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Introduction

Being a director of a company can be rewarding, worthwhile and fulfilling. At the same time, it is a demanding and challenging task, even in the best of circumstances.

In accepting the position, a director automatically assumes onerous duties, responsibilities and personal liability under both common law and statutory law.

Directors cannot avoid their responsibilities nor completely delegate them. They must answer to their company’s stakeholders, such as shareholders, regulators, employees, lenders, trade creditors and customers. Directors are under increasing pressure to become more accountable, transparent and responsive to stakeholder and community interests. In extreme cases, they face the possibility of litigation brought by disgruntled stakeholders. New legislation, Regulations as well as voluntary and statutory codes aimed at improving standards of corporate governance make this even more challenging.

The test of a board’s effectiveness is its ability to increase the value of the organisation on a sustainable basis. This objective demands an emphasis on performance, not just conformance. KPMG has produced this Toolkit to help directors (and aspiring directors) make a worthwhile contribution to the performance of their companies.

The Toolkit was first published in 1995 following the introduction of the King Report in 1994. The second edition was released in 2002 after the release of King II. This edition of the Toolkit has been revised and updated to reflect the new Companies Act, 71 of 2008 as well as the King III Code of Governance Principles and the King Report on Governance for South Africa (King III) issued by the Institute of Directors in Southern Africa in 2009.

In preparing the Toolkit, KPMG has not attempted to establish a model or pattern for the optimum composition and conduct of a company board. The way in which a board pursues its objectives will be influenced by many factors, including the industry or industries in which the company operates; its stage in the typical corporate life cycle; its ownership structure; the places in which it does business; the legal and regulatory environment; and even the personalities of those that inhabit the boardroom and executive suite. No two boards will ever function in exactly the same way, and nor should they. However, KPMG has identified certain qualities likely to be found in a successful board.

Benefits of good corporate governance

Good corporate governance benefits all companies, small and large. McKinsey’s well-known investor surveys in 2001 and 2002 revealed that investors are prepared to pay a premium for well governed companies. Indeed, good corporate governance benefits the wider stakeholders – the economy, society and the environment - i.e. the concept of the organisation being a responsible corporate citizen. The principles of effective governance do not change as companies get bigger. While entrepreneurs may choose whether or not to seek capital on public markets, if they do, shareholders can reasonably expect as much, if not more, accountability from the board of a smaller company as they can from a larger company. While smaller companies may have more difficulty implementing some of the practices, it is in their own self-interest to address these practices as far as is feasible.

What constitutes good corporate governance practices is the subject of numerous guides and laws. The Toolkit addresses a variety of issues relevant to directors in a user-friendly manner.

Drivers of good governance

If the purpose of good governance is to lower the cost of capital and ensure the effective use of resources in a sustainable manner, then the KPMG approach to corporate governance is to focus on the drivers that support the value that can be achieved by adopting best practices whilst ensuring compliance with legal and regulatory requirements.

Some of the fundamentals that establish effective corporate governance are as follows:

• Investor and stakeholder confidence - through transparent engagement with, recognition of legitimate expectations, and accountability for meeting commitments (an inclusive stakeholder approach).
• Leadership - ensuring effective and ethical leadership in an organisation.
• Balance of power - diversity of views and protection against abuse.
• Sustainable organisational performance.
• Relevant, useful and transparent communication.
• Efficient legal and regulatory compliance.

The ethical values of good corporate governance are the four primary pillars of responsibility, accountability, fairness and transparency. These have not changed between King II and King III.

By emphasising sustainable value creation, KPMG’s view on corporate governance goes beyond traditional conformance. Likewise King III emphasises the board’s role as being a board that should apply governance principles and practices, as opposed to blindly conforming in a ‘tick-box manner’ to latest governance guidelines. Undoubtedly this requires an application of mind as to what best befits a company - no one size suits all.

What is new in the Toolkit?

This Toolkit is designed as a hands-on guide and source of reference for both new and experienced directors. The Toolkit addresses a variety of issues relevant to directors in a user-friendly manner.

Important topics are discussed at a relatively high level and, where relevant, supporting detail on new, topical or challenging aspects is provided.

Certain of the topics covered in the Toolkit are duplicated, to a greater or lesser extent, in various parts of the document. This duplication has not been eliminated, as there are significant advantages to the user being able to refer to the relatively comprehensive self-contained parts.

