals and institutions of South Africa. To phrase this another way, the contributions made by DFIs must be measured not by sterile statistics, but by their direct impact on the lives of the ordinary people of South Africa. This must be observable through sustained improvements in incomes and standards of living, as a result of people and qualifying organisations having gained access to DFI funding, and the projects, facilities, and infrastructure base that is the result of larger scale DFI-funded projects.

To measure the performance of DFIs, several measures have been introduced and applied over time. However, most of these do not calculate subsidy flow, and the

institutional dependence this creates. This is important since the owner of these institutions (the state) wants to know the costs to society of maintaining these institutions in order to compare this to the benefits that society derives from their activities.

A Subsidy Dependence Index (SDI) is a financial tool developed to measure the degree to which an institution is reliant on subsidies. According to Sharma and Uriam (1992:7), it measures subsidy dependence by aggregating all subsidies (S) received and comparing this to the total loan revenues, being the product of the bank's on-lending interest rate (i) and the average loan portfolio (LP). This is mathematically expressed as:

$$SDI = \frac{S}{LP \cdot i}$$

Thus, the index expresses how much the average lending interest rate would have to be increased to compensate for complete and immediate subsidy elimination. E.g., an SDI of 100 percent indicates that a doubling of the yield obtained on the outstanding loan portfolio (OLP) is required if subsidies are to be eliminated. Similarly, an SDI of 200 percent indicates that a threefold increase in the yield obtained on the OLP is needed to compensate for the subsidy elimination.

On the other hand, a lower SDI indicates, that the institution is more sustainable. Once the SDI reaches zero, the DFI has achieved full self-sustainability. Should the SDI become negative, this indicates that the DFI has not only achieved complete self-sustainability, but that its annual profits minus its capital (equity), charged at the approximate market interest rate, exceeds the total annual value of subsidies

(assuming subsidies had been received). A negative SDI also indicates that the DFI could have lowered its average lending interest rate while simultaneously eliminating the need for subsidies in that year (Yaron, 2004:39).

However, the SDI measure does not mean that adjusting interest rates is feasible in all cases: successful rural finance institutions vary greatly in their dependence on subsidies. Measuring the performance of credit programs is not accomplished by the uniform application of narrowly defined criteria. A flexible approach yields the best results, but evaluation criteria must address these core areas of performance (Yaron, 1994:33).

The objective of the SDI methodology is to provide a comprehensive method of assessing and measuring the overall financial costs involved in operating a DFI and to quantify its level of subsidy dependence. The SDI methodology indicates a need to move away from reliance on the financial profitability ratios used in conventional accounting procedures for the financial analysis of DFIs. It provides a public interest analysis of DFI financial performance and its subsidy dependence. Although this type of analysis does not take into account the full social benefits, it does try to include the overall social costs entailed in operations, including the full value of all subsidies received by the institution (Yaron, 2004:37), in the assessment.

Coetzee and Graham (2002) emphasise that the SDI aims to provide an objective assessment and measurement of a specialised credit institution's financial performance. Feijo (2001:11) shares this view, adding that the SDI also provides a starting point for comparing the cost of alternatives for any given public intervention.

It further serves as a long-term planning and monitoring tool, enabling government to track a specific DFI's progress towards self-sustainability.

According to Yaron, Benjamin and Charitonento (1998), the SDI is being used in Malaysia, India, France and Japan, to evaluate state-owned financial institutions and non-governmental organisations that provide financial intermediation services, because the profitability of these intermediaries often depends on their access to subsidies.

The need for effective oversight is of critical importance, as is the need to ensure the continuing efficiency and viability of those DFIs that are apparently succeeding in fulfilling their mandates, and to gauge the degree of the problems associated with other less-successful DFIs. Use of the SDI would additionally assist the National Treasury in demonstrating the relative efficiency of the DFIs, their commitment to social responsibility, and the DFIs' commitment to achieving financial sustainability that goes beyond short term financial self-sufficiency.

The SDI method has the following advantages (Yaron, 1992):

- It reveals whether or not a DFI is financially self-sustaining;
- if not self-sustaining, the cost of keeping it afloat is quantified;
- values for the SDI calculation can be compared across DFIs, and are especially appropriate where DFIs are engaged in lending to a similar clientele; and
- past trends and future projections can be calculated, providing management and policy makers with a valuable planning and evaluation indicator.

Calculating SDI would enable the National Treasury to track the movement of funds to and identify the need for subsidisation of DFIs such as the Land Bank. Furthermore, it would also assist in measuring the social cost to society of the subsidisation of the development finance sector. This would further assist the National Treasury to assess future risks and opportunities that may result from any particular reliance by DFIs on a government subsidy.

However, the method also has a number of limitations (Yaron, 1992):

- the SDI does not discount flows of funds. This is not a problem over short time frames (such as one year), and in low inflation environments. But not all time frames are short, and inflation rates can vary greatly. For example, governments or donors need to decide whether or not to establish a new DFI from scratch. To inform this choice, they may ask whether an existing DFI would have been judged as subsidy-independent from its birth, had its eventual performance been known then. Alternatively, they may want to plan their support so that projected performance over a long time frame meets a specific goal (Helms, 1997). However, for longer time frames, one might still consider solving this problem by using the net present values of the subsidies (or in ex-post views, their terminal values) (Teka, Erasmus & Klingelhöfer, 2012:11).
- a subsidy-dependent DFI need not be sustainable. Government or other agencies may be willing and able to subsidise it indefinitely. In particular, this is true if they use DFIs to implement policies to achieve political targets.
- positive SDI values provide no clear guidance as to whether the subsidies should be removed, because the SDI measures the costs but not the benefits generated by a DFI.

- the SDI indicates subsidy independence but not degree of self-sustainability. A subsidy-independent DFI could pay the social opportunity costs of its funds and still show a profit, while a self-sustainable DFI can meet its goals now and in the long term. Being currently subsidy-independent does not guarantee self-sustainability.

Yaron (1992) further emphasises that SDI is not a general equilibrium analysis. Thus, the effect on market rates of a DFI's entry into the market for deposits is not considered. However, this argument is largely irrelevant, especially in developing countries, since their markets are not perfect and are not normally in a state of equilibrium. Furthermore, the concern is not pertinent to the South African DFIs either, because these DFIs are not deposit-taking financial institutions, and neither is there a policy decision to change the status quo.

The SDI is the percentage change in the yield on loans (or, equivalently, in revenue from loans) that, all else remaining constant, would make the subsidy variable equal to zero. For example, an SDI of 1.00 means that an increase in the yield of 100 percent would wipe out the subsidy and make the SDI equal to zero. An SDI of less than zero means the DFI could compensate society for its opportunity cost and still show a profit (Schreiner & Yaron, 2001:27).

As mentioned the objective of the SDI methodology is to provide a comprehensive method of assessing and measuring the overall financial costs of operating a DFI, and to quantify its subsidy dependence. The SDI methodology suggests moving away from over-reliance on the financial profitability ratios used in conventional

accounting procedures for the financial analysis of DFIs. Instead, it provides a public interest analysis of DFI financial performance and its level of subsidy dependence. This type of analysis involves taking full account of the overall social costs incurred in the DFI's operations, including the full value of all subsidies received by the institution (Yaron, 2004:37).

2.6.2 The CAMELS rating system

The uniform financial institution rating system, commonly referred to as the "CAMEL (capital adequacy, asset quality, management quality, earnings and liquidity) rating" (since the "S" for sensitivity was only introduced later), was adopted in the United States of America by the Federal Financial Institution Examination Council on November 13, 1979, and then adopted by the National Credit Union Administration in October 1987. It is used for supervision purposes as an internal tool to measure risk and to allocate resources. The last version of the CAMEL rating system was published in the Letter to Credit Unions No. 161, dated December 1994. (The United States. Uniform Financial Institutions Rating System 1997:1) According to Rau (2002) it has proven to be an effective internal supervisory tool for evaluating the financial soundness of the institutions.

According to Barr, Kilgo, Siems and Zimmel (as cited by Dang, 2011) CAMEL rating became a concise and indispensable tool for examiners and regulators to assess a bank's health by reviewing different aspects of the bank's operations by referring to a variety of information sources, such as financial statements, funding sources, macroeconomic data, budget and cash flow.

Hirtle and Lopez (1999) examined the usefulness of previous CAMEL ratings in assessing a bank's current conditions. They found that, conditional to current public information, the private supervisory information contained in previous CAMEL ratings did provide further insight into a bank's current condition. They found that, over the period from 1989 to 1995, the private supervisory information gathered during the immediately previous on-site examination remained useful with respect to the current condition of a bank for between 6 and 12 quarters (or 1.5 to 3 years). The overall conclusion drawn from these academic studies is that private supervisory information, as summarized by CAMELS ratings, is clearly useful in the supervisory monitoring of banks' conditions.

The CAMELS model has been used successfully by many researchers to evaluate the financial performance of banks. One of the latest studies was conducted by Sangmi and Nazir (2010). They used the CAMELS parameters to assess the position of banks in Northern India after evaluating their capital adequacy, asset quality, management capability and liquidity.

Being one of the central banks which was involved in the exercise of drawing up the Basel Core Principles of Banking Supervision, the Reserve Bank of India (1999) at that time, states that the main instrument of bank supervision in India is the periodic on-site inspections that are supplemented by off-site monitoring and surveillance via financial statements and other accounting reports. Since 1995 on-site inspections have been based on the CAMELS assessment framework, and aim to achieve the following objectives:

- evaluation of bank's financial safety and soundness;
- appraisal of the quality of the board and top management;
- an assessment of compliance with prudential regulations.
- identification of the areas where corrective action is required to strengthen the bank;
- appraisal of soundness of the bank's assets;
- analysis of key financial factors such as capital, earnings, and liquidity, and to determine the bank's solvency;
- assessment of the quality of the bank's management team and an evaluation of the bank's policies, systems of management, internal operations and control; and to
- review compliance with banking laws and regulations as well as to provide supervisory guidance on specific policies.

In order to gain detailed insight into the CAMELS rating, each category will be discussed separately.

2.6.2.1 C - Capital adequacy

Capital adequacy is the expected capital required to maintain balance with the risk exposure of the financial institution (exposure to credit risk, market risk and operational risk), and should be an amount large enough to absorb the potential losses and to protect the financial institution's debt holder. "Meeting statutory minimum capital requirement is the key factor in deciding the capital adequacy, and

maintaining an adequate level of capital is a critical element” (The United States Uniform Financial Institutions Rating System, 1997:4).

Karlyn (quoted by Dang, 2011:17) defines capital adequacy in term of a capital-deposit ratio, because the primary risk is depository risk derived from sudden and substantial deposit withdrawals. In 1930, the Federal Deposit Insurance Corporation (FDIC) created a capital model for capital-asset ratios, since default on loans had come to be the greatest risk facing banking institutions, replacing excessive deposit withdrawals. To gauge a bank’s capital adequacy, bank supervisors currently use the capital-risk asset ratio. The adequacy of capital is examined based upon the two most important measures - the Capital Adequacy Ratio (CAR) (also known as the Capital to Risk-weighted Assets ratio), and the ratio of capital to assets.

2.6.2.2 A - Asset quality

Asset quality is assessed using the ratio of loan loss provisions/total loans. This ratio gives dimension to the state of bad loans relative to the total loans. According to conventional theory, the higher the ratio the poorer the quality of assets, but in fact quality depends on whether information on ‘bad loans’ has been correctly described and presented. The situation of Japanese banks suggests that systematic underestimation of ‘bad loans’ has been used by distressed banks as a strategy to avoid a loss of confidence amongst shareholders and the government’s oversight authorities. Consequently the ratio may be a blurred or underestimated variation of the reality (Bou-Said & Saucier, 2003:6).

According to the Basel Committee on Banking Supervision (2010), one of the main reasons why the economic and financial crisis which began in 2007 became so severe was that the banking sectors of many countries had built up excessive on- and off-balance sheet leverage. This was accompanied by a gradual erosion of the size and quality of the capital base. At the same time, many banks were holding inadequate liquidity buffers. The banking system therefore was not able to absorb the resulting systemic trading and credit losses, nor could it cope with the re-intermediation of large off-balance sheet exposures that had built up in the shadow banking system.

Therefore, to determine the quality of the assets the credit analyst should perform an assessment of the credit risk management policies, and evaluate the quality of the loan portfolio by using trend analysis and peer comparison. However, measuring the asset quality is difficult because of the presence of a great deal of “gut feel” and subjectivity on the part of the analyst, and the original loan application assessors.

2.6.2.3 M - Management quality

Management quality is essentially an assessment of the capability of a board of directors and their management team to identify, measure, and control the risks inherent in an institution’s activities, and to ensure the safe, sound, and efficient operation of their institution in compliance with applicable laws and regulations (Uniform Financial Institutions Rating System, 1997:6). Grier (2007) also suggests that management is considered to be the single most important element in the CAMELS

rating system because it plays a substantial role in a bank's success; thus, it is essential to subject management to measurement during the asset quality examination.

2.6.2.4 E - Earnings

This rating reflects not only the quantity and trend in earnings, but also the factors that may affect its sustainability. Inadequate, inappropriate and/or incompetent management may result in loan losses and, as a consequence, require higher loan allowances or expose the bank to a higher level of market risk. The future performance in earnings should be given equal or greater value than past and present performance (cp. Uniform Financial Institutions Rating System, 1997:7). Actually, from an investment and business valuation point of view, future earnings determine the value of a company – not the past or existing assets.

In addition, Grier (2007) is of the opinion that a consistent profit not only builds public confidence in the bank, but enables the bank to absorb loan losses and provides sufficient provisions to cover bad debt. It is also necessary for a balanced financial structure and helps reward shareholders. Thus consistently healthy earnings are essential to the sustainability of banking institutions. Profitability ratios, therefore, measure the ability of a company to generate profits from revenue and assets on hand. DFIs should provide profitability and efficiency analyses showing the historical and projected trends together with the main drivers.

Typical profitability and efficiency ratios that would be analysed include:

- a return on assets ratio compared to peer group averages;
- bank's own trends, material components, and income and expenses compared to peers, and

- bank's own trends, adequacy of provisions for loan losses, quality of earnings, and dividend payout ratio in relation to the adequacy of bank capital.

2.6.2.5 L - Liquidity

There should be adequate liquidity sources to meet present and future needs, and an availability of assets readily convertible to cash without undue loss, in order to ensure the financial health of a bank. The management of funds policies and practices should ensure an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner; and the bank should be capable of quickly liquidating assets with minimal loss (Uniform Financial Institutions Rating System, 1997:8). However too much liquidity inhibits profit maximisation. Therefore, it is necessary to find the right balance between "cash on hand" and the nature of the liquidity risks faced by the bank.

2.6.2.6 S - Sensitivity to market risks

The sensitivity to market risk is assessed by the degree to which changes in market prices, notably interest rates, exchange rates, commodity prices, and equity prices adversely affect a bank's earnings and capital. The following factors may be taken into consideration to measure the sensitivity to market risk: The sensitivity of the bank's earnings or the economic value of its capital base or net equity value due to adverse effect in the interest rates of the market. The amount of market risk arising from trading and foreign operations. As regards the sensitivity to market risk, Basel Committee on Banking Supervision (2010) highlights the aspects like a) sensitivity of the financial

institution's net earnings or the economic value of its capital to changes in interest rates under various scenarios and stress environments, b) volume, composition and volatility of any foreign exchange or other trading positions taken by the financial institution, c) actual or potential volatility of earnings or capital because of any changes in market valuation of trading portfolios or financial instruments, and d) ability of management to identify, measure, monitor and control interest rate risk as well as price and foreign exchange risk where applicable and material to an institution (Sahajwala & Bergh, 2000).

This supervisory work includes assessing the capability of a bank to identify, measure, monitor and control its exposure to market risk according to business volume and its complexity. These aspects cover the capital accumulation and availability for covering adverse movements of interest rates and exchange rates, and the implementation of market risk management and its effectiveness in the implementation of internal control (Muljawan, 1997:313).

Muljawan elaborates that the involvement of qualitative judgment as an additional factor may improve the quality of the assessment. The assessment report covers both the financial ratios and also an assessment of the quality of management in achieving particular financial objectives. The assessment report on the operational soundness of the bank is normally used by the banking authority as an internal guidance indicator to set supervisory actions in motion. This is conducted in the light of risk-based supervision that focuses the supervisory activities on the critical points all under the influence of a forward-looking principle.

Hirtle and Lopez (1999), examine the usefulness of past CAMEL ratings in assessing a DFI's current conditions. They find that, dependent on current public information, the private supervisory information contained in past CAMELS ratings provides further insight into a bank's current conditions, as summarized by the current CAMELS rating. The applicability of the CAMELS analysis technique to the Land Bank, focusing on improving the financial oversight role played by the National Treasury over this bank and other South African DFIs, is at the centre of the case study being investigated by the author.

The analysis of the Land Bank is an outstanding opportunity to discover how well the CAMELS rating system works locally. These results support the author's efforts to identify and understand both the benefits and drawbacks to implementing the CAMELS framework in the oversight of local DFIs.

2.6.3 Advantages

- the CAMELS rating index is being standardised internationally; it keeps the DFIs within set parameters. Consequently, the rating index is a perfect choice to use for government supervision of DFIs. The structure of the CAMELS rating system and the use of standardised financial components, definitions and calculations would assist National Treasury to ensure a consistently high quality financial appraisal of DFIs, including the Land Bank.
- in regard to the need for a flexible system, the CAMELS index and associated financial model, can be administered as an off-site examination using historical financial and accounting data to achieve a good assessment. Instead of

performing all examinations on-site, this would enable National Treasury to save at least the expenses associated with frequently visiting the target DFI. (All the indications are that the National Treasury has already employed the off-site examination option to perform the oversight of the DFIs.) The flexibility of the CAMELS system may encourage the National Treasury to also undertake periodic on-site examinations, affording the oversight officials the opportunity to visit DFIs' premises in order to understand their value chain. Such personal visits could further improve the working relationship between the DFI and the National Treasury.

- it is the primary framework used to evaluate a bank's overall performance and to generate the reports that inform investment decisions with respect to DFIs (Dang, 2011:36). The CAMELS model would assist the National Treasury to assess and monitor DFI profitability, efficiency, cash flows, capital structure and ability to pay dividends, amongst others. As a result, it is anticipated that the implementation of this tool will contribute to the overall improvement in the quality of financial analysis conducted by National Treasury. Implementation of the CAMELS model to analyse the Land Bank's overall financial performance on capital, assets, management, liquidity, earnings and market sensitivity would assist the National Treasury to proactively determine a funding requirement of the Land Bank.
- the CAMELS model can be employed as an early warning system to detect DFIs in need of close monitoring due to financial distress, and would allow the National Treasury to take early remedial action where needed. For example, an analysis of the Land Bank's corporate plans, using the CAMELS analysis of its capital adequacy, could provide an early warning to the National Treasury, alerting it to the probability that the Land Bank will shortly have to approach the government

for funding. Thus, thanks to the predictive nature of the model, National Treasury would be assisted in identifying future risks, and by working closely with DFIs should be able to proactively find appropriate mitigating strategies.

2.6.4 Disadvantages

- The current CAMELS approach to bank analysis is tailor-made to accommodate the U.S. banking laws and regulations. Thus, it requires modification before it can be fully implemented in the South African market. Notwithstanding the fact that the CAMEL rating system follows U.S banking law and regulations, it should be noted that a total of 48 scheduled commercial banks, including 9 foreign banks, in Bangladesh were assessed according to the CAMELS system. Other countries have adopted the CAMELS rating system, including India and Pakistan, indicating that the system can be successfully adapted to the specific requirements of other countries. The author therefore does not anticipate any difficulties that would prevent the National Treasury from adopting the CAMELS approach for use in performing their oversight duties with regard to South African DFIs.

The CAMELS framework overlooks or ignores the challenges of effecting interaction with the top management of banks being investigated. The comprehensive analysis of management may, however, reveal the relative effectiveness of the board of directors and its management, which is a significant factor in determining the soundness of the bank's finances. In interacting with DFIs (as with all big businesses, whether in the private or public sectors) there is always the irritation that arises when National Treasury attempts to schedule meetings with a DFI's

management, but this is a universal problem faced by analysts of any business sector.

2.7 FINANCIAL OVERSIGHT OF DFIs IN OECD COUNTRIES

2.8.1 The availability of information pertinent to financial oversight of DFIs

The availability of information concerning DFIs also varies across the Organisation for Economic Cooperation and Development (OECD) countries: similar reporting documents are made public or kept confidential, according to the laws of the various countries. Some reports remain confidential, only seen by the DFI concerned and its ownership entity, advisory units and/or the government. In other countries, similar documents are tabled in the parliament or published in official gazettes (Witherell, 2004:89).

There is obviously some trade-off between public accountability and commercial confidentiality, or between the costs related to reporting and control, and its benefits. Costs relate to resources needed to develop various reports, as well as to the potential danger related to the disclosure of commercially sensitive information. Some DFIs in countries with high standards of public accountability complain about the extra burden of public accountability, which also leaves them at a competitive disadvantage. But benefits are also potentially great, with a reduced risk of unsatisfactory performance and a similar reduction in the associated political and social costs. Each country has to make its own decision about the balance between these costs and benefits (Witherell, 2004:89). In South Africa, the Land Bank is not

required to make its corporate plan available to the public, primarily due to the commercial sensitivity of the information it contains.

In most OECD countries individual DFIs (and especially if they are relatively large enterprises), have to report on their objectives in a more public manner. This reporting takes various forms, such as statements of corporate intent (SCI), management contracts, and corporate plans, amongst others. Typically, DFIs will initially have to submit annual business plans and obtain approval from the ministries they report to, or from the Ministry of Finance. Then DFIs have to report to the ownership entity and/or to the Ministry of Finance and/or the Treasury, on a quarterly, semi-annual or annual basis, with quantitative and qualitative information that enables monitoring of the current performance relative to targets and objectives (Witherell, 2004:89).

Transparency of DFIs' endeavours will not only depend on the content of their disclosure, but also on the quality, timeliness and relevance of the documents, and on the effectiveness of the auditors as well as the specific state controlled entities in charge of controlling the quality of DFI reporting. The discussion shows that DFIs are in general subject to additional controls when compared with those an ordinary joint stock company would employ, but that the extensiveness and quality of these additional controls may also vary greatly (Witherell, 2004:88). In South Africa, DFIs are also subject to additional controls; however the Public Finance Management Act (PFMA) always takes precedence over any other Act if there is a conflict.

2.8.2 Other international financial oversight experience

Witherell (2004:62) states that in some OECD countries, including Australia, Belgium and Canada, DFIs have to submit corporate plans which set broad objectives to be achieved over a period spanning 3 to 5 years. These corporate plans include the information contained in SCIs and are designed as accountability mechanisms in the relationship between the DFI boards and the ownership entities. The corporate plan is the cornerstone of the control and accountability framework.

A DFI's corporate plan must indicate, for example, how it will balance its commercial objectives with its public policy objectives, the trade-offs required to achieve that balance, and how it can contribute to government priorities and initiatives while still ensuring that its activities are consistent with its mandate. Corporate plans are reviewed by the ownership entities, with the objective of having a clear and shared understanding of the DFI's mandate, targets and performance indicators, and how the DFI will balance its different objectives and also take into consideration the government's policy priorities.

In the New Zealand Treasury's owner expectation manual (2012:15) the corporate plan preparation process adopted by some of the OECD countries such as Australia, Belgium and Canada is explained in the outline below:

- Shareholding Ministers write to each DFI's board before the beginning of each planning round to provide details of the information requirements, the timing

(milestone dates) and any special issues the company is to address during the planning round.

