29 November 2019

Key findings of PwC investigation

Tongaat Hulett Limited

1 Introduction

Shareholders are referred to the announcements released by Tongaat Hulett Limited (**THL**) on SENS on 18 November 2019 and 29 November 2019.

As stated in the 18 November 2019 announcement, it is envisaged that THL's restated audited consolidated annual financial statements for the year ended 31 March 2018 (**2018 AFS**) and its audited consolidated annual financial statements for the year ended 31 March 2019 (**2019 AFS**) will be released in the week commencing 9 December 2019.

2 Background

Following the appointment of Mr Gavin Hudson as new CEO of THL in February 2019, the THL board of directors (**Board**) gave the new CEO the mandate to conduct an immediate and comprehensive strategic and financial review with the objective of stabilising the business, addressing the debt levels and setting the path towards acceptable returns for shareholders.

The strategic and financial review, as well as an initial investigation of allegations that came through the whistleblowing line, revealed certain business, accounting and other practices which were of concern to the Board and required further examination. It soon became clear that, over and above the operational difficulties facing THL, there was insufficient internal accountability, governance and financial oversight.

To prepare for litigation by and against THL, to facilitate a comprehensive review of these practices and the necessary corrective action and to allow executive management to focus on the strategic and financial review and the repositioning of the business, Bowman Gilfillan Inc., at the instance of the Board, appointed PricewaterhouseCoopers Advisory Services Proprietary Limited (**PwC**) on 13 March 2019 to:

- assist with a legally privileged investigation into alleged irregularities (**PwC Investigation**); and
- submit a report (**PwC Report**) to a committee of the Board appointed to consider the PwC Report (**Board Committee**). The Board Committee currently comprises Mr Louis von Zeuner, Mr Gavin Hudson and Ms Linda de Beer.

The PwC Report has been submitted to the Board Committee. It sets out PwC's findings following a six-month investigation. PwC reviewed a vast amount of information and data and interviewed a significant number of past and current employees.

The Board Committee and THL's advisors have reviewed the content of the PwC Report to prepare for litigation by and against THL, to understand the impact on the financial results for the financial years (**FY**) ended 31 March 2018 (**FY 2018**) and 2019 (**FY 2019**) and to determine whether further investigation is required and what remedial action to take. The Board Committee has provided detailed feedback to the Board.

As the PwC Report is subject to legal privilege and other confidentiality restrictions, the Board does not intend publishing the PwC Report. However, in the interest of transparency, the Board has decided to take the proactive step of releasing this document, which sets out (i) the key findings of the PwC Report, and (ii) the Board's approach in dealing with various matters and deciding what remedial measures to take. By releasing this document, THL does not waive the legal privilege and confidentiality which inheres in the PwC Report.

3 **Scope of the PwC Investigation**

PwC was requested to investigate alleged undesirable business, accounting and other practices and the potential impact they had on the financial statements of THL for FY 2018 and FY 2019. PwC undertook this work in two phases, firstly gathering information and gaining an understanding of the allegations, and then undertaking a detailed investigation.

While most individuals from whom PwC requested interviews made themselves available, there were a number of senior executives who have left the organisation who declined to be interviewed, did not co-operate or imposed conditions that made it difficult to get their input.

PwC has confirmed that it has not been influenced by THL, or restricted in terms of access to information, in undertaking the PwC Investigation or in preparing the PwC Report.

4 **Key Findings**

The Board Committee's assessment of PwC's key findings is as follows:

General

The PwC Investigation identified, *inter alia*, that:

- certain senior executives initiated or participated in undesirable accounting practices that resulted, amongst others, in revenue being recognised in earlier reporting periods than it should have been, and in expenses being inappropriately capitalised to assets. This resulted in profits in the respective years being overstated, and in the overstatement of certain assets in THL's financial statements;

- there was a culture of deference and lack of challenge at THL that resulted in employees following instructions on accounting practices, without questioning the basis for those accounting practices; and

- there were a number of governance failures pursuant to which internal policies, guidelines and frameworks were not followed, creating an environment in which senior executives could initiate or participate in the financial reporting misstatements.