One of the challenges with the third edition of the Toolkit is not so much what to include in the Toolkit, but what to leave out. New chapters and sections include the following:

• Chapter 2
An overview of the new Companies Act, 71 of 2008.
• Chapter 3
Corporate governance - this includes South Africa’s ‘inclusive stakeholder approach’ to governance and a quick reference guide to King III.
• Chapter 7
Shareholder interaction and stakeholder management contains new information on shareholder meetings and resolutions, as well as an expanded section on stakeholder management.
Doing business in Africa

The attractiveness of Africa as an investment destination has been positively impacted by a number of developments in the regulatory environment affecting potential new entrants to markets, infrastructure development and the presence of professional services firms which have experience of the complexities the continent poses. In addition, increases in productivity on the continent, the diversification of African economies, the size of the African market and urbanisation are creating conditions that could potentially be favourable to investment.

At the inaugural KPMG Africa Conversations held in Johannesburg in 2011, Moses Kgosana, Chairman and Senior Director for KPMG Africa and Chief Executive of KPMG in South Africa pointed to higher than average growth forecasts for Africa for 2011 as a motivating factor for investors to look to African markets. “It is estimated that the sub-Saharan African economy will grow by 5.3% in 2011, with individual economies – such as Nigeria and Angola projected to grow at over 7%. Clearly, there is increasing confidence in Africa’s economic potential as a collection of diverse emerging markets with much to offer the global economy.”

We have collated the key facts relating to:

- Constitution
- Legal system
- Board structure
- Mandatory committees
- Directors duties
- Directors liability
- Citizenship
- Ownership of shares
- Special considerations
- Governance code

for the following countries:

- Angola
- Botswana
- Ghana
- Kenya
- Malawi
- Mauritius
- Mozambique
- Namibia
- Nigeria
- Rwanda
- Sierra Leone
- Swaziland
- Tanzania
- Uganda
- Zambia
- Zimbabwe.

This analysis can be found in Annexure One.

Use of the Toolkit

The Toolkit covers both the functions and responsibilities of the board as a whole, and the role of the individual director.

The Toolkit has been structured to allow a director either to address specific areas of concern by reading specific sections, or to gain an overview of corporate governance issues by working through the entire document.

Each section, where relevant, sets out certain minimum compliance considered necessary. This draws on the requirements of the relevant legislation, Regulations together with the King III principles and recommendations.

The KPMG Toolkit will inform you of relevant important financial, accounting, statutory and other business matters of interest. Of course, as with any publication of this nature, the information contained in this Toolkit should not be considered complete or be used or relied upon as a substitute for detailed advice or as a basis for formulating business decisions, because the facts and circumstances of individual cases can be significantly different.

What works?

We believe that this publication will serve both as a useful introduction to new directors and as a practical reference guide for experienced directors.

We would however, like to hear any practical suggestions you may have to help your fellow directors. If you have something to share please write to directorstoolkit@kpmg.co.za.

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Introduction

The Companies Act, 71 of 2008 (as amended by the Companies Amendment Act, 3 of 2011), and the Companies Regulations 2011, came into effect on 1 May 2011.

The Companies Act, 71 of 2008 replaces the Companies Act, 61 of 1973. Some of the provisions relating to the winding-up of insolvent companies in the 1973 Act will continue to apply until alternative legislation has been brought into force to deal with the winding-up of insolvent companies. Also, any investigation by the Minister or the Registrar of Companies under the 1973 Act may be continued.

For the most part however, the Companies Act, 71 of 2008 contains new provisions to which companies are required to adhere to from 1 May 2011. There are certain exceptions set out in Schedule 5 which deal with transitional arrangements to facilitate the transition from the 1973 Companies Act to the Companies Act, 71 of 2008.

The Companies Act, 71 of 2008 introduces fundamental changes to South African company law and corporate actions.

Categories of companies – s8, s11

The following categories of companies exist:

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<td>Profit Companies</td>
<td>to be reflected as Proprietary Limited or (Pty) Ltd</td>
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<td>Personal Liability Companies</td>
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<td>Public Companies</td>
<td>to be reflected as Limited or Ltd</td>
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<tr>
<td>State-owned Companies</td>
<td>to be reflected as SOC Ltd</td>
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If a company’s Memorandum of Incorporation (MoI) includes special conditions, the name of the company must include the expression “RF”. This would typically apply to a special purpose company where the capacity of the company to carry out certain activities has been limited in its MoI and where such provisions in the MoI may not be amended or may only be amended under particular circumstances.

