

## AFRICA RISK CONSULTING

### South Africa Monthly Briefing September 2017

#### South Africa Summary 29 September 2017

*International audit firm KPMG issues a full admission of improper business practices relating to the Gupta family, fires its chief executive and eight other senior members of staff, recants the findings of a controversial report, and offers to repay fees related to Gupta dealings. The Congress of South African Trade Unions (Cosatu) organises marches at urban centres across South Africa to protest so-called state capture and corruption in the administration of President Jacob Zuma (2009-present). State statistics agency Statistics South Africa (Stats SA) reveals that gross domestic product (GDP) growth in the second quarter of 2017 was 2.5%, bringing the economy out of recession.*

#### KPMG fires CEO & executives, repays fees relating to Gupta dealings

International audit firm **KPMG** issued a full admission on 15 September of improper business practices relating to the **Gupta** family, fired its chief executive and eight other senior members of staff, recanted the findings of a controversial report, and offered to repay fees related to Gupta dealings.<sup>1</sup> KPMG is facing an international reputational crisis over its role in auditing companies linked to the Gupta family who allegedly profited illicitly from state-owned enterprises (SOEs) colluding with President **Jacob Zuma** (2009-present).<sup>2</sup> Emails leaked to the press in June showed KPMG partners approved Gupta-owned **Linkway Trading** spending money on a Gupta family wedding in 2013 as a business expense.<sup>3</sup> The wedding was a controversial event as the Gupta family flew friends and family out of the military **Waterkloof Air Base**.<sup>4</sup> The emails show that four KPMG partners attended the wedding, with one referring to it in correspondence as “*the event of the millennium*”.<sup>5</sup> **KPMG International**, the parent company of **KPMG SA**, concluded its internal investigation into the firm’s dealings with the Gupta family on 15 September.<sup>6</sup> It then fired KPMG SA CEO **Trevor Hoole**, chief operating officer and risk manager **Steven Louw**, board chairman **Ahmed Jaffer**, and six other senior executives and board members.<sup>7</sup> KPMG SA is now pursuing disciplinary action to dismiss **Jacques Wessels**, the lead partner of the audit entities linked to the Gupta family.<sup>8</sup>

*“This is just too little too late for KPMG, the firm will probably survive but they have lost the trust of the business community even under new leadership.”<sup>9</sup>*

The firm went further later that day with interim COO **Andrew Cranston** retracting a controversial KPMG report commissioned by the **South African Revenue Service (SARS)** into a so-called ‘rogue unit’ at SARS.<sup>10</sup> The report, commissioned by SARS commissioner **Tom Moyane** in 2015, found that then finance minister **Pravin Gordhan** had operated an illegal unit within SARS during his time as

<sup>1</sup> Rand Daily Mail, 15 Sep 2017.

<sup>2</sup> See previous ARC Briefing South Africa.

<sup>3</sup> Business Live, 11 Sep 2017.

<sup>4</sup> Financial Times, 12 Sep 2017.

<sup>5</sup> Financial Times, 12 Sep 2017.

<sup>6</sup> Rand Daily Mail, 15 Sep 2017.

<sup>7</sup> Rand Daily Mail, 15 Sep 2017.

<sup>8</sup> Rand Daily Mail, 15 Sep 2017.

<sup>9</sup> Source, company director, Johannesburg

<sup>10</sup> Rand Daily Mail, 15 Sep 2017.

commissioner that had spied on senior members of government.<sup>11</sup> Moyane was an adversary of Gordhan and a key Zuma ally, and the report contributed to Zuma firing Gordhan as finance minister in April 2017. Cranston apologised to Gordhan for the implication that the unit was illegal and that Gordhan should have known about it – neither of which the firm was qualified to make.<sup>12</sup> He said that KPMG would pay back the \$1.7m in fees to SARS or donate it to charity.<sup>13</sup>

