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www.financialmail.co.za
October 5 - October 11, 2017

SA: R29.20 inc Vat
Botswana: P29.20
Swaziland: SZL29.20
Zimbabwe: US$5

ISSN 0015201-3

Genie out the bottle

How **McKinsey** and **Trillian** milked billions from SA Inc

THE GUPTAS' GENIE

How Gupta-linked boutique firm Trillian and global consultancy McKinsey used political muscle to milk billions from Transnet and Eskom

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Among the stories in *The Arabian Nights* is one about a poor tailor with a son named Aladdin, an idle boy without a trade who gets a lucky break: he finds a magic lamp that unleashes a genie who turns him into a rich sultan who marries a princess . . .

Some consulting firms struggling to make ends meet in tough times must have concluded that all they needed was an Aladdin and his magic lamp to start raking in hundreds of millions in fees.

Ask Regiments, Trillian and McKinsey, who extracted over R2bn from state-owned enterprises (SoEs) Transnet and Eskom thanks to the intervention of the politically connected Salim Essa, codenamed "Aladdin" by one of his business associates.

Regiments Capital is a financial advisory and management consulting firm, founded in 2004 by Litha Nyhonyha, Eric Wood and Niven Pillay. By 2012 the company had some impressive gigs under its belt but lacked a heavy-hitting international partner to take it to the next level. What was needed was Aladdin's magic.

According to several sources familiar with the facts, Pillay's golfing partner Kuben Moodley brought Essa, a close business associate of the Gupta family and President Jacob Zuma's son Duduzane Zuma, to Regiments' offices in late 2012. Court filings show Moodley was a fixer whose company Albatime was paid a fee or revenue cut by Regiments to bring in business.

Essa and Moodley, who was previously an adviser to mineral resources minister Mosebenzi Zwane, presented a proposal that would prove very lucrative to Regiments: "We have brought you McKinsey," they apparently said.

After conducting a due diligence, McKinsey appointed Regiments as its supplier development partner in January 2013, for work it was conducting for several SoEs, including Transnet, with Essa and Moodley apparently receiving a cut of the proceeds. McKinsey would not confirm Essa and Moodley had brokered its relationship with Regiments, stating only that the global consultancy hadn't paid them any fee. But this obscures the fact that their cut would have come from Regiments' fee.

According to two sources familiar with the deal, Essa was paid more than 30% of all revenue Regiments earned from its work with McKinsey at SoEs. Regiments did not respond to questions about payments to Essa. Wood confirmed in a statement last week that "Mr Moodley introduced Mr Essa to Mr Pillay in 2012" and "subsequent to this meeting Regiments contracted with McKinsey". Moodley and Essa did not respond to questions about their role in setting up the deal.

There'd soon be enough cash around for everyone. So much so that the hyenas were starting to circle the camp. But first the competition had to be knocked out of the race.

In 2012 McKinsey's supplier development partner was Letsema, SA's first black-owned and managed consulting firm. It was founded by Isaac Shongwe in 1996. Letsema joined forces with McKinsey in 2005. Over the years the rail and port sector became one of Letsema's specialities.

By 2012 Letsema's work with McKinsey generated about 80% of its total income, almost half of this with Transnet. In 2013 Letsema partners Derek Thomas and Aldo Sguazzin were called to a meeting with Garry Pita, chief procurement officer at Transnet at the time.

He told them Letsema could no longer work on the 50bn 1,064 locomotives programme, citing a possible conflict of interest. Shongwe, Letsema's chairman, was an executive director of Barloworld, which acted as a distributor for Caterpillar in SA. And Caterpillar Inc owned Electro-Motive Diesel, a company that was bidding for a portion of the contract. "It turned out to be the start of kicking Letsema out of Transnet," said Sguazzin. "Suddenly Regiments was injected into the McKinsey relationship. From then on we were sidelined." Soon Letsema's Transnet income fell to 10% of total revenue before drying up altogether.