The Companies Act, 71 of 2008 does away with the concepts of “widely-held” and “limited interest” companies that were previously provided for in the 1973 Companies Act.

Non-profit companies

There are similarities to s21 companies under the 1973 Companies Act. They must have a “public benefit” object or an object relating to cultural or social activities or communal or group interests. Not all the provisions of the Companies Act, 71 of 2008 apply to non-profit companies and there are specific provisions contained in Schedule 1 to the Companies Act, 71 of 2008 that govern these companies.

Overall the provisions applicable to non-profit companies are less formalistic and restrictive than used to be case under the 1973 Companies Act. By way of example, non-profit companies are no longer required to have seven members. In terms of Schedule 1 a non-profit company may in its constitution set out whether it will have any members and, if it has members, whether the members will be entitled to vote.

Private companies

These are similar to private companies under the 1973 Companies Act in that they prohibit an offer of securities to the public and restrict the transferability of their securities. However, they are no longer limited to fifty members as was previously the case.

Personal liability companies

The directors and past directors of such companies are jointly and severally liable together with the company, for any debts and liabilities that were contracted during their periods of office. These are similar to the “inc” used for incorporated professional practices under the 1973 Companies Act.

Public companies

These are similar to public companies under the 1973 Companies Act, although only one member is required (compared to the seven members requirement previously).

State-owned companies

A state-owned company is a company which is listed as a public entity in Schedule 2 or 3 of the PFMA, or is owned by a municipality and is similar to a public entity listed in Schedule 2 or 3 of the PFMA.

The majority of the provisions of the Companies Act, 71 of 2008 which apply to a public company will apply to a state-owned company unless specifically exempted by the Minister.

Foreign company and external company

A “foreign company” is a company incorporated outside of South Africa irrespective of whether it carries on business here. A foreign company is prohibited from offering its securities to the public unless it follows the specific provisions relating to “offers to the public” in the Companies Act, 71 of 2008.

A foreign company is required to register as an “external company” if it conducts business in South Africa. Section 23 provides that a foreign company will not be regarded as conducting business in South Africa merely by virtue of its carrying out any of certain specified activities. The test for whether or not a foreign company needs to register as an external company will be to ascertain whether the foreign company has engaged or is engaging in a course of conduct or a pattern of activities in South Africa over a period of six months which would lead a person to reasonably conclude that such foreign company intended to continually engage in business in South Africa.

A foreign company will also need to register if it is a party to employment contracts in South Africa.

Once registered, the external company must maintain an office in South Africa, register its address with the Commission and submit annual returns. It is not subject to the preparation of financial statements or to the audit or independent review requirements of the Companies Act, 71 of 2008.

Differences between the categories of companies

The Companies Act, 71 of 2008 has a number of requirements that differ depending on the relevant category of company.

For a detailed comparison between the categories of companies, refer to appendix two.
Close corporations in existence on 1 May 2011 will continue to exist. Close corporations may be converted into companies. No new close corporations can be registered and companies cannot be converted into close corporations after 1 May 2011. The Companies Act, 71 of 2008 does not currently anticipate any date by when close corporations will cease to exist.

There are some significant changes made to the Close Corporations Act, 69 of 1984, by the Companies Act, 71 of 2008 and a close corporation may be required to be audited if it falls within the category of Regulations passed by the Minister stipulating the entities requiring an audit. In addition, the business rescue provisions will apply to close corporations.

Alterable and unalterable provisions

The Companies Act, 71 of 2008 distinguishes between “alterable provisions”, which can be effectively amended by the Mol and “unalterable provisions” which may not be overridden by the Mol. The Mol may impose a more onerous requirement than would otherwise apply in terms of an unalterable provision.

The rationale for including these concepts is to allow flexibility so that, within certain limits, each individual company could adapt its Mol to create the appropriate balance of power between the shareholders and the board as may be considered appropriate. The board essentially has the inherent power to carry out most actions, unless that power is expressly restricted by the Shareholders and the board as may be considered appropriate. The board essentially has the inherent power to carry out most actions, unless that power is expressly restricted by the Companies Act, 71 of 2008 or the Mol.

Alterable provisions cover matters that typically would be matters of a private nature and that can be altered as determined by the shareholders and as set out in the Mol. Unalterable provisions cover matters that typically would be matters which would have greater public interest.

