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Standing Committee on Public Accounts

P O Box 15

Cape Town

8000

2 October 2017

Dear Mr T Godi

**Re : Invitation to appear before SCOPA**

Please find attached our response to your letter dated 22 September 2017.

Yours faithfully

Chief Executive Officer

KPMG Southern Africa

MHLAMULO DLOMU

KPMG Services Proprietary Limited is a company incorporated under the South African Companies Act and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

KPMG Services Proprietary Limited is not a Registered Auditor in terms of the Auditing Profession Act, 26 of 2005 and does not provide audit services as defined in Section 1 of this Act.

Registration number 1999/012876/07

The company's principal place of business is at KPMG Crescent, 85 Empire Road, Parktown, where a list of the directors' names is available for inspection.

## KPMG SOUTH AFRICA RESPONSE TO SCOPA

### 1. INTRODUCTION

- 1.1 The 3,400 South Africans who make up KPMG South Africa have supported state and constitutional institutions for many years. The work we do for our country is an honour and a privilege and one that we understand comes with great responsibility.
- 1.2 KPMG South Africa's professionals make hundreds of decisions each day. The services we perform for state and constitutional institutions differ widely in terms of their nature and circumstance. Almost always these are delivered to a high quality and result in very satisfied clients.
- 1.3 We achieve this through exceptional people and detailed policies, processes and methodologies underpinned by a focus on integrity and quality, but sometimes, in a firm of 3,400 people, some people do fall short of the standards we set. I have publicly committed that wherever I find evidence that people have failed to do what they should have done, they will be held accountable, and I have made it my personal responsibility to ensure that this firm recommits to our values and culture.
- 1.4 Although we are proud of the work that we perform, both in the public and private sectors, I have personally been greatly disappointed by how we have fallen short of the standards we set ourselves in relation to the work that we have done for SARS and for Gupta related entities. It affects me deeply. Equally, it hurts all of the people who make up KPMG South Africa. They are just as outraged as every other South African and many are bitterly disappointed about what has happened. On behalf of KPMG South Africa, I would like to apologise to each member of the Standing Committee on Public Accounts (SCOPA) for these mistakes.
- 1.5 I am determined that these mistakes do not happen again, which is why we have already made a number of changes, and I am leading other reforms. These include ensuring that all people accountable have exited the firm; strengthening the governance of KPMG South Africa; and centralizing client acceptance procedures.
- 1.6 I understand that people want independent reassurance that the issues have been examined properly and are being dealt with appropriately. So, in addition to the steps that we have taken already, a senior legal figure will lead a full and independent inquiry. This will be independent of both KPMG South Africa and KPMG International. We anticipate that an announcement will be made in the coming days.
- 1.7 In addition, we have already made reports to regulatory authorities where appropriate and further steps of this kind will be taken as necessary.
- 1.8 All 3,400 of our people are South Africans first, and we are all committed to the fight against corruption, to new standards for our profession, and to building our country.
- 1.9 I know that the public's trust and confidence in us has been damaged. They rightly expect us to demonstrate that we consistently hold ourselves to the highest standards and I am committed to

making sure this happens. This response seeks to answer the questions you have asked of me and I look forward to appearing before SCOPA on 5<sup>th</sup> October 2017.

## 2. **KPMG'S TRACK RECORD AND THE SERVICES IT PROVIDES TO THE STATE AND PUBLIC INSTITUTIONS**

### **Background to KPMG**

- 2.1 The origins of KPMG in South Africa go back to 1895. Just like our country, our story is one built on restarts and rebirths. Over the years, we have played a significant role in supporting the effective functioning of South Africa's capital market and have worked closely with multinational companies, family-owned businesses and entrepreneurs helping them to mitigate risks and grasp opportunities in an ever-changing landscape.
- 2.2 In these ways KPMG South Africa has played an instrumental role in the growth of the economy, but also more specifically in the training of chartered accountants over the 122 years of its existence. More broadly in the new South Africa, we have played our part in the transformation agenda and are proud of the role we played in the first democratic elections and in the advancement of broad-based black economic empowerment.
- 2.3 In the past 20 years, KPMG South Africa has trained 4655 prospective chartered accountants, 1594 of whom are black. At the moment we employ 979 trainees, of whom 588 are black.
- 2.4 KPMG South Africa commits itself, with other business leaders, to actively combat corrupt practices wherever we encounter them. We do not act anti-competitively. We have zero tolerance for corruption. We protect whistleblowers. We will take all steps necessary to give effect to these commitments, and to lead change in our profession.