- boards are then required to: assess their business environment; reassess their strategic direction; provide a detailed plan for the immediate year; and provide financial projections for the following 2 to 4 years.
- following the delivery of the board's outlook and business plans to the shareholding Minister, advisors then prepare a report on these documents for the shareholding Minister's consideration. Draft SCIs are delivered together with the business plans. The SOE Act and other relevant company-specific legislation require boards to deliver their draft SCIs to shareholding Ministers at least one month before the end of each financial year.
- shareholding Ministers may then, through their advisors, seek further information.
- shareholding Ministers then consult with boards on any issues or concerns they have with the business plans and draft SCIs. This occurs either by letter or, more often, in personal meetings attended by shareholding Ministers, advisors and the board (referred to as the business planning meeting).
- following the business planning meeting (if held) shareholding Ministers write to boards outlining their understanding of the main outcomes and issues discussed.
- boards then consider the outcomes from business planning meetings and the shareholding Ministers' written comments, and if necessary, revise their business plans and SCIs. Boards then deliver to shareholding Ministers their finalised business plans and SCIs.
- shareholding Ministers table the finalised SCIs before Parliament.

The corporate plan preparation process adopted by some members of the OECD is remarkably similar to that required by South Africa's National Treasury. The author has detected from the survey one key difference in terms of the corporate plan preparation process between that required by the National Treasury and the OECD countries. In OECD Shareholding Ministers write to each DFI's board before the beginning of each planning round to detail the information requirements, the timing (milestone dates) and any special issues the company is to address during the planning round; National Treasury expects the Land Bank to prepare the corporate plan and shareholder compact, and obtain board approval prior to submission to National Treasury. Asset and Liability Management division within the Treasury then performs a review and makes recommendations to the Minister of Finance for corrective actions, as required. In some instance the findings are discussed with the Land Bank.

2.8.3 Prudential regulation and supervision

According to Carmichael and Pomerleano (2002) the DFIs should be subject to prudential regulation and supervision by the relevant authorities. This should apply not only to deposit-taking institutions but also to DFIs that receive exclusively wholesale or government funding, since they are also highly leveraged institutions that have the potential to create systemic risk. They further state that the banking supervisors should put special emphasis on governance arrangements, the sustainability of the business model, and the quality of the bank's management systems.

Government comptrollers or government audit offices are poor substitutes for specialized banking supervision, since these institutions usually lack the expertise to assess the risks inherent in banking. The findings published in are aligned with the purpose of this research, in that the research also seeks to explore the best financial oversight instruments, and to recommend these to the National Treasury in order to ensure the development and implementation of an efficient and effective shareholder oversight mechanism.

2.8.4 Need for strong financial oversight of DFIs

There is still unresolved debate as to whether the financial supervision of DFIs should be less or more stringent than that applicable to private banks. On the surface, the answer is ambiguous, as there are arguments in favour of both looser and more stringent oversight. Arguments for looser oversight are that DFIs have lower profit-seeking motivations, and therefore lower risk taking incentives and proclivities. They also enjoy more stable and longer-term financing sources and have a commitment of government support in the event of financial distress. However, the author believes that the arguments supporting the need of more stringent oversight presented by Ratnovski and Narain (2007:21) are more compelling (Ratnovski & Narain, 2007:21). The research supports the argument for more effective oversight for DFIs, as this could ensure that taxpayers' money is efficiently and economically utilised, which in turn could mitigate (to a slight degree) the growing burden on the country's fiscus.

In order to determine the desirable level of financial supervision of DFIs, their risk profiles, the value and intensity of the activities within the DFIs, and the size of the DFIs are taken into account. However, the author believes that the arguments in favour of the need of more stringent oversight are more powerful than those favouring a less rigorous oversight environment for the reasons indicated below.

- DFIs are likely to operate at higher risk levels. While risk-taking incentives may be lower, risks inherent in the activities they support seem to be much higher. The housing and agriculture sectors are characterized by high systematic risks. Also, the volatility of the Small and Medium Enterprises (SME) sector is typically above that of the economy's average. The high risks are amplified by the low diversification and the low profitability of the public financial institutions.
- DFIs are likely to have less attractive managerial incentives to excel. Close government affiliation may also create a bureaucratic environment that accommodates and enables low transparency, under-reporting of risks, and concealment of losses. Due to government guarantees, DFIs' exposure to market discipline is limited. Lastly, there may be incentives for low-quality, politically-driven and connected lending practices.
- the financial distress of DFIs may have severe implications, particularly when such institutions are large and have systemic importance. They provide financial services that are otherwise missing from the market, and their failure or withdrawal may leave target industries (e.g., agriculture) without financing, or even result in an economy-wide credit crunch (as for housing finance). The potential failures of DFIs also carry significant fiscal risks, there being high costs in the form of additional taxation that becomes necessary in the event of such a failure.

Keeping these arguments in mind, the supervision of DFIs should ideally be at least as stringent as that applicable to private commercial banks. From the regulatory perspective, DFIs have much in common with too-big-to-fail (TBTF) banks. Both enjoy implicit or explicit government guarantees that reduce market discipline. The financial distress can lead to systemic (national economic) instability and large fiscal costs. Relevance to this research rests in the point that the research problem highlights the importance of managing the contingency risks. The National Treasury's apparent preference of issuing guarantees to financially distressed DFIs, as opposed to providing capital injections, can result to reduced market discipline.

Lastly, corrective action is problematic as such institutions cannot be easily liquidated or put under external management, recapitalizations are costly, and regulatory intervention may be market or politically sensitive, with negative impact. Because characteristics are similar, the supervisory practices for TBTF banks can provide a useful reference for DFIs. For example, recognizing the difficulty of implementing corrective action for TBTF banks, some regulators adopt so-called preventive supervision, where continuous inspection by permanently placed and dedicated on-site teams is designed to reveal and stop any problems before they become too large and costly to handle (Ratnovski & Narain, 2007:22).

2.8.5 Financial oversight of DFIs in practice

Ratnovski and Narain (2007:22) stated that in well-functioning systems, DFIs are subject to multiple layers of increasingly stringent administrative oversight and audit. For example, in Canada DFIs are overseen by the ministries in charge and, through

the approval of annual plans, also by other central agencies (including the treasury); they also have their financial statements audited externally by a private-sector auditor and by the Auditor General of Canada. Furthermore, they are subject to a special examination conducted by the Auditor General of Canada every five years. Co-financing with the private sector may motivate additional (private sector-defined) scrutiny and impose some market discipline.

In addition to administrative oversight, governments typically exercise control by insisting on stringent corporate governance mechanisms. In many of the DFIs studied, the government appoints the CEO and the Board. The Board may consist of public officials, industry representatives, or independent directors (such as CEOs) drawn from other industries.

Yet, routine financial supervision may still be helpful and necessary to ensure prudence in such aspects of financial operations as risk management assumptions, or the control of large (and systemically important) exposures to the rest of the financial sector. Paradoxically, the stringent oversight one might have expected, given the nature and magnitude of the risks faced by DFIs, is typically absent: DFIs typically do not usually have routine external financial supervision. In particular, none of those DFIs are fully supervised by the principal financial sector supervisor, whether from the public or private sectors. DFIs in Japan submit their annual reports to supervisors, but are not subject to a regime of routine inspections. The National Treasury, as executive authority with oversight over the Land Bank in South Africa, also does not subject the Land Bank to any routine inspections.

As a South African DFI the Land Bank is accountable to the South African Government and is thus required to report on its activities through the National Treasury. The National Treasury acts as the representative shareholder on behalf of the South African Government, for whom it holds oversight responsibilities that include governance and statutory compliance issues. In addition, the Land Bank is indirectly responsible to the (Department of Agriculture, Fisheries and Forestry (DAFF), which oversees the effective implementation of agricultural policies.

According to the Public Finance Management Act (PFMA), the relationship between the Land Bank and National Treasury is governed by a shareholder compact, which is a mutually agreed set of strategic intentions, key performance areas and performance targets. The compact includes strategic objectives, policies, financial, technical and other significant key performance indicators and reporting requirements. The Land Bank's performance against these targets is monitored through the submission of quarterly and annual reports to the National Treasury.

2.8.6 Dedicated and shared supervision of DFIs

Government-sponsored financial institutions in the U.S. are supervised by dedicated offices: thus, e.g. the Office for Federal Housing Oversight oversees the performances of Fannie Mae and Freddie Mac, while the Federal Housing Finance Board oversees the Federal Home Loan Banks. Some form of external (Federal or State government) supervision is considered essential, as in the U.S. the financial institutions are privately owned, and it is the shareholders or cooperative members who exercise corporate governance functions and appoint CEOs and the boards of directors (Ratnovski & Narain, 2007:24).

The benefits of dedicated supervision by a Financial Service Agency(FSA), rather than general external supervision of DFIs, are not clear. Dedicated supervisors may have less experience and fewer resources than mainstream supervisors, and are a likely target for regulatory capture. On the other hand, the supervision of DFIs may be viewed as special due to their low profitability and the un-diversifiable risks typically involved in public financial intermediation. DFIs also have the ability to breed political conflicts. Because of this, the governments may wish to avoid burdening otherwise efficient mainstream financial regulators with problem institutions, and to institute a separate organizational arrangement instead.

Japan represents the case of supervision shared between the financial supervisor (Japan Financial Service Agency) and the ministry to which the DFI reports operationally. While the financial supervisor may review major financial documents, it has limited inspection rights, and can implement corrective action only through the ministry in charge. It is not clear whether such an approach is conducive to financial soundness, or whether the implementation of a more equal distribution of authority might be more effective (Ratnovski & Narain, 2007:24). This situation is also applicable in South Africa. The Land Bank reports to the DAFF with regards to policy matters while the National Treasury is in charge of the financial oversight role.

2.8.7 Oversight challenges facing the shareholders of the DFIs

Ratnovski and Narain (2007) emphasise that there are a number of specific challenges in the oversight of DFIs, different from those experienced by private banks. These challenges include the following:

- Critically, there may be a within-government conflict of interests between its functions as an owner and as a supervisor;
- preserving financial performance may require a reduction in lending, or a recapitalization, which the government may be hesitant to undertake;
- independence of external supervisors may be compromised by political pressures;
- the lack of market discipline reduces the information content of prices, and deprives regulators of an important source of information.

Independent boards may be one of the mechanisms to alleviate opacity, contribute to independent supervision, and help resolve within-government conflicts of interest. However, while occasionally present (in the U.S.), independent boards are generally absent from DFIs according to International Monetary Fund survey in Canada and Germany, boards commonly include a large proportion of industry representatives, who, while usually possessing relevant skills, may put their own vested interests first. For example, real estate managers on the boards of housing finance corporations are likely to favour the expansion of activities (Ratnovski & Narain, 2007:25). In contrast, most DFIs in Japan have managerial boards with no outside (independent) members. A similar board membership problem exists in developing countries where, as Marston and Narain (2004) report from a broader sample of DFIs, there is commonly no independent representation on the board.

Increased disclosure may be another route to improve transparency. Many DFIs have simplified accounting and disclosure requirements, often rationalized as being a means of reducing costly paperwork. However, the merits of such savings,

compared to the costs of the opaque and unaccountable environment they contribute to, are questionable.

In South Africa the boards of the DFIs are governed by the corporate governance frameworks ruling their particular business sectors. Corporate governance embodies processes and systems by which all business entities are directed, controlled and held to account. In addition to requirements laid out in a DFI's enabling legislation, and the Companies Act, corporate governance with regard to DFI's is applied through the precepts of the PFMA, which is applied in tandem with the Protocol on Corporate Governance (an encapsulation of the principles contained in the King III Report on Corporate Governance).

The Land Bank has had its fair share of challenges regarding its board of directors. Boards have been removed by the executive authority because the executive management of the bank operated with complete disregard to the board's collective decisions. A correlative feature of this consistent undermining of the decision-making processes of the board has been the emergence of a culture where management made unilateral decisions.

2.8.8 Capital requirements

Based on their risk profiles, and with higher exposure to un-diversifiable risks, one would expect DFIs to operate under at least as stringent prudential requirements as those that apply for private banks. In private banks, capital has two major roles: reducing shareholders' risk-taking incentives and providing a cushion in case of

financial distress. In DFIs, this disciplining function may be redundant as the owner (government) and managers may have limited risk-taking incentives anyway. As for the insurance function, where a private bank has to draw on its capital to cover possible losses or otherwise go bankrupt, DFIs may turn to the government and use its guarantees. When loss events are rare, governments may be better off by not investing taxpayers' money in an idle capital cushion, but rather use its deep liquidity to cover these (occasional) losses in the case of financial distress (Ratnovski & Narain, 2007:24).

On the other hand, using guarantees instead of capital may create major accountability challenges. Firstly, fiscal risks need to be properly accounted for, but such measurements and contingency planning seem to be commonly lacking in DFIs. Secondly, capital requirements impose natural limits on the expansion of an institution's activities in that there can be no lending above the threshold defined by existing capital and statutory capital requirements.

Guarantees do not provide such automatic limitations. Instead, they create incentives for expanding operations, in order to capitalize on their option value. Therefore, and given pervasive accountability problems in private financial institutions, it seems advisable to rely on capitalization rather than guarantees as a default solution. Relevance to this research exists in the point that the South African government has a preference for providing guarantees rather than allowing a more normal capital injection. This is evident from the Land Bank having recently received a total of R3.5 billion in guarantees (Land Bank 2011/12 annual report). The research problem advocates that it is necessary to manage this situation carefully as

it has the potential to pose contingent liability risk to the state. It should be noted that the Land Bank's guarantee has since been converted into equity.

2.8 TRANSPARENCY AND DISCLOSURE OF INFORMATION IN OBJECTIVE SETTING PROCESSES IN OECD COUNTRIES

According to the OECD report for guidelines on corporate governance DFIs (2005) difficulties with the process, and criticisms of its implementation have often arisen in OECD countries regarding the transparency of the objective setting process, as well as of its monitoring. Performance monitoring could become a powerful accountability mechanism as long as it is disclosed and effectively implemented. This disclosure would allow parliaments and the general public to assess how efficiently resources vested in DFIs are being used, how effective the DFIs' corporate strategies are, and how vigorously the government's ownership policy is being implemented. Pursuant to this, management contracts or Statements of Corporate Intent are usually submitted to national parliaments. For example, in Australia, statement of corporate intent (SCI) are tabled in Parliament within 15 sitting days of the beginning of Parliament's financial year. On the other hand, corporate plans usually remain confidential as they often contain commercially sensitive information.

The usual challenge regarding implementation of all these different kinds of objective setting and performance monitoring efforts lies in the balance that needs to be struck between accountability to parliament and the risk of disclosing commercially sensitive information. Some companies have complained that this may place them at a competitive disadvantage vis-à-vis their private sector banking peers. Despite the

perceived competitive disadvantage inherent in the risk of disclosing commercially sensitive information, DFIs in Australia and UK are required to provide confidential information to their respective shareholders. The OECD report thus continues by expressing that:

- in Australia, DFIs are required to provide confidential performance reports to shareholder Ministers on a half-yearly basis, and shareholder Ministers may ask DFIs to provide these reports on a quarterly basis.
- in the UK, DFIs report periodically, usually monthly, to the Shareholder Executive, on the performance of the business against their plan and budget. Moreover, ownership entities are usually supposed to be informed of any major events that may significantly alter the DFI's performance. The crucial difficulty lies in the role of the DFI boards in reporting on performance, and in the balance required between proper monitoring of performance by the ownership entity, and interference in day-to-day management. Direct monitoring of management performance by the ownership entity can be seen as by-passing the board in one of its key functions. Thus, performance monitoring systems should be structured to achieve an increasing involvement by the board in monitoring management, while simultaneously reporting on performance to the ownership entity.

Reporting on how objectives and targets have been met (i.e. how management contracts have been fulfilled) takes different forms and involves various entities, depending on the country, and Parliaments are increasingly being involved in reviewing corporate objectives as well as any kind of annual report on performance.

- in France, annual reviews of performance contracts are carried out under the jurisdiction of the State Controller, who reports directly to the Ministry of Finance. These reports are not made public.
- in Greece, boards have to submit Annual Reports on Activity, containing all information related to the achievement of objectives agreed upon in the business plans and management contracts. The Annual Report on Activity has to be submitted to the Ministry of Economy and Finance, and to the branch Ministry concerned with oversight, as well as to the Parliamentary Committee: Financial Performance of Government Trading Enterprises.
- in Italy, by the end of February, non-listed, fully state-owned enterprises are required to submit annual reports to the Ministry of Economy and Finance. These reports must include descriptions of the principle managerial issues encountered, as well as the main financial results which are compared with the forecast results. DFIs also provide mid-year updates on both financial items and managerial issues.
- in Belgium, the boards of DFIs report to the ministers in charge of the individual DFIs on the DFIs' public services activities every year.
- when DFIs are required to provide corporate plans, such as in Australia and Canada, they are also asked to provide reports tracking progress against them.
- under all these reporting regimes the results that have been observed embrace a wide spectrum of effectiveness.

A survey conducted by the OECD (2005:65) revealed that the results regarding fulfilment of performance contracts by DFIs have been mixed, as has been documented by a number of studies. This has been especially applicable to

developing countries as a group, where these performance contracts have been under development since the 1970's, often with the assistance of the World Bank. The survey has shown that the effects of performance contracts on DFI efficiency have been disappointing, with no apparent pattern of improvement in trend productivity or profitability.

The results of having instituted objective setting and performance monitoring systems have been quite varied. The effectiveness depends on three main aspects: first, the quality of the preparation and negotiation of the contracts; second, the quality of performance indicators selected to monitor performance; and finally, the effective independence of DFI management and their capacity to protect themselves from political interference. Management or performance contracts for DFIs have usually contributed positively to the clarification of objectives and to the independence of management. In some cases they have also permitted a better co-ordination between different governmental bodies with interests in particular DFIs' strategies, allowing an early debate between these different bodies/administrations to resolve differences or to plan new strategies.

However, management contracts have not always been sufficient to prevent political interference. A survey of OECD countries researching corporate governance of state owned entities (2005:97) revealed the following:

- in France, the process of performance contracts is widely recognised as having been a success in the formerly non-competitive sector of DFIs (La Poste), but a relative failure in the competitive sectors, or in sectors with sensitive social and

employment issues such as in the railways and public transportation. In this latter case, the relative failure was partly due to continuing political interference regarding employment issues.

- in Canada, a survey found significant deficiencies in a third of corporate plans surveyed, as well as less serious problems in another third. These weaknesses were related, for example, to a lack of clarity in the definition of objectives as well as to a lack of information about how the DFI was supposed to monitor its performance. Deficiencies were also linked to the approval process, as very little feedback was received from the ownership entities. The process was thus transformed into a ritual instead of a clarification of the different understandings of the corporation's objectives. Consequently, a recommendation was made that was intended to align expectations: each corporation and its responsible minister should reach an understanding on the most effective ways to outline priorities, provide feedback and reach consensus on corporate plan submissions, and to maintain on-going contact between them.

Financial disclosure by DFIs has improved significantly in recent years in many OECD countries. Generally speaking, DFIs now have to report in the same way as public companies do, since they are now also subject to Company Law.

The OECD 2005 survey further indicates that in all OECD countries DFIs have to submit annual reports. Annual reports are the primary reporting documents summarising the main outcomes and financial results of DFIs for the year. Requirements regarding the content and quality of annual reports are usually formulated in the company law and in other legislation and regulations governing

commerce, or in laws specific to the status of a DFI. Annual reports aim to convey information relevant to the full spectrum of different stakeholders, including ownership entities, the general public, other government agencies, and the wider political arena, including the media.

In most OECD countries surveyed, DFIs also publish bi-annual reports (as in Norway), but only a few countries publish quarterly reports. Quarterly reports have to be submitted by all DFIs in New Zealand, Sweden and Turkey, and by only some DFIs in Norway. In France, only listed DFIs published biannual reports, but all DFIs issuing securities committed themselves to do so from 2004. These interim reports usually include interim financial statements, information on capital expenditure to date, and reports on operations, as well as discussion on the evolution of strategy and changes in overall operating conditions.

The main differences between countries and DFIs relate to the comprehensiveness, quality and clarity of these annual reports. In many countries studies or specific audits have shown that the content and quality of DFIs' annual reports do not always achieve particularly high standards. To improve the situation, certain countries have issued specific guidelines or booklets detailing key items that must be included in annual reports. This is the case, for example, in the state of Queensland, Australia (the Annual Reporting Guidelines for Queensland Government Agencies), and in Poland (Guidelines on Financial Reporting).

DFI annual reports are in most cases available to the public. Interim reports are often not as widely available to the public as are annual reports. Annual or interim reports may also be posted on DFIs' websites or on the ownership entities' websites. In

Sweden, for example, close to 80% of annual reports are posted on the individual DFI websites, as are more than 50% of their quarterly reports. In many cases annual reports and (less frequently) bi-annual reports are submitted to the scrutiny of parliamentary oversight committees, which may in turn require additional audits, and develop specific recommendations related to improving the content of DFIs' annual reports.

The conclusion can also be inferred from the OECD's 2005 survey on corporate governance, that there is another factor which may have a decisive impact on the usefulness of annual reports the timeliness of its publication. Some countries have adopted clear policies to encourage DFIs to publish their reports within a specified time frame. This is the case, for example, in Sweden where the goal is to have all state-owned companies publish their annual reports by January of the year following financial year end. Reporting dates for DFIs are summarised in the aggregate annual report published by the ownership entity. In many OECD countries, large DFI have also, since 2000, started publishing consolidated accounts as part of the annual reports. This is the case, for example, in Greece and in France.

The ownership entities usually have extensive powers to enforce demands that DFIs provide reports on important matters as they arise. They may also ask external auditors or reviewers to submit a report on a specific issue, asking the DFI to provide the reviewers or auditors with full access to documentation, management and premises. Special investigations may also be undertaken by Auditors General or other state control entities. These additional layers of reporting and monitoring are intended to avoid unpleasant surprises, making the state a more predictable owner,

and avoiding any public outcry about DFI performance or other politically sensitive issues related to DFIs. This is part of the overall reinforcement of risk management.

In some countries, DFIs' annual general meetings may be open to the general public, as they are the ultimate shareholders. This is the case in Sweden, where it is considered appropriate for wholly-owned state enterprises to have members of the public attend their AGMs. This gives the general public the opportunity to question DFI management and individual board members. Procedures to avoid abuses have been developed, such as in-advance registration. Members of the Swedish parliament may also be invited to attend DFIs' annual general meetings.

DFIs may also, and indeed often have to, appear before Parliamentary Committees, in the framework of reviews of state expenditure, or for specific mandates such as dedicated enquiries or audits of DFI performance. They also indirectly report to their parliaments through questions from shareholder ministries. The Malaysian model however has proven to be successful and as a result, for the purposes of this research the Malaysian model will be discussed in detail.

2.9 MALAYSIAN FINANCIAL OVERSIGHT MODEL FOR DFIs

According to the Annual Report of Bank of Negara Malaysia (2002), DFIs have been established and funded by the government to develop and promote certain strategic sectors of the economy, and to achieve social goals. The Development Financial Institute Act (DFIA) of Malaysia provides a comprehensive regulatory and supervisory framework to ensure safe and sound financial management of DFIs.

Given the significant role of DFIs in the economic and social development of Malaysia, it is essential for the government to develop DFIs into effective and efficient implementing agencies. The strategies outlined in the Financial Sector Master Plan (FSMP) for systematic development of DFIs include strengthening the regulatory and supervisory framework, building capacity and capability, and enhancing operational efficiency.

The DFIA lays emphasis on efficient management and effective corporate governance by prescribing the procedure for the appointment of directors, chief executive officers and external auditors, as well as requiring the disclosure of information in a timely and transparent manner. This is intended to put a sufficient number of checks and balances in place to enhance accountability on the part of the board of directors and management.

In South Africa, the PFMA provides a supervisory and regulatory framework intended to ensure effective, efficient and economical utilisation of limited public sector resources. For the purpose of this research it should be noted that the Land Bank is required to comply with the PFMA, as was indicated in the problem statement. The researcher is aware that compliance with the requirements of the PFMA is mandatory, and that the Land Bank complies; however the quality of the information provided to Treasury is not of the highest standard.

2.9.1 Administration and enactment of DFIA 2000 in Malaysia

In order to provide a comprehensive regulatory and supervisory framework to ensure safe and sound financial management of the DFIs, the DFIA of 2000 was promulgated and came into effect on 15 February 2002. The DFIA aims to ensure effective and dynamic supervision of DFIs, and provides for the appointment of Bank Negara Malaysia as the central regulatory and supervisory body for the DFIs. The Central Bank's focus is to promote the development of effective and efficient DFIs whose objective is to minimise their cost to the government while assisting government to meet its policy objectives (Bank of Negara Malaysia, 2002).