"It almost destroyed us," said Shongwe. "Transnet should have been proud to use a local company with our track record."

At Regiments, things were going swimmingly, for a while at least. "Salim knew the executives at Denel, Transnet and Eskom," said one former employee. His message to them was simple. "He told them if they don't open the door, they're out. Suddenly Regiments was flying."

Wildly differing accounts exist of Regiments' earnings from Transnet through its partnership with McKinsey since 2013 until Wood left with its advisory division in 2016. The amaBhungane centre for investigative journalism puts the figure at R484m, the *Sunday Times* at R800m. Regiments said these numbers were way off the mark but declined to provide the correct figures, citing client confidentiality. Ironically this also left some crumbs on the table for Letsema. In 2015 Regiments subcontracted Letsema for six months to work on a Transnet project.

"We had the rail expertise. Suddenly they needed us," said Thomas.

AmaBhungane also reported that in November 2014, payments totalling R84.3m began to flow from Regiments to Gupta front company Homix, with a large chunk funnelled to offshore letterbox companies linked to Essa.

E-mails from the "Gupta leaks" show that in mid-2014 the Gupta family were beginning to eye Regiments, apparently using Essa and Wood as their Trojan horse.

Essa and the Gupta family did not respond to questions e-mailed to them.

Draft agreements attached to the leaked e-mails obtained by the *Financial Mail* circulated among Essa, Tony Gupta and other Gupta employees show the Saxonwold family wanted to buy a 50% stake in Regiments for R200m. One e-mail suggests Wood was party to the talks, even though Nyhonyha and Pillay said in court documents these were conducted without their knowledge.

Wood, who owns 32% of Regiments, disputes this. In a company statement last week he said it would be "patently impossible" to secretly sell a controlling stake of the company to the Guptas as the deal would have required their buy-in. He said the Guptas had approached Regiments through Essa to buy a stake in the company. The Regiments directors had invited Essa to join them at their weekly meeting at Tortellino D'Oro restaurant in Oaklands, Johannesburg.

"Following on from this interaction Dr Wood was authorised by Messrs Niven Pillay [and] Litha Nyhonyha to provide such information as would be necessary for a formal offer to be tabled," Woods's statement said.

The plan fell through after a meeting held at Saxonwold in April 2015 attended by Pillay, Wood and Tony Gupta.

Pillay and Wood provide vastly differing accounts of the meeting. Pillay told the *Sunday Times* last year that the Guptas wanted to buy a controlling stake in Regiments and offered to make him a "dollar billionaire" if he stayed on as CEO with Wood and ousted Nyhonyha. He said that when he refused, Regiments lost its Transnet work.

But in court filings Wood alleges that when the Guptas offered to buy a controlling stake in Regiments, Pillay was in favour of the deal and disappointed at losing his "large pay day" when Nyhonyha rejected it.

Wood also rejected allegations that he was the Guptas' "inside man" at Regiments. He has "no relationship with the Gupta family and is most certainly not a proxy for the Gupta family (or anyone else)", his statement said. Asked why he'd been invited to the Gupta wedding at Sun City, which he apparently accepted with alacrity, he "surmised" it was because Regiments "had been appointed to advise ANN7, the Gupta news channel, on its bid to acquire Independent [Media] and he was the lead adviser at Regiments in respect of this transaction".

In court filings and his statement last week, Wood insists he only came to know Essa, widely regarded as a front for the Guptas' business interests, through Pillay and Moodley. He repeated allegations made in news reports that Nyhonyha and Pillay were implicated in "questionable conduct in setting up of investments that stood to benefit certain politically connected individuals".

Reuters also recently reported Regiments had allegedly used its political connections to ensure McKinsey kept being awarded lucrative contracts from SoEs despite concerns McKinsey had about Regiments' capabilities.

Regiments said last week the allegations were "patently false" as the company had "no political connections" and McKinsey dominated "the strategy and management consultancy work in the public sector without help or assistance from Regiments".

