

REPORT OF THE FINANCE AND RISK MANAGEMENT COMMITTEE



Mr Kabelo Seitshiro

Market Overview

With the financial crisis having spilled over into the real economy, economic activity in both high income and developing countries has dropped sharply, leading to increased unemployment and rising poverty levels. However, the global economy may be on a road to recovery, as we see rapidly recovering capital market issuances and easing credit spreads. On the domestic front, the economy contracted by a significant 6.4% led by a declining demand for SA exports, particularly in mining and manufacturing.

The contraction has had a negative impact on SMEs, a core target market of the NEF. Sectors worst affected by this downturn include the transport and logistics sectors, and the retail sector. Given the NEF's exposure to the transport and logistics sector, the NEF has not been immune to the current financial crisis, leading to the erosion of capital being classified as one of our top five risks for the organisation.

Rolling out our services to the Northern Cape, North West and Limpopo provinces remains a challenge despite management's best efforts to attract investment requests from these provinces. As an organisation, the NEF now has systems and procedures in place that allow it to have a more aggressive approach to actualising its mandate as a BEE development finance institution.

Risk Management

The NEF's mandate requires it to operate in a much riskier segment of the market and it is critical that it has a clear and focused approach to Risk Management. The NEF has, as a result, chosen to use an Enterprise-Wide Risk Management (ERM) approach versus a silo approach to Risk Management. The ERM approach looks at risks within and across all business lines and activities of the organisation to consider how one area of the organisation may affect the risks of other business units and the enterprise as a whole.

The Board Risk Management Committee

The NEF Board of Trustees is accountable for Risk Management. To assist with this process, the Board has established a separate Finance and Risk Management Committee (FRMC) that reports directly to the Board. The FRMC operates pursuant to the provisions of the NEF Delegation of Authority and the charter of the FRMC.

The FRMC oversees all credit, market, treasury and operational risk management activities, as well as co-ordinating corporate oversight units.

The FRMC is largely constituted by the Executive Management of the NEF to ensure that management takes ownership of the risks of the organisation. In addition, the committee is chaired by a Non-Executive Board of Trustee Member and the Audit Committee is represented by its Chairperson.

The role of the FRMC is to:

- review procedures for identifying and managing risks,
- ensure that executive management have effectively identified key risk and that they are adequately managed,
- establish and maintain an understanding of risks that need to be managed,
- consider the control environment directed towards the proper management of risk including reviewing internal auditor's conclusions for audits conducted over specific risk areas,
- consider the results/reports of the combined assurance efforts by all assurance providers and to ensure that appropriate action is taken to address identified areas for improvement,
- ensure that management identify all relevant legislation that needs to be adhered to and that adequate measures are in place to adhere to legislation,
- receive updates on investigations into theft, fraud, etc,
- review any other matters that fall within the ambit of its Charter, and
- report to the Board of Trustees on overall risk management and the extent of any action taken by management to address areas identified for improvement.

During the current financial year, the role of the Risk Management Committee was expanded to include finance and it was renamed the Finance and Risk Management Committee (FRMC). Further responsibilities of the FRMC include oversight and review of:

- the budgetary process,
- quarterly management accounts and Annual Financial Statements, and
- reported financial control weaknesses and other key financial matters.

Risk Management Framework

The NEF has a Risk Management Framework in place which provides guidance on the risk management process to be followed.

The key elements of the Risk Management framework are:

- policies,
- structures,
- processes (how we identify, assess, address and report on our risk), and
- standards for risk management at the NEF.

Risk Management Awareness

Risk management awareness sessions are held regularly with management and staff to inculcate a risk management culture at the NEF.

Fraud Prevention Plan

An approved Fraud Prevention plan is in place. The plan indicates the fraud risks identified, measures in place to mitigate against these risks and the fraud risk management strategy of the NEF. The plan is currently being re-examined and updated.

Disaster Recovery Plan

An approved disaster recovery plan is in place, certain elements of which were tested during the current year.

Delegation of Authority Framework

An approved Delegation of Authority framework is in place and currently being re-examined to determine if it caters for the growth in operations.

Risk Assessment

Operational risk assessments have been completed for all areas within the NEF and key strategic risks have been identified. Risk registers are updated every quarter in terms of any changes and/or progress made on actions identified. Updated risk registers are submitted to the FRMC on a quarterly basis and semi-annually to the Board.

Risk Appetite Exercise

External specialists were engaged to assist with completing the second part of the risk appetite exercise. The results are used to calculate the Risk-Bearing Capacity (RBC) of the NEF. The RBC is defined as "the financial loss that can be borne in the medium term without changing strategic plans or financing requirements, also defined as an acceptable amount of financial impairment that can be retained without a significant impact on the business within a finite time horizon".

This exercise will help determine the level of risk the NEF is willing to accept without influencing its future sustainability. In addition, various scenario planning stress testings have been made to the NEF Balance sheet.