Asia Productivity Organisation Survey on Micro-Financing (2006:137) indicated that the DFIA provides a comprehensive supervision mechanism which incorporates prudential rules, onsite and off-site supervision, reporting requirements and disclosure standards. It also provides the regulator with the necessary powers to deal with any mismanagement and malpractices. The legislation provides the mechanism to strengthen the financial position of DFIs through the specification of prudential requirements such as in the management of assets, and capital and liquidity management.

2.9.2 Monitoring of DFIs' activities and performance

Malaysian Investment in the Manufacturing Sector Report (2012:131), highlighted that as the DFIA was enacted to promote the financial and operational soundness of the DFIs through sustainable practices and the requisite regulatory and supervisory

framework, and that the institutions perform their mandated roles prudently, efficiently and effectively. With the enactment of the DFIA, the Bank was appointed as the central regulatory and supervisory body for DFIs. As part of the regulatory and supervisory framework, the Bank monitors the activities and financial performance of the DFIs to ensure that they perform their mandated roles in a prudent manner and are supported by strong corporate governance and best practices.

These reports contain quantitative and qualitative indicators on the economic and social contribution of the individual DFIs, including their financial performance. These inputs facilitate in the formulation of appropriate policy measures to enhance their capacity and to address areas of concern. In the case of South Africa's Land Bank, the bank is required to submit quarterly reports as part of the covenants that secured the guarantees to assure the guarantor organisations that the bank is utilising the guarantee in accordance with the original agreement. This research attempts to investigate successful financial oversight tools/models of similar institutions to the Land Bank, internationally, for comparison to the system applied by the National Treasury

2.9.3 Supervisory activities of DFIs

In ensuring that the operations of DFIs are carried out in a prudent, effective and efficient manner to meet their mandated roles, supervisory activities by the Bank in 2005 were focused on enhancing the standard of corporate governance, risk management and operational efficiency of the DFIs. (Bank of Negara Malaysia, 2002).

In strengthening corporate governance, the quality and proactiveness of the board's oversight as well as effectiveness of leadership of the DFIs, in terms of providing strategic direction and contribution towards the overall management of the DFIs were assessed. In this context, the roles and functions performed by the board of directors towards enhancing the DFIs' capacity, capabilities and competitiveness were rigorously evaluated. (Bank of Negara Malaysia, 2002).

2.9.4 Submission of SCI and annual funding requirement

Malaysia's DFIA provides mechanisms intended to ensure that DFIs focus their activities on their mandated roles. One of the mechanisms is through the monitoring and assessment of the DFIs' planned activities. Sections 34 and 35 of the DFIA require the prescribed institutions to submit, on an annual basis, their SCI and their Annual Funding Requirement (AFR). The SCI highlights the planned business activities, their implementation strategies, sources of funding, performance targets and social obligations. The SCIs are required to include the business activities of the DFIs' subsidiaries.

In chapter 5 of the annual report of the Bank of Negara Malaysia (2002), the SCI, which has to be approved by the Minister-in-charge, is submitted to the Central Bank. This facilitates the monitoring of the activities of the DFI with the aim of ensuring that the activities undertaken are in line with the mandated roles and Government's objectives. In addition, it also aims to monitor the contributions of the DFI to meeting the government's annual performance targets set in the previous year.

The AFR details the projected sources of funding and the additional funding required from the government to meet the activities planned for the following year. The AFR is submitted to the Central Bank for evaluation prior to submission to the Minister of Finance, and thereafter for incorporation of the funding request into the annual Federal Government Budget allocation. In compliance with the requirements of sections 34 and 35 of the DFIA, the procedures for submission of the SCI and AFR specify the format and contents of the SCI and AFR, date of submission, and the approval processes. In addition, the roles and responsibilities of the DFIs, the Ministers-in charge and other stakeholder Ministries are also comprehensively laid out. (Bank of Negara Malaysia, 2002).

In South Africa, section 53 of the PFMA requires the Land Bank to submit a corporate plan, in the prescribed format, covering the intended affairs of the Land Bank for the following three financial years. The plan is required to include financial projections as well as the borrowing plan. The PFMA does not require the Land Bank to submit an annual funding plan which would detail projected sources of funding and the additional funding required from the government to meet the activities planned for the following year. If such a comprehensive annual funding plan were to be introduced, it could assist the Treasury to improve the accuracy of its forecast and include the financial request from the Land Bank in the national budget.

2.9.5 Specification on permitted lending by DFIs

The importance for DFIs to remain focused on their mandated roles is further emphasised through the provision of subsection 28(1) of Malaysia's DFIA (2002) which prohibits DFIs from extending credit facilities (including the provision of guarantees and insurance), other than for the purposes stated. This provision is intended to ensure that credit facilities are extended by DFIs to businesses and activities in accordance with their main purposes and objectives, as policy-based institutions. Pursuant to this provision of the DFIA (2002), the specifications on credit facilities that can be granted by the six DFIs have been formulated in line with the existing mandated roles. Broadly, these specifications are tailored to cover extending credit facilities to SMEs, infrastructure projects, capital-intensive and high-technology industries, exports, imports, personal and consumer financing, housing and retail financing.

2.9.6 Verification procedures for appointment of Directors/CEOs

The DFIA (2002) places emphasis on corporate governance by requiring that directors and chief executive officers (CEOs) in DFIs fulfil the "fit and proper" criteria for their appointment as specified in the Act. Whilst the authority for appointing the directors/CEOs remains vested with the relevant Ministries, subsection 6(2) of DFIA (2002) requires prescribed institutions to obtain the Central Bank's verification that the intended appointee (director/CEO) satisfies the "fit and proper" criteria set out in the Schedule to DFIA (2002) prior to such appointment being confirmed.

The DFIA (2002) provides for an initial appointment of directors and CEOs of two years, and that any reappointment would be for a period of one year. The performance and suitability of directors and CEOs of DFIs are thus subject to periodic assessment and review. The verification of the appointments is undertaken by the Central Bank with the main objectives of strengthening management integrity and capability, and to ensure competent, responsible and effective management and stewardship by board members and CEOs of DFIs. To facilitate the verification process, a guideline has been drawn up, specifying the minimum information to be submitted, and the initial credit check that is required. In addition there is a list of disqualification criteria that has been provided to guide the DFIs and Ministries involved in the appointment process. The verification process covers character issues, and financial and security vetting on the candidate to ensure the candidate meets the stipulated criteria.

In South African, the norm is that the initial appointment of directors and CEOs is for five years and any reappointment would be for a further period of five years. There is no prescribed verification process or oversight of that process in force in South African legislation. According to an investigation by auditing firm Ernst & Young, the Land Bank's previous CEO's fake academic record was uncovered during a probe by the Limpopo Government. This includes confirmation from the Department of Education that he failed matric. The previous CEO's dubious qualifications were not previously uncovered despite his presumably having gone through rigorous appointment processes for each of the several government departments and parastatal organisations he headed, including his appointment to the Land Bank (Hofstatter & Afrika, 2011).

Seitshiro (2006:16), Chief Director at the National Treasury of South Africa responsible for DFIs, noted that DFIs are generally used to address market failure in risky sectors. In this regard, they fill gaps in the supply of financial services and strive to succeed in the arena otherwise dominated by private sector entities. He insisted that international experience shows that appropriate and efficiently managed DFIs can contribute to economic growth and development, but acknowledged that certain policy-based DFIs have given rise to severe market distortions. Seitshiro reiterated that clearly identified policy objectives are essential. They should be prioritized, and established in cooperation between all involved ministries. Also, in outlining the role of DFIs in public policy, he called for a periodic review and (re)alignment of their mandates. He further indicated the need to harness the private sector for development, by mobilizing private resources. He also insisted on the crucial need for positive corporate governance, under three priorities: transparency, equity and accountability; the de-politicizing of DFI operations, and appropriate risk mitigation policies and practices.

2.10 CHAPTER SUMMARY

The purpose of the literature review has been to review the relevant oversight tools being employed by the OECD countries and Malaysia. Literature provides support for the research problem. Thus, in summary, the research defined a DFI as an institution created, promoted or assisted by Government mainly to provide development finance to one or more sectors or sub-sectors of the economy. The institution distinguishes itself by a judicious balance between commercial norms of

operation, as adopted by any private financial institution, and (commercially less desirable) developmental obligations.

According to Rudolph (2010:5) the mandate of DFIs is essentially that of a financial institution that is required to address market failures by providing financial support to sectors inadequately served by private institutions. In addition, DFIs must have a clear public policy mandate. The mandate should include at least three elements. First, to avoid the involvement of state financial institutions in the purely commercial and most profitable parts of the market, the mandate should define target sectors and address a specific market failure, such as a lack of finance for infrastructure or for SMEs.

The information presented in this chapter reveals that there are numerous approaches towards addressing the different aspects of financial oversight of DFIs. In addition, the literature reviewed above reveals that there is not much difference in terms of the financial oversight processes adopted by the DFIs internationally. However, the researcher referred to above identify that there is a significant difference in execution and implementation, and in the quality of monitoring and evaluation between DFIs based internationally.

Chapter 3 presents a review of how financial oversight is being conducted at South African DFIs and in particular the Land Bank. It reveals the effect of financial oversight on the management and administration of DFIs. It also explores the reasons for and different aims of financial oversight functions for DFIs and their managements in South Africa

CHAPTER 3

FINANCIAL OVERSIGHT OF THE LAND BANK: A LITERATURE REVIEW

3.6 INTRODUCTION AND BACKGROUND

In this chapter a review of how financial oversight is being conducted for DFIs in South Africa is presented. It reveals the role playing by the different organs of the state regarding the financial oversight of the Land Bank. It also explores the reasons for and different aims of financial oversight functions for DFIs and their managements in South Africa.

The Land Bank is directed, controlled and held to account in terms of generally accepted corporate governance principles, and in addition by the legislative requirements prescribed in its enabling legislation. There is yet a third level of governance the Land Bank must comply with: as a statutory company, the Land Bank must comply with the precepts of the PFMA and with the Protocol on Corporate Governance, which encapsulates the principles contained in the King III Report on Corporate Governance (Du Toit, 2005:1). The following section discusses financial oversight over the Land Bank, and draws on documents intended to guide the governance oversight roles for DFIs, compiled by the Asset and Liability Management Division within the National Treasury, and on the Protocol on Corporate Governance, drawn up by Du Toit (2005).

The Land Bank was established in terms of Land Bank Act, Act 18 of 1912, to promote the development of the agricultural sector. From its establishment until 1936, the Bank provided mortgage loans to white emerging and commercial farmers. Government provided funding for the Land Bank and put in place a number of institutional support mechanisms to augment its original mortgage loan services:

- the Agriculture Marketing Act was promulgated in 1936 to promote price stability, regulate agricultural imports and to reduce risk in the financing of agriculture;
- the Farmers Assistance Board was established in 1962, and
- agriculture Credit Boards were set up in 1966.

The support structure has changed over time:

- government stopped funding the Land Bank in 1959 when the Land Bank became financially sustainable;
- the Marketing Act was repealed in 1996;
- agriculture Credit Boards were abolished in 1999;
- the Land Bank bills that qualified for liquid asset status declined over time and by March 2007 amounted to only R558 million; and
- in 2002, a new legislative framework was introduced with the passage of amendments to the Land Bank Act, which required the Bank to focus on assistance and support for historically disadvantaged individuals, and to change its structure to become a DFI.

The Land Bank remains wholly owned by the South African Government and is a key financial player in the agricultural sector. It provides retail and wholesale finance to development (emerging) and commercial farmers.

Notwithstanding the depth of the challenges confronting the bank, a number of factors support the hope of a successful turnaround. These include on-going government support in the form of guarantees (which provide the bank with unique opportunities), its exemption from income tax, and the previously mentioned capital injection. In addition, the government's land and agrarian reform policy targets the redistribution of land in areas where the bank can play a significant development role.

With the agricultural sector experiencing an upturn, several positive recent developments will also open the door to more financing opportunities:

- production is likely to increase as farmers respond to higher food prices;
- rising input costs have the potential to attract new market participants to the downstream portion of the value chain;
- higher farm incomes are likely to support increased production; and
- growing numbers of emerging farmers will lead to greater demand for development funds.

3.7 MANDATE OF THE LAND BANK

The Land Bank's corporate finance plan (2010:11) revealed that the long-term objectives flow from the Land Bank Act, and are aligned with government policies and South Africa's socio-economic needs. The Land Bank's broad mandate, as expressed in the Land Bank Act, and discussed in the Social Report 2010/11, addresses 11 objectives:

- equitable ownership of agricultural land, in particular the increase of ownership of agricultural land by historically disadvantaged persons;
- agrarian reform: land redistribution or development programmes aimed at historically disadvantaged persons;
- land access for agricultural purposes;
- agricultural entrepreneurship;
- removal of the legacy of racial and gender discrimination in agriculture;
- enhancing productivity, profitability, investment and innovation;
- growth of the agricultural sector and better use of land;
- environmental sustainability of land and related natural resources;
- rural development and job creation;
- commercial agriculture; and
- food security.

3.8 FRAMEWORK FOR FINANCIAL OVERSIGHT OVER THE LAND BANK

According to National Treasury's Strategic Plan 2010/13, there were measurable objectives and medium-term outputs that the National Treasury was attempting to achieve: these were to ensure prudent cash and financial management by the Land Bank, and to exercise effective oversight of the Land Bank's activities. These measurables included reporting on and resolving Land Bank issues regarding cost effectiveness, development effectiveness and financial sustainability.

The executive authority (Minister of Finance), as owner/shareholder, is concerned with the achievement of appropriate returns on investments, and ensuring the financial viability of the Land Bank. The Minister of Finance (through the National Treasury) is responsible for financial oversight. In addition, Government, as policymaker, is concerned with policy implementation through effective service delivery, and also acts as regulator. Thus responsibilities vest in Cabinet as policymaker, the Minister of Finance and his department (executive authority), and to a lesser degree, in the national department responsible for specifics of agricultural policy (i.e. shareholder management of the Land Bank vests with the National Treasury while policy development and implementation vests with the DAFF).

Oversight by the executive authority rests by and large on the prescripts of the PFMA. The PFMA governs/gives authority to the National Treasury for oversight powers with particular reference to the corporate plans, shareholder's compacts and quarterly reports. The executive authority also has the power to appoint and dismiss the board of the Land Bank. It must also ensure that the appropriate mix of executive

and non-executive directors is appointed and that directors have the necessary skills to guide the Land Bank.

The board of directors of the Land Bank is the governing body of the Land Bank. The board has absolute responsibility for the performance of the Land Bank and is fully accountable for the performance of the Land Bank. Governance principles regarding the role and responsibility of Land Bank boards are those contained in the PFMA and the Protocol on Corporate Governance.

3.3.1 The role of Parliament in the financial oversight of the Land Bank

The Constitution of South Africa (1996) grants the National Assembly and Provincial Legislatures oversight roles over their respective executive councils/organs of state. Section 55(2) of the Constitution deals with the powers of the National Assembly, and states that the National Assembly must provide a mechanism to:

- ensure that all executive organs of state in the national sphere of government are accountable to it; and
- to maintain oversight over the national executive authority, including the implementation of legislation, and any organ of the state. Furthermore, Section 42(3) of the Constitution grants the National Assembly the power to scrutinise and oversee the executive action. In addition, Section 92(3)(b) of the Constitution requires that Members of the Cabinet must provide Parliament with full and regular reports concerning matters under their control. The challenge facing members of parliament is to improve the capacity of the parliamentary committee

members to enable them to more effectively hold National Treasury and Land Bank to account for their performance, using the bank's strategic plans, budget documents and annual reports as the basis of their assessments.

The PFMA places a greater responsibility for the implementation of effective financial management with managers, and makes them more accountable for their performance. (Du Toit, 2005:3). It is left to the Minister of Finance (in consultation with Cabinet) to resolve management failures. The National Assembly is vested with the power to oversee the Land Bank and the Executive.

According to Rapoo (2003:2), to discharge their oversight responsibilities effectively and efficiently, legislative institutions around the world, including those in South Africa, have come to rely increasingly on the use of specialist committees within their legislatures. Government in South Africa has also established a variety of specialist committees to undertake some of the more technically precise and detailed scrutinizing work. It should be noted though that while much of the oversight work of DFIs occurs at the individual DFI audit committee level, nonetheless, the bulk of the oversight work and monitoring, with the related operational techniques, are employed mainly at committee level. However, the existence of the various legislative committees in itself does not necessarily mean that the committees are effective in their operations. Not much is known about the effectiveness of the various oversight methods currently in use in South Africa.

3.3.1.1 Public Accounts Committee

The Standing Committee on Public Accounts (SCOPA) has the responsibility of reviewing the audit reports of the Auditor General. This committee plays the important and specialised role of being the protector of public monies. In fulfilling this role the SCOPA focuses on the following:

- issues raised in the General Report of the Auditor-General on Audit outcomes;
- issues of financial probity as highlighted in the audit report or disclosed in the management report or notes to the financial statements;
- compliance with the PFMA, Treasury Regulations, the entities' audit committees' recommendations, and the management report of the entities' accounting officers;
- interrogation and evaluation of instances of over-expenditure and instances of unauthorised expenditure;
- interrogation of instances relating to irregular, fruitless and wasteful expenditure;
- the functioning of risk management systems; and
- corporate governance of departments, public entities, and constitutional institutions.

3.3.1.2 Portfolio Committees

Given their involvement in the legislative, budget and in-year monitoring processes, portfolio committees exercise oversight of the service delivery performance of DFIs, including the Land Bank, and it is the portfolio committee that fulfils the responsibility of reviewing non-financial information contained in the annual reports of the Land

Bank. These committees should determine whether entities have fulfilled the service delivery commitments they made in their corporate plans. They must also consider the Land Bank's financial performance in order to develop a holistic understanding of the Land Bank's performance. To give effect to this role, the portfolio committee focuses on the following aspects of the annual reports of the Land Bank (Du Toit, 2005:4):

- the technical quality of the annual reports produced by the Land Bank;
- the economy, efficiency and effectiveness of service delivery as measured by performance indicators presented in the annual reports;
- evaluating management's explanation as to why the entity's service delivery performance did not attain the targets set in the corporate plans;
- equity of service delivery; and
- investigating the circumstances that led to financial underperformance, the impact this had on service delivery, and the measures taken by management to rectify the situation.

The National Assembly Portfolio Committees are responsible for overseeing the performance of their associated National Departments. The Land Bank reports to the Minister of Finance (as the shareholder minister) and their annual reports are submitted to both the SCOPA and the Minister of Finance, who forwards it to the appropriate portfolio committees.

National Treasury as the executive authority to attend the portfolio meetings where the Land Bank is expected to report on their deliverables as measured against their

corporate plan and the shareholder compact. The objective of attending these sittings is to ensure that the Treasury and the Land Bank disseminate the same information to Parliament.

3.3.1.3 Portfolio Committees and the Public Accounts Committee (SCOPA)

Ideally the oversight process should provide a complete picture of the Land Bank's performance, encompassing its finances, its systems, its human resources and its service delivery performance. In addition, the exercising of the Land Bank's mandate must also be scrutinised to ensure that policy objectives are being met. While SCOPA focuses on financial matters and the Portfolio Committee focuses on policy and service delivery, the sharing of information between them is important (Du Toit, 2005:24).

3.3.2 The role of the Auditor-General of South Africa (AGSA) in the financial oversight of the Land Bank

The Auditor-General is a state institution accountable to the National Assembly. In terms of Section 188 of the Constitution, the Auditor-General must audit and report on the accounts, financial statements and financial management of all national and provincial departments, all municipalities and any other institution or accounting entity required by national and provincial legislation. In this regard the Auditor-General must submit audit reports on the various DFIs to the relevant legislatures (Du Toit, 2005:5).

3.3.3 The role of the National Treasury in the financial oversight of the Land Bank

The executive authority plays various roles in its relationship with the Land Bank. On one hand, Treasury, as an owner and shareholder, is concerned with obtaining a suitable return on investments, and ensuring the financial viability of the Land Bank. Treasury, this time as policymaker, is also concerned with the service delivery policy implementation. Finally, the DAFF is concerned, as the Land Bank's regulator, with its industry practices, its pricing structures, and the interests of consumers (Du Toit, 2005:5).

According to Presidential State Owned Entities (SOEs) Review discussion paper (2012:43), the National Treasury must not play any on-financial oversight role over any SOE, in line with the principle of separation of Government roles. The role of National Treasury in relation to oversight of SOEs should be strictly in relation to fiscal and financial matters affecting SOEs, but in consultation with other Government Institutions playing other roles and with an interest in SOE performance.

According to Du Toit (2005:9), the role of the National Treasury as the protector of the National Revenue Fund and the sovereign credit rating of the country is to exercise financial oversight through:

- setting reporting guidelines to promote and enforce transparency in respect of revenue, expenditure, assets and liabilities of the Land Bank;
- oversight over the funding/borrowing programmes of the Land Bank;

- controlling the utilisation of contingent liabilities; and
- effective treasury management models.

The Minister of Finance's responsibility to ensure at least a nominally positive return on investment (ROI) entails reviewing, monitoring and overseeing the Land Bank's implementation of its strategic and business plans. In addition the Minister ensures that the Land Bank's day-to-day operations, service delivery and performance targets are being met, and that the Bank is fulfilling expectations, and meeting agreed levels of return on investment and/or return on assets.

Financial performance, from the shareholder's perspective, is about monitoring whether the Land Bank has (Du Toit, 2005:6):

- appropriate and effective planning and budgeting processes in place [Section 52 of the PFMA];
- the financial management and control structures and processes are such that accurate, timeous and reliable recording and reporting of all financial transactions takes place [Section 51 of the PFMA];
- that the appropriate financial management systems and controls are in place to ensure the effective management of the financial affairs of the Land Bank [Section 51 of the PFMA]; and
- that the financial affairs and performance of the Land Bank, as reported, is acceptable in terms of the corporate plans and shareholders' compacts [Section 52 and Treasury Regulations 29.1] (SA, 2000).

The concerns of the owner/shareholder regarding administrative issues focus on the appropriateness, adequacy and effectiveness of the organisational structure, administrative structures, and the administrative and management procedures and practices within the Land Bank, to ensure that the infrastructure and practices are in place to manage and conduct a well-run and optimally performing business and organisation.

3.3.3.1 Land Bank annual reports

Annual reports allow Parliament to evaluate the performance of the Land Bank after the end of the financial year. Since the promulgation of the PFMA the Minister of Finance, who is also the executive authority of the Land Bank, is required to table an annual report in Parliament in line with Section 65 of PFMA within 6 months of the end of each financial year – currently 30 September.

In that Section 65 of the PFMA requires the Minister of Finance to table the annual reports for the Land Bank by 30 September, the implication is that Land Bank annual reports should be tabled in Parliament a month after the accounting officer has received them. This requirement is binding on all government entities, but because it would be impossible for the National Assembly to exercise proper oversight by reviewing all performance aspects of all 35 National Departments and approximately 250 National Public Entities, Parliamentary Portfolio Committees were established to streamline and rationalise the oversight role. This division of labour enables the committee members to become experts in different fields, and to spend more time doing the actual oversight work.

The National Treasury also reviews the annual reports of the Land Bank annually and highlights and refers critical matters that need intervention to the Minister of Finance for corrective actions. For the purpose of this research, the preparation process of the annual reports will not be examined, as the annual reports are audited.

3.3.3.2 Corporate Plan and Shareholder's Compact

The oversight role of the Minister of Finance and his department is done in accordance with Section 52 of the PFMA, which deals with annual budgets and corporate plans. Section 52 provides that the board of the Land Bank must annually submit:

- (a) A projection of revenue, expenditure and borrowings for the forthcoming financial year, in the prescribed format.
- (b) A corporate plan in the prescribed format covering the affairs of the Land Bank for the following three financial years, and, if it has subsidiaries, the affairs of the subsidiaries must also be included.