KPMG's actions have had further consequences for the company that faces losing all of its considerable public sector contracts and being censured from South Africa's major regulatory body. Moyane told the media on 18 September that he stood by the report and its original conclusions and has reported the firm to finance minister **Malusi Gigaba** to be blacklisted from all public entities.<sup>14</sup> Gordhan is also considering legal action against KPMG and its former executives.<sup>15</sup> Parliament's public accounts standing committee has summoned KPMG to appear before it to explain its actions; the **Independent Regulatory Board for Auditors** is conducting an investigation into KPMG's actions.<sup>16</sup>

Pressure group **Save South Africa** and anti-corruption watchdog **Corruption Watch** are putting pressure on businesses to close their KPMG accounts.<sup>17</sup> KPMG SA has lost six clients since July over the scandal. Financial services company **Sasfin** dropped the firm after eighteen years on 19 September, as did investment fund **Hulisani**.<sup>18</sup> **Sygnia Asset Management** was the first company to fire KPMG on 28 July.<sup>19</sup> Significantly major corporate clients including investment banks **Investec**, **Standard Bank**, **Old Mutual** and **Absa** have all publicly stated they are reviewing their contracts with KPMG.<sup>20</sup> Other major clients, including property developer **Growthpoint Properties** and mining firm **Sibanye Stillwater**, have also put KPMG on notice.<sup>21</sup> If just one major client decides to leave, analysts in South Africa believe that the firm could face the same scale of client flight that led public relations firm **Bell Pottinger** into administration on 12 September.<sup>22</sup> KPMG is one of the largest auditing firms in South Africa and its collapse would pose a wider economic risk.<sup>23</sup> The central **South African Reserve Bank (SARB)** is reportedly briefing that KPMG is "too big to fail"<sup>24</sup> and is allegedly putting pressure on domestic banks not to drop its services.<sup>25</sup>

*"The SARB comments demonstrate the fundamental threat that state capture poses to the private sector. By working with established services companies to gain legitimacy the Guptas have undermined vital players in the economy."*<sup>26</sup>

It is unlikely that KPMG will suffer the same fate as Bell Pottinger. There is a much greater cost to replacing an auditor than a PR firm, especially for a major financial institution. The tactics used to bring down Bell Pottinger of attacking the firm outside of South Africa have also not led to client flight. However, the pressure on KPMG will warn other companies off working with the Guptas in the future. It will also prompt companies to examine contracts with the state and SOEs in South Africa in greater detail. KPMG demonstrated how partners were able to bypass the firm's compliance mechanisms in order to chase the Gupta accounts. More stringent internal checks or a third party report prior to

<sup>11</sup> Rand Daily Mail, 15 Sep 2017.

<sup>12</sup> Rand Daily Mail, 15 Sep 2017.

<sup>13</sup> Rand Daily Mail, 15 Sep 2017.

<sup>14</sup> Business Day, 18 Sep 2017.

<sup>15</sup> Business Day, 18 Sep 2017.

<sup>16</sup> Rand Daily Mail, 20 Sep 2017.

<sup>17</sup> Financial Times, 12 Sep 2017.

<sup>18</sup> Rand Daily Mail, 20 Sep 2017.

<sup>19</sup> Moneyweb, 28 July 2017.

<sup>20</sup> Rand Daily Mail, 20 Sep 2017.

<sup>21</sup> Rand Daily Mail, 20 Sep 2017.

<sup>22</sup> Rand Daily Mail, 20 Sep 2017.

<sup>23</sup> Reuters, 29 Sep 2017.

<sup>24</sup> Reuters, 29 Sep 2017.

<sup>25</sup> Reuters, 29 Sep 2017.

<sup>26</sup> Source, editor of a newspaper, Johannesburg

engaging the Guptas would have easily determined that they posed a severe reputational threat to any services company working with them.