Company formation – s13

One or more persons or an organ of state may incorporate a profit company. An organ of state, a juristic person or three or more persons acting in concert may incorporate a non-profit company.

A company is incorporated by completing and filing a Mol and a Notice of Incorporation.

Memorandum of incorporation, rules and shareholder agreements

Mol

The founding document of a company under the Companies Act, 71 of 2008 is the Mol. The previous memorandum and articles of association of existing companies automatically became the Mol on 1 May 2011 (s1 definition of Mol). The Mol can deal with any matter that the Companies Act, 71 of 2008 does not address and may alter the effect of any provision in the Companies Act, 71 of 2008 which is an “alterable provision”.

Rules

In addition to the Mol, unless the Mol provides otherwise, the board may make rules that are necessary or incidental to the governance of the company. Any rules made by the board will be effective on an interim basis until voted on by the shareholders at the next general shareholder meeting. If such rules are ratified at such general shareholder meeting, the rules will remain binding and have the same effect as if incorporated in the Mol. The rules must not be inconsistent with the Companies Act, 71 of 2008 and the Mol.

Shareholder agreements

The Companies Act, 71 of 2008 expressly provides that the shareholders of a company may conclude shareholder agreements but provides that any such agreement must be consistent with the Companies Act, 71 of 2008 and the Mol. This may require a number of existing shareholder agreements to be reviewed and if necessary amended.

There are transitional provisions which provide that, for an interim period of two years (i.e. from 1 May 2011 to 30 April 2013) existing shareholder agreements will prevail in the event of a conflict between that shareholder agreement and the Companies Act, 71 of 2008 or the Mol (Schedule 5 item 4). If the shareholder agreement is amended at any time during the two year interim period its provisions will no longer prevail over the Companies Act, 71 of 2008 or the Mol.

Existing memorandum and articles of association

There are transitional provisions in the Companies Act, 71 of 2008 which provide that the memorandum and articles of association of an existing company will continue to be effective for two years (i.e. from 1 May 2011 to 30 April 2013) even if there is a conflict between the articles and the Companies Act, 71 of 2008, and beyond two years if there is no conflict between the articles and the Companies Act, 71 of 2008. There are a number of exceptions to this relating to directors duties and conduct, the rights of shareholders to receive information and the provisions relating to fundamental transactions.

Accountability and transparency

All companies are required to:

- Have a registered office (s23).
- Maintain certain records for seven years (s24).
- Have a fixed financial year (s27).
- Maintain accurate and complete accounting records (s28).
- Prepare annual financial statements (s30).
- File an annual return (s33).

All companies must prepare annual financial statements which satisfy the financial reporting standards.

The annual financial statements of public companies and state-owned companies will continue to require an audit. Refer to annexure three for the audit and independent review requirements.
Capitalisation of profit companies – Chapter 2 Part D

Class and Issue of Shares

Shares will no longer have a par or nominal value. Existing par value shares will remain and the Regulations provide for a voluntary conversion of existing par value shares to no par value shares (Regulation 31).

The MoI will set out the number of authorised shares, the class of such shares and the rights and terms associated with the authorised shares. It is now also possible to have a category of shares referred to as “unclassified” shares and the directors may determine the rights and terms which will attach to such “unclassified” shares on issue.

Generally, directors may issue shares without shareholder approval. Shareholder approval, (by way of a special resolution), will only be required for the issue of shares, convertible securities or share options to directors or prescribed officers (and other persons that are related to the company or to any director or prescribed officer) or if there is an issue of shares or convertible securities with voting power exceeding 30%.

The directors may only issue shares for adequate consideration. The term “adequate consideration” is not defined. There may be particular facts or circumstances which justify the shares being issued at a discount to fair value which in the circumstances could be regarded as “adequate consideration”. If it subsequently transpires that shares were issued not for “adequate consideration”, this will not invalidate the issue of the shares but may result in a claim against the directors for a breach of their duties as set out in the Companies Act, 71 of 2008.

The Companies Act, 71 of 2008 now allows for shares to be issued for a consideration of future services, future benefits or future payment. Shares are no longer required to be fully paid before they are issued but the Companies Act, 71 of 208 includes a detailed and complex process for the shares to be held in “trust” pending receipt of payment of the consideration.