In addition, Treasury Regulation 29.1 also requires the Land Bank to submit corporate plans. This regulation provides that the accounting authority for a public entity listed in Schedule 2 and 3B must annually submit a corporate plan to the National Treasury. The corporate plan must cover a period of 3 years and include:

- strategic objectives and outcomes identified and agreed on by the Ministry of Finance in the shareholder's compact;
- strategic and business initiatives as embodied in business function strategies;
- key performance measures and indicators for assessing the entity's performance in delivering the desired outcomes and objectives;
- a risk management plan;
- a fraud prevention plan;
- a materiality/significance framework, as specified in Treasury Regulation 28.3.1; and,
- a financial plan addressing -
 - projections of revenue, expenditure and borrowings;
 - asset and Liability management;
 - cash flow projections;
 - capital expenditure programmes; and
 - dividend policies.

In addition to the Corporate Plan, the executive authority of the Land Bank must annually conclude a shareholders' compact with the Bank (Du Toit, 2005:8). Treasury Regulation 29.2.2 directs that: "The shareholder's compact must document the mandated key procedures for quarterly reporting to the executive authority [in order to facilitate effective performance monitoring, evaluation and corrective action". The shareholder's compact represents an agreement between the Minister of Finance, the shareholder and the Land Bank's accounting authority, with respect to performance expectations and parameters. It does not replace the strategic, corporate and business plans, but rather, it is complimentary to these. It describes

the relationship between the signatories and identifies the behaviour that would be required on both sides to support effective management and performance of the entity. The shareholder's compact finds its origin, on the one side, in the public sector's protocol on corporate governance, which is time independent. On the other side, it is anchored in the strategic, corporate and business plans of a public entity, which are time dependent.

The shareholder's compact results from the need to have a clear understanding of the relationship between the shareholder and the Land Bank as the Land Bank is an extension of government charged with delivering public service through its business entities. The Land Bank's compact is the product of research and development into corporate governance and performance agreements between majority/sole shareholders and boards, and subsequent discussions and debate with the parties concerned.

According to Presidential SOEs Review Committee Discussion paper (2012:43) the shareholder's compacts as an instrument for SOE oversight have failed and should be done away with. On an annual basis Government should communicate in writing its strategic intent and expected delivery by each of its SOEs therein. This should be underpinned by consultation (not negotiation or contracting).

3.3.4 Government policy's role in the financial oversight of the Land Bank

According to Du Toit (2005:7) the ultimate authority to direct policy vests in the national government's Cabinet of Ministers. Cabinet decides on the appropriate and desired policy to meet the mission and mandate government holds with the country.

This policy, through the Minister of Finance and his department, is then issued as a policy directive to the Land Bank as the designated entity charged with implementing and delivering against that policy.

Having issued the policy directive, the Minister should immediately ensure that the necessary structures, processes, practices, and business activities exist or are being put in place within the Land Bank to facilitate the implementation of that policy, and thereafter, that the delivery of the required service or product is being achieved. Thereafter, the Department of Finance is required to monitor, review and oversee service delivery from the Land Bank, specifically to ensure that service delivery is consistent with the expected outputs and represents delivery in terms of the policy. Treasury Regulation 30.2 provides that the CEO of the Land Bank must make quarterly reports to the Minister of Finance in order to facilitate effective performance monitoring, evaluation and corrective action (Du Toit, 2005:7)

3.3.5 The Board of Directors' role in the financial oversight of the Land Bank

The board of directors is the governing body of the Land Bank. The Land Bank should be headed and controlled by an effective and efficient board, comprising an appropriate mix of executive and non-executive directors possessing the skills necessary to strategically guide the Land Bank. The board has an absolute responsibility for the performance of the Land Bank and is fully accountable to the Land Bank for such performance. The board should also give strategic direction to the Land Bank (Du Toit, 2005:10).

3.9 LEGISLATION AND REGULATION PERTAINING TO THE FINANCIAL OVERSIGHT OF THE LAND BANK

3.4.1 Public Finance Management Act (PFMA)

The Board of the Land Bank shall produce an annual budget and corporate plan (PFMA Section 52, and Treasury Regulation 29.1) which shall be submitted to the National Treasury at least one month (or another period as agreed with National Treasury), before the start of its financial year. The budget and corporate plan shall consist of the following (SA, 2000):

- a projection of revenue, expenditure and borrowings for that financial year, presented in the prescribed format; and
- a corporate plan in the prescribed format, covering the affairs of the Land Bank for the following three financial years, and, if it has subsidiaries, also the affairs of the subsidiaries.

Without derogating from any duty imposed by law, the Board shall (Du Toit, 2005:11):

- ensure that the executive management implements the Land Bank's strategy as established from time to time;
- ensure that the Land Bank has effective, efficient and transparent systems of operational, risk management and financial internal controls [Sec 51(1)(a)(i) of the PFMA];

- monitor the activities of the executive management;
- provide information on the activities of the Land Bank to those entitled to receive it;
- ensure the succession, and approve the appointment of senior executives;
- ensure that the Land Bank operates ethically;
- address the adequacy of retirement and health care benefits for personnel, and the funding thereof;
- ensure that the Land Bank has and maintains a system of internal audit under the control and direction of an audit committee. The internal audit function must comply with and operate in accordance with regulations and instructions prescribed in terms of sections 76 and 77 of the PMFA;
- ensure that the Land Bank has and maintains an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective [Section 51(1)(a)(iii) of the PFMA]
- ensure that all legislative frameworks and requirements pertaining to black economic empowerment are complied with; and
- ensure that the Land Bank has and maintains a system for properly evaluating all major capital projects prior to a final decision being taken on the project.

In addition, the Board must take effective and appropriate steps to [Section 51(1)(b) of the PFMA]:

- collect all revenue due to the Land Bank;

- prevent irregular expenditure, fruitless and wasteful expenditure, losses resulting from criminal conduct, and expenditure not complying with the operational policies of the Land Bank; and
- manage available working capital efficiently and economically. The Board is responsible for the management (including the safeguarding) of the assets and for the management of the revenue, expenditure and liabilities of the Land Bank [Section 51(1)(c) of the PFMA].
- the board must comply with any tax, levy, duty, pension and audit commitments as required by the Statutes [Section 51(1)(d) of the PFMA].
- the board must take effective and appropriate disciplinary steps against any employee of the Land Bank who [Section 51(1)(e) of the PFMA]:
 - contravenes or fails to comply with a provision of the PMFA;
 - commits an act which undermines the financial management and internal control system of the Land Bank; or
 - makes or permits an irregular expenditure or a fruitless and wasteful expenditure.
- the board is responsible for the submission by the Land Bank of all reports, returns, notices and other information to Parliament, the Member, and to the Treasury, as may be required by the Statutes [Section 51(1)(f) of the PFMA].

The board must promptly inform the Treasury of any new entity which the Land Bank intends to establish, or in the establishment of which it takes the initiative, and allow the Treasury a reasonable time to submit its decision prior to the formal establishment of such an entity, and seek approval of the establishment of the new entity from the Land Bank's executive authority [Section 51(1)(g) of the PFMA].

The board must ensure that the Land Bank has an affirmative action plan in place to advance members of groups historically discriminated against, including on the grounds of race, colour, origin, gender and disability. The directors shall, in the exercise of their powers, use their best endeavours to achieve the objectives of the Land Bank as set out in the memorandum of association of the Land Bank and as conveyed to them by the executive authority. If the board is unable to comply with any of the responsibilities determined for it in the PMFA, it must promptly report such inability, together with reasons, to the Minister and the National Treasury [Section 51(2) of the PFMA].

In terms of Section 55 of the PFMA, the Board of the Land Bank is compelled to:

- keep full and proper records of the financial affairs of the Land Bank;
- prepare financial statements for each year in accordance with Generally Accepted Accounting Practice;
- submit the draft financial statements within two months after financial year-end to the treasury and to their auditors for auditing; and
- in accord with Treasury Regulations published supplementary to the PFMA (Government Gazette number 22219), submit the audited statements within 5 months after the financial year-end to the National Treasury and the Auditor-General.
- the board of the Land Bank must also establish procedures for reporting quarterly to the executive authority to facilitate effective performance monitoring, calculation and corrective action (Du Toit, 2005:13).

3.4.2 National Treasury practice note: Protocol on Corporate Governance

The Protocol on Corporate Governance (D u Toit, 2005) was accepted by Cabinet in 2003 and all Public Entities were subsequently informed that they must comply with the principles contained therein. The Protocol is a code of conduct similar to the King Reports on Corporate Governance (2009) and also has not been formally legislated. It encapsulated at the time the King III Report and aligned corporate governance principles to the requirements of the PFMA, while striving to preserve the independence of DFIs.

The Government, as the major shareholder in the Land Bank, is exposed to a wide range of risks associated with the operations of the Land Bank, including financial, reputation, political and operational risks. It is the responsibility of the National Treasury to ensure that these risks are identified, reduced and managed. The Land Bank must report and account for their financial and non-financial performances to their executive authority, while maintaining independence in the conduct of their duties, free from day-to-day involvement by the executive authority. The purpose of the Protocol is to guide this relationship. With regard to governance issues the Protocol states that the Government's relationship with the Land Bank is similar to the relationship between a holding company and its subsidiaries, features of which include:

- a strong interest in the financial performance of the Land Bank;
- reporting and accountability arrangements that facilitate an appropriate oversight by the shareholder; and

- remedial action initiated by the shareholder where the Land Bank's strategic direction deviates from that preferred by the shareholder. The Minister of Finance, as contemplated in the PFMA, represents the Government's ownership interest in the Land Bank, while the Minister of Finance (National Treasury) is responsible for financial oversight.

The guiding principles of the Protocol are:

- the Minister of Finance also exercises policy control over the Land Bank consistent with the Minister's accountability to Parliament and the public;
- the executive authority should set clear objectives for Land Bank;
- any social service obligations that the Land Bank is to undertake should generally be specified through a shareholder's compact; and
- the directors of the Land Bank should ensure the development of business strategies, policies and procedures, and monitor management in the implementation thereof
- the directors of a Land Bank should ensure that (Du Toit, 2005:14):
- the Land Bank's activities are conducted so as to minimise any divergence of interests between the Land Bank and the shareholder;
- the Land Bank is managed in the best interests of the Land Bank, its shareholder and other stakeholders;
- the Land Bank and their officers maintain the highest standards of integrity, accountability and responsibility; and
- as recommended by the King Code, the board has a charter setting out its responsibilities, which should be disclosed in its annual report. At a minimum, the

charter should confirm the board's responsibility for the adoption of strategic plans, monitoring of operational performance and management, determination of policy processes to ensure the integrity of the Land Bank's risk management and internal controls, communication policy, and director selection, orientation and evaluation policy.

The board of directors of the Land Bank embodies the application of sound corporate governance principles in the Land Bank. The Land Bank should be guided and controlled by an effective and efficient Board, the majority of whose members should be non-executive, to ensure independence and objectivity in decision-making. The role of the board is as follows:

- it holds absolute responsibility for the performance of the Land Bank;
- it retains full and effective control over the Land Bank;
- it has to ensure that the Land Bank complies with applicable laws, regulations and government policy;
- it has unrestricted access to information concerning the Land Bank;
- it formulates, monitors and reviews corporate strategy, major plans of action, risk policy, annual budgets and business plans;
- it ensures that the shareholder's performance objectives are achieved;
- it manages potential conflicts of interest;
- it develops a clear definition of levels of materiality;
- the board must attend annual meetings;
- it ensures financial statements are prepared;
- the board must appraise the performance of the chairperson;

- it must ensure effective Board induction; and
- it must maintain integrity, responsibility and accountability.

Since a board cannot attend to all the matters effectively itself, the Protocol recommends the establishment of the following committees:

- audit committee;
- remuneration committee;
- nomination committee; and
- risk management committee

According to Du Toit (2005:15), in line with the precepts of the PFMA the relationship between the executive authority and SOE boards should be governed by a shareholder's compact. The National Treasury as executive authority should closely monitor the extent to which the board as a whole achieves the objectives and specific performance targets set, and where necessary, effect remedial action. With regard to the role of the chief executive officer, the Protocol states: "Unless otherwise agreed in the shareholder's agreement or shareholder's compact (as the case may be) the executive authority should appoint the chief executive officer whose role should, preferably, be separate from that of the chairperson"

According to Presidential Review Committee Discussion Paper (2012:36), there is no evidence of government ever having taken steps against any SOE/DFI Board for having failed to sign the shareholder compact. This is so because in most instances it is not the SOE/DFI that fails to sign, but Government itself. Therefore this brings

about general non-commitment to signing these as no consequences arise therefrom.

The executive authority should consult with the board about its preferred candidate for the position of chief executive officer and provide sufficient time for the board to consider the candidate and respond, prior to an appointment being made. The chief executive officer's role should focus mainly on the operations of the Land Bank, ensuring that the Land Bank is run efficiently and effectively and in accordance with the strategic decisions of the Board. The chief executive officer is accountable to the board. Regarding financial governance the Protocol relies on the PFMA (as the principle Act) to stipulate the rules and regulations related to financial management of SOE's, and by extension, the Land Bank.

3.10 CHAPTER SUMMARY

This chapter highlighted the process that the Land Bank is required to adhere to in terms of the PFMA, Treasury Regulations and the Companies Act. The final section also highlighted the processes and systems by which the Land Bank is directed, controlled and held to account in addition to the legislative requirements contained in the Land Bank's enabling legislation, and the Companies Act were discussed.

Chapter 4 will present research methodology that was applied to achieve the remaining research objectives. The study design, the survey population and the sample are described next, where-after the instrument used to collect the data, (including methods implemented to maintain validity and reliability of the survey instrument), is described.

CHAPTER 4

RESEARCH METHOD AND DESIGN

4.6 INTRODUCTION

In Chapters 2 and 3 (the literature review), financial oversight processes and experiences from OECD countries, from other African countries, and South Africa's own experience from the perspective of the Land Bank, were discussed. The literature review revealed that the financial oversight mechanisms employed internationally and in some African countries have very strong similarities; however, the framework for implementation, and the process of monitoring and evaluation differs in both quality and quantity.

In this chapter the research methodology that was applied in this study, is discussed. The study design, the survey population and the sample are described next, whereafter the instrument used to collect the data, (including methods implemented to maintain validity and reliability of the survey instrument), is described.

4.7 RESEARCH APPROACH AND DESIGN

A qualitative approach was deemed to be both effective and appropriate in that it helped the author to understand and assessed the perception regarding the financial oversight of the Land Bank by the National Treasury. In order to ensure fair reflection of the perception of the participants, the author interviewed the officials from the Land Bank and the National Treasury. Patton (2002:215) defined qualitative

research as attempting to understand the unique interactions in a particular situation. The purpose of understanding is not necessarily to predict what might occur, but rather to understand in depth the characteristics of the situation, and the meaning brought to that situation by the participants, and (as a consequence) achieving an understanding of what is happening to them at that moment. The aim of qualitative research is to truthfully present findings to others who are interested in the study. In this study the information was collected through personal interviews conducted by the author.

Denzin and Lincoln (2000:3) added that: “Qualitative research is multi-method in focus, involving an interpretive, naturalistic approach to its subject matter”. This means that qualitative researchers study things in their natural settings, attempting to make sense of, or interpret phenomena in terms of the meanings people bring to them.

The rationale for using a qualitative approach in this research was to explore and describe the body of opinions held by those within the National Treasury responsible for the financial oversight of the Land Bank. A qualitative approach was seen as appropriate to capture the opinions of the participants regarding the financial oversight model adopted by the National Treasury.

In this investigation a case study method was selected as an appropriate method of research. There are a number of advantages in using case studies. First, the examination of the data is most often conducted within the context of its use (Yin, 1984:23), that is, within the situation in which the activity takes place. A case study

might be focus, for example, on the process by which a subject comprehends an authentic text. To explore the strategies the reader uses, the researcher must observe the subject within his/her environment, such as reading in a classroom (group/interactive situation) or reading for leisure (alone/in private). This would significantly contrast with the experiment, for instance, which deliberately isolates a phenomenon from its context, focusing on a limited number of variables (Zainal, 2003:4).

The case study was chosen to meet the objective of the study, namely to investigate the effectiveness of financial oversight by the National Treasury over the Land Bank. In addition, the study was intended to examine the Land Bank's management information system, including financial reporting models, and to make an assessment of (and to offer recommendations on improving) the effectiveness thereof. In addition to examining whether appropriate systems are in place to support the corporate planning process, and to establish whether the corporate plans provided by the Land Bank are in line with the National Treasury Practice Note requirements, was the objective of identifying a mechanism, system and/or plan which would assist the National Treasury in curbing the strain placed on the fiscus by unbudgeted financial bailouts of the Land Bank. This information was gathered to enable the author to examine, identify and recommend the best financial oversight systems, which may assist the National Treasury in performing its oversight role more effectively.

4.2.1 The study's population and sample

To select participants for the study, purposive sampling was applied. According to Burns and Grove (2005:341), purposive sampling involves selecting a group of people, events, behaviours, or other elements from a given population, upon which (or with whom) to conduct a study. The study sample was drawn from the population which consisted of National Treasury officials responsible for:

- advising on strategic and policy issues on the Land Bank;
- providing an in-depth financial analysis on the Land Bank performance; and
- advising on appointment of boards, governance issues and, oversee candidate management issues.

The Land Bank officials sampled are those who are involved in the corporate planning process, which represented the following business unit.

- management accounting;
- compliance unit;
- agricultural and economic research unit; and
- business strategy planning unit.

The sample comprised five Land Bank and four National Treasury officials. The participants who met the predetermined criteria were identified by the author, drawing on his work-place professional interactions with them at the National Treasury and Land Bank. The sample size of four National Treasury and five Land

Bank officials was the total number of officials who were willing to participate in the research, and who also met the sampling criteria that follows.

4.2.2 The sampling criteria

Participants in the survey were selected to meet specific pre-determined criteria. For the National Treasury officials, they had to meet the following criteria to be included in the sample.

In order to ensure that the participant's contributions and inputs are meaningful to the research, they were required to be actively involved in the following areas of expertise at National Treasury:

- analysis of all performance, efficiency and solvency indicators;
- forecasting of income statements, balance sheets and cash flows;
- utilising appropriate company comparisons - both from SA and globally - to identify best practice performance and efficiency ratios
- possess an ability to make recommendations on the benefits and risks proposed financial transactions;
- analysis of the financial impact of the Land Bank's strategic plans;
- identify and note the extent of compliance (or failure to comply) with applicable legislation and government policy;
- analysis of the business trend direction of the broader private and global industries impacting on the financial space also occupied by the Land Bank;
- understand and utilise key macro-economic data;

- monitor the financial performance of the Land Bank against shareholder compliance requirements, corporate plans, and pre-agreed key performance indicators; and
- evaluate the potential impact of the Land Bank's financial and non-financial performance.

The Land Bank officials had to meet the following criteria to be included in the sample. They were required to be competent and actively involved in the following areas of expertise:

- implementing strong planning and forecasting techniques as directed by the Land Bank mandate;
- manage and control functional budget and expenditure across the budget lifecycle;
- manage expense control procedures for the functions, identifying and implementing cost savings;
- collate and report progress against Land Bank objectives via a balanced scorecard;
- provide analysis and business case development and implementation support across a wide range of strategic initiatives, as directed by the Land Bank mandate;
- identify and deliver process improvement and optimisation opportunities, including enhancements to systems;
- identify and implement initiatives to improve stakeholder engagement;

- challenge data quality across the Land Bank's reporting spectrum. Ensure that the methodology and approach adopted by the Metrics team is consistent and accurate. Work closely with the National Treasury's published guidance to help produce meaningful figures; and
- understand, follow and demonstrate compliance with all relevant internal and external rules, regulations and procedures that apply to the conduct of the business in which they are involved, specifically the agreed internal controls and any compliance policy including, the PFMA, amongst others.

4.2.3 Justification for using a case study method and qualitative analysis

A series of management challenges have contributed to the situation at the Land Bank. Towards the end of 2007/08 the acting CEO, who had been seconded from the Department of Agriculture to the Land Bank, was recalled to the department. At that point, the General Manager: Operations was appointed acting CEO of the Land Bank. Following the end of the reporting period, the acting CEO resigned (Land Bank annual report 2007/8:34). This has resulted in the removal of 5 board members (including two board chairpersons), and the replacement of three CEOs over a short period.

In addition, the government's oversight over the Land Bank was also moved to the National Treasury, and subsequently the government commissioned four forensic audits. These forensic audit reports have been submitted to the Serious Economic Offences Unit of the South African Police Service and the Hawks. In addition, the Financial Intelligence Centre, and the Compliance Unit at the South African Revenue

Service (SARS) have also been drawn into these investigations (annual report, 2008).

Thus, the decision to make use of qualitative method for this research was prompted by the fact that quantitative data was already being gathered by forensic auditors, which, because of legal ramifications of on-going criminal investigations, and the extended time frame of that process, made a purely statistical and accountancy-driven quantitative investigation problematic.

The case study method (underpinned by purposive sampling of respondents, and the use of a qualitative approach to data analysis) was therefore chosen in order to explore the nature of financial oversight of DFIs (or lack thereof) that resulted in the negative situation that arose at the Land Bank. Arising from an understanding of the situation the researcher was then able to recommend the best (most effective and appropriate) financial oversight practices to apply to the Land Bank. The detailed qualitative accounts often produced in case studies not only help to explore or describe the data in its real-life environment, but also help to explain the complexities of real life situations which may not be captured through experimental or (purely numerical) survey research data.

4.2.4 Limitations of the Case Study Method

According to Zainal (2007:5), case studies have various advantages, particularly in that they present data from real-life situations and that they provide better insights into the detailed behaviours of the subjects of interest, they are also criticised for

their inability to create widely applicable generalisations from their results – to move from the specific to the general. The case study method has always been criticised for its lack of rigour and the tendency for a researcher to have a biased interpretation of the data.

Zainal (2007:5) further stated that the grounds for establishing reliability and generality are also subjected to scepticism when a small sampling is employed. Most often, case study research is dismissed as useful only as an exploratory tool. Despite these criticisms, researchers continue to employ the case study method particularly in studies of real-life situations governing social issues and problems.

4.8 DATA COLLECTION

4.3.1 Data collection instrument: Semi structured interview

The primary means of data collection in this study was through a semi-structured (in-depth) interview, using open ended questions. An interview guide (Appendix A) with the questions was presented to the interviewee (respondent) to give structure to the interview, rather than to rely on a series of purely oral questions. The same questions were directed to the National Treasury and Land Bank officials. The questions were focused on the four primary objectives and based on the literature review of the study.

The author began with a brainstorming session to arrive at the interview questions. Then, the considered interview questions were systematically evaluated and refined.

Every question that was considered for inclusion was reviewed carefully for its clarity and ability to convey the intended meaning.

An audio recorder was used to record the interviews and a transcription of each of the recordings was made in order to recall the events and content of the interviews, and to allow the researcher to more easily check details. The recordings and their transcripts also serve as evidence of the completed process. Primary materials and confidential research data are being kept in secure storage. Audio recorded interviews were transcribed and the recordings will be destroyed after the postgraduate degree process has been finalised. Participants' rights to privacy, anonymity, confidentiality and fair treatment were protected. The interviews were in-depth (open ended) as this enabled the participants to tell the researcher what was important to them, and to share their experiences, perceptions and feelings. It also facilitated continued reflection and interaction with interviewees. The researcher could also observe attitudes, body language and silent moments, and probe where necessary. Handwritten notes recording these non-audible details were also taken during each of the interviews.

4.3.2 Advantages of interviews

Data was collected with the aid of the semi-structured interview instrument to evaluate the participants' knowledge, expertise and views on financial oversight as it applies to the Land Bank. This design of instrument was decided upon because it allows an in-depth semi-structured interview to be conducted, with open-ended questions that encourage unique responses and allows participants to request

clarification of confusing questions. Similarly, this style of interview allows the researcher to ask the respondent to provide additional information if answers appeared incomplete.