The PwC Investigation identified major historical shortfalls in a number of important areas, including, *inter alia*, governance practices, delegation of authority, decision-making, oversight, financial discipline, record keeping, systems usage and financial reporting.

Main categories of financial misstatements

The PwC Investigation identified certain primary areas in which financial restatements are required. Management is in the process of quantifying the adjustments and the financial statement impact will be included in the 2018 AFS and 2019 AFS, due to be released shortly.

Following its review of the PwC Report, the Board Committee is of the view that the primary categories of financial misstatements are as follows:

The early recognition of revenue from the sale of land

The PwC Investigation identified that a number of internal policies, guidelines and frameworks in place at Tongaat Hulett Developments (**THD**) were in many instances ignored or incorrectly applied. These included:

- the frameworks which outline internal processes to be followed for land sales;
- the Meaningful Deposit Guideline, which outlines the criteria for calculating the deposit to be paid for land sales; and
- the Revenue Recognition Policy, which governs the requirements to be fulfilled before revenue from land sales is recognised for financial reporting purposes, including payment of deposits and fulfilment of conditions precedent.

PwC identified in respect of THD land sales transactions entered into between FY 2013 and FY 2019 that, *inter alia*:

- a number of land sale agreements were backdated i.e., those agreements reflected dates of signature which preceded the actual dates of signature; and
- a number of methods were used to enable THD to recognise sales before zoning and sub-division approvals had been obtained.

This had the effect of recognising revenue too early, inflating THD's revenue in the earlier reporting period in which the sale was accounted for.

The overstatement of the carrying amount of cane roots and standing cane

The PwC Investigation identified that the values of cane-related assets were overstated as a result of, amongst others, the excessive capitalisation of expenses, such as head office overhead costs to the establishment cost of roots, the inclusion of the full value of share cropped cane (cane farmed by tenants on land owned by third parties) in the standing cane valuation, the use of overly optimistic estimates in the standing cane valuations, the use of standard costing models rather than actual costs and the overstatement of the value of fallow land.

The overstatement of the carrying amount of capital work in progress and plant and machinery as a result of the inappropriate capitalisation of maintenance and other internal costs to capital projects

The PwC Investigation identified a practice whereby operating expenses, including repairs and maintenance costs, were incorrectly capitalised into assets (including projects to be developed in the future), instead of being expensed as generally required. This increased the carrying amount of assets, including capital work in progress and property, plant and equipment.

The overstatement of sugar sales in Zimbabwe

The PwC Investigation identified that certain agreements in Zimbabwe which, in substance, were financing arrangements, were structured as sales of significant sugar stocks, and accounted for as sales every six months, at financial half year and year-end. Furthermore, even though at least part of the sugar stocks comprised raw sugar, these 'sales' were accounted for as sales of refined sugar, and priced accordingly. As a result, revenue pertaining to sugar sales was overstated.

The capitalisation of infrastructure costs

The PwC Investigation identified that certain infrastructure costs (for example, infrastructure for electricity provision, roads and bridges) which should have been reflected as expenses against land sales were inappropriately allocated and capitalised to future land development projects resulting in earlier land sales appearing to be more profitable.

The incorrect apportionment of revenue between land sales and infrastructure

The PwC Investigation identified the incorrect apportionment of revenue from land subject to conversion and development between sale of land and the provision of infrastructure not yet commenced and/or completed, with too great a portion of the revenue recorded as consideration for land sales, and too little attributed to the infrastructure. As a result, a large portion of the revenue from these sales was recognised in earlier reporting periods.

The provision of cash collateral in relation to a sale of land

On occasion, THL entered into arrangements whereby it provided cash collateral to assist a potential purchaser of land to finance the purchase.

The overstatement of projected revenue

The PwC Investigation identified that the projected revenue from certain projects used in the allocation of infrastructure costs to land was overstated by including infrastructure rights that had not yet been approved in the estimate, and that bulk infrastructure costs were allocated based on these 'rights'.

Categorisation of financial restatements for purposes of the financial statements

In order to provide meaningful disclosures for purposes of the financial statements, the financial restatements will be categorised as follows:

- cost capitalisation;
- revenue recognition and other income;
- asset recoverability; and
- consequential effects of accounting irregularities.