### **Cosatu marches against state capture, corruption & Jacob Zuma**

The **Congress of South African Trade Unions (Cosatu)** organised marches at urban centres across South Africa on 27 September to protest so-called state capture and corruption in the administration of President Zuma.<sup>27</sup> The protests are putting significant strain on the tripartite alliance Cosatu has with the **African National Congress (ANC)** and the **South African Communist Party (SACP)**, from which the president draws the executive.<sup>28</sup> Crowds gathered in **Braamfontein (Gauteng Province)** before marching to the city centre in **Johannesburg**.<sup>29</sup> The media reported that at lunchtime there were roughly 5,000 participants at the Johannesburg rally, at least 3,000 joined a march in **Durban (KwaZulu Natal Province)**, as well as around 1,000 at a rally in **Cape Town (Western Cape Province)**.<sup>30</sup>

*“This is a totally unprecedented situation, five years ago the thought that Cosatu would be leading protests to oust an ANC president was unthinkable.”<sup>31</sup>*

Participants held placards and shouted slogans calling for an end to state capture, the expulsion of the Gupta family from South Africa, and for President Zuma to step down.<sup>32</sup> Crowds also shouted their support for deputy president **Cyril Ramaphosa**, who is Cosatu’s favoured successor to Zuma as president of the ANC.<sup>33</sup> Cosatu has backing from the SACP, which is also considering quitting the alliance with the ANC over the state capture scandal.<sup>34</sup> The ANC provincial leadership in Gauteng Province is also supporting the marches.<sup>35</sup> In an unprecedented move, business associations including **Business Leadership South Africa**, the **South African Chamber of Mines**, and **Business Unity South Africa** have also lent their support to the march and associated strike.<sup>36</sup> Cosatu general secretary **Bheki Ntshalintshali** and SACP secretary general and higher education minister **Blaise Nzimande** both addressed the crowds in Johannesburg.<sup>37</sup> Nzimande stated that the marches were against corruption and state capture and not the ANC in general.<sup>38</sup> Ntshalintshali told the marchers it was time to *“recapture the electoral mandate we gave to the ANC today.”<sup>39</sup>*

Other labour groups have attacked Cosatu for using a strike as a way to play out internal ANC politics.<sup>40</sup> Rival federation **South African Federation of Trade Unions (Safu)**, led by former Cosatu general secretary **Zwelinzima Vavi**, has dismissed the strike as a farce.<sup>41</sup> The independent **Associated Mineworkers and Construction Union (AMCU)** president **Joseph Mathunjwa** accused Cosatu of using the protest to *“advance a particular faction”<sup>42</sup>* in favour of Ramaphosa in the run up to the ANC’s December national conference.<sup>43</sup>

*“This is definitely the ANC’s internal divisions spilling out onto the streets. But in the end this is how the ANC has operated for years...the interesting thing here is that Vavi, Safu and the others*

<sup>27</sup> Business Day, 27 Sep 2017.

<sup>28</sup> Daily Maverick, 27 Sep 2017.

<sup>29</sup> Daily Maverick, 27 Sep 2017.

<sup>30</sup> Daily Maverick, 27 Sep 2017.

<sup>31</sup> Source, editor of a newspaper, Johannesburg

<sup>32</sup> Business Day, 27 Sep 2017.

<sup>33</sup> Business Day, 27 Sep 2017.

<sup>34</sup> Daily Maverick, 27 Sep 2017.

<sup>35</sup> Daily Maverick, 27 Sep 2017.

<sup>36</sup> EWN, 26 Sep 2017.

<sup>37</sup> Business Day, 27 Sep 2017.

<sup>38</sup> EWN, 27 Sep 2017.

<sup>39</sup> Daily Maverick, 27 Sep 2017.

<sup>40</sup> Daily Maverick, 27 Sep 2017.

<sup>41</sup> Daily Maverick, 27 Sep 2017.

<sup>42</sup> Daily Maverick, 27 Sep 2017.

<sup>43</sup> Daily Maverick, 27 Sep 2017.