"It should be noted that the relationship was preceded by a thorough due diligence that McKinsey (internationally) carried out on Regiments. We passed the due diligence with flying colours. There were no concerns about our capacity or political connections."

Either way, within three months after several fallouts with his partners, Wood and Regiments decided to part company. The fallout is laid bare in court proceedings each party has brought against the other. In his affidavit Wood reveals that Essa mandated Regiments to conduct corporate finance work for his purchase of VR Laser in a deal that included the Guptas and Duduzane Zuma. It later emerged that the real aim of the deal was to secure exclusive rights to Denel's R100bn arms sales to India.

Pillay and Nyhonyha said they were unaware Regiments had worked on the deal. "The current executives are still piecing together the chronology of the questionable activities perpetrated by Wood without their knowledge," Regiments told the *Financial Mail*.

Wood said Essa had also suggested Regiments should carry out advisory work for the Guptas in their bid to buy Independent Media "given Regiments' involvement in the acquisition of VR Laser". To this end "meetings were held between representatives of the Gupta family and Regiments" but the deal ultimately fell through.

Nyhonyha and Pillay denied any knowledge of this deal too.

Responding to allegations he'd been instrumental in diverting over R80m paid by Transnet to offshore entities associated with Essa and the Guptas, Wood said: "Over the past few months various sensational news reports have been published making widespread allegations, none of which has been proven true in a court of law. Similarly, the allegations in regard to the diversion of funds offshore by Dr Wood are categorically false."

Moodley denies being a Gupta associate and describes Essa as someone "known to me from social circles". But the evidence suggests his relationship with Essa goes far

What it means:
The seemingly magical connections of Salim 'Aladdin' Essa saw the money taps turned on in an astonishing way

deeper. The evidence includes Wood's affidavit that refers to confirmatory affidavits by Essa and Moodley.

By mid-2015, following Wood and Pillay's April meeting at Saxonwold, the relationship between Wood and his partners at Regiments was on the rocks. After acrimonious meetings they decided to part company.

A source with direct knowledge of the events said that when the Gupta bid to buy Regiments failed, Wood and Essa switched to Plan B. That's where Trillian came in.

"Eric and Salim needed a company with an FSB [Financial Services Board] licence after the Regiments deal fell through," said a former employee. "Trillian was the perfect vehicle." The name apparently comes from a character in Douglas Adams' cult sci-fi novel *The Hitchhiker's Guide to the Galaxy*, Tricia "Trillian" McMillan. In the book the unemployed astrophysicist is described as "beautiful, charming, devastatingly intelligent".

When Trillian was up for sale, the boutique financial advisory firm — owned by four investment professionals, brothers Rowan and Ben Swartz, Daniel Roy and Jan Fourie — was struggling to make ends meet. Trillian's financial statements obtained by the *Financial Mail* show it made a modest profit that year of R440,487 and generated R2.7m in revenues. This was marginally better than the previous year, when Trillian earned R2.5m and posted a small loss.

"The business was ticking along but it never shot the lights out," was how one fund manager familiar with the company's dealings at the time described it. "It was floundering, really."

In September 2015 the Swartz brothers sold their 50% stake for what's understood to be a modest sum to what they were told was a black empowerment consortium.

Then Aladdin's lamp worked its magic again. Rowan Swartz confirmed the brothers had sold their shares to a buyer whose identity wasn't disclosed, but declined to say what they were paid. He said Trillian "had never done any work at Transnet, Eskom or any state-owned entity. That's all I'm prepared to say."

It later transpired Essa was the crucial ingredient missing from Trillian before September 2015. The deal would give Trillian direct access to the highest echelons of two lucrative clients, Transnet and Eskom.