### **Issues in relation to services to SARS and to Gupta family related companies and steps KPMG South Africa has taken in response**

- 2.5 Recently, as is a matter of public knowledge, KPMG South Africa has been the subject of significant public criticism, primarily as a result of work that it performed in two areas:
- 2.5.1 First, KPMG South Africa served as auditor of a number of South African companies related to the Gupta family, and it is alleged these entities participated in money laundering, tax evasion and corruption.
- 2.5.2 Second, KPMG South Africa was engaged by SARS to conduct a confidential investigative document review into allegations of misconduct by certain SARS officials. Extracts of KPMG South Africa's draft report dated 3 September 2015 were leaked. The report subsequently became the subject of public and political debate arising from statements made in the report's conclusions concerning the former finance Minister, Pravin Gordhan.
- 2.6 Some criticism of KPMG South Africa has suggested that these areas of work are linked, and that KPMG South Africa has provided support to a corrupt strategy by the Guptas or Gupta-related entities to gain control of state assets and institutions.

- 2.7 KPMG South Africa takes these issues extremely seriously, and understands the significant public response to them. We accept that the underlying allegations are a matter of enormous concern to the country, and that they must be fully examined, investigated, and addressed.
- 2.8 In response to these allegations, in August and September 2017 KPMG International undertook an investigation with the support of external lawyers. The outcomes of that investigation and actions taken by KPMG South Africa as a result were reflected in a public statement issued on 15 September 2017.
- 2.9 As reflected in that statement, KPMG South Africa took various steps to address the concerns that had been identified. These steps included:
- 2.9.1 the exit of the Chairman of the Board, the CEO, and the COO of KPMG South Africa and their replacement by a new leadership team;
  - 2.9.2 the exit from the firm of other partners who were either responsible for specific failures or who, by virtue of their knowledge or senior leadership role, should have acted to ensure that those failures were identified and stopped sooner;
  - 2.9.3 a commitment to enhance KPMG South Africa's corporate governance practices by reference to the KING IV report on corporate governance, and the appointment of a senior independent non-executive director to complement current board members;
  - 2.9.4 a commitment to overhaul the firm's public reporting, including a commitment to publish an annual transparency report detailing the firm's quality processes and controls;
  - 2.9.5 separating the role of risk management partner and chief operating officer to ensure sufficient focus on risk management matters;
  - 2.9.6 with respect to the SARS report, a statement that the part of the report which refers to conclusions, recommendations and legal opinions should no longer be relied upon and with respect to KPMG South Africa's audit work for the Gupta-related entities an acknowledgment that this fell well short of the quality expected;
  - 2.9.7 a review of and changes to client acceptance and continuance processes; audit quality and risk management processes; and processes for identifying and acting upon integrity and ethical issues which may arise in the course of engagements; and
  - 2.9.8 an offer to repay to SARS the fee paid for the SARS report work (or to make a donation of that amount to charity) and a donation of R40 million to education and anti-corruption not for profit organisations.
- 2.10 We are, in addition, co-operating with the regulatory authority, IRBA, in its investigations, and on 22 September 2017 we publicly announced our support for a separate and independent inquiry dealing with these matters.
- 2.11 The affected pieces of work represent a very small proportion of the services that KPMG South Africa has delivered to private and public entities over the relevant period, during which KPMG South

Africa has provided services to more than 10,000 clients. But we do not want to downplay the significant impact that these events have had on South Africa and on public confidence in our work; and we are completely committed to acknowledging and learning from our mistakes and bringing about whatever changes and improvements are needed to ensure that they do not happen again. We also believe that we need to take the initiative in supporting reform of our profession as a whole.

2.12 That is the context in which we have been invited to meet with SCOPA. I turn now to deal with the specific questions that we have been asked to address.

**3. PARAGRAPHS 1 AND 2 (OF THE SCOPA LETTER): THE QUANTUM (IN NUMBER AND RAND VALUE) OF CONTRACTS WITH STATE AND CONSTITUTIONAL INSTITUTIONS FOR THE PAST THREE YEARS, THE CATEGORIES OF CONTRACTS AND THE RAND VALUE OF EACH CATEGORY**

3.1 The attached table (A) sets out the total rand value of the contracts which KPMG South Africa has performed for state and constitutional institutions during the past three years, in each of the categories of tax; advisory (which includes forensic investigations); and audit.

3.2 With respect to the number of contracts to which these figures relate, we have not been able to collate this information (which is not held in a single repository) in the time available. We can, however, confirm that during the twelve months ending 31 August 2017, KPMG South Africa performed services on 1,301 projects for state and constitutional institutions; in the 2016 financial year we performed services on 1,410 such projects; and in the 2015 financial year we performed services on 1,237 such projects.