Unless the MoI provides otherwise, directors may:
- Increase or decrease the number of authorised shares of any class.
- Reclassify any authorised but unissued classified shares.
- Classify shares that are authorised but are unclassified and unissued.
- Determine the preferences, rights, limitations and other terms of “unclassified” shares which have been authorised but not issued.

Application of the solvency and liquidity test

The Companies Act, 71 of 2008 has a solvency and liquidity test (s4). Solvency relates to the assets of the company, fairly valued, being equal to or exceeding the liabilities of the company, fairly valued. Liquidity relates to the company being able to pay its debts as they become due in the ordinary course of business for a period of twelve months.

In the 1973 Companies Act, solvency and liquidity applied to share buy-backs, share buy-ins (a subsidiary acquiring shares in its holding company) and distributions to shareholders (commonly referred to as s90 payments). It also applied to one of the exemptions in terms of which the company is permitted to give financial assistance to its shareholders (or the shares of its holding company). In the Companies Act, 71 of 2008, the solvency and liquidity test has much wider application than in the 1973 Companies Act and applies to:
- Financial assistance in connection with shares (s44).
- Loans or other financial assistance to directors and related and inter-related companies (s45).
- Distributions to shareholders (which are very widely defined) (s46).
- The offering of a cash alternative in place of capitalisation shares (s47).
- Share buy-backs or buy-ins (s48).
- Amalgamations or mergers (s113).

The Companies Act, 71 of 2008 specifies that the financial information to be considered for purposes of the solvency and liquidity test must be based on accounting records and financial statements that meet the prescribed financial reporting standards. It further stipulates that, in addition, the board must consider any reasonably foreseeable contingent assets and liabilities and may consider any “other” valuation of the company’s assets and liabilities that is reasonable in the circumstances.

Financial assistance for the subscription or purchase of shares – s44

The Companies Act, 71 of 2008 provides restrictions on a company providing financial assistance for the subscription or purchase of its own shares or shares in a related or inter-related company. This restriction is wider than s38 of the 1973 Companies Act which only applied to financial assistance by a company for its own shares or shares in its holding company. The Companies Act, 71 of 2008 will effectively apply to financial assistance given in relation to shares of the company or any other company within the group of companies of which the company forms part.

The directors may authorise the provision of financial assistance if immediately after the provision of the financial assistance the company will meet the solvency and liquidity test and the financial assistance has been approved by a special resolution passed within the previous two years. In addition, the directors must be satisfied that the financial assistance is fair and reasonable to the company. A special resolution will not be required if the financial assistance has been given pursuant to an employee share scheme (which meets the requirements of the Companies Act, 71 of 2008).
Financial assistance to directors and to related and inter-related companies – s45

Looking at the heading of s45, it appears that this section was intended to cover financial assistance to directors which was previously dealt with in s226 of the 1973 Companies Act. However, on a closer reading, s45 is wider and covers financial assistance to directors and prescribed officers but also covers financial assistance to related and inter-related companies. Financial assistance is widely defined and would include loans. All intra-group loans will therefore need to meet the requirements set out in this section.

A board may only authorise financial assistance if:

- Financial assistance contemplated is not prohibited by the MoI.
- Financial assistance is pursuant to an employee share scheme or in terms of a special resolution adopted within the last two years.
- The board is satisfied that after providing the financial assistance, the solvency and liquidity test will be satisfied.
- The terms are fair and reasonable to the company.

A notice of any resolution passed by the board relating to such financial assistance must be given to the shareholders and to any trade union representing employees.

Share buy-backs and buy-ins – s48

A company may repurchase its own shares (a share buy-back) provided that the company meets the solvency and liquidity test. A share buy-back may generally be authorised by the board without the need for shareholder approval. This is different to the 1973 Companies Act which required a special resolution for a share buy-back. However, a special resolution will still be required where the company buys back shares from directors, prescribed officers or persons related to them or where the buy-back of shares amounts to more than 5% of the particular class of issued shares of the company. There is also a requirement to comply with certain of the provisions relating to fundamental transactions where the buy-back of shares amounts to more than 5% of the particular class of issued shares of the company.

A subsidiary company can buy shares in its holding company (a share buy-in) provided that the number of shares in the holding company held by all its subsidiaries collectively does not exceed 10% of the number of issued shares of any class of shares in the holding company. A share buy-in may be authorised by the board without the need for shareholder approval. Again, this is different to the 1973 Companies Act which required a special resolution for a share buy-in.