In December 2015 Trillian received a deposit of R93m from Transnet, for whom Trillian had began to work immediately after the sale. The *Sunday Times* reported that by then, McKinsey and Trillian were discussing how they should divide up a staggering R9.4bn they expected to earn from Eskom over four years. In the end they received R1.6bn for six months' work from a single contract before it was cancelled. Trillian received R595m of this as McKinsey's BEE partner even though it did not have a contract with either Eskom or McKinsey

An investigation by advocate Geoff Budlender later referred to McKinsey's partnership with the politically connected Trillian as a "sham" arrangement designed to keep the Eskom taps flowing. McKinsey denies this. "We take supplier development seriously, and have done so for many years," McKinsey spokesman Steve John said in September.

However, the allegation that Trillian used political muscle to milk billions from Transnet and Eskom is supported by Bianca Goodson, the former CEO of a division of Trillian, who released a whistleblower statement last week. The company's "business model was that work is secured through Essa's relationships and [Trillian] benefits from these relationships", she said. The company didn't conduct the work itself but once it was secured, "passed [it] over to internationally recognised companies and acted as the supplier development partner of choice, with roughly a 50% share in revenue."

In the next eight months Trillian billed Transnet and Eskom close to R500m. By March 2017 earnings since December 2015 topped R800m — not bad for a company that was earning less that R3m two years earlier.

Trillian's spectacularly improved cashflow came in handy for the Guptas. Both the public protector and a Deloitte probe for the Reserve Bank found Trillian had also helped Gupta mining business Tegeta pay for Optimum coal.

The original approach to the owners of what was then called Trillian Asset Management in 2015 came from Stanley Shane, a member of the Transnet board who headed the strategically important acquisitions and disposals committee and ran a small financial advisory and capital raising firm called Integrated Capital Management (ICM), together with Clive Angel and Marc Chipkin. Like Wood, Angel and Chipkin both previously worked for Investec.

At the end of 2014 the Swartz brothers told their partners they wanted out. Trillian Asset Management was 100% white-owned so Daniel Roy and Jan Fourie started casting about for a black partner. Shane then introduced Roy to Essa as a potential partner and shareholder.

In an interview last week, Roy said at the time Essa's name didn't raise any red flags. "When I met Salim and did a due diligence there was very little about him in the public domain. I had no idea he had anything to do with the Gupta family. All I knew was the one thing we were seriously lacking was a BEE partner."

When they met, Essa sketched his vision of creating a top-notch financial services firm that would attract SA's best talent and clients. "Here was a BEE guy who's got cash and connections and doesn't want to be involved in operational matters. It was the holy grail," he recalls. "In hindsight it was too good to be true."

A shell company was registered that bought the Swartz brothers' 50% stake in Trillian Asset Management, which was renamed Trillian Capital Partners. Roy and Fourie's stake was diluted to 3%. Eric Wood, who brought the advisory division of Regiments with him, took 25% and Essa 60%. Another 12% was held by Aeriom Nominees on behalf of a mysterious group of shareholders Wood described as "employees".

Then five subsidiaries were created, including one that took the original name Trillian Asset Management, headed by Roy.

Court papers, e-mails, and other documents obtained by the *Financial Mail*, show the directors of ICM were involved in setting up the Trillian group and initially played an operational role, including in negotiations with McKinsey. Several sources said Shane and his company, ICM, were the intended owners of at least some of the shares held by Aeriom. This was supported by Goodson's statement as well as Roy.

"There was a discussion with Stan [Shane] and Salim about [Shane] being remunerated for setting up the company," said Roy. He confirmed that "one of the options on the table" was granting Shane shares in Trillian.

In a clear conflict of interest, Shane at the time chaired the acquisitions committee at Transnet, a parastatal that had controversially ceded Regiments' contracts to Trillian. In his report Budlender also raised questions about whether Transnet had paid Trillian for work already done by Regiments.

However, Transnet doesn't see anything amiss. The rail company had "satisfied itself that there was no conflict of interest involving Mr Shane and entities that were doing business with Transnet," spokesman Molatwane Likhethe said last week. Transnet also maintains "there was no illegal cession of contracts (from Regiments) to Trillian", insisting all due processes were followed, including obtaining "a legal opinion which supported its decision to pay Trillian for the services rendered". Where a dispute existed over who had done the work, Trillian had been obliged to issue credit notes "and the monies were received by Transnet".