*are not finding common cause with Cosatu. This shows you it is not about corruption but about power. The other unions want Cosatu to fail for supporting the ANC.”<sup>44</sup>*

The strike is unlikely to result in any shift in policy, however it shows the extent of the splits in the tripartite alliance. When government ministers are able to protest against the president supported by factions within the president’s own party, the ANC’s attempts to show unity ring hollow. Cosatu is hoping to reclaim an independent voice from the ANC by marching against Zuma and the Guptas. However, they chose not to act until the weight of public opinion was on their side. They are not standing up to the ANC, they are backing Ramaphosa and laying the groundwork for a potential ANC split if he doesn’t win. If this is the case, it will fundamentally alter the landscape of South African politics.

### South Africa exits recession

State statistics agency **Statistics South Africa (Stats SA)** revealed on 5 September that gross domestic product (GDP) growth in the second quarter of 2017 was 2.5%.<sup>45</sup> Growth in the second quarter brings South Africa out of recession following three consecutive quarters of negative growth.<sup>46</sup> According to Stats SA, the largest contributor to growth was the agricultural sector where output increased 33.6%, contributing 0.7% to the GDP growth results.<sup>47</sup> This was due to the impact of better weather on production and follows a 22% growth in the first quarter of 2017 after eight quarters of consecutive contraction.<sup>48</sup> The growth statistics also revealed a recovery in the mining and industrial sector of 3.9%, contributing 0.3% to GDP growth,<sup>49</sup> supported by recovering local demand and higher global commodities prices.<sup>50</sup> There was also a modest recovery within professional services and real estate of 2.5% contributing 0.5% to GDP growth.<sup>51</sup> Government services, however, continued to contract by 0.6%, due to ongoing slowdown in public sector expenditures.<sup>52</sup>

While South Africa is no longer in recession, the statistics show that the fundamental issues underlying the economy remain. The end of the region-wide drought that decreased agricultural output in 2015 and 2016 is the primary factor in the increased growth. The economy remains vulnerable to weather fluctuations in the future. The mining recovery is also due to global fluctuations in the price of key commodities. If the commodities supercycle turns down again the economy will suffer. The government has yet to drive any genuine growth of South African industry, create further jobs or even expand the public sector. South Africa’s economic troubles are far from over.

---

<sup>44</sup> Source, journalist, Johannesburg

<sup>45</sup> StatsSA press release, 5 Sep 2017.

<sup>46</sup> Mail & Guardian, 5 Sep 2017.

<sup>47</sup> StatsSA press release, 5 Sep 2017.

<sup>48</sup> Business Day, 6 Sep 2017.

<sup>49</sup> StatsSA press release, 5 Sep 2017.

<sup>50</sup> Business Day, 6 Sep 2017.

<sup>51</sup> StatsSA press release, 5 Sep 2017.

<sup>52</sup> StatsSA press release, 5 Sep 2017.

## Planner

May 2019: Next presidential election

17 Dec 2017: ANC *lekgotla* to determine the new president of the party.

30 Sep 2017: Deadline to refinance \$700m of public sector and state-owned enterprise debt.

## Chronology

27 Sept 2017 **Johannesburg (South Africa)** *Business Day*. The **Congress of South African Trade Unions** calls for a moratorium to prevent the **Public Investment Corp** from financing government institutions;

22 Sept 2017 **Johannesburg (South Africa)** *Mining Weekly*. Coal miner **Exxaro Resources Ltd** and the **National Union of Mineworkers** reach a three-year wage agreement, ending a strike begun on 13 September;

21 Sept 2017 **Pretoria (South Africa)** *Bloomberg*. The **South African Reserve Bank** (central bank) holds its benchmark interest rate at 6.75%;

21 Sept 2017 **Pretoria (South Africa)** *Business Day*. The **High Court of Pretoria** dismisses the **Gupta** family's application for an interdict to prevent the **Bank of Baroda South Africa** from closing their bank accounts;