Distribution to shareholders – s46

All distributions to shareholders require board approval and need to satisfy the solvency and liquidity test. Distributions are extremely widely defined and include dividends and share buy-backs.

Offers to the public

The Companies Act, 71 of 2008 continues to regulate the offer of securities to the public. It sets out the circumstances in which offers will not be regarded as offers to the public and the requirements to be followed where offers are regarded as offers to the public.

Employee share schemes – s95 and s97

A share scheme will qualify as an “employee share scheme” for the purposes of the Companies Act, 71 of 2008 if it is a scheme established by the company for the purposes of offering shares or options in the company solely to employees, officers (which is not defined) and other persons closely involved in the business of the company or a subsidiary of the company. The Companies Act, 71 of 2008 also prescribes certain obligations relating to the appointment of a Compliance Officer for the employee share scheme which is similar to the 1973 Companies Act. Employee share schemes are exempt from the requirements for the issue of shares to directors or prescribed officers, relating to the granting of financial assistance and relating to approvals for loans or financial assistance to directors or prescribed officers.

Shareholder meetings and resolutions – s61

Annual general meetings – s61

Annual general meetings (AGM) shall be held no later than fifteen months after the previous AGM. Only public companies and state-owned companies are obliged to have an AGM.

The AGM convened by public and state-owned companies shall consider:

- The directors’ report.
- The audited financial statements.
- The audit committee report.
- Election of directors.
- Appointment of the auditor.
- Appointment of the audit committee.

In terms of the 1973 Companies Act, the audit committee was appointed by the board, whereas in terms of the Companies Act, 71 of 2008, the audit committee is now to be appointed by the shareholders. As an auditor can only be appointed at an AGM, all companies which are required to be audited, whether in terms of their MoIs or the Regulations, will be required to hold an AGM (s90). However, such company will not necessarily have to deal with matters other than the appointment of the auditor, as is required for public and state-owned companies.

Shareholders meetings – s61

A quorum of 25% of the votes represented at a general meeting of members/shareholders is required, provided that if the company has more than two shareholders, there must be at least three shareholders present to constitute a quorum (s64). The MoI can raise or lower the percentage required for a quorum (but not the requirement of three shareholders where applicable). The Companies Act, 71 of 2008 makes provision for the postponement of a meeting if a quorum is not present.

The minimum notice period of meetings of shareholders of a public company is fifteen business days and of a private company is ten business days. These notice periods apply irrespective of whether the meeting is held to consider ordinary or special resolutions. The Companies Act, 71 of 2008 also allows for waiver of notice of meetings.

The Companies Act, 71 of 2008 allows for shareholders’ decisions to be taken by way of “round robin” (s60), thereby alleviating the need to hold a formal meeting. This is permitted for all matters other than matters for which the Companies Act, 71 of 2008 specifically indicates that the decision must be taken at an AGM.

A public company must allow for reasonable access by electronic participation by shareholders at every shareholders’ meeting of the company.
Resolutions – s65

Ordinary resolutions must be approved by more than 50% of the voting rights exercised in respect of the resolution. Special resolutions must be approved by 75% of the voting rights exercised in respect of the special resolution. The MoI may provide for a higher percentage for ordinary resolutions and for a higher or lower percentage for special resolutions provided that there is at least a 10% difference between the percentage approval required for ordinary and special resolutions. Different percentages may be prescribed in the MoI for resolutions pertaining to different matters.

The need for special resolutions – s65(11)

Special resolutions are required to:

- Amend the MoI or ratify a consolidated revision of the MoI.
- Ratify actions by the company or directors in excess of their authority.
- Approve an issue of shares or securities to directors and related companies.
- Approve an issue of shares or securities in excess of 30% of the voting power of the shares or securities in that class.
- Authorise the board to grant financial assistance to directors or prescribed officers or related or inter-related companies.
- Authorise the board to provide financial assistance for transactions in connection with the securities of the company or related or inter-related companies.
- Approve the acquisition by the company of its own shares in certain circumstances.
- Authorise the basis for compensation of directors of a profit company.
- Approve a voluntary winding-up.
- Approve the winding-up of a solvent company by the court.
- Approve the transfer of the company’s registration to a foreign jurisdiction.
- For “fundamental transactions”.
- Revoke a previous special resolution that gave rise to appraisal rights.
- For such other matters that the MoI requires a special resolution.