Despite this glowing endorsement Transnet decided to "terminate" its relationship with Trillian in November 2016 "in an effort to safeguard its reputation".

Roy said Essa performed the same function at Trillian as he had at Regiments — making key introductions. "I was introduced to the guys at McKinsey by Salim," he said.

Roy said last week that he, Fourie and their asset management team have now decided to leave Trillian. "The situation has become untenable. In the interests of our clients we have decided to part ways."

In the end, the plan to cede shares to Shane and ICM never came to fruition. Earlier this year the shares were transferred from Aeriom Nominees to Trillian nominees, again for the benefit of "staff", according to Wood. By now they are probably worthless. Nevertheless, Shane's documented involvement in Trillian while occupying an influential position at Transnet when suspect payments were made is a red flag. Another is that Shane's partners at ICM allegedly received R700,000/month for "services" rendered to Trillian, says a well-placed source.

Asked last week if they were ever party to or aware of discussions to grant them or ICM shares in Trillian, Angel and Shane dodged the question. In cut-and-paste responses to written questions, they said ICM "has never owned and does not own any shares in TCP". Despite evidence to the contrary in e-mails and court filings, both insisted "Integrated Capital performed no services for Trillian". They conceded, however, that Trillian had "contracted a company operated by Angel and Chipkin to provide . . . primarily start-up services for Trillian".

Another key player in the game was former Blue Label director Mark Pamensky. Documents obtained by the *Financial Mail* suggest he, too, was conflicted.

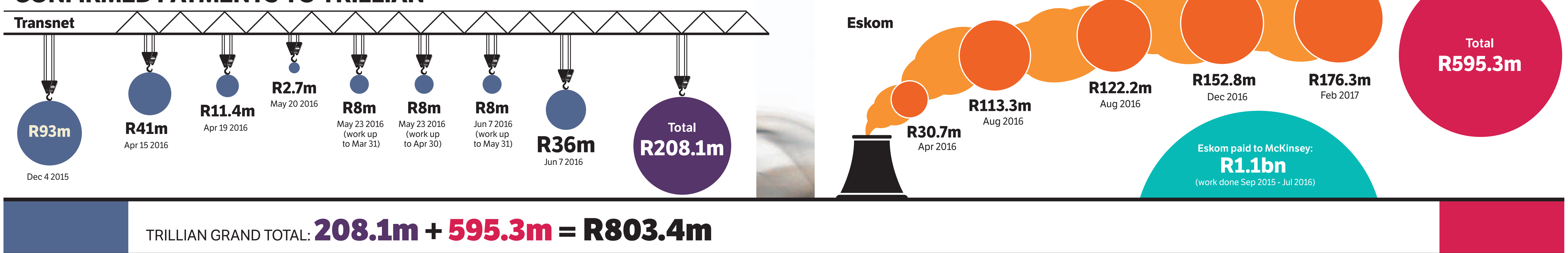
In January 2016 a letter from Pamensky, then a director of Gupta company Oakbay, was sent to Trillian. His letter assessed whether being a director of Eskom and a consultant "and potential shareholder" of Fuel Property Group represented a conflict of interest.

At the time Pamensky chaired Eskom's investment and finance committee, which was investigating the sale of noncore real estate assets to a dedicated fund to optimise the power utility's balance sheet.

In March 2016 Pamensky declared his potential shareholding of Fuel Property to Eskom. In his declaration the firm is described as a potential Trillian shareholder through Aeriom. He also declares that his company Markpam Consulting, as well as Fuel and Trillian, planned to offer balance sheet optimisation "to state-owned entities through (unlocking) potential value in SoE's real estate portfolios".