Investment Portfolio

Risk management of the invested portfolio is a key focus of the FRMC. To this extent it has closely considered the risk management initiatives put in place by management on the current investment portfolio. A Post-Investment Business Unit is in place to closely monitor the portfolio. The Post-Investment Unit has visited all investees during the March 2009 financial year. The results of the post-investment visits are reported to the Post-Investment Business Unit's management committee each month and are reported to the FRMC each quarter. In addition, various initiatives i.e. restructuring of Imbewu portfolio and the appointment of mentors have been put in place to assist clients with the poor trading conditions.

Compliance with Laws and Regulation

A formalised compliance framework has been prepared and is being implemented to ensure that all legislation that influences the NEF's operations are complied with. A compliance register has been prepared and is currently being monitored. The impact of new legislation (New Companies Act) has also been analysed for the NEF.

Policies

The FRMC has reviewed and ensured the implementation of the following policies over the past four years:

- Cash Management Policy (currently being re-examined)
- Materiality Framework (currently being re-examined)
- Delegation of Authority Framework (currently being re-examined)
- Risk Management Framework
- Fraud Prevention Plan (currently being re-examined)
- Disaster Recovery Plan

KEY CATEGORIES OF RISKS

Credit Risk

The risk that the NEF portfolio may be eroded due to funding poor quality and high risk deals such as start-ups, poor monitoring of investees and lack of sufficient business skills by entrepreneurs.

The NEF mitigates this risk by ensuring that we have adequate screening and due diligence processes in place before an investment is approved. An approved investment policy and procedure manual is in place to guide staff. All staff have been trained on this manual. In addition we have prudential limits in place and have also entered into strategic partnerships with banks and other DFIs to share risks. The rollout of product categories such as franchising, procurement contracts etc, will also assist in reducing our exposure in this area.

The establishment of an effective Post-Investment Unit is also playing a key role in monitoring and managing the existing portfolios. This unit identifies potential problems with investees before they occur. In addition mentors are also appointed to assist investees who lack skills and expertise. A Mentorship Panel has been established and the mentorship strategy is in the process of being rolled out. Legal action is also taken against defaulting clients and these matters are reported on at the monthly Post-Investment Committee meetings.

Market Risk

The impact of shrinking global and local economy has negatively impacted on the NEF's operations.

The close monitoring of the portfolio by the Post-Investment Unit has identified industries and businesses that are in distress and initiatives such as restructuring of loan and mentorship have been implemented.

In addition portfolio prudential limits are in place to ensure that exposure to specific sectors are capped.

Operational Risks

These relate to human capital, systems and reputational risks. As the activities of the NEF is dependent on skills and performance of its staff we need to ensure that we have robust human capital practices in place.

The NEF mitigates this risk by having a robust recruitment process and various training initiatives. Significant progress has been made in this area and the total staff complement has increased from 86 as at 31 March 2008 to 104 as at 31 March 2009.

A performance management process is in place and linked to reward mechanisms. In addition, a balanced scorecard tool to monitor and track performance is being rolled out. Various incentive structures are in place and an employee-wellness programme has been implemented.

The NEF has implemented an Information Technology system to ensure that efficiencies are maximised and controls are enhanced.

The NEF also places a significant emphasis on managing its stakeholders and reputation and during the current year a brand audit was completed and results were presented to the Finance and Risk Management Committee.

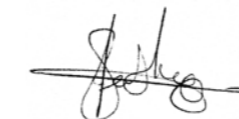
Membership and Attendance

- As at 31 March 2009, the FRMC comprised the following members:
- Mr Kabelo Seitshiro, Chairman of the Committee and Trustee
 - Mr Anthony Coombe, Independent and Audit Committee Chairman
 - Ms Philisiwe Buthelezi, Chief Executive Officer and Trustee
 - Mr Colin Clarke, Chief Operating Officer (appointed on 1 March 2009)
 - Mr Frenel Gillion, Chief Investment Officer
 - Mr Mohammed Mia, Risk and Compliance Manager
 - Ms Prabashnee Pillay, Human Resources Manager
 - Mr Andrew Wright, Chief Financial Officer

During the year under review, the attendance record of the members of the FRMC was as follows:

Member	19/06/2008	16/09/2008	18/11/2008	06/03/2009
Mr K Seitshiro	✓	✓	✓	✓
Mr A Coombe	✓	✓	✓	✓
Ms P Buthelezi	✓	✓	✓	✓
Mr C Clarke*	-	-	-	✓
Mr F Gillion	✓	Apology	✓	✓
Mr M Mia	✓	✓	✓	✓
Ms P Pillay	✓	✓	Apology	✓
Mr A Wright	✓	✓	✓	✓

* Appointed on 1 March 2009



Mr Kabelo Seitshiro
Chairman of the Finance and Risk Management Committee

"Many businesses collapse in the first two years of operation, and the mentorship programme, which provides on-going support, guidance and monitoring is an important support service which the NEF provides at no cost to its investees."

Ms Thabisa Mange – Legal Services