3.3 Since projects may continue from year to year, and a single contract may govern more than one of these projects, the total number of contracts may be less than the number of projects. These figures do, however, provide an indication of the extent of the work KPMG South Africa has done, and continues to do, for state and constitutional institutions.

**4. PARAGRAPH 3 (INCLUDING 3.1- 3.3): APPOINTING PERSONNEL TO PROJECTS, CLIENT INTERACTION, PREPARATION OF REPORTS AND HANDOVER TO CLIENTS**

4.1 We are engaged on a variety of different projects, in each of the categories of tax, advisory and audit referred to above. The staffing of a project is guided by the nature, size and complexity of the specific project. We set out below the process which is typically followed in appointing personnel to projects, although this may vary, depending on the engagement.

4.2 KPMG typically establishes an engagement team led by an engagement partner.

4.3 The engagement partner, together with an engagement management and an HR partner or planning manager is responsible for allocating sufficient personnel and other resources to the project. This allocation includes identifying persons with the requisite knowledge, skills and experience to successfully perform the work required, taking into account transformation, workload, and similar matters. The engagement team will include persons with the necessary qualifications and appropriate accreditation for the performance of the work.

- 4.4 When required, and in consultation with the client, the KPMG South Africa team procures the services of specialists, not in the employment of KPMG South Africa, and facilitates and co-ordinates the contribution of these specialists in the performance of the work.
- 4.5 The engagement partner is primarily responsible for communication with the client, including dealing with requests from and to the client, monitoring the work of the team, facilitating communication amongst team members and reviewing and signing off on the final deliverables which have been agreed with the client.
- 4.6 As mentioned above, the engagement partner is principally responsible for communicating with the client. Key members of the team are introduced to the client and also interact directly with the client. Together with the client, the engagement partner and key team members discuss and determine key milestones and deliverables for the project, including timing of the agreed deliverables.
- 4.7 The interaction with the client is guided by the contract or engagement letter. When required by the client, or where this is otherwise appropriate (for example on particularly large projects) a work plan may be created. The engagement team monitors its progress with reference to the work plan.
- 4.8 In consultation with the client, the engagement team determines an appropriate means for reporting on progress, including the frequency, content and format of progress reports.
- 4.9 The engagement team prepares deliverables in accordance with terms agreed with the client. When required, a written report is prepared, in a form which is appropriate to the engagement.
- 4.10 In KPMG South Africa's experience it is best to keep clients regularly informed of progress on the engagement. This process frequently includes ongoing advice and interim or draft reports.
- 4.11 It is KPMG South Africa's policy that written reports, and other deliverables more generally, clearly explain the source of the information referred to in them and the basis for any conclusions which have been reached.
- 4.12 The engagement partner is responsible for the quality of the deliverables including:
- 4.12.1 ensuring that deliverables are consistent with the terms of the engagement (engagement letter or contract or any variation);
  - 4.12.2 reviewing and approving significant deliverables (whether in draft or final form) prior to their delivery to the client; and
  - 4.12.3 preparing deliverables which are in accordance with KPMG South Africa's policies and procedures, professional standards and legal and regulatory requirements.
- 4.13 The persons who may rely on the engagement deliverables are usually restricted to clients or any other parties specifically identified in the engagement terms, and these may be subject to caveats, disclaimers or restrictions relevant and appropriate in the circumstances.

**5. PARAGRAPH 4 (INCLUDING 5.1 – 5.4): KPMG SOUTH AFRICA'S UNDERSTANDING OF THE PRACTICAL AND LEGAL IMPLICATIONS OF DECLARING A REPORT "FINAL" AND "HANDING IT OVER TO CLIENTS"**