The need for ordinary resolutions is dealt with in chapter four.

Directors and prescribed officers  – s66, s69 and s70

A private company or personal liability company requires at least one director and a public company and a non-profit company requires at least three directors in addition to the minimum number of directors that may be required for the audit committee or social and ethics committee where the company is required to have such committees. If a single director is able to serve on more than one committee, this reduces the actual minimum number required.

Only a natural person with full legal capacity is eligible to be a director. The MoI may also set out minimum qualifications for directors.

A person is disqualified from being a director of a company for various reasons including if a court has prohibited that person from being a director, or declared the person to be delinquent, or the person has been removed from an office of trust or convicted of certain specified crimes or is an unrehabilitated insolvent or is prohibited by public regulation.

A profit company must allow for shareholders to elect a minimum of 50% of the directors and alternate directors. The remaining directors may be appointed by any other person stipulated in the MoI.

Directors’ remuneration is required to be approved by a special resolution of shareholders approved within the last two years. There is some debate as to whether this applies to all directors remuneration. The more widely held view (as supported by King III) appears to be that this requirement only applies to non-executive directors fees.

If the number of directors is below the minimum required by the Companies Act, 71 of 2008 or the MoI, this does not limit or negate the authority of the board, or invalidate anything done by the board or the company.

The board is obliged, within forty business days, to convene a shareholders meeting to elect directors (s67), if the number of directors falls below the minimum.

The definition of “director” includes alternate directors and de facto directors. Generally, where the Companies Act, 71 of 2008 deals specifically with the duties, liabilities etc of directors, these provisions also apply to board committee members and prescribed officers, even though these persons are not directors.

A “prescribed officer” is a person who exercises (or regularly participates in) material degree in the exercise of general executive control over and management of the whole or a significant portion of the business or activities of the company (Regulation 3B).

Removal of directors – s71

A director may be removed by an ordinary resolution at a shareholders’ meeting. The director concerned must be given notice of the meeting and be afforded reasonable opportunity to make a representation on the matter before a vote is taken by the shareholders.

The board may remove a director whom it has determined is ineligible, disqualified, incapacitated, negligent or guilty of dereliction of duty.

Nothing in the Companies Act, 71 of 2008 precludes a director who has been removed from claiming damages for loss of office.

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1 Many of these transactions only require shareholder approval by special resolution in certain circumstances as detailed in s66(11).

2 The definition of “director” in a number of sections includes an alternate director, prescribed officer and a member of a committee of the board or of the audit committee. This includes the sections which deal with “ineligibility and disqualification of persons to be director or prescribed officer”, “director’s personal financial interests”, “standards of directors conduct”, “liability of directors and prescribed officers” and “indemnification and director’s insurance”.

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Board committees – s72
The board may appoint any number of board committees and delegate to any committee any authority of the board. Board committees may include non-directors but non-directors will not have a vote. The delegation to any committee does not in itself relieve the director of the directors’ duties. In relation to standards of conduct and liability all members of the board committees are deemed to be directors (s75 – s78).

Social and ethics committee – s72(4) Regulation 43
The Companies Act, 71 of 2008 has brought in a new statutory committee called a social and ethics committee. All state-owned companies, listed public companies and any other company with a public interest score above 500 (refer to chapter six on how to calculate the public interest score) in any two of the previous five years is required to appoint a social and ethics committee. This is dealt with in more detail in chapter six.

Board meetings – s73 and s74
In addition to typical directors’ meetings, the Companies Act, 71 of 2008 makes provisions for board meetings to be held by electronic communication or for the board to be taken by “round robin”, provided all the directors have received notice of the meeting. The majority required for a “round robin” decision does not differ from that of a meeting, unless the Mol provides differently.

Director’s personal financial interests – s76
The Companies Act, 71 of 2008 sets out procedures that are required to be followed for a director (including prescribed officers and board committee members) to disclose a financial interest of that director or of a person related to that director in respect of any matter to be considered by the board. A director may also disclose any personal financial interest in advance, by delivering to the board, or the shareholders (in certain circumstances), a written notice setting out the nature and extent of that interest. If a director of a company has a personal financial interest in respect of a matter to be considered at a meeting of the board, or knows that a person related to that director has a personal financial interest in the matter, the director must make certain specified disclosures and must leave the meeting immediately after making the disclosures and may not take any part in the consideration of the matter.