Patton (2002:343) recommends that interviewers should “ ... explore, probe, and ask questions that will elucidate and illuminate that particular subject ... to build a conversation within a particular subject area, to word questions spontaneously, and to establish a conversational style but with the focus on a particular subject that has been predetermined.”

Gray (2004:214) has given the following reasons for using open-ended questions:

- where there is a need to obtain highly personalized data;
- where there are opportunities for discovering greater insights that require probing;
- where a good response rate is important; and
- where respondents are not fluent in the native language of the country, or where they have difficulties with written language.

4.3.3 Disadvantages of interviews

The technique does however rely on the respondent being willing to give accurate and complete answers (Breakwell, Hammond & Fife-Schaw, 1995:238). It has been observed that respondents may lie due to feelings of embarrassment, inadequacy, lack of knowledge on the topic, nervousness, memory loss or confusion. Equally disadvantageous for the research, interviewees may also provide very elaborate

answers in an attempt to figure out the purpose of the study (Wimmer & Dominick, 1997:162).

4.9 DATA ANALYSIS

The structured interviews' data was transcribed by the researcher. Data was analysed by using a Qualitative Content Analysis (QCA) method. QCA involves a process designed to condense raw data into categories or themes based on valid inferences and interpretation. This process uses inductive reasoning, by which themes and categories emerge from the data through the researcher's careful examination of that data, and by constant comparison. But QCA does not need to exclude deductive reasoning (Patton, 2002:83). The QCA method is used because it complements the data collection method that was used in this study.

Hsieh and Shannon (2005) discuss three approaches to QCA, based on the degree of involvement of inductive reasoning. The first is *conventional QCA*, in which coding categories are derived directly and inductively from the raw data. This is the approach used for grounded theory development. Grounded theory is a complex *iterative* process. The research begins with the raising of *generative questions* which help to guide the research but are not intended to be either static or confining. As the researcher begins to gather data, *core theoretical concept(s)* are identified. Tentative *linkages* are developed between the theoretical core concepts and the data.

The second approach is *directed content analysis*, in which initial coding starts with a theory or pertinent research finding. Then, during data analysis, the researchers

immerse themselves in the data and allow themes to emerge from that data. The purpose of this approach usually is to validate or extend a pre-existing conceptual framework or theory.

The third approach is *summative content analysis*, which starts with the counting of words or manifest content, then extends the analysis to include latent meanings and themes. This approach seems quantitative in its early stages, but its goal is to explore the usage of the words/indicators in an inductive manner.

The directed content analysis approach was applied in this study. The interviews were audio recorded and transcribed. The transcriptions are in the possession of the author. In the analysis an alpha numerical number was allocated to each interviewee to ensure anonymity. Central themes were then identified and presented in table format together with a cross-reference to applicable literature in the literature chapters.

4.10 CHAPTER SUMMARY

The researcher used a qualitative design for the research instrument. The interviews were conducted with Land Bank and National Treasury officials – nine in total. The professional characteristics of the participating individuals included National Treasury officials who are involved in financial oversight of the Land Bank's affairs, and the Land Bank officials responsible for strategy and planning, management accounting, compliance and agricultural research.

The questionnaire was approved and ethical clearance was given by Faculty of Economics and Finance Research Ethics Committee of Tshwane University of Technology. Consent was obtained from the interviewees themselves, after having been given written undertaking assuring them of the anonymity of their responses, and of self-determination during the interviews (i.e., they were made aware of their right to end their participation in the research in its entirety, or their response to a particular question at any time). This chapter described the research methodology, including the population, sample, data collections instruments as well as strategies used to ensure the ethical standards, reliability and validity of the study. Chapter 5 will present the results of the data analysis. The data was collected and processed in support of the objectives posed in Chapter 1 of this dissertation.

CHAPTER 5

ANALYSIS AND INTERPRETATION OF RESEARCH RESULTS

5.1 INTRODUCTION

The previous chapter outlined the research methodology, and discussed the appropriateness of the research instrument. In this chapter the results of the data analysis are presented. The data was collected and processed in support of the objectives presented in Chapter 1 of this dissertation.

5.2 OCCUPATIONAL POSITION OF PARTICIPANTS

The author targeted respondents throughout the decision-making levels of both the Land Bank and National Treasury. All Land Bank participants (100.0%) were from the decision-making levels of the Land Bank, while the majority of National Treasury officials surveyed were from the operational and advisory levels within the Asset and Liability Management divisions.

Since the participants were from the highest decision making structures it was accepted that their inputs, through sound analysis, provided suitable data for a thorough evaluation of the financial oversight of the Land Bank, and gave a variety of perspectives on those oversight issues. The data will be discussed in the next subsection.

5.3 SEMI-STRUCTURED INTERVIEW DATA

The participants represent different directorates and business units from the Land Bank. Participants were requested to indicate their business unit in order to attribute the views of the participants to their respective units. Table 5.1 identifies the units from which the respondents were drawn.

Table 5.1: Land Bank Participants

Land Bank Participants	No. of respondents
Agricultural Research Unit	1
Compliance Unit	2
Strategy and Planning Unit	1
Management Accounting Unit	1

Total	5
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The four business units that are directly involved in the Land Bank's corporate plan preparation process were each represented by one participant. Participating business units include the Agricultural Research Unit, Compliance Unit, Management Accounting Unit and Strategy and Planning Unit. The business units were represented by participants who are involved in decision making and who assist in providing strategic direction to the Land Bank.

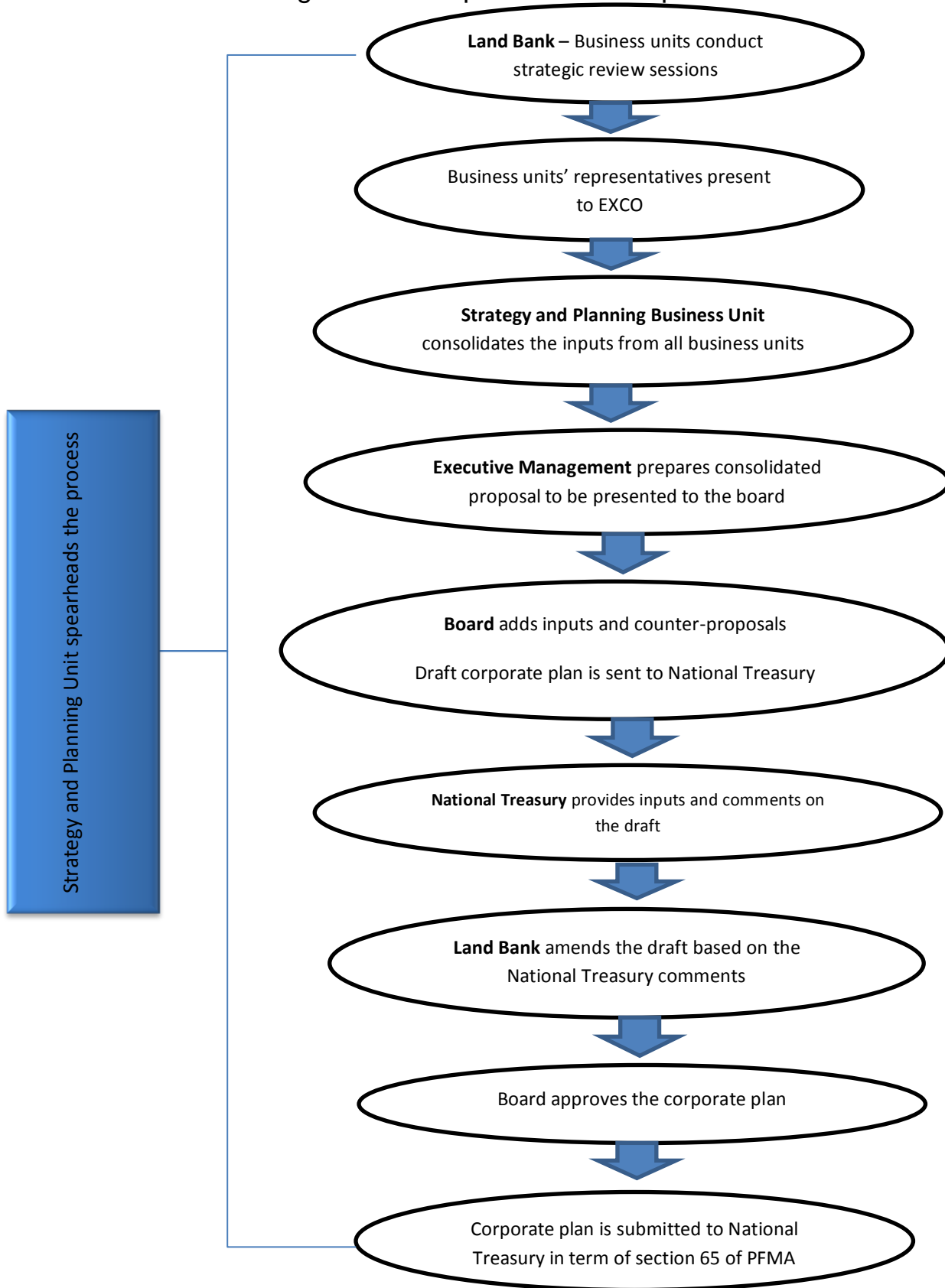
5.4 PRESENTATION OF THE SEMI-STRUCTURED INTERVIEW DATA: LAND BANK

The analysis of the transcribed interviews was tabulated and presented in annexure A to this dissertation. The detailed discussion of the different answers is in the annexure and this chapter presents the main results of these discussions. Following is a discussion of this analysis pertaining to each question that was asked during the interview.

5.4.1 The corporate plan preparation process

The corporate plan preparation process is coordinated by the Strategy and Planning business unit. The main steps in the process include conducting a strategic review process in order to identify the challenges presented by the current strategy. The executive management then prepares a proposal to be presented to the board.

Figure 5.1: Corporate Plan Preparation Process



Source: Land Bank participants Interviews

The board then add their inputs and counter-proposals where necessary before finally approving the corporate plan. After the board's approval, the corporate plan draft is submitted to the National Treasury for further inputs and comments. The Land Bank receives the National Treasury's input around January each year, which is then processed into the final corporate plan. The corporate plan is then finalised and made operational.

5.4.2 Possible changes to the corporate plan preparation process

It can be deduced that there is a need for an improvement in the preparation process (see A2.1¹). This is evidenced by ongoing initiatives that the Land Bank is implementing in order to ensure that the process comply with the requirements of Section 52 of the PFMA. Some of the initiatives implemented by the Land Bank include strategic session by business units with the key objective of exploiting synergies amongst the business units. It can further be deduced that the National Treasury should communicate any proposed changes to the corporate plan submission timeously. This will ensure that the concerns raised are properly and timeously addressed and that there is no detrimental impact on the Land Bank process plan.

¹ Annexure 2.1

5.4.3 The Land Bank compliance with the requirements of Section 52 of the PFMA

In terms of Section 52 of the PFMA, the accounting authority for a public entity listed in Schedule 2, or a government business enterprise listed in Schedule 3, must submit to the relevant treasury, at least one month before the start of its financial year, a corporate plan in the prescribed format covering the affairs of that public entity or business enterprise for the following three financial years, including the affairs of its subsidiaries.

From the above it is clear that the National Treasury and Land Bank participants are in consensus in terms of compliance with the PFMA by the Land Bank (see A2.2). However, the author is of the view that compliance should not be reduced to a mere submission of required reports as per PFMA. Great care should also be taken to ensure the quality of the data contained in the reports. The National Treasury participants have indicated that there has been an incident whereby the Land bank was required to resubmit its corporate plan due to insufficient information. This is a clear indication that the constant engagements between the National Treasury and the Land Bank are necessary to ensure ongoing improvements of the corporate plan submissions.

5.4.4 Impact of the National Treasury Practice Notes in ensuring compliance with the requirements of the PFMA

The Practice Notes issued by the National Treasury seek to provide clarification to the accounting officers of public entities and national government business enterprises (public entities), regarding the information that the National Treasury requires as part of submissions from Schedule 2 public entities and national government business enterprises (National Treasury, 2009).

From the above it can be deduced that the Practice Notes are fundamental to improving compliance and ensuring that the Land Bank provides the level of detail necessary to enable the National Treasury to appropriately exercise its oversight over the bank (see A2.3). The environment in which the Land Bank operates changes rapidly, with new risks and challenges emerging unpredictably. Therefore the Practice Notes should also be amended and improved in order to reflect these and other changes and to attempt to close loopholes that could develop as a result. To this end, it was also clear that there should be better communication when the practice notes are issued. This will ensure minimum interference with the current processes and also ensure effective implementation.

5.4.5 Board involvement in the corporate plan preparation process

As depicted in Graph 5.1, the board involvement in the corporate plan preparation process entails providing inputs and determining the appropriate strategy to achieve the objectives of the bank. This ensures that management is given space and

mandate to develop and recommend to the board a well thought-out corporate plan that will generate satisfactory levels of shareholder value and positive reciprocal relations with relevant stakeholders; and also to develop and recommend to the board corporate plans and budgets that support the company's long-term strategy. This is in line with the Chapter 1 of the King Report III on corporate governance, which requires the board to exercise objective judgment on the corporate affairs of the bank, independent from management but with sufficient management information to enable the directors to collectively make a proper and objective assessment (Du Toit, 2005:20).

5.4.6 Financial projection assumptions

In line with best international practice, the Land Bank's financial projections include the income statement, balance sheet and cash flow statement. The author has ascertained that the Land Bank considers the macroeconomic situation when building their financial projections. The financial projections are based on the following drivers:

- Overall economic growth rate of GDP during the projection period
- Timing and duration of economic recessions
- Rate of inflation
- Level of interest rates

From above it can be deduced that the Land Bank financial projections are developed in line with the National Treasury Corporate Plan Practice Note (see

A2.5). The Practice Note required that the economic and financial assumptions, that have been used to develop the financial projections, should be clearly explained in the corporate plan.

5.4.7 Future financial support to the Land Bank

From the discussions and interviews held with the participants, the author was able to deduce that the Land Bank will most likely approach the Government for further financial support (see A2.6). This is due to the CAR getting closer to the 20% target ratio required by the National Treasury. During the year under review the CAR declined from 30% in financial year 2012 to 24% in financial year 2013. The decline in the CAR is the result of increased funding liabilities being taken on in order to fund the growing loan book. It is a concern that the equity position is expected to record declining growth rates against significant growths in total debt, particularly interest bearing debt. The Land Bank's balance sheet is primarily dependent on the cash injection, and very little on the cash generated from operations. The Land Bank's management needs to revitalise the cash generating model to ensure an improving contribution to growth in equity and, ultimately, financial sustainability.

To assist the Land Bank to maintain the CAR within acceptable levels, the National Treasury has previously supported the Land Bank through capital injections. The ratio includes cash injections of R1 billion in 2009, R750 million in 2010, R750 million in 2011, and R200 million in 2012.

5.4.8 Additional oversight support to the Land Bank

There seems to be an urgent need for the inclusion of a National Treasury official on the Land Bank board as a shareholder representative. An official in such a position would be able to make meaningful and timeous contributions to the board. The National Treasury representative would further have an influence on key decision making, ensuring the alignment of the bank's strategy with government objectives even before the strategy's final presentation to Treasury. The author has noted that there are representatives on the boards of all the state owned companies where the National Treasury is the executive authority (Public Investment Corporation, DBSA, and Sasria), with the exception of the Land Bank. Shareholder representatives should have skills, experience, and other qualities necessary to make meaningful contributions, in order to ensure the effectiveness of the board in discharging its mandate.

It can also be deduced that there is need for establishment of a technical committee which should comprise of the Land Bank, National Treasury and other relevant stakeholders (see A2.7). The mandate of the committee should be to allow the technocrats with the platform to deliberate on strategic priorities, information workflow, risks faced by the bank and the mitigating factors thereof.

5.5 NATIONAL TREASURY INTERVIEW DATA ANALYSIS

Table 5.2: National Treasury participants

National Treasury Participants	No. of participants
Corporate Governance	1
Investment Analysis	1
Development Finance Institute	2
Total	4

The majority of the participants surveyed were from the Development Finance Institution (DFI) directorate, which is responsible for oversight of DFIs; the Investment Analysis and Corporate Governance business units each provided one representative.

The Asset and Liability Management (ALM) division within National Treasury is responsible for the financial oversight role of DFIs. It can be deduced that the views presented are those of informed participants who understand their financial oversight roles.

The discussion of the individual responses includes quotations from the interview transcripts and limited references to the literature review where necessary to substantiate the points being made. It is followed by specific findings that emanate from the responses to the interview questions. In the final part of this section, the author attempts to summarise the overall findings from these interviews.

5.5.1 The role of the PFMA in empowering the National Treasury to perform its oversight role over the Land Bank?

The PFMA does empower the National Treasury to perform its oversight role. This is evidenced by the submission of the oversight instruments such as the annual report and corporate plan which is required in terms of Section 55 and 52 of the PFMA respectively. The Act requires the Land Bank to submit these instruments annually to the National Treasury in the prescribed format. However, the author has also noted that the PFMA was enacted in 1999 and has not, to date, benefited from any amendments. The National Treasury has in the past issued Practice Notes in order to cover some of the PFMA loopholes and shortcomings. Therefore, there is a need for amendments to the legislation, to ensure that the loopholes and gaps are closed, and that the Act reflects current conditions and changing realities.

5.5.2 The quality of the corporate plan received from the Land Bank

It can be deduced from their responses that the National Treasury participants are generally satisfied with the Land Bank's corporate plan submission, as it complies with the requirements of the PFMA (see B1.2). Due to a lack of implementation of a financial oversight model by the National Treasury that would guide the interrogation and validation of the financial data submitted by the Land Bank, the National Treasury participants could not confidently express their opinion on the quality and usefulness of the financial data contained on the corporate plan.

5.5.3 Substantial compliance with the requirements of the PFMA

It can be deduced that the Land Bank complies with the requirements of the relevant laws and regulations in terms of submission of the corporate plan to the National Treasury (see B1.3). According to the report of the Auditor General to Parliament on the Land Bank, the Auditor General did not identify any instance of material non-compliance with specific matters in key laws and regulations.

5.5.4 Resubmission of the corporate plans due to lack of information

There are ongoing engagements and consultations between the National Treasury and the Land Bank prior to the final submission of the corporate plan. This process ensures that the final submission addresses all the strategic objectives, key performance measures and indicators for assessing the Land Bank's performance and financial aspect in the prescribed format.

5.5.5 The National Treasury oversight role over the Land Bank

It is quite clear that the participants are strongly of the view that the current oversight model should be improved (see B1.5). The author has noted some material improvements to the shareholder oversight model that have been implemented since the bank was shifted away from the Department of Agriculture, Fisheries and Forestry (DAFF). General accountability has improved, as evidenced by the emergence of a number of matters that are currently being investigated relating to historical IT system implementation irregularities, Land and Development Finance

Unit irregularities, and irregularities in respect of AgriBEE and Mafisa Funds administered on behalf of DAFF.

The National Treasury has also ensured that the Land Bank adopts the preferred liquidity model to ensure that the bank consistently maintains liquidity above a defined minimum level. The National Treasury has implemented the submission of quarterly progress reports on the turnaround strategy, measured against the key performance indicators, as part of the oversight mechanism.

5.5.6 Discussion of the corporate plan findings with the Land Bank

The corporate plan findings are discussed within the National Treasury in order to deliberate and decide whether the key issues that have been identified requires close monitoring, ongoing monitoring or immediate intervention at the Land Bank. The key issue that required immediate intervention are then taken up with the Land Bank during the stakeholder engagement exercise.

However, it is not clear what needs to happen after the sharing of the findings. It seems there is no agreed-upon action plan requiring reports within specific timelines to ensure that all pressing matters arising from the corporate plan analysis are adequately addressed. The adoption of a clear action plan, whereby matters that require feedback are allocated to specific individuals for better monitoring and reporting would ensure that no matter will fall by the wayside.

5.5.7 Compliance with the conditions set by the National Treasury e.g. on the guarantees

The Land Bank is in clear compliance with the guarantee conditions set by the National Treasury, some of which include the submission of quarterly reports and payment of guarantee fees. However, the indication is that, in order to improve the monitoring process for the guarantees, a more stringent approach should be adopted by the National Treasury. According to the 2013 annual report, the Land Bank met all the guarantee conditions.

The author has established that the Land Bank will have difficulties in maintaining the required CAR of 20% in 2014. According to the 2013 annual report, the Land Bank is engaging the National Treasury to identify a suitable solution that will allow the bank to continue on its growth trajectory while remaining financially sustainable.

The government's balance sheets are exposed to the risks of explicit contingent liabilities, such as guarantees. The author is of the view that the National Treasury and the Land Bank should have agreed on the risk mitigation protocols, and/or the penalties to be enforced for breaching of the required CAR of 20% when the covenant was put in place. This could have ensured better monitoring of contingent liabilities and promoted a pre-emptive approach to identifying possible solutions.

5.5.8 Analysis of the financial projections to limit surprises in the budget process

The corporate plan must include a detailed projected income statement, cash flow statement, and a balance sheet for the public entity for the next three years. Financial projections are highly dependent on the underlying economic and financial assumptions. The economic and financial assumptions that have been used to develop the financial projections should be clearly explained in the corporate plan.

From the above, it can be deduced that the goal in analysing, evaluating and updating a public entity's financial projections annually is to ensure that the figures provided are realistic and achievable. However, due to the confidentiality of the corporate plan, the author could not establish whether all previous government financial support to the Land Bank was accurately forecast or anticipated by the National Treasury.

Due to a lack of a financial model, it will be difficult for the National Treasury to scrutinise the Land Bank's financial projection with the desired degree of accuracy and certainty (see B1.8). It seems that the National Treasury is utilising the historical audited financial statements in the absence of a financial supervisory model, and is reviewing the financial projections with the view of limiting fiscal and budget shocks.

5.5.9 Unbudgeted financial assistance perception

It can thus be stated that the bank funds itself by participating in the open market through the issuance of debentures, promissory notes, floating rate notes, call bonds and bills; however, the Land Bank's balance sheet is largely dependent on the cash injection from government and minimally dependent on the cash generated from operations. This is evidenced by the increase in debt to equity (gearing ratio) from 288% in 2011 to 351% in 2012, primarily as a result of growth in interest-bearing debt.

Therefore, existing measures need to be reviewed and improved by developing a financial model that will enable the National Treasury to assess and monitor, among other elements, the Land Bank's profitability, efficiency, cash flow, capital structure, and future risks.

5.5.10 Oversight tools implemented by the National Treasury

The current oversight tool-of-choice employed by the National Treasury is the PFMA. The PFMA mandates a review of corporate plans, annual reports and quarterly reports. It was clear that the current oversight tools should be supplemented with a supervisory tool in order to improve the oversight role (see B1.11). The author is further of the opinion that the continuous issuing of Practice Notes is a clear indication that the PFMA needs to be reviewed and subsequently amended.

This is further indication that the PFMA has shortcomings which should be addressed urgently in order to improve the monitoring and evaluation role carried out by the National Treasury. The National Treasury should consider supplementing it with other internationally proven financial oversight tools, such as SDI and CAMELS, adopted by some successful foreign development finance institutions.

These tools can be utilised as mechanisms to minimize risk and fiscal vulnerabilities. The CAMELS rating will assist the National Treasury to determine the bank's overall condition and to identify its financial, operational, and managerial strengths and weaknesses. The CAMELS tool can be used to highlight the position of a bank by evaluating the capital adequacy, asset quality, management capability, and liquidity.

Alternatively, SDI can be utilised as a financial tool to measure the reliance of the Land Bank on government support. SDI can further serve as a long-term planning and monitoring tool, allowing government to track the Land Bank's progress towards self-sustainability over time. Adoption of an internationally recognized financial model will allow better monitoring of implicit contingent liabilities, such as financial bailouts of the Land Bank.

5.5.11 Effectiveness and relevance of the existing oversight tool

It can be deduced that the current oversight tools are still relevant for providing financial oversight. However, it is clear that in order to improve the effectiveness of the existing tools, they should be supplemented with a financial supervisory model such as SDI and CAMELS, in order to strengthen monitoring and evaluation

processes (B1.11). SDI can provide a comprehensive method of assessing and measuring the overall financial costs involved in operating a DFI and quantifying its subsidy dependence, while CAMELS can be used to evaluate financial performance.