According to Budlender's report, citing a whistleblower, a month later Wood sent Transnet a property analysis proposal from Fuel

CONFIRMED PAYMENTS TO TRILLIAN



Property, with an invoice for R41m. The invoice is stamped "paid" in May 2016. In her statement Goodson also points out there were plans to make Pamensky CEO of Trillian's proposed property division. Several sources said Pamensky regularly worked at the Trillian offices on the company's property proposals.

Eskom did not respond when asked if it had accepted Pamensky's declaration of interest and Pamensky did not respond to e-mailed questions and text messages over several weeks after initially agreeing to an interview.

Eventually the party came to an abrupt halt in July this year after Eskom's lenders threatened to pull the plug if the utility didn't clean up its act. Within weeks Eskom launched several investigations into the R1.6bn paid to Trillian and McKinsey. These concluded the contracts were unlawful and should be subjected to court review to allow Eskom to recover the money.

An interim report by law firm Bowmans as well as internal memos obtained by the *Financial Mail* recommended suspending seven officials for their role in the payments, issuing letters of demand to Trillian and McKinsey, as well as opening a corruption case with the Hawks.

First in the firing line was Eskom's CFO Anoj Singh, who was suspended last week. Eskom issued three more suspension notices this week. Singh, at the centre of a host of corruption allegations including those involving Trillian and McKinsey, promised to release a "tell all" document in July but hasn't yet done so.

It also emerged that Eskom had received a legal opinion in December 2015 – a month before it signed up McKinsey – warning that the contract was unlawful. The legal opinion, obtained by the *Financial Mail*, says the McKinsey contract is in breach of a national treasury instruction that stipulates consultants should be paid a prescribed hourly rate. Instead McKinsey and Trillian worked "at risk", which means they were paid a percentage of savings achieved at Eskom as a direct result of their work, allowing fees to balloon. Sources at Eskom said McKinsey was hard-pressed to explain how it arrived at its savings calculations, accepted by the utility under Singh's tenure.

For now, McKinsey and Trillian are toughing it out. Both have denied wrongdoing and insist they are proud of the tangible results they've delivered at Eskom even though the utility posted irregular expenditure of R3bn this year and says it needs a 20% tariff increase to meet revenue targets.

McKinsey has so far only suspended one partner, Vikas Sagar, and says it is investigating the allegations against him. Both firms say there is no basis for a criminal corruption case against them. True or not, they'll need magic powers if they want to repair their battered reputations. x

ON THE ROPES

Questions are now being asked about whether KPMG could go bust within six months — but that would not mean its auditing role at the big banks would go to smaller firms, whether black- or white-owned

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What it means:
The more immediate threat to financial stability is the prospect that more than one big bank would suddenly be without auditors

When KPMG quietly resigned from its role as external auditor of Oakbay Resources and other Gupta companies in March 2016, it evidently thought the issue would just go away and that the firm, now under the leadership of a new CEO, could go back to normal.

In retrospect, it seems astonishing that the firm could have been so insensitive to SA's political realities, or so arrogant, that it imagined it could dodge the bullet of its 15-year-long involvement with the Guptas – or of the role it played at the SA Revenue Service, where a forensic report on the so-called "rogue unit" by KPMG was used as a pretext to fire then finance minister Pravin Gordhan. Now, after an ever-more-turbulent 18 months, the "big four" accounting firm's very survival is at stake in SA. And there are questions about how much of a hit KPMG's reputation might take globally, with parallels being drawn between the way the Enron scandal sank Arthur Andersen in 2002.

Reserve Bank governor Lesetja Kganyago warned, in an interview with the *Financial Times* on Monday, that KPMG's international business could be imperilled if the firm failed to do more to salvage its reputation in SA. He said KPMG had taken a step in the right direction by appointing an independent inquiry but urged this should be genuinely independent and the results should be made public: "KPMG has to own up. South Africans are angry with what it has done. It accepted work it should not have. This is a global firm that is supposed to have global standards and understandably clients will be asking lots of questions … I don't think that if KPMG goes in SA, it will only go in SA."