18 Sept 2017 **Johannesburg (South Africa)** *Reuters*. The main opposition **Democratic Alliance** party claims it will lay a criminal complaint against consultancy **McKinsey & Co** for alleged "fraud, racketeering and collusion" in its work for **Gupta** family-owned businesses;

15 Sept 2017 **Johannesburg (South Africa)** *Financial Times*. **KPMG South Africa** CEO, **Trevor Hoole** resigns, admitting to missing red flags in its auditing of **Gupta** family-owned companies;

12 September **Pietermaritzburg (South Africa)** *Business Day*. The **Pietermaritzburg High Court** invalidates the results of the ruling **African National Congress (ANC)** provincial executive committee (PEC) elections for **KwaZulu Natal (KZN)** in October 2015;

12 Sept 2017 **Johannesburg (South Africa)** *Business Day*. President **Jacob Zuma's** son, **Duduzane Zuma**, will sell shares reportedly worth R850m (\$65.3m) in **Gupta** family-owned companies;

11 Sept 2017 **Johannesburg (South Africa)** *Reuters*. The **National Union of Metalworkers of South Africa** calls for **Glencore South Africa (Pty) Ltd** to raise coal mining wages by 15%;

10 Sept 2017 **Pretoria (South Africa)** *Business Day*. The **Reserve Bank of South Africa** (central bank) alleges that public prosecutor **Busisiwe Mkhwebane** colluded against it with the presidency before Mkhwebane's release of a report calling for the amendment of the central bank's constitutional mandate;

5 Sep 2017 **Western Cape (South Africa)** *Money Web*. **Russia**-based oil and gas company **Rosgeo** and South Africa's state-owned oil and gas company **PetroSA** announce a \$400m strategic partnership;

31 Aug 2017 **Johannesburg (South Africa)** *Bloomberg*. Six gold miners – **Anglo American Plc**, **Sibanye Gold Ltd**, **Harmony Gold Mining Co Ltd**, **AngloGold Ashanti Ltd**, **Gold Fields Ltd** and **African Rainbow Minerals Ltd** – are close to agreeing to pay \$390m to settle a class-action lawsuit from mine workers who contracted lung disease;

---

### About Africa Risk Consulting:

**Africa Risk Consulting (ARC)** is a pan-African consulting company that provides timely, relevant information and advice that enables its clients to take informed investment decisions and to safeguard their reputations.

**ARC's** core consulting services include integrity due diligence and corporate investigations, political advisory and country assessments, opportunity monitoring and reputation risk management. Most relevant to private equity firms is ARC's integrity due diligence and corporate investigations capability. Specifically, ARC offers pre-deal integrity checks to highlight red flags before negotiations start; full detailed multi-jurisdictional reputation due diligence; and supplier and senior hire vetting and repeat due diligence for compliance programmes. ARC is unique in that it offers a 10-day delivery for a routine integrity due diligence. ARC also offers a suite of corporate investigations services from immediate investigation, evidence gathering, e-discovery, forensic accounting and whistleblower support on one end to crisis media management and regular monitoring on the other.

[www.africariskconsulting.com](http://www.africariskconsulting.com)

### About ARC Briefing:

**ARC Briefing** is ARC's essential online business information service.

Companies at any stage in their Africa expansion, whether building or communicating an Africa strategy, investing directly, expanding current operations, financing other investors, doing the legal leg-work or researching the Africa growth trend, need ARC Briefing.

**ARC Briefing** is an online information service keeping you:

- Up to date with Country Chronologies of business-critical events
- In the know via Country Briefings on political, economic, business and operating trends. Written in-country, ARC experts analyse and comment
- Ahead with Country Planner which details future elections, budgets, regulatory changes etc.

[www.africariskconsulting.com](http://www.africariskconsulting.com)

### Getting in touch

Please contact us by email [info@africariskconsulting.com](mailto:info@africariskconsulting.com) or call + 44 (0) 20 7078 4080

Follow us on Twitter: [@ARCBriefing](https://twitter.com/ARCBriefing)