- 5.1 The issuing of reports, whether in draft or final form, is regulated by client requests on specific contracts. The value and significance of a report, whether in draft or final form, differs from case to case depending on the type of service being offered. In some cases the value of the work lies in the production of a final report. In others, the value of the work lies in the services themselves, with a report merely standing as a summary or description of the work performed and actions taken as a result.
- 5.2 In the area of forensic services the question whether KPMG South Africa will produce a report, whether in draft or final form, for any particular piece of work depends on what has been agreed with the client and will be subject to specific client requests according to the provisions of specific terms of engagement.
- 5.3 KPMG South Africa places a duty on all engagement leaders to employ skill and diligence in reviewing work product before delivery to clients. It is the duty of each engagement partner to ensure the quality of the work and to uphold the integrity and reputation of KPMG South Africa. In appropriate circumstances the engagement partner also obtains the assistance of a second reviewer or reviewers, or technical reviewers to review technical input.
- 5.4 In the normal course and following delivery of a final deliverable KPMG South Africa does not again review the deliverable. An exception to this is when the work is selected for review as part of KPMG South Africa's quality performance review programme. In these circumstances a final report will be reviewed together with the underlying work papers supporting that report.
- 5.5 If, however, KPMG receives information suggesting work it has done for its clients does not meet the standards it expects, it will consider that information. If appropriate, it will deal with that by way of a review of the work performed.
- 5.6 In the case of the SARS report, at the request of KPMG South Africa, a KPMG International investigation assessed whether the engagement team, in performing the work, did so in accordance with our methodology, processes and procedures and whether the work was performed in compliance with risk management protocols. This investigation did not involve re-doing the underlying work.
- 5.7 Whenever it comes to our attention that our work has fallen short, we seek to correct it. It is important that this view is communicated to the client, and it may, depending on the circumstances, be necessary to communicate it to others.
- 5.8 In this case, given the failure to appropriately apply our own risk management and quality controls, KPMG South Africa decided that the part of the report which refers to conclusions, recommendations and legal opinions should no longer be relied upon. This was communicated in the public statement on 15 September 2017.
- 5.9 With respect to communications to SARS, we informed SARS of our conclusion and intention to make the statement on 15 September 2017, in advance of making a public statement. Given the urgency

with which we felt we needed to act following the KPMG International investigation, it was not possible for us to provide SARS with more time to consider the practical implications of this, if any. We have offered to engage with SARS, and remain available to do so.

**6. PARAGRAPH 6.1: HOW DOES KPMG SOUTH AFRICA BILL ITS CLIENTS?**

- 6.1 KPMG South Africa bills its clients in the manner agreed in the contracts under which its services are engaged.
- 6.2 The timing of the presentation of invoices to a client is largely determined by the nature of the project or work to be done. When dealing with short term or less complex projects invoices are presented on a milestone basis and when specific deliverables are handed over to the client.
- 6.3 In dealing with longer term or more complex projects, and subject at all times to the terms of the agreement with the client, invoices may be presented on a monthly basis or at appropriate intervals during the life of the project. In the ordinary course KPMG South Africa's invoices are payable within 30 days of receipt.

**7. PARAGRAPH 6.2: HOW WAS THIS FOLLOWED IN THE INSTANCE OF KPMG SOUTH AFRICA'S WORK IN THE PROGRAMME MANAGEMENT OFFICE (PMO) OF THE IFMS AT NATIONAL TREASURY?**

- 7.1 We have noted the suggestion, in the letter inviting us to meet with SCOPA, that KPMG South Africa received irregular payments in the IFMS project at National Treasury. We do not believe there is any basis at all for the suggestion that any payment made to KPMG South Africa in that project was irregular. It has never been suggested to KPMG South Africa, by any official within National Treasury responsible for the project, that any of the work was not delivered to the required standard, or that any part of the contract or payment for it was irregular.
- 7.2 The invoices and supporting reports were presented to National Treasury for inspection and consideration in line with the contract under which our services were engaged. After any queries raised had been resolved, the responsible official within National Treasury approved payment of the invoices.

**8. PARAGRAPH 7: WHY SHOULD SCOPA HAVE CONFIDENCE IN KPMG SOUTH AFRICA'S WORK NOW, IN THE FUTURE, OR IN THE PAST**

- 8.1 KPMG South Africa operates in a highly regulated profession, with an independent regulator which conducts regular checks that provide external validation of the quality of our work. We have operated successfully in this environment for many years. As mentioned above, the work which has caused these issues is a very small proportion of the work that KPMG South Africa has delivered to private and public entities over the relevant period, during which KPMG South Africa has provided services to more than 10,000 clients.
- 8.2 Throughout that period we have provided a valuable training ground for young people entering the profession, and we continue to train large numbers of new entrants to the profession, including large numbers of young black professionals. Continuing professional development is part of our culture and part of the requirements of our profession.



- 8.3 We have taken strong action to deal with those accountable for the failings that we have identified, and we support an independent inquiry to establish if there is any further action that we should take.
- 8.4 KPMG South Africa is fully aware that trust and confidence in our work has been weakened. While a lot of action has been taken to restore trust and confidence, I know that more is needed. My more than 3,000 South African colleagues who help me to make up KPMG South Africa are determined to regain the respect of our fellow citizens.
- 8.5 I look forward to discussing these matters with SCOPA.

**MS NHLAMU DLOMU**

**CHIEF EXECUTIVE OFFICER**

**KPMG SOUTH AFRICA**

**2 October 2017**