5 **Remedial measures to be taken by the Board**

Contemplated legal action against individuals involved in the above practices

In light of the information that has come to light in the PwC Report, the Board intends to pursue claims against certain individuals who appear to have been responsible for, or party to, the undesirable activities outlined in the PwC Report. Their involvement was such that at the very least they knew or ought to have known, *inter alia*, that the 2018 AFS contained information that was materially inaccurate.

From the PwC Investigation, it appears that personal financial enrichment of key senior employees was largely limited to the financial incentives paid to them during the years in which they achieved their employment targets.

The PwC Investigation found that the senior executives involved in some or all of the above practices, to a greater or lesser extent, include, *inter alia,* in alphabetical order, Mr John Chibwe (Hippo Valley Estates Finance Director), Mr Michael Deighton (former managing director of THD), Mr Steve Frampton (former Zimbabwe Sugar Sales General Manager), Mr Shelton Nhari (Triangle Finance Director), Mr Sydney Mtsambiwa (former managing director of THL's Zimbabwean operations), Mr Les Munro (former Finance Executive of Tongaat Hulett SA Sugar), Mr Murray Munro (former Chief Financial Officer of THL), Mr Raphael Pfunye (Zimbabwe Sugar Sales Finance Executive), Mr Sean Slabbert (former Finance Executive of THL) and Mr Peter Staude (former Chief Executive Officer of THL).

Disciplinary action has been or is being taken in relation to certain of the senior executives referred to above and other individuals.

The Board is considering the institution of civil actions against the senior executives referred to above and other individuals, including, amongst others:

- actions to recover bonuses and benefits paid to specific executives and other individuals for the relevant periods; and
- applications to court for orders declaring relevant people to be delinquent directors or otherwise incapable of occupying fiduciary positions.

From a criminal law perspective, the Board is engaging with the South African Police Services (**SAPS**) and the National Prosecuting Authority of South Africa (**NPA**). The Board will provide relevant information and necessary support to the SAPS and NPA to assist them in pursuing those parties who the NPA determines should be prosecuted. Equivalent authorities will be engaged in Zimbabwe and Mozambique where applicable.

Other remedial measures

The Board and the management team are developing a robust remedial plan that will contribute to further significantly improving the operations, oversight of the business and the governance at all levels within the organisation. A number of measures have been and will continue to be taken:

- revised management and oversight practices have been implemented and company policies, guidelines and frameworks have been refreshed;
- governance practices have been improved and centralised decision-making implemented;
- THL's employee numbers, requirements and skills base have been reviewed, with the aim of ensuring that the company has the right people to do the job of turning the business around and setting it on a new course;
- a Board Legal Committee has been formed to oversee relevant ongoing investigations, and to identify measures that need to be put in place in an attempt to recover money that is owing to THL as a result of undesirable activities;
- a revised delegation of authority framework is being developed;
- critical Board committees, including the Risk, Capital and Investment Committee, the Social and Ethics Committee and the HR and Remuneration Committee, have been established or reconstituted;
- internal and external controls, monitoring and oversight are being enhanced; and

- a culture change programme is continuing to drive a culture of ownership, excellence, trust, responsibility and the right behaviour.

The Board has given strong support to the turnaround strategy, as well as clear guidance, based on the Board Committee's review, on how to deal with the findings of the PwC Investigation

THL has made a decision to be as transparent as is prudent and possible in the circumstances on the work it is doing to turn around the business and restore the company's reputation as a leading corporate in the consumer goods business. A fundamental reshape of the business is needed to restore trust and put the business on a sustainable footing.

6 Continuing actions by the THL leadership

The Board is committed to take a number of actions, including the following:

- ensuring that the management team keeps a strong focus on the business in executing the turnaround plan and enhancing shareholder value;
- ensuring that the findings of the PwC Report and the financial impact are reflected appropriately in the 2018 AFS and 2019 AFS;
- co-operating fully with the relevant authorities regarding criminal investigations against those who perpetrated the actions identified in the PwC Report;
- seeking to recover losses incurred as a result of these actions. Key senior people at THL who have left the organisation appear to have been involved in perpetrating these undesirable practices; and
- working with PwC, the JSE, the Financial Sector Conduct Authority and other relevant authorities, regulators and bodies.