5.5.12 Views on the current oversight process.

The author has noted that the Land Bank has adopted a financial sustainability model in order to ensure better financial management. This is a clear indication that the National Treasury needs to improve the performance of its oversight role over the Land Bank. The environment within which the Land Bank operates has changed significantly over the past 5 years, and continues to change. Therefore it is even more important for the National Treasury to enhance its oversight model to ensure the effective fulfilment of its oversight role. Effective oversight models adopted by the National Treasury will also ensure better accountability on the part of those entrusted with the power to run the Land Bank.

5.6 CHAPTER SUMMARY

This study's main objective was to investigate the effectiveness of the National Treasury financial oversight over the Land Bank. The research methodology used was a qualitative research framework. Within this framework a case study approach was used to conduct the research. Interviews were conducted with officials of the Land Bank and the National Treasury.

This chapter provided analysis and interpretation of the interview data. Information gathered from all participants, and the analysis and interpretation of this information, was done with direct reference to the research objectives. While there are some consistent responses regarding compliance with PFMA, it is clear that the adoption and development of financial models such as SDI and CAMELS could enhance financial oversight capacities. These oversight instruments could further empower the National Treasury to interrogate the validity and reliability of the information submitted by the Land Bank in its annual corporate plans. This will ensure effective shareholder management and further assist in eliminating reactive oversight approach.

Chapter 6 will present the research findings, recommendations and conclusions. The literature and research findings that result from the research work will be discussed, and appropriate recommendations, based on the research findings, will be examined.

CHAPTER 6

RECOMMENDATIONS AND CONCLUSIONS

6.5 INTRODUCTION

The previous chapter presented, analysed and interpreted the data collected from the Land Bank and the National Treasury by means of semi-structured interviews with selected, knowledgeable members of staff. The data was collected and processed in support of the objectives posed in Chapter 1 of this dissertation. This chapter provides an overview of the study, together with the conclusions drawn from the study, and the resultant recommendations. In addition, this chapter describes the obstacles encountered in conducting this study, and mentions possible avenues for future research. The chapter concludes with a summary and an assessment of the value of this research study.

6.6 DISCUSSION OF FINDINGS IN RELATION TO RESEARCH OBJECTIVES

The following section will discuss the study's findings in relation to its research objectives. The findings will be discussed in relation to how the objectives of the study have been achieved.

6.2.1 Primary objective

This research aims to investigate successful financial oversight tools/models of similar institutions to the Land Bank, internationally, for comparison to the system applied by the National Treasury. Arising from this a more efficient and effective oversight tool/model is proposed.

The first step in achieving the primary objective was to examine factors impacting on the ability of the National Treasury to anticipate requests for financial assistance from the Land Bank. To achieve the aforementioned objective, an examination of the following factors was necessary: (1) a historical review of the Land Bank, (2) the financial model employed by the National Treasury to perform financial oversight of the Land Bank, and (3) the strategic direction of the Land Bank as published in its corporate plan.

Arising from pursuing this objective it appears that the implementation of a recognised financial model would assist the National Treasury to develop and maintain a forward-looking assessment of the Land Bank's risk profile, proportionate to their systemic importance. Such a financial model would be able to identify, assess and address risks emanating from the Land Bank (and development financial institutions in general), would have a framework in place for early intervention, and would have plans in place, in partnership with other relevant authorities, to allow the National Treasury to take action to resolve risks in an orderly manner, if they become non-viable.

It was found that the National Treasury relies on the information provided by the Land Bank to perform its oversight role. It was further found that the current oversight model should be enhanced by implementing financial oversight tools (see B1.5). Financial oversight tools can be implemented in the form of a financial model, which would enable the National Treasury to assess and monitor the Land Bank's profitability, efficiency, cash flows, capital structure, and key business drivers, and the impact of changes in key business drivers on the Land Bank's business.

The use of a predictive model to accurately anticipate financial requests from the Land Bank will place the National Treasury in a better position to identify future risks and work hand-in-hand with the Land Bank to find appropriate mitigating strategies. This would then allow the National Treasury to play a proactive role in dealing with the Land Bank.

Based on the findings of this research (see section 5.5.2), it is clear that a financial oversight model would allow the National Treasury to thoroughly interrogate financial projections and recapitalization requests made by the Land Bank. Said model would provide in-depth financial analysis on the Land Bank's performance.

It was further found that the structure of the financial model, and the use of standardized financial definitions and calculations, would ensure a consistent and robust appraisal of the Land Bank's financial projections (see section 2.13). As a result, it is anticipated that the implementation of a financial oversight tool (such as CAMELS) will contribute immensely to an overall improvement in the quality of financial analysis conducted by the National Treasury.

The impact on capital adequacy could be promptly detected by using a financial model that can perform stress testing. The stress test would form part of the risk profile of the Land Bank and would require the bank to maintain a shock-absorbing capital buffer, as per the annual shareholder compact agreement. 'Stress testing' is a general term covering the techniques and methodologies that the National Treasury and the Land Bank can employ to measure their vulnerability or exposure to the impacts of exceptional, but usually rare, events, such as significant interest rate changes, exchange rate fluctuations, changes in credit rating, and other contingencies influencing liquidity.

The findings of the interview analysis supported the view that, under the current system, the National Treasury relies primarily on information provided by the Land Bank, without comparing or interrogating it against any data generated through a financial model or benchmarking references. An analytical tool, such as the CAMELS model, can be employed as an early warning system to detect DFIs that require close monitoring due to (imminent) financial distress. This would allow the National Treasury to take early remedial action where there are signs of financial distress.

All participants stated clearly that the PFMA is still relevant as a regulatory tool; however, there is a serious need for the National Treasury to adopt additional oversight practices in order to strengthen its monitoring and evaluation processes. Participants further stated that the National Treasury should consider adopting internationally recognized oversight tools such as SDI and CAMELS.

6.2.2 Secondary objectives 1

To perform a review of literature on the oversight tools/models employed at international institutions similar to the Land Bank

It was found that the Land Bank utilises the financial sustainability model to make financial projections (see section 5.4.5). This model runs various scenarios to determine outcomes that indicate the Land Bank's sustainability and profitability. The model has been approved by the board and is reliable, but depends on the quality of the data and other variables and assumptions to produce useful outcomes.

The Land Bank's financial sustainability model is based on specific, measurable, attainable, realistic and time bound (SMART) principles. This concept ensures that the projections are specific, measurable, attainable, realistic, and time bound. The model helps the Land Bank to interrogate targets and projections.

The researcher was not provided access to current data to test the financial sustainability systems of the Land Bank. The participants from the Land Bank, however, confidently stated that the system enables the bank to decide, in a timely manner, whether the Land Bank is likely to be vulnerable to financial shocks, and thus to anticipate the extent of the Land Bank's financial sustainability. The findings revealed that a meaningful evaluation of the effectiveness of the Land Bank model could only be performed during the last year of the current corporate plan, which is for the 2014/15 financial year. During that period, the researcher will be in a better

position to review the last corporate plan's targets against the Land Bank's actual performance, in order to review whether the set targets have been achieved.

The findings of the interview analysis suggest that the Land Bank's financial sustainability model is reliable and effective, but dependent on the quality of data inputs. The accuracy and creditability of the model is further evident in the business activities and key performance, as disclosed on the Land Bank's annual report 2013, which reported that the Land Bank had achieved most of its financial sustainability and funding targets for that year. Based on the key performance indicators, there are no material variances to cast doubt on the reliability of the Land Bank's current financial model.

6.2.3 Secondary objective 2

To gain the perceptions of selected National Treasury and Land Bank officials with regard to the oversight role and model applied by the National Treasury

It was found that there are appropriate systems in place to support the corporate plan preparation processes in terms of Section 52 of the PFMA. There is ongoing engagement between the Land Bank and the National Treasury during the corporate plan planning process to ensure that the final corporate plan submission addresses all the deliverable as per the Land Bank mandate. The Land Bank is also guided by the Practice Note 4 of 2009/10 which is discussed in section 5.4.4 of this study, and stipulates that "the accounting authority for a public entity listed in Schedule 2 or a government business enterprise listed in Schedule 3 must submit...to the relevant

treasury, at least one month...before the start of its financial year...a corporate plan in the prescribed format covering the affairs of that public entity or business enterprise for the following three financial years, and, if it has subsidiaries, also the affairs of its subsidiaries.”

It was found that the Land Bank’s executive management does conduct assessments of their business environment (see section 2.14.3); reassesses their strategic direction; provides a detailed plan for the immediate year; and provides financial projections for the following 2 to 4 years. The board conducts strategy sessions in order to analyse the operating environment, highlighting key strengths, weaknesses, opportunities, and challenges for the Land Bank. The analysis includes factors such as industry trends and structure, market size and growth potential, technological changes, and the regulatory environment. It may also contain an analysis of comparable companies according to the agreed key performance indicators (KPIs). The strategy should speak to how these opportunities and challenges will be leveraged or addressed.

Although the interview analysis found that the practice notes are effective support mechanisms in ensuring that the Land Bank complies with the applicable legislature, the Land Bank participants expressed concern with regard to the issuance of new practice notes, indicating that the National Treasury does not inform the compliance unit of the Land Bank when new practice notes are issued. It was found that a lack of communication when issuing practice notes could delay the implementation and enforcement of the latest practice notes, which would be construed as non-compliance.

6.2.4 Secondary objective 3

To perform an analysis of the Land Bank's financial information using the identified international oversight tools

On identifying the best oversight tools (see section 5.5.9) for effective and efficient performance of an oversight role, it was found that the adoption of financial supervisory tools, such as CAMELS and SDI, would ensure rigorous and transparent financial analysis of the Land Bank. Based on the Land Bank's 5-year period analysed using the CAMELS approach, this approach could assist the National Treasury in determining the Land Bank's capital adequacy requirement, assessing the quality of the assets, analyse the quality of the management and analyse the liquidity requirement (see section 6.2.4.5 of this study). This approach could also serve as early warning system and ensures that remedial actions are taken when necessary.

6.2.4.1 SDI approach

From the literature review performed in Chapter 2 (see section 2.9), it was found that SDI provides a public interest analysis of DFI financial performance and subsidy dependence. Although this type of analysis does not take into account the full extent of social benefits provided by a DFI, it attempts to consider the overall social costs entailed in operations, including the full value of all subsidies received by the institution.

It was found that the SDI approach would provide an objective measurement of the Land Bank's financial performance. This would involve taking into account the total cost of operating the Land Bank, including the actual value of all subsidies received.

It was found that using a measurement method such as SDI would assist the National Treasury in monitoring the Land Bank's financial efficiency. The implementation of effective oversight is of critical importance to ensure the continuing efficiency and viability of the Land Bank (see section 5.5.9). SDI would additionally assist the National Treasury in demonstrating the Land Bank's efficiency, social responsibility, and commitment to achieving financial sustainability that goes beyond mere financial self-sufficiency.

The findings suggest that calculating SDI would enable the National Treasury to track the movement and cause of subsidisation of the Land Bank, and assist in measuring the social cost of subsidising the development finance sector. This would further assist the National Treasury in assessing future risks and opportunities that may result from the Land Bank's reliance on government subsidies.

The SDI analysis found that the Land Bank needs a continuous infusion of alternative sources of funding, instead of continued reliance on government support. The necessity of continued recapitalisation and guarantees is a drain on the State's budget, and deprives other sectors of the economy of their full budget allocations.

6.4.2.2 Analysis of the Land Bank - SDI approach

In measuring the magnitude of the Land Bank's subsidy dependence, this study uses the SDI measurement method, as developed by Yaron (1992) and presented in section 2.3 (cp. Table 5.1).

Table 6.1: Calculation of the Land Bank's SDI

Details	2009	2010	2011	2012	2013
	R'000	R'000	R'000	R'000	R'000
Revenue from lending	1,949,921	1,754,394	1,305,020	1,498,791	2,047,842
<u>Subsidy</u>					
Guarantee	1,500,000	3,800,000	3,800,000	3,600,000	4,600,000
Capital injection		1,000,000	750,000	750,000	1,000,000
SDI% on Guarantee	77%	57%	57%	50%	37%

Source: Land Bank Annual report 2009 to 2013

In his 2010 budget speech, Minister of Finance Pravin Gordhan announced support for the Land Bank in the form of a guarantee of R3.5 billion, to be converted into a capital injection over the next medium-term budget period. The Land Bank had already received R1 billion in December 2009 from the Adjustment Appropriation Act 2009, reducing this guarantee to R2.5 billion. The Land Bank was allocated R750 million in the 2010/11 financial year, a further R750 million in 2011/12, and R1 billion in 2012/13.

The table above shows that the Land Bank' SDI is down from a high of 57% in 2010 to a low of 37% in 2013. The Land Bank's SDI has been on a decreasing trend over the past five years but, although the financial performance of the Land Bank has

improved during 2010, the SDI of 37% suggests that the Land Bank's on-lending interest rate would have to be increased by 37% to compensate for full subsidy elimination.

All indications are that the Land Bank is not expected to report a negative SDI in the next three years. The Land Bank received additional funding until the 2013 financial year, as indicated by the Minister of Finance during the 2010 budget speech. The Land Bank's SDI is anticipated to remain constant, due to expected continued financial support from the National Treasury. Thus, it will not be able to break even and compensate society for its opportunity costs and will therefore not break even, and the subsidy-adjusted return on equity (ROE) will not exceed the social opportunity cost.

However, as previously discussed, this need not be crucial, as a DFI can be used to implement political targets and, therefore, does not necessarily need to be sustainable. Nevertheless, in the recent past the Land Bank has failed to implement its developmental mandate. This was primarily due to financial and management challenges that caused the Land Bank's balance sheet to deteriorate significantly. The government had to provide support of R3.5 billion to the Land Bank to allow it to pursue its new developmental financing strategy. To be consistent with this new strategic thrust, the Land Bank launched the Land Bank Development Fund (LBDF), a facility earmarked to drive loan financing for developing and emerging farmers.

Without the government guarantee and/or cash injection facility, the Land Bank would have recorded a Capital Adequacy Ratio (CAR) change from 18% in 2009 to 53% in 2011, and at least 33% in 2013. This means that the Land Bank failed to

comply with the CAR requirements in 2009. During the 2013 financial year the Land Bank's CAR increased to 33%. The Land Bank is required to maintain a CAR of not less than 20%, even after taking into account the support provided by Government. This indicates that the Land Bank is highly subsidised and without the government cash injection the Land Bank's financial sustainability will be detrimentally impacted. The adoption of SDI will assist in measuring the Land Bank's level of subsidy dependence by showing the total social cost involved in operating the Land Bank.

6.4.2.3 The CAMELS approach

The CAMELS model is designed to be employed as an early warning system to detect DFIs that require close monitoring due to financial distress. Implementing the CAMELS model in its assessment of the Land Bank would allow the National Treasury to take early remedial action where there are signs of financial distress (see section 2.13). It was also found that, due to the predictive nature of the model, the National Treasury would be assisted in identifying future risks and would be able to work closely with the Land Bank to find appropriate mitigating strategies beforehand.

It was found that the CAMEL model reflects the conditions and performances of banks over years excellently, as well as enriching on-site and off-site examinations to bring better assessments of a bank's condition. Its purpose is to provide an accurate and consistent evaluation of a bank's financial condition and operations in the areas of capital, asset quality, management, earning ability and liquidity.

It was further found that, even after controlling for a wide range of publicly available information about the condition and performance of banks, the CAMEL system remains a useful assessment tool. This composite index further acts as a failure-prediction model. The up-to-date examination ratings provided by the CAMELS system help identify whether a bank requires increased oversight attention well before it actually fails.

It was clear from the interview analysis that, in order to ensure financial sustainability for the DFIs (and the Land Bank in particular), it is necessary to implement a financial oversight tool to strengthen the National Treasury's monitoring and oversight role. It was further found that failure to implement credible financial models has led to a global failure of DFIs. Findings from the interview analysis identified CAMELS as an ideal tool for assessing and measuring the overall financial costs involved in operating a DFI such as the Land Bank and quantifying its subsidy dependence.

6.4.2.4 Analysis of the land bank - the CAMELS approach

After the discussion under section 2 pertaining to the oversight role of governments over DFIs, this section intends to employ the CAMELS framework and SDI, to analyze the Land Bank and thus identify the strengths and weaknesses of the methods. To do so, the researcher took the financial information from the Land Bank audit reports of the five years from 2009 to 2013 and summarized it in Table 6.2.

Table 6.2: The Land Bank Financial Summary 2009-2013

Details	2009	2010	2011	2012	2013
	R'000	R'000	R'000	R'000	R'000
Revenue	1,949,921	1,754,394	1,305,020	1,498,791	2,047,842
Net profit	168,135	379,089	265,008	161,356	304,591
Net profit margin	9%	22%	20%	11%	15%
Net Equity	2,327,867	3,707,756	4,719,464	5,626,474	6,131,063
Total Debt	15,236,057	12,248,257	13,579,390	19,724,932	24,650,943
Debt to equity	565%	290%	255%	319%	374%
CAR	18%	43%	53%	40%	33%
CAR(Including guarantees)	15%	30%	35%	29%	25%
Current Ratio	0.8	0.9	0.8	0.8	0.8
Cash balance	4,023,284	1,934,823	2,087,520	1,941,406	1,891,383

Source: Land Bank Annual report 2009 to 2013

6.2.4.5 The application of CAMELS approach on the Land Bank

First, the CAMELS model shall be used to analyse the Land Bank's overall performance on capital, asset, management, earnings, liquidity and sensitivity to the market from 2009 to 2013, and to find the strengths and weaknesses of the method.

6.2.4.6 Capital adequacy analysis

The Land Bank recorded a very low Capital Adequacy Ratio (CAR) in the 2009 (see Table 6.2). The main drivers of this position were the Land Bank's high debt position

and very low maintenance of equity. Upon the transfer of the oversight role over the Land Bank from the Department of Agriculture, Fisheries and Forestry to the National Treasury (thus effectively reporting directly to the Minister of Finance), the Land Bank was granted a government guarantee/cash injection in the amount of R3.5 billion, resulting in improved earnings. This boosted the Land Bank's financial position when it recorded increases in the CAR moving from 15% in 2009 to 25% in 2013 (See Table 6.2). The Land Bank's CAR is currently well above the required benchmark of 20%.

6.2.4.7 Asset quality analysis

By 31 March 2013, the Land Bank's total assets reached R31 billion, of which 88% were loans to customers, and 6% in cash and cash equivalents (Land Bank annual report, 2013). The Land Bank realised positive impairments when it produced asset quality percentages of 16% in 2009 and 30% in 2010. This was driven purely by the implementation of a turnaround strategy, which also brought about recoveries from its previously non-performing loans and the reversal of interests that were wrongfully suspended. The Land Bank's asset quality continues to improve as evidenced by a decrease in non-performing loans by 3.7% to R1.4 billion in 2013. This is in line with the decrease in the impairment charge of R75 million in 2013. This was achieved through collection and restructuring initiatives (Land Bank annual report, 2013).

6.2.4.8 Management analysis

The appointment of the full complement of the executive team was completed during the 2010 reporting period and has brought stability and a culture of accountability back to the Land Bank. To this end, policies were approved by the executive management to formalise guidance in a number of operational areas, specifically those areas where the Land Bank was exposed to operational and credit risks. The bank is solely owned by the Government, which is regarded as the best mitigating factor to financial problems. In addition, the new board of directors has performed fairly effectively.

6.2.4.9 Earnings analysis

The Land Bank's income statement produced ratios ranging between 1% and -3% during the 2006 and 2008 financial periods, respectively. At the time, the Land Bank's income statement suffered predominantly from negative high loan impairments, higher operating costs and poor income generation. Between the 2009 and 2013 financial periods, due to the implementation of the turnaround strategy, the net profit margin started to improve, recording 9% in 2009 and 20% in 2011 before softening to 11% in 2012 (see Table 6.2). The turnaround strategy prioritised cost containment and income maximisation, which contributed to this improvement. Attention is drawn to the fact that the Land Bank has converted most of its revenue into profits, especially when it produced a higher-than-projected net profit margin of 15% for the 2013 financial period.

6.2.4.10 Liquidity analysis

The Land Bank's cash interest cover ratio was on a decreasing trend from 2010 to 2013, when it moved from a coverage ratio of 3.01 times to a coverage ratio of 1.50 times. This movement was driven by the fact that the Land Bank's interest costs had started to increase exorbitantly, while its cash position decreased. More recently this ratio began to increase and the Land Bank maintained the ratio between 2.40 times and 1.50 times for 2012 and 2013 (Land Bank annual report, 2013). The Land Bank is currently in a good financial position to cover its interest costs using available cash.

However, when viewing the trend analysis of this ratio, the Land Bank's current ratio is stable, averaging 0.8 times from 2009 to 2013 (see Table 6.2). This decreasing trend is attributable to the fact that the Land Bank's total current assets have been decreasing faster than its total current liabilities. The Land Bank was in a better liquidity position in 2005, when it held 26% of its current assets in cash with low current debt positions. A conversion of short-term loans (debtors) into cash by the Land Bank could have resulted in immediate debt service of up to 0.95 times.

6.4.2.11 Sensitivity to the market

A scenario analysis involves simulating various hypothetical evolutions of events (scenarios) in order to determine their effect on the value of a portfolio. When changes in the value of the portfolio are determined under stress conditions, the analysis is called "stress testing". Weak spots or risk holes are said to have been

identified when stress testing reveals excessive risk exposures to movements in underlying market variables. Stress testing is used to manage the risks in a portfolio more decisively and quickly, should the worst case scenario materialise.

The Land Bank's 2010 annual report shows that simulation techniques were already being employed as a tool to measure interest rate risk in relation to financial instruments. These simulation techniques involve detailed assessments of the potential effects of changes in interest rates on earnings and economic values by simulating the future path of interest rates and impact thereof on cash flows. The simulation techniques are based on projected changes in the interest rate environment. In static simulations, the cash flows arising from current positions are assessed.

The sensitivity analysis has been carried out based on the Land Bank's exposure to interest rates for derivatives and other financial liabilities and assets at the balance sheet date. The effect on the Land Bank's profits of a 100 basis point increase or decrease in the interest rate, representing management's assessment of a reasonably possible change in interest rates, is used when assessing interest rate risk. Thus, these techniques already contribute to a quality review of the sensitivity to the market component of CAMELS, in that the information would be readily available and disclosed in the audited annual report of the Land Bank. However, it should be accompanied by a thorough sensitivity analysis of the expected cash flows as well.

6.7 RECOMMENDATIONS

Based upon the findings of this study, the following recommendations were made:

- based on the results of this research, it is recommended that the National Treasury implement the SDI tool, which will provide a comprehensive method for measuring the overall financial cost of operating the Land Bank and quantifying its dependence on subsidies. This tool will also provide a public interest analysis of the Land Bank's performance and subsidy dependence.
- the National Treasury should consider adopting CAMELS. This tool would contribute immensely to improving the overall quality of financial analysis conducted by the National Treasury. The CAMELS model can be employed as an early warning system to detect DFIs that require close monitoring due to financial distress. This would allow the National Treasury to take early remedial action where there are signs of financial distress.
- the National Treasury should perform periodic on-site oversight visits to the Land Bank. Such visits would ensure that the National Treasury officials in charge of the financial oversight of the Land Bank are well versed with the value chain systems of the Land Bank, and would further improve accountability. This will help to address the challenges raised by the participants regarding the importance of understanding the Land Bank business activities by the National Treasury officials tasked with the oversight role. It will also improve stakeholder relations, which was indicated during the interview as the area which need improvement. On-site examinations should be commensurate with the size, activities, and specific

nature of operations, as well as the risk profiles of the Land Bank. This exercise would also improve stakeholder relationships.

- there should be a National Treasury representative on the board of the Land Bank. This would allow the National Treasury to influence the strategic direction of the Land Bank, while ensuring that the shareholder's interest is protected by maximizing the return on investments.
- the National Treasury should consider a review of the PFMA in order to establish whether the Act is still effective and relevant as a monitoring tool in this volatile and rapidly changing economic environment. A review of the Act would ensure that the loopholes and gaps which have been identified are closed and/or bridged for the betterment of the shareholder oversight mechanism.

