



AUDITOR - GENERAL
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MEDIA RELEASE

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Auditor-General of South Africa (AGSA) sets the record straight on the termination of contracts with audit firms KPMG and Nkonki Inc.

PRETORIA – Auditor-General (AG) Kimi Makwetu says he has noted some misleading statements about his office's decision to terminate the auditing contracts with KPMG and Nkonki Inc.

Makwetu says, contrary to these misleading statements that seek to project his office's decision to terminate these contracts as irrational and unsympathetic, his office had given the affected audit firms ample time to explain the matters that were raised with them on the slew of unflattering governance issues raised against them.

Setting the record straight

The AG explains further: "Our termination of these contracts was not merely based on media reports on the governance of these firms. For example, when we met the acting chief executive officer (CEO) and leadership of Nkonki Inc., we gave them an opportunity to give their side of the story on the media reports as well as some governance issues we were concerned about.

"There was no disputing the severity of any of the matters we raised with them. The stock response we received from them on these matters was that they did not know of and were not involved in all the transactions that took place in 2016, including the payments that were made between the buyer and sellers."

The AG says they also requested the Nkonki Inc. leadership to provide his office with the outcome of the recent firm-level review that was performed by the Independent Regulatory Board of Auditors (Irba) to assess the firm's compliance with the

International Standards on Quality Control 1 (ISQC 1), which deal with an audit firm's responsibilities for its system of quality control for audits and reviews of financial statements, and other assurance and related services engagements. This report was not forthcoming.

"The firm also informed us that they were instituting internal forensic investigations; however, none of the legal firms were keen on the engagement due to various conflicts of interest, among others".

AGSA cannot do business with an audit firm owned by undisclosed outside shareholders

It appears, in the rush to respond emotionally to the issues at hand, most commentators have missed the fundamentals around the Nkonki matter and rushed off to do their own analysis about other things. Here's what Section 38 of the Audit Professions Act stipulates:

- 1) the only firms that may become registered auditors are:
 - a. partnerships of which all the partners are individuals who are themselves registered auditors.
 - b. sole proprietors where the proprietor is a registered auditor and
 - c. companies - the Regulatory Board must register a company as a registered auditor if only individuals who are registered auditors are shareholders of the company.

Upon learning of the significant change in shareholding at Nkonki Inc. in 2016, our enquiry with the Nkonki leadership was to establish the facts around this matter. It is clear to us that any investigation on this would be to establish circumstances surrounding the transaction rather than establishing the fact – are the new shareholders registered auditors or not? We did not believe that the investigation referred to by the Acting CEO was intended to address the matter at hand and therefore felt justified to proceed on the basis that Section 38 was not adhered to. Up to the most recent interview on Radio 702, the Acting CEO conceded that as current leadership of Nkonki they did not know and still do not know.

The AGSA is the statutory auditor to government of the Republic of South Africa and wish to remain vigilant in ensuring that no further aspersions are cast on opinions that

may be issued under circumstances where the shareholders of the audit entity are not known.

Unfounded allegations of unequal treatment of the two affected audit firms

Makwetu has dismissed emerging accusations that his office has treated the two firms differently in the lead-up to the contract terminations.

“In some quarters we are accused of treating KPMG differently. This is also baseless. KPMG issues were brought to light in September 2017 and we issued our position on them soon thereafter, once we had directly engaged the firm's leadership. It must be recalled that this event emerged at the beginning of the current financial year and there was still some time to track the progress on this before the current financial year was over.

“More importantly, we made it clear that the reason why we would await these independent investigations on KPMG to be concluded was to enable us to assess whether the matters raised in the KPMG international report were either a mere aberration confined to the areas that were a subject of the report or whether they were indicative of a systemic breakdown in the risk management and practice disciplines within KPMG that could render audit opinions signed on our behalf questionable. While tracking the progress on this with the KPMG leadership, it became clear that none of the Irba- and the South African Institute for Chartered Accountants-sponsored investigations would be concluded ahead of our statutory audit sign-off dates. Instead, many delays and new issues were being followed up by Irba as they were digging deeper. This increased our risk on these audits to a significantly higher level. This was also compounded by the findings that were made on the VBS Mutual Bank, which also triggered other actions that were widely publicised.”

The AG say it is important also to note that the Nkonki story broke just when his office was very close to these sign-off deadlines, therefore requiring his office to take immediate steps. “On both firms it was clear that we may not get the necessary clarifications or outcomes of investigations before the deadlines for signing off on the statutory audit deadlines, which prompted our decision on both firms”

Makwetu says on instances involving both audit firms, his office, while fulfilling its mandate to keep the public informed, had ensured that it respected the desire of each firm to continue with their intended investigations. “However, due to the

increased levels of risk associated with the above matters affecting both firms, our leadership decided to terminate these engagements until we have complete clarity on the outcome of these investigations. We had a singular view on this, which was to ensure that we protect the independence and integrity of the South African supreme audit office."

The AG says since the decision to terminate the auditing contracts, his office has been working closely with the affected audit firms to ensure "transition management that maintains audit quality and minimises disruption to the audit process as well as the impact on professional staff" at these companies.

The cooperation with the affected firms, Makwetu says, "has been premised on our fundamental belief that the termination of these contracts is not a judgement on the capabilities or integrity of the professionals that work in these firms, but rather relates to recognition of the significant reputational risks associated with matters that affect the firms".

Allocation of audit work

The AG says his office has made a decision, in consultation with the two affected firms, that the remaining statutory audit work for the financial year ending 31 March 2018, will be completed without significant impact on audit fees. To this end, for audits handled by Nkonki Inc. and KPMG, the AG has changed the audit assignment to a contracting-in relationship utilising professionals from the firms while the necessary review and quality assurance responsibilities will be handled by his office.

In conclusion, Makwetu says: "We have also made the decision to continue with the contracting in of professionals from both firms with the understanding that these resources will work within our existing audit teams."

Media note: As the country's supreme audit institution that audits South Africa's public sector, the AGSA, due to the size of its audits, uses various private audit firms – such as KPMG and Nkonki Inc. – to audit on its behalf and to augment its auditing staff. When conducting these audits, the contracted firms stringently follow AGSA auditing standards, which include layers of rigorous internal and external, independent quality assurances and peer reviews to ensure that quality audit work is produced.

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