It is a measure of how global the implications potentially are that the *Financial Times* has given it significant coverage in recent weeks. It is a measure, too, of how severe the potential implications of a KPMG failure are for SA's financial sector that the Reserve Bank has gone public with its views.

At the same time, the controversy has highlighted questions about the audit profession itself, as well as the roles of the boards that sign off the annual financial statements. Nobody should celebrate the challenges KPMG faces, former finance minister Trevor Manuel told a Deloitte conference this week. Manuel, who is also chairman of Old Mutual Emerging Markets, talked about a crisis for the profession and the need for a healing process that would ensure no further deterioration in trust. However, he said the focus should be not just on the external auditors but must start with the financial management inside any company, and the audit committee of the board which was supposed to be the first safeguard. Deloitte CEO Lwazi Bam said: "This affects all of us as a profession and as a profession we need to introspect."

KPMG admitted in August that it had been far too slow to react to the controversies around its reports for Sars and its relationship with the Guptas. By then it was too late. The Independent Regulatory Board for Auditors (IRBA) had initiated an investigation. JSE listed Sygnia had gone public in late July with its decision to fire KPMG as its external auditor, prompting other clients to review their relationships with it.

KPMG's board responded by suspending one partner and relieving two others of their board and executive positions pending the outcome of a comprehensive review, and its then CEO Trevor Hoole admitted that mistakes had been made. But that only served to stoke anger against the firm. When it eventually went public in mid-September with the results of a damning investigation by KPMG International, and got rid of the top leadership of the SA firm, it was seen as too little, too late.

The report itself was more damning, in a way, because while it concluded there was no evidence of corrupt or illegal activity by KPMG, it found the firm's quality control processes had failed, and that its leadership had shown extremely poor judgment and failed to respond as it should have to "red flags".

If clients hadn't been worried already, they were now, and that was particularly the case for the banks and other financial services firms that are KPMG's largest clients. Audit firms are there because they are supposed to spot red flags and exercise judgment, and as one banker put it, what made it even worse was that KPMG seemed not to have picked up the signs that the Guptas might be laundering money – a particularly disturbing failure for the banks, as they are charged by the Reserve Bank with looking out for money laundering or exchange-control contraventions.

KPMG looms large in SA's financial sector. Banking regulations require banks to have two auditors and KPMG is joint auditor for three of the big four banks – Standard, Nedbank, and Absa – with the latter two having brought KPMG in only this year. Absa has said it is reviewing its relationship in the light of the report. So has Investec, another audit client. KPMG is sole auditor for Old Mutual and that includes the highly complex task of auditing Old Mutual's managed separation process, and it is also MMI's auditor, among others.

Saffin has already said it will dismiss KPMG as its joint auditor, as have several other clients, and questions are being asked about whether KPMG could go bust within six months. That would certainly be the case if it were to lose one or more of the big banks that are its largest clients. Some put its chances of going under at well over 60%.

Lesetja Kganyago: Clients will be asking questions
Freddy Mavunda

It's a scenario that's of extreme concern to SA's financial sector regulators – which is why the banking regulator called the CEOs and chairs of the board audit committees of the big banks to a meeting on the evening of September 21, as the heat rose following KPMG's report and its change of leadership. "We all agreed we should lower the temperature and provide some breathing space," says one who attended the meeting at the Reserve Bank.

The trouble with SA's big banks is that they are particularly complex and cross-border creatures to audit, which is why only the "big four" audit firms take on those contracts. Nor is SA's banking sector alone in this – in the US, for example, only two of the top 100 banks are audited by non-big four audit firms. The dominance of the auditing big four – KPMG, PwC, EY and Deloitte – tends to be controversial everywhere, but so far no-one is willing to be without them.