6.8 CONCLUSION

Based on the findings of this study, the following conclusion may be reached. The adoption of financial supervisory oversight tools will assist the National Treasury in performing its financial oversight role. The SDI tool will quantify subsidies and show the extent of the Land Bank's subsidy dependence. The government does not know precisely how much the Land Bank costs society. This knowledge is necessary to allow the comparison of the Land Bank's need for funds with other priority uses of public funds. The SDI can also help the National Treasury to track the Land Bank's subsidy dependence through time. Its use can bring about a disciplined approach to the judgement of social costs of public support for the Land Bank. Since the data needed to perform such analysis should be easily extracted from the financial statement, the SDI can also help to detect weaknesses in accounting systems.

The findings revealed that the CAMELS rating system can be an important tool for financial oversight of DFIs such as the Land Bank. Its approach may be beneficial as it is an internationally standardised rating system, and provides flexibility between on-site and off-site oversight; hence, it is the model most used internationally in assessing a bank's performance. However, it has drawbacks, such as the fact that it ignores the interaction with bank's top management. This can be mitigated using the good stakeholder relationship the National Treasury has established with the Land Bank.

As a result of the investigations carried out in the course of this study, it can be stated that the adoption of the CAMELS rating could assist the Land Bank to guide the growth rate in a positive direction by enhancing capital adequacy, improving asset quality and management, improving earnings and strengthening liquidity. The researcher suggests that the CAMELS rating system should be used together with SDI in order to ensure effective financial oversight of the Land Bank, accurate measurement of social costs, and to enlighten public debate on the use of scarce public funds. Without an SDI indicator, the public would be continuously presented with information that is confined to partial DFI performance indicators, such as profit, which is the residual value of the subsidy received, and the amount associated with recapitalisations whenever they occur, thereby missing the full picture of the social costs associated with maintaining the Land Bank.

In terms of compliance with Section 52 of the PFMA, all participants from the National Treasury were in agreement regarding the Land Bank's high degree of compliance with the PFMA; however, it was clear that the compliance with the PFMA

as an instrument to improve financial management is not sufficient to ensure effective and efficient financial oversight.

It can be concluded that the provisions of the PFMA empower the National Treasury in performing its oversight role by ensuring that the Land Bank submits an annual budget and corporate plan in the prescribed format (covering the affairs of the Land Bank for the following three financial years), to the National Treasury. However, the participants from the National Treasury raised concerns regarding a lack of financial supervisory tools to process and analyse data submitted by the Land Bank, as is also required by the PFMA.

The Land Bank uses a financial sustainability model that runs various scenarios to determine outcomes to measure its sustainability and profitability. The researcher was not given the access to the model and was thus not able to ascertain its reliability. The researcher was however able to establish that the factor that could contribute negatively to the reliability of the model is historical data. The Land Bank has legacy challenges with regard to their historical data. All indications are that the challenges are being addressed, and there is already visible improvement in this regard.

Participants emphasised a need for adoption of a risk-based oversight protocol. This approach would ensure a proactive and efficient oversight process, which would enable the National Treasury to prioritize and focus efforts and resources on areas within the Land Bank that have high-risk profiles. It entails a shift from a rigid rules/compliance-based oversight approach to a more risk-sensitive one, which

seeks to encourage the Land Bank to develop, and continuously update, its internal risk management system, to ensure that it is commensurate with the scope and complexity of its operations.

6.9 FURTHER RESEARCH

As the nature of research always gives rise to other questions, further investigation in the following areas is recommended:

- as the research study was limited to financial oversight of the Land Bank by the National Treasury, the other development finance institutions should be surveyed and their results compared to the findings of this undertaking, thereby enabling a national system of DFI performance benchmarking.
- further research should be undertaken to establish the financial sustainability of the development finance institutions and to explore mechanisms that could be employed to reduce their reliance on government support.
- the Off-Site Supervision Unit is responsible for supervising bank operations on the basis of submitted data and reports. It reviews and analyses the financial performance of banks using prudential reports, statutory returns, and other relevant information. It also monitors trends and developments in financial indicators for the banking sector as a whole, and generates industry reports on a quarterly basis. Further research should be undertaken to establish whether the process enables the National Treasury to detect early warning signs and emerging problems.

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ANNEXURE A: LAND BANK PRESENTATION OF STRUCTURED INTERVIEW QUESTIONS

The following table sets forth alphanumerical numbering assigned to National Treasury and Land Bank participants.

Table A1: Referencing

Referencing:	<p>Interviewed participants from Land Bank interview were assigned an alphanumerical number, e.g. LB1 (Land Bank participant 1). Comments from National Treasury participants were also assigned an alphanumerical number, e.g. NT2 (NT participant 2). Where the researcher made a summary or a comment during the discussion, he is referenced as RC (Researcher Comment participant 1).</p> <p>The literature reference indicates the page number and paragraph in the literature chapter that address the theme highlighted in the table.</p>
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Is there anything that you think should be changed regarding the preparation process?

Table A2.1: Question 1 Analysis

Participant ref	Corporate plan preparation process	Lit. ref.
LB1, LB2, LB3 and LB4	Strategic review process session	2.3.1 (p16)

The majority of participants indicated that there are ongoing initiatives to improve the current process, which include conducting SWOT analysis, ensuring that all the business units within the Land Bank conduct strategic sessions, and streamlining

certain processes to avoid duplication of functions and inefficiency within the Land Bank.

Is the Land Bank, in your opinion, fully complying with the requirements of Sec 52 of PFMA?

Table A2.2: Question 2 Analysis

Participant ref	Compliance with PFMA
LB1, LB2, LB3 and LB4	There is high level of compliance with requirements of the PFMA.
LB3	The PFMA is clear in terms of what is expected of the Land Bank.

Responding to this question, participants were in agreement regarding the Land Bank's high compliance with the PFMA. Participant LB2 summarised as follows: *"I think we are doing pretty well. We have strong compliance and internal audit units. We are also in the process of housing previously outsourced internal audit units in order to improve on compliance. All in all, there is a high level of compliance with the PFMA"*.

All National Treasury participants were of the view that the Land Bank adequately complies with the requirements of the PFMA in terms of the submission of the relevant reports.

How are the National Treasury practice notes assisting in ensuring compliance with the requirements of the PFMA?

Table A2.3: Question 3 Analysis

Participant ref	National Treasury practice notes
LB1, LB3, LB3 and LB4	Procedure for issuing of National Treasury practice notes

All participants were in agreement that the issuing of practice notes is a very good support mechanism for ensuring that the Land Bank complies with the applicable legislature. However, participant LB4 expressed the following view: *“The National Treasury does not inform the compliance unit of the Land Bank when new practice notes are issued. The compliance unit does not receive formal communication. The National Treasury does not use the compliance unit to communicate the issuing of new practice notes as per Land Bank procedure. This results in some practice notes not being implemented on time”*.

Participant LB1 further mentioned that the practice note could provide good temporary instruction; however, the National Treasury should ensure that the communication procedure for issuing practice notes is improved. The process should be streamlined in order to avoid interference with the Land Bank’s current processes when being implemented.

Participants from the National Treasury stated that the issuing of the Practice Notes in terms of section 76(1) to 76(4) of the PFMA was intended to provide clarification regarding the information that the National Treasury requires as part of their

corporate plan submissions. They further stated that the Practice Notes were intended to supplement any prescripts contained in legislation.

On what level is the board involved in this process?

Table A2.4: Question 4 Analysis

Participant ref	Board involvement in corporate plan process
LB2, LB3 and LB4	The board monitors the progress.
LB1	The board gives strategic direction.

All participants stated that the board as a whole is actively involved in discussing, reviewing and ultimately approving the corporate plan. They are a valuable resource in that they provide a new perspective and, by asking questions to satisfy themselves, ensure that the corporate plan is well thought out, realistic, and compatible with the Land Bank’s mandate.

Participant LB3 further stated that, to ensure sufficient time for review and discussion, a special strategy session is often scheduled. This session may take place offsite, be significantly longer than a regular board meeting, and also involve a professional facilitator. Final approval of the strategic plan takes place at a board meeting.

Participant LB2 summarises the process as follows: *“The board helps determine what will be achieved, and then allow[s] management to decide on how to accomplish board-determined goals. For instance, the board helps set the mission,*

core values, longer-term vision, and strategic goals (e.g., ‘To be a profitable Bank in land and commercial agribusiness banking and insurance, in order to enable the generation of capital resources to deliver our financial and non-financial development mandate in an impactful, visible, and sustainable way’). Then management is responsible for the action steps that will make that vision a reality. The board comes back in to monitor management’s implementation of the strategy”.

What are the financial projections based on?

Table A2.5: Question 5 Analysis

Participant ref	Financial projections
LB2, LB3 and LB4	The financial sustainability model.
LB1	The concept of smart principle.

All participants stated that the Land Bank utilises the financial sustainability model to produce financial projections. The financial sustainability model runs various scenarios to determine the optimum capital structure and consequently assists in raising the required capital that determines the Land Bank’s sustainability and profitability. The model has been approved by the board. According to the participants, the model is reliable but depends on the quality of the data and variables being of a high quality in order to make accurate projections. Due to policy and confidentiality constraints the researcher was not able to perform a practical walkthrough of the model to gain an understanding of its construction and key value drivers.

Participant LB2 stated that the Land Bank has employed a financial sustainability model that enables the bank to assess and monitor, among others, the Land Bank’s financial sustainability, profitability, efficiency, cash flows, capital structure, and ability to pay dividends, the bank’s key business drivers and the impact of changes in key business drivers.

Participant LB1 responded to the question as follows: *“Our financial projections are informed by the business environment. We also use a geographic model whereby we look at the level of the competition and business opportunities [in a specific geographic area]. Our financial projections are also based on what we call SMART principles. This concept ensures that our projections are Specific, Measurable, Attainable, and Realistic and Time bound. The concept helps the Land Bank to interrogate targets and projections.”*

In your opinion, will the Land Bank require further financial support from the fiscus?

Table A2.6: Question 6 Analysis

Participant ref	Additional financial support
LB1, LB3 and LB4	Dual mandate challenges faced by the Land Bank.
LB2	Land Bank is required to maintain 20% Capital Adequacy ratio

In answering the question of whether the Land Bank will require further financial support from the fiscus, the majority of participants clearly stated that in order for the Land Bank to deliver on its development mandate it will require further governmental

support. Participant LB1 felt the issue of government support depends on the direction the government wants the Land Bank to take. LB1 continued by saying *“If the government introduces certain priorities which it require[s] the Land Bank to undertake, it is only fair for the government to provide a subsidy that could be ring fenced for that particular objective”*.

Participant LB2 shared the same view when commenting that it would be unethical business practice for the Land Bank to utilise investments made by private investors to deliver on national government priorities without any contribution by the government.

Participant LB3 raised a serious concern about the capital adequacy requirement, saying, *“...if the National Treasury insists on the capital adequacy ratio (CAR) of 20%, the Land Bank will definitely require further financial support.”* LB3 added that the financial projections indicate that the Land Bank will bridge the 20% CAR covenant in the next two years.

Participant LB4 summarised the situation as follows: *“The overall growth in the Land Bank’s assets will awaken the CAR to lower the set targets, which will in turn trigger a possible downgrade by the rating agency, increasing the risk premium on the Land Bank when raising funds in the money and capital markets. It will result in diminishing interest margins and impact negatively on the sustainability of the Land Bank.”*

In your view, what kind of additional oversight support should the National Treasury provide to the bank, if any?

Table A2.7 Question 7 Analysis

Participant ref	Additional oversight support by the National Treasury
LB1, LB2, LB3 and LB4	Understanding of the Land Bank value chain.
LB1	National Treasury representative on the Land Bank board.

Participant LB3 responded to this question as follows: *“Currently, I don’t think there is a need for further oversight support. We don’t want a situation whereby there is too much red tape in the system, which could cause inefficiency. There is no need for the National Treasury to employ stringent control, as this could cripple the Land Bank processes”.*

Participant LB1 indicated that the current oversight model still needs enhancement at the strategic level; communication and coordination has improved significantly. LB1 expressed a serious concern about the lack of National Treasury representatives on the Land Bank board. LB1 went on to suggest that the National Treasury representatives should form part of the board, albeit as observers.

**ANNEXURE B: NATIONAL TREASURY PRESENTATION OF STRUCTURED
INTERVIEW QUESTIONS**

**Does the PFMA fully empower the National Treasury in performing its
oversight role over the Land Bank?**

Table B1.1: Question 1 Analysis

Participant ref.	PFMA empowering the National Treasury
NT2	Yes, the PFMA does empower the National Treasury in performing its oversight role.
NT1	The National Treasury receives corporate plans, annual reports and quarterly reports in terms of PFMA.
NT3	Minister of Finance is the custodian of the PFMA.
NT4	Compliance with Section 52 of the PFMA.

All participants agreed that the provisions of the PFMA do empower the National Treasury to perform its oversight role. During the interview two of the interviewees indicated that, in terms of the Section 52 of the PFMA, the Land Bank is required to submit an annual budget and corporate plan in the prescribed format covering the affairs of the Land Bank for the following three financial years to the National Treasury at least one month before the start of its financial year. The Land Bank is also subject to Section 29 of the Treasury Regulation, which deals with quarterly reporting.

Participant NT2 summarised the situation as follows: *“Yes, the PFMA does empower the National Treasury in performing its oversight role. The accounting authority for a public entity listed in Schedule 2, or a government business enterprise listed in Schedule 3, must submit in terms of Section 52...to the relevant treasury, at least one month...before the start of its financial year...a corporate plan in the prescribed format covering the affairs of that public entity or business enterprise for the following three financial years, and, if it has subsidiaries, also the affairs of its subsidiaries, annual report and financial statements in terms of section 56 and quarterly reports in terms of Section 28 of the Treasury regulations must be submitted to the relevant treasury.”*

Is the National Treasury satisfied with the quality of the annual corporate plan received from the Land Bank?

Table B1.2: Question 2 Analysis

Participant ref.	Quality of the reports
NT3	Yes, we are satisfied with the quality of information.
NT1, NT4	The Land Bank submits draft reports to the National Treasury for comments.
NT2	The Land Bank submits detailed reports.

All participants supported each other and maintained that the corporate plan preparation process, whereby the National Treasury provides input and comments on the corporate plan of the Land Bank, has helped in improving the quality of the reports. Furthermore, they indicated that the Land Bank also makes thoughtful inputs to the corporate plan prior to its adoption and approval. Participant NT2 further

stated that the issue is not only the quality of the corporate plan, but whether the strategic direction is in line with the government's developmental agenda. There is also ongoing engagement between the Land Bank and the National Treasury to ensure that the Bank submits quality information which can be analysed meaningfully by the National Treasury in executing its oversight role.

Participant NT3 responded to the question as follows: *"In terms of the submission of the reports, the Land Bank does submit detailed reports; but the question is whether the reports speak to the development agenda of the government. The Land Bank submits draft reports to the National Treasury, which are interrogated, analysed and validated to ensure that they meet quality standards required by the National Treasury. This process assists in ensuring that the final reports submitted by the Land Bank are acceptable and meet the requirements in terms of the PFMA."*

Participant NT1 went on to state that *"the Land Bank might make a good quality submission to the National Treasury, however, the question is whether the National Treasury has adequate tools at its disposal to interrogate, verify and validate the quantitative information contained on the corporate report, in order to ensure a high level of reliability in the data submitted to the National Treasury"*.

Does the bank substantially comply with the requirements of the PFMA?

Table B1.3: Question 3 Analysis

Participant ref	Requirements of PFMA
NT1, NT2, NT3, and NT4	YES, the Land Bank complies with the requirements of the PFMA.

All participants are of the view that the Bank adequately complies with the requirements of the PFMA. One interviewee indicated that in the event that there is fundamental non-compliance with the provision of the PFMA, the National Treasury engages the bank to highlight non-compliance. One such non-compliance issue is the late submission of corporate plans due to internal control constraints; however in such an event, the Land Bank solicits approval from the National Treasury for late submission.

Participant NT1 responded to the question by stating that the regulatory compliance alone in the oversight environment is not sufficient to justify a proactive oversight role. However, what is of significance is the process undertaken by the National Treasury in reviewing and analysing the data submitted for compliance purposes. In the researcher's view, the Land Bank should move from compliance-based to a risk-based oversight. The current oversight is based on compliance with regulations which has not been significantly updated in over a decade.

Participant NT2 indicated that the Land Bank, as a Schedule 2 public entity, submits corporate plans to the executive authority in terms of Section 52 of the PFMA. The

bank also submits annual and quarterly reports in terms of Section 52 of the PFMA and Section 29 of Treasury Regulations respectively.

How often does the National Treasury refer back the bank’s submission due to lack of information?

Table B1.4: Question 4 Analysis

Participant ref	Refer back submissions
NT1, NT2, NT3, and NT4	The National Treasury receives draft corporate plans for comments prior to being adopted as final drafts.

All participants (100.0%) indicated that the Land Bank’s submission contains sufficient information to allow the National Treasury to assess the current financial health of the Land Bank and the prospects over the medium term, as no such submissions have been sent back to the Land Bank (NT1: NT2: NT3).

Participant NT4 further stated that the level of detail in the corporate plan is similar to that required in a company’s audited financial statements. The format for the income statement, cash flow statement, and balance sheet is in line with the minimum level of detail required in terms of the PFMA

According to the National Treasury participants, there is ongoing engagement with the objective of ensuring that the corporate plans submitted meet the requirements of the PFMA prior to submission to the National Treasury. Therefore, there is no

instance of the submission being referred back to the Land Bank primarily due to lack of information.

How do you feel about the oversight role by the National Treasury over the bank?

Table B1.5: Question 5 Analysis

Participant ref	Existing oversight tools
NT1	More should be done with regard to monitoring and management practices.
NT2	I think improvement is necessary in this regard.
NT3, NT4	Our monitoring and evaluations processes are not effective.

All participants indicated that the current oversight model should be improved to ensure better monitoring and evaluation (NT1: NT2: NT3 and NT4). NT3 indicated that the PFMA, being the main legislative instrument for oversight, was enacted in 1999, since which time there have been a lot of changes which could have rendered the PFMA ineffectual. The majority of the participants from the DFI unit of the National Treasury indicated that there was grave concern regarding the current tools, as more reliance is being placed on information provided by the bank.

Participant NT1 stated that, internationally, other executive authorities have adopted systems such as the SDI and CAMELS to evaluate the sustainability. NT1 further stated that the National Treasury should consider adopting scientific tools to assist

with monitoring and evaluation, as it cannot depend solely on financial information provided by the bank in the performance of its oversight role.

After the review of the corporate plans, does the National Treasury discuss the findings with the Land Bank?

Table B1.6: Question 6 Analysis

Participant ref	Findings of the corporate plan
NT1, NT2, NT3	Yes, the findings of the corporate plan are discussed with all the relevant stakeholders.

All National Treasury participants agreed that they engage the Land Bank through meetings to discuss findings from the analysis of the corporate plans and annual reports and then agree on solutions and a way forward. There is also ongoing engagement with some stakeholders, with whom reports are shared. National Treasury also makes presentations to relevant internal stakeholders on the findings of the analysis.

It can be deduced that the existing stakeholder engagement is adequate and, therefore, the process is fulfilling its desired objectives. It can also be deduced that the process helps in scrutinising the set targets, as agreed in the corporate plan.

Q7: Is the Land Bank fully complying with conditions set by the National Treasury e.g. on the guarantees?

Table B1.7: Question 7 Analysis

Participant ref	Conditions of guarantees
NT1, NT2, NT3, and NT4	Yes, the Land Bank does comply with conditions of guarantees such as submission of quarterly reports.

All participants responded positively to the question and motivated their answers by indicating that the bank complies fully with the current conditions on guarantee issuance, which includes guarantee conditions to maintain capital adequacy ratio (CAR) of 20%, submission of quarterly reports to the National Treasury on the turnaround strategy, and submission of quarterly reports to the National Treasury on loan recovery progress, demonstrating sound management of non-performing loans. Participant NT3 further highlighted the concern regarding the Land Bank’s ability to maintain CAR requirement going forward. NT3 stated that the National Treasury has recommended a prudential limit of 20% for the Land Bank’s CAR. In the current financial year (2013), this ratio decreased to 21.0% from 28.4%. The ratio declined in financial year 2012, due to a significant increase in new funding liabilities. Further decreases are anticipated over the next three years as the loan book continues to grow. To assist the Land Bank to maintain the CAR within acceptable levels, the National Treasury has previously supported Land Bank through capital injections.

Q8: Are the financial projections being effectively scrutinised to limit surprises in the budget process?

Table B1.8: Question 8 Analysis

Participant ref	Financial projections
NT1, NT2, NT3, and NT4	Yes, we do scrutinize and interrogate the Land Bank's financial projection for any material deviations.

All participants supported each other in maintaining that the financial projections are adequately scrutinised in order to determine the authenticity of the projections, and whether the current resources would be sufficient to finance the current and the future investments (NT1, NT2, and NT3). Participant NT4 went on to say that whether the projections are realistic or not is a different topic altogether.

In the view of participant NT3, the Land Bank was recapitalised when it was moved from the Department of Agriculture, Fishery and Forestry to the National Treasury. In some cases, the Land Bank makes assumptions in its corporate plans regarding the provision of a guarantee or financial support by Government. Where such assumptions are made, the Land Bank clearly explains the rationale for these assumptions.

Q9: If yes, why is there always a perception that financial assistance for the bank is unbudgeted?

Table B1.9: Question 9 Analysis

Participant ref	Unbudgeted financial support
NT3	The perception is incorrect; the Land Bank borrows funding from the open market on the strength of its balance sheet.
NT2	The use of scientific and proper financial tools will ensure accurate financial forecast.
NT1	I think it is the correct perception.
NT4	Government supports and enables the Land bank to access funding.

Participant NT3 disagreed with the statement entirely, indicating that the Land Bank borrows funding from the open market on the strength of its balance sheet. NT3 further indicated that investors' confidence was restored after the recapitalisation of the bank. The Land Bank was able to raise R1, 2 billion funding in the market.

Participant NT2 took a different view and responded to the question as follows: *“Whether [or not] requests are budgeted for ... is not of significance; what is important is for the National Treasury to ensure that it develops financial tools that can be utilised to produce forecast financial requests from the bank.”*

Participant NT4 indicated that, although the Land Bank is able to raise funding from the open market, it should be noted that without government support the Land Bank will have difficulties in securing funding on the strength of its balance sheet. Having

said that, government support is instrumental in ensuring that the Land Bank is able to access affordable funding in the open market.

Q10: What are some of the oversight tools being employed by the National Treasury?

Table B1.10: Question 10 Analysis

Participant ref	Oversight tools
NT3	Corporate plan - in the prescribed format, covering the affairs of the Land Bank for the following three financial years, including financial projections as well as the borrowing plan.
NT2 and NT4	Annual report - containing all information related to the achievement of objectives agreed upon in the business plans and management contracts.
NT1	Quarterly report - actual non-financial performance vs. planned non-financial performance, including monthly financial reports.

All participants indicated that the current financial oversight tools include annual review of corporate plans in terms of Section 52 of the PFMA, review of annual reports in terms of Section 55 of the PFMA, and quarterly reports as required by Section 29 of the Treasury regulations.

Participant NT1 mentioned that the National Treasury also performs monitoring and reporting of infrastructure spending and borrowing by the Land Bank, which is executed by analysis of quarterly report submissions on the Land Bank's infrastructure spending and borrowing.

Participant NT2 indicated that the National Treasury also reports on compliance of the Land Bank with the Companies Act, the King III Code, and Treasury regulations, which include reporting annually on remuneration of the Land Bank Board in terms of the King III Report on Corporate Governance, and the Land Bank’s own Remuneration Guidelines.

Q11: Are those tools still effective and relevant in this rapid changing environment?