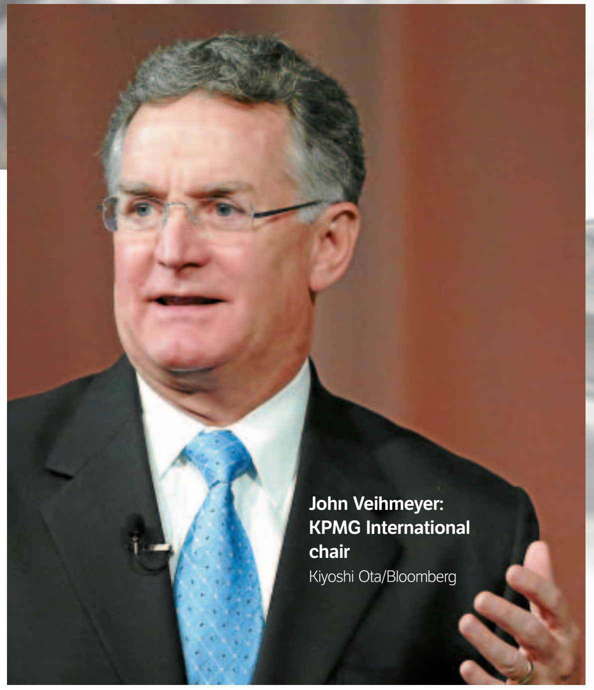
Nor is it likely that if KPMG were to go down, the business would go to smaller firms, whether black or white owned.

Finance minister Malusi Gigaba has upped the temperature if anything, calling for all government departments to review their relationships with KPMG, and has pointed to the risks posed by the market dominance of a few firms in a key industry. He has called for a "concerted effort by all stakeholders to open up the sector to more players for a more de-concentrated and transformed audit sector".

In the case of the big banks, that's not going to happen. And one of the big concerns at the Reserve Bank and within banks' boards is that if KPMG goes under, or the banks have to bow to pressure to get rid of them as auditors, the risk concentration will be even worse, because there would be just three firms to choose from.

That would present real practical problems in a context in which each bank has to have two auditors – and in which the rules on audit independence prevent a client taking on a firm that is already providing certain kinds of non-audit services such as IT or human-resources consulting. The challenges will be even greater when mandatory audit firm rotation is introduced, as IRBA has announced it will be from 2023. There are also concerns about reduced choice when it comes to the kind of non-auditing work which firms such as KPMG do for the banks and for the Reserve Bank itself.

The reason banks, and large insurers, are different when it comes to auditing has to do with the scale and the risks of auditing them. Smaller firms are unlikely to have the resources to devote a dozen or more partners and more than 100 staff to a single client,



John Veihmeyer: KPMG International chair
Kiyoshi Ota/Bloomberg

which is what a big bank audit would typically require, nor would they necessarily want the exposure – or to pay the billions of rand in professional indemnity that's required.

For banks and their regulator, the more immediate threat to financial stability is the prospect that more than one big bank would suddenly be without auditors, at least temporarily. No-one wants any question marks to be raised over the quality of banks' own financial statements. The damage KPMG has done to the reputation of the audit profession itself is already an issue for the banks, as it is for the profession and the markets.

Disturbingly, SA has already lost the top place it long enjoyed in the World Economic Forum's ranking of countries' audit and reporting standards, with the WEF's latest global competitiveness index showing SA plummeted 30 places, from one to 31, on this measure.

Though the Reserve Bank has not explicitly come out and said the banks should think twice about dismissing KPMG, it is said to have privately urged the banks to do so. At the same time, however, it has urged KPMG International to take charge and restore trust in the firm.

Belatedly, KPMG International chairman John Veihmeyer and chairman-elect Bill Thomas visited SA in the third week of September, meeting Pravin Gordhan and others who suffered the consequences of the Sars report and issuing a public statement to say the firm would launch an independent investigation, chaired by a "senior SA legal figure". It also said KPMG International would provide its full support to the SA firm, to restore trust and rebuild confidence – and ensure the firm was doing business with the right people.

Veihmeyer and Thomas have recognised the damage done and, at last, have understood the significance of the issues to SA itself. They have promised full disclosure. Whether their intervention will be enough to save the firm has yet to be seen. x