Table B1.11: Question 11 Analysis

Participant ref	Effectiveness of oversight tools
NT3	Monitoring and evaluations in order to measure the developmental impact are lacking.
NT2	There is a need for National Treasury to explore other oversight tools.
NT1 and NT4	Current process is still relevant, but can be strengthened.

All participants stated clearly that the PFMA as a regulatory tool is still relevant; however there is a serious need for the National Treasury to adopt other oversight practices in order to strengthen its monitoring and evaluation processes. They further stated that the National Treasury should consider adopting internationally recognized oversight tools such as SDI and CAMELS. These tools would assist in evaluating the Land Bank’s financial sustainability and determining whether the Land Bank would still remain financially sustainable without government support.

In the view of participant NT3 “...with the current system, the National Treasury relies solely on the information provided by the bank without [comparing it] to any independently generated data. An analytical tool, such as the SDI, which incorporates the total amount of the financial support received by a DFI measured against the interest earned on the loans extended to its targeted clientele, could assist as a planning and monitoring tool.”

Q12: In your opinion do you think the current process should be upheld or changed in order to ensure better oversight?

Table B1.12: Question 12 Analysis

Participant ref	Existing oversight process
NT3 and NT4	Assessment of social benefit should also be performed.
NT2	Discussion outside the formal protocol should be discouraged.
NT1	The PFMA remains an integral part of the oversight process.

In response to this question, all participants were of the opinion that, while the PFMA as a regulatory oversight tool and an integral part of the current process should be maintained, significant improvement is necessary to ensure better and more effective oversight by the National Treasury. Participant NT2 expressed the following view: “...lack of adoption of scientific oversight tools could undermine the National

Treasury's objectives of providing effective oversight role; this hinders the National Treasury's progress in ensuring an effective and proactive oversight role".

In terms of the relationship between executive authority and executive management, participant NT3 felt that there are discussions that take place outside the formal protocol. However, he felt that the official reporting lines should be respected at all times, regardless of who is involved.

All participants were in agreement that there is a serious need for the adoption of scientific oversight tools. They further commented that the PFMA is still relevant as a regulatory oversight tool, but it could be rendered ineffective as the act was promulgated in 1999 and became effective on 1 April 2000, and the environment has undergone numerous changes which require the continuous enhancement of oversight tools to ensure effective oversight of the Land Bank.

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ANNEXURE A: LAND BANK PRESENTATION OF STRUCTURED INTERVIEW QUESTIONS

The following table sets forth alphanumerical numbering assigned to National Treasury and Land Bank participants.

Table A1: Referencing

Referencing:	<p>Interviewed participants from Land Bank interview were assigned an alphanumerical number, e.g. LB1 (Land Bank participant 1). Comments from National Treasury participants were also assigned an alphanumerical number, e.g. NT2 (NT participant 2). Where the researcher made a summary or a comment during the discussion, he is referenced as RC (Researcher Comment participant 1).</p> <p>The literature reference indicates the page number and paragraph in the literature chapter that address the theme highlighted in the table.</p>
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Is there anything that you think should be changed regarding the preparation process?

Table A2.1: Question 1 Analysis

Participant ref	Corporate plan preparation process	Lit. ref.
LB1, LB2, LB3 and LB4	Strategic review process session	2.3.1 (p16)

The majority of participants indicated that there are ongoing initiatives to improve the current process, which include conducting SWOT analysis, ensuring that all the business units within the Land Bank conduct strategic sessions, and streamlining certain processes to avoid duplication of functions and inefficiency within the Land Bank.

Is the Land Bank, in your opinion, fully complying with the requirements of Sec 52 of PFMA?

Table A2.2: Question 2 Analysis

Participant ref	Compliance with PFMA
LB1, LB2, LB3 and LB4	There is high level of compliance with requirements of the PFMA.
LB3	The PFMA is clear in terms of what is expected of the Land Bank.

Responding to this question, participants were in agreement regarding the Land Bank’s high compliance with the PFMA. Participant LB2 summarised as follows: *“I think we are doing pretty well. We have strong compliance and internal audit units. We are also in the process of housing previously outsourced internal audit units in order to improve on compliance. All in all, there is a high level of compliance with the PFMA”*.

All National Treasury participants were of the view that the Land Bank adequately complies with the requirements of the PFMA in terms of the submission of the relevant reports.

How are the National Treasury practice notes assisting in ensuring compliance with the requirements of the PFMA?

Table A2.3: Question 3 Analysis

Participant ref	National Treasury practice notes
LB1, LB3, LB3 and LB4	Procedure for issuing of National Treasury practice notes

All participants were in agreement that the issuing of practice notes is a very good support mechanism for ensuring that the Land Bank complies with the applicable legislature. However, participant LB4 expressed the following view: *“The National Treasury does not inform the compliance unit of the Land Bank when new practice notes are issued. The compliance unit does not receive formal communication. The National Treasury does not use the compliance unit to communicate the issuing of new practice notes as per Land Bank procedure. This results in some practice notes not being implemented on time”.*

Participant LB1 further mentioned that the practice note could provide good temporary instruction; however, the National Treasury should ensure that the communication procedure for issuing practice notes is improved. The process should be streamlined in order to avoid interference with the Land Bank’s current processes when being implemented.

Participants from the National Treasury stated that the issuing of the Practice Notes in terms of section 76(1) to 76(4) of the PFMA was intended to provide clarification regarding the information that the National Treasury requires as part of their corporate plan submissions. They further stated that the Practice Notes were intended to supplement any prescripts contained in legislation.

On what level is the board involved in this process?

Table A2.4: Question 4 Analysis

Participant ref	Board involvement in corporate plan process
LB2, LB3 and LB4	The board monitors the progress.
LB1	The board gives strategic direction.

All participants stated that the board as a whole is actively involved in discussing, reviewing and ultimately approving the corporate plan. They are a valuable resource in that they provide a new perspective and, by asking questions to satisfy themselves, ensure that the corporate plan is well thought out, realistic, and compatible with the Land Bank's mandate.

Participant LB3 further stated that, to ensure sufficient time for review and discussion, a special strategy session is often scheduled. This session may take place offsite, be significantly longer than a regular board meeting, and also involve a professional facilitator. Final approval of the strategic plan takes place at a board meeting.

Participant LB2 summarises the process as follows: *"The board helps determine what will be achieved, and then allow[s] management to decide on how to accomplish board-determined goals. For instance, the board helps set the mission, core values, longer-term vision, and strategic goals (e.g., 'To be a profitable Bank in land and commercial agribusiness banking and insurance, in order to enable the generation of capital resources to deliver our financial and non-financial development*

mandate in an impactful, visible, and sustainable way’). Then management is responsible for the action steps that will make that vision a reality. The board comes back in to monitor management’s implementation of the strategy”.

What are the financial projections based on?

Table A2.5: Question 5 Analysis

Participant ref	Financial projections
LB2, LB3 and LB4	The financial sustainability model.
LB1	The concept of smart principle.

All participants stated that the Land Bank utilises the financial sustainability model to produce financial projections. The financial sustainability model runs various scenarios to determine the optimum capital structure and consequently assists in raising the required capital that determines the Land Bank’s sustainability and profitability. The model has been approved by the board. According to the participants, the model is reliable but depends on the quality of the data and variables being of a high quality in order to make accurate projections. Due to policy and confidentiality constraints the researcher was not able to perform a practical walkthrough of the model to gain an understanding of its construction and key value drivers.

Participant LB2 stated that the Land Bank has employed a financial sustainability model that enables the bank to assess and monitor, among others, the Land Bank’s financial sustainability, profitability, efficiency, cash flows, capital structure, and

ability to pay dividends, the bank’s key business drivers and the impact of changes in key business drivers.

Participant LB1 responded to the question as follows: “*Our financial projections are informed by the business environment. We also use a geographic model whereby we look at the level of the competition and business opportunities [in a specific geographic area]. Our financial projections are also based on what we call SMART principles. This concept ensures that our projections are Specific, Measurable, Attainable, and Realistic and Time bound. The concept helps the Land Bank to interrogate targets and projections.*”

In your opinion, will the Land Bank require further financial support from the fiscus?

Table A2.6: Question 6 Analysis

Participant ref	Additional financial support
LB1, LB3 and LB4	Dual mandate challenges faced by the Land Bank.
LB2	Land Bank is required to maintain 20% Capital Adequacy ratio

In answering the question of whether the Land Bank will require further financial support from the fiscus, the majority of participants clearly stated that in order for the Land Bank to deliver on its development mandate it will require further governmental support. Participant LB1 felt the issue of government support depends on the direction the government wants the Land Bank to take. LB1 continued by saying “*If the government introduces certain priorities which it require[s] the Land Bank to*

undertake, it is only fair for the government to provide a subsidy that could be ring fenced for that particular objective”.

Participant LB2 shared the same view when commenting that it would be unethical business practice for the Land Bank to utilise investments made by private investors to deliver on national government priorities without any contribution by the government.

Participant LB3 raised a serious concern about the capital adequacy requirement, saying, “...if the National Treasury insists on the capital adequacy ratio (CAR) of 20%, the Land Bank will definitely require further financial support.” LB3 added that the financial projections indicate that the Land Bank will bridge the 20% CAR covenant in the next two years.

Participant LB4 summarised the situation as follows: “*The overall growth in the Land Bank’s assets will awaken the CAR to lower the set targets, which will in turn trigger a possible downgrade by the rating agency, increasing the risk premium on the Land Bank when raising funds in the money and capital markets. It will result in diminishing interest margins and impact negatively on the sustainability of the Land Bank.*”

In your view, what kind of additional oversight support should the National Treasury provide to the bank, if any?

Table A2.7 Question 7 Analysis

Participant ref	Additional oversight support by the National Treasury
LB1, LB2, LB3 and LB4	Understanding of the Land Bank value chain.
LB1	National Treasury representative on the Land Bank board.

Participant LB3 responded to this question as follows: *“Currently, I don’t think there is a need for further oversight support. We don’t want a situation whereby there is too much red tape in the system, which could cause inefficiency. There is no need for the National Treasury to employ stringent control, as this could cripple the Land Bank processes”.*

Participant LB1 indicated that the current oversight model still needs enhancement at the strategic level; communication and coordination has improved significantly. LB1 expressed a serious concern about the lack of National Treasury representatives on the Land Bank board. LB1 went on to suggest that the National Treasury representatives should form part of the board, albeit as observers.

ANNEXURE B: NATIONAL TREASURY PRESENTATION OF STRUCTURED INTERVIEW QUESTIONS

**Does the PFMA fully empower the National Treasury in performing its
oversight role over the Land Bank?**

Table B1.1: Question 1 Analysis

Participant ref.	PFMA empowering the National Treasury
NT2	Yes, the PFMA does empower the National Treasury in performing its oversight role.
NT1	The National Treasury receives corporate plans, annual reports and quarterly reports in terms of PFMA.
NT3	Minister of Finance is the custodian of the PFMA.
NT4	Compliance with Section 52 of the PFMA.

All participants agreed that the provisions of the PFMA do empower the National Treasury to perform its oversight role. During the interview two of the interviewees indicated that, in terms of the Section 52 of the PFMA, the Land Bank is required to submit an annual budget and corporate plan in the prescribed format covering the affairs of the Land Bank for the following three financial years to the National Treasury at least one month before the start of its financial year. The Land Bank is also subject to Section 29 of the Treasury Regulation, which deals with quarterly reporting.

Participant NT2 summarised the situation as follows: *“Yes, the PFMA does empower the National Treasury in performing its oversight role. The accounting authority for a public entity listed in Schedule 2, or a government business enterprise listed in Schedule 3, must submit in terms of Section 52...to the relevant treasury, at least one month...before the start of its financial year...a corporate plan in the prescribed format covering the affairs of that public entity or business enterprise for the following three financial years, and, if it has subsidiaries, also the affairs of its subsidiaries, annual report and financial statements in terms of section 56 and quarterly reports in terms of Section 28 of the Treasury regulations must be submitted to the relevant treasury.”*

Is the National Treasury satisfied with the quality of the annual corporate plan received from the Land Bank?

Table B1.2: Question 2 Analysis

Participant ref.	Quality of the reports
NT3	Yes, we are satisfied with the quality of information.
NT1, NT4	The Land Bank submits draft reports to the National Treasury for comments.
NT2	The Land Bank submits detailed reports.

All participants supported each other and maintained that the corporate plan preparation process, whereby the National Treasury provides input and comments on the corporate plan of the Land Bank, has helped in improving the quality of the reports. Furthermore, they indicated that the Land Bank also makes thoughtful inputs to the corporate plan prior to its adoption and approval. Participant NT2 further

stated that the issue is not only the quality of the corporate plan, but whether the strategic direction is in line with the government's developmental agenda. There is also ongoing engagement between the Land Bank and the National Treasury to ensure that the Bank submits quality information which can be analysed meaningfully by the National Treasury in executing its oversight role.

Participant NT3 responded to the question as follows: *"In terms of the submission of the reports, the Land Bank does submit detailed reports; but the question is whether the reports speak to the development agenda of the government. The Land Bank submits draft reports to the National Treasury, which are interrogated, analysed and validated to ensure that they meet quality standards required by the National Treasury. This process assists in ensuring that the final reports submitted by the Land Bank are acceptable and meet the requirements in terms of the PFMA."*

Participant NT1 went on to state that *"the Land Bank might make a good quality submission to the National Treasury, however, the question is whether the National Treasury has adequate tools at its disposal to interrogate, verify and validate the quantitative information contained on the corporate report, in order to ensure a high level of reliability in the data submitted to the National Treasury"*.

Does the bank substantially comply with the requirements of the PFMA?

Table B1.3: Question 3 Analysis

Participant ref	Requirements of PFMA
NT1, NT2, NT3, and NT4	YES, the Land Bank complies with the requirements of the PFMA.

All participants are of the view that the Bank adequately complies with the requirements of the PFMA. One interviewee indicated that in the event that there is fundamental non-compliance with the provision of the PFMA, the National Treasury engages the bank to highlight non-compliance. One such non-compliance issue is the late submission of corporate plans due to internal control constraints; however in such an event, the Land Bank solicits approval from the National Treasury for late submission.

Participant NT1 responded to the question by stating that the regulatory compliance alone in the oversight environment is not sufficient to justify a proactive oversight role. However, what is of significance is the process undertaken by the National Treasury in reviewing and analysing the data submitted for compliance purposes. In the researcher's view, the Land Bank should move from compliance-based to a risk-based oversight. The current oversight is based on compliance with regulations which has not been significantly updated in over a decade.

Participant NT2 indicated that the Land Bank, as a Schedule 2 public entity, submits corporate plans to the executive authority in terms of Section 52 of the PFMA. The

bank also submits annual and quarterly reports in terms of Section 52 of the PFMA and Section 29 of Treasury Regulations respectively.

How often does the National Treasury refer back the bank’s submission due to lack of information?

Table B1.4: Question 4 Analysis

Participant ref	Refer back submissions
NT1, NT2, NT3, and NT4	The National Treasury receives draft corporate plans for comments prior to being adopted as final drafts.

All participants (100.0%) indicated that the Land Bank’s submission contains sufficient information to allow the National Treasury to assess the current financial health of the Land Bank and the prospects over the medium term, as no such submissions have been sent back to the Land Bank (NT1: NT2: NT3).

Participant NT4 further stated that the level of detail in the corporate plan is similar to that required in a company’s audited financial statements. The format for the income statement, cash flow statement, and balance sheet is in line with the minimum level of detail required in terms of the PFMA

According to the National Treasury participants, there is ongoing engagement with the objective of ensuring that the corporate plans submitted meet the requirements of the PFMA prior to submission to the National Treasury. Therefore, there is no

instance of the submission being referred back to the Land Bank primarily due to lack of information.

How do you feel about the oversight role by the National Treasury over the bank?

Table B1.5: Question 5 Analysis

Participant ref	Existing oversight tools
NT1	More should be done with regard to monitoring and management practices.
NT2	I think improvement is necessary in this regard.
NT3, NT4	Our monitoring and evaluations processes are not effective.

All participants indicated that the current oversight model should be improved to ensure better monitoring and evaluation (NT1: NT2: NT3 and NT4). NT3 indicated that the PFMA, being the main legislative instrument for oversight, was enacted in 1999, since which time there have been a lot of changes which could have rendered the PFMA ineffectual. The majority of the participants from the DFI unit of the National Treasury indicated that there was grave concern regarding the current tools, as more reliance is being placed on information provided by the bank.

Participant NT1 stated that, internationally, other executive authorities have adopted systems such as the SDI and CAMELS to evaluate the sustainability. NT1 further stated that the National Treasury should consider adopting scientific tools to assist

with monitoring and evaluation, as it cannot depend solely on financial information provided by the bank in the performance of its oversight role.

After the review of the corporate plans, does the National Treasury discuss the findings with the Land Bank?

Table B1.6: Question 6 Analysis

Participant ref	Findings of the corporate plan
NT1, NT2, NT3	Yes, the findings of the corporate plan are discussed with all the relevant stakeholders.

All National Treasury participants agreed that they engage the Land Bank through meetings to discuss findings from the analysis of the corporate plans and annual reports and then agree on solutions and a way forward. There is also ongoing engagement with some stakeholders, with whom reports are shared. National Treasury also makes presentations to relevant internal stakeholders on the findings of the analysis.

It can be deduced that the existing stakeholder engagement is adequate and, therefore, the process is fulfilling its desired objectives. It can also be deduced that the process helps in scrutinising the set targets, as agreed in the corporate plan.

Q7: Is the Land Bank fully complying with conditions set by the National Treasury e.g. on the guarantees?

Table B1.7: Question 7 Analysis

Participant ref	Conditions of guarantees
NT1, NT2, NT3, and NT4	Yes, the Land Bank does comply with conditions of guarantees such as submission of quarterly reports.

All participants responded positively to the question and motivated their answers by indicating that the bank complies fully with the current conditions on guarantee issuance, which includes guarantee conditions to maintain capital adequacy ratio (CAR) of 20%, submission of quarterly reports to the National Treasury on the turnaround strategy, and submission of quarterly reports to the National Treasury on loan recovery progress, demonstrating sound management of non-performing loans. Participant NT3 further highlighted the concern regarding the Land Bank's ability to maintain CAR requirement going forward. NT3 stated that the National Treasury has recommended a prudential limit of 20% for the Land Bank's CAR. In the current financial year (2013), this ratio decreased to 21.0% from 28.4%. The ratio declined in financial year 2012, due to a significant increase in new funding liabilities. Further decreases are anticipated over the next three years as the loan book continues to grow. To assist the Land Bank to maintain the CAR within acceptable levels, the National Treasury has previously supported Land Bank through capital injections.

Q8: Are the financial projections being effectively scrutinised to limit surprises in the budget process?

Table B1.8: Question 8 Analysis

Participant ref	Financial projections
NT1, NT2, NT3, and NT4	Yes, we do scrutinize and interrogate the Land Bank's financial projection for any material deviations.

All participants supported each other in maintaining that the financial projections are adequately scrutinised in order to determine the authenticity of the projections, and whether the current resources would be sufficient to finance the current and the future investments (NT1, NT2, and NT3). Participant NT4 went on to say that whether the projections are realistic or not is a different topic altogether.

In the view of participant NT3, the Land Bank was recapitalised when it was moved from the Department of Agriculture, Fishery and Forestry to the National Treasury. In some cases, the Land Bank makes assumptions in its corporate plans regarding the provision of a guarantee or financial support by Government. Where such assumptions are made, the Land Bank clearly explains the rationale for these assumptions.

Q9: If yes, why is there always a perception that financial assistance for the bank is unbudgeted?

Table B1.9: Question 9 Analysis

Participant ref	Unbudgeted financial support
NT3	The perception is incorrect; the Land Bank borrows funding from the open market on the strength of its balance sheet.
NT2	The use of scientific and proper financial tools will ensure accurate financial forecast.
NT1	I think it is the correct perception.
NT4	Government supports and enables the Land bank to access funding.

Participant NT3 disagreed with the statement entirely, indicating that the Land Bank borrows funding from the open market on the strength of its balance sheet. NT3 further indicated that investors' confidence was restored after the recapitalisation of the bank. The Land Bank was able to raise R1, 2 billion funding in the market.

Participant NT2 took a different view and responded to the question as follows: *“Whether [or not] requests are budgeted for ... is not of significance; what is important is for the National Treasury to ensure that it develops financial tools that can be utilised to produce forecast financial requests from the bank.”*

Participant NT4 indicated that, although the Land Bank is able to raise funding from the open market, it should be noted that without government support the Land Bank will have difficulties in securing funding on the strength of its balance sheet. Having

said that, government support is instrumental in ensuring that the Land Bank is able to access affordable funding in the open market.

Q10: What are some of the oversight tools being employed by the National Treasury?

Table B1.10: Question 10 Analysis

Participant ref	Oversight tools
NT3	Corporate plan - in the prescribed format, covering the affairs of the Land Bank for the following three financial years, including financial projections as well as the borrowing plan.
NT2 and NT4	Annual report - containing all information related to the achievement of objectives agreed upon in the business plans and management contracts.
NT1	Quarterly report - actual non-financial performance vs. planned non-financial performance, including monthly financial reports.

All participants indicated that the current financial oversight tools include annual review of corporate plans in terms of Section 52 of the PFMA, review of annual reports in terms of Section 55 of the PFMA, and quarterly reports as required by Section 29 of the Treasury regulations.

Participant NT1 mentioned that the National Treasury also performs monitoring and reporting of infrastructure spending and borrowing by the Land Bank, which is executed by analysis of quarterly report submissions on the Land Bank's infrastructure spending and borrowing.

Participant NT2 indicated that the National Treasury also reports on compliance of the Land Bank with the Companies Act, the King III Code, and Treasury regulations, which include reporting annually on remuneration of the Land Bank Board in terms of the King III Report on Corporate Governance, and the Land Bank’s own Remuneration Guidelines.

Q11: Are those tools still effective and relevant in this rapid changing environment?

Table B1.11: Question 11 Analysis

Participant ref	Effectiveness of oversight tools
NT3	Monitoring and evaluations in order to measure the developmental impact are lacking.
NT2	There is a need for National Treasury to explore other oversight tools.
NT1 and NT4	Current process is still relevant, but can be strengthened.

All participants stated clearly that the PFMA as a regulatory tool is still relevant; however there is a serious need for the National Treasury to adopt other oversight practices in order to strengthen its monitoring and evaluation processes. They further stated that the National Treasury should consider adopting internationally recognized oversight tools such as SDI and CAMELS. These tools would assist in evaluating the Land Bank’s financial sustainability and determining whether the Land Bank would still remain financially sustainable without government support.

In the view of participant NT3 “...with the current system, the National Treasury relies solely on the information provided by the bank without [comparing it] to any independently generated data. An analytical tool, such as the SDI, which incorporates the total amount of the financial support received by a DFI measured against the interest earned on the loans extended to its targeted clientele, could assist as a planning and monitoring tool.”

Q12: In your opinion do you think the current process should be upheld or changed in order to ensure better oversight?

Table B1.12: Question 12 Analysis

Participant ref	Existing oversight process
NT3 and NT4	Assessment of social benefit should also be performed.
NT2	Discussion outside the formal protocol should be discouraged.
NT1	The PFMA remains an integral part of the oversight process.

In response to this question, all participants were of the opinion that, while the PFMA as a regulatory oversight tool and an integral part of the current process should be maintained, significant improvement is necessary to ensure better and more effective oversight by the National Treasury. Participant NT2 expressed the following view: “...lack of adoption of scientific oversight tools could undermine the National

Treasury's objectives of providing effective oversight role; this hinders the National Treasury's progress in ensuring an effective and proactive oversight role".

In terms of the relationship between executive authority and executive management, participant NT3 felt that there are discussions that take place outside the formal protocol. However, he felt that the official reporting lines should be respected at all times, regardless of who is involved.

All participants were in agreement that there is a serious need for the adoption of scientific oversight tools. They further commented that the PFMA is still relevant as a regulatory oversight tool, but it could be rendered ineffective as the act was promulgated in 1999 and became effective on 1 April 2000, and the environment has undergone numerous changes which require the continuous enhancement of oversight tools to ensure effective oversight of the Land Bank.