Where there are common directors on boards of companies who contract with each other, these provisions must be carefully considered. A director could be regarded as having a personal financial interest if the director sits on both boards of the contracting companies.

A decision made in contravention of the procedures in this section can be ratified by an ordinary shareholders resolution or by the court, failing which such decision will not be valid.

Standards of directors conduct – s76
The Companies Act, 71 of 2008 incorporates certain common law duties and certain additional statutory duties of directors.

A director (including prescribed officers and board committee members) must:
- Not use the position of director, or any information obtained while acting in the capacity of a director;
- To gain an advantage for himself or any person other than the company or a wholly-owned subsidiary of the company.
- To knowingly cause harm to the company or a subsidiary of the company.
- Communicate to the board any information that comes to the director’s attention, unless the director reasonably believes that the information is immaterial to the company or generally available to the public or known to the other directors or the director is bound not to disclose that information by reason of confidentiality.
- In good faith and for a proper purpose.
- In the best interests of the company.
- With the degree of care, skill and diligence that may reasonably be expected of a person;
  - Carrying out the same functions in relation to the company as those carried out by that director.
  - Having the general knowledge, skill and experience of that director.

These duties effectively re-state a director’s common law fiduciary duties and the duty of care and skill.

The Companies Act, 71 of 2008 includes the “business judgment test” which effectively provides that if the director has taken reasonable steps to be informed, has no material financial interest (or disclosed such financial interest) and has a rational basis to believe the decision was in the best interests of the company, the director will not be liable for a breach of duty, unless the director acted in bad faith or for an improper purpose.

A director is entitled to rely on the advice or information provided by employees, professional advisors, experts and board committees, provided that the person appears reliable. The Companies Act, 71 of 2008 sets out criteria for each class of persons that must be met prior to a director relying on such person. Without detailing each of these the general approach appears to be that the person must be qualified in respect of the particular matter and must merit confidence.

Liability of directors and prescribed officers – s77
A director, prescribed officer and a member of a board committee may be held liable for any loss suffered by the company:
- For a breach of fiduciary duty.
- Arising from breaches of the Companies Act, 71 of 2008 or the Mol.
- As a consequence of the director;
  - Acting without the necessary authority.
  - Acquiescing to the company carrying on business recklessly.
  - Being present or participating in a decision or failing to vote against certain specified decisions which contravene the Companies Act, 71 of 2008.
  - Being party to any act or omission intended to defraud.
  - Signing or authorising the publication of any false or misleading financial statements.

The above list is not exhaustive of the provisions of s77 which includes a comprehensive list of acts or omissions which could give rise to liability. In addition, directors could also be liable to third parties, for example to shareholders for fraudulent acts or acts of gross negligence Companies Act, 71 of 2008 (s206(1)) or to any third person who has suffered loss by virtue of the directors breaching the Companies Act, 71 of 2008 (s218B(2)).
While the Companies Act, 71 of 2008, to a large extent, has removed many of the criminal offences which were prevalent in the 1973 Companies Act, the potential for civil claims against directors in terms of the Companies Act, 71 of 2008, appears far greater. It is also important to note that members of board committees and prescribed officers will have the same liability as directors under s77 even if the members of the board committees or prescribed officers are not directors and even though they have no right to vote on any matters considered at board committees.

Indemnification and directors’ insurance – s78

A company may not indemnify a director against liability arising from:
• Willful misconduct or breach of trust by the director.
• The director acting without the necessary authority.
• Reckless trading.
• Fraudulent acts of the director.
• A fine related to an offence committed by the director unless the fine was based on strict liability.

Other than the specific instances mentioned above, a company may indemnify a director in respect of any liability, including liability arising from a directors’ negligence. A company may also purchase insurance to protect a director or the company against any liability in respect of which the company is permitted to indemnify a director.

Fundamental transactions – s115

The following transactions are categorised as fundamental transactions for the purposes of the Companies Act, 71 of 2008:
• A disposal of all or the greater part of the assets or undertaking of a company (s112).
• An amalgamation or merger (s113).
• A scheme of arrangement between a company and its shareholders (s114).

Required approval for fundamental transactions

A special resolution is required to authorise a fundamental transaction. In addition, notwithstanding the approval by way of special resolution, the company may not proceed to implement the approval given in terms of the special resolution without the approval of a court if:
• The resolution was opposed by at least 15% of the voting rights exercised on that resolution and any shareholder who voted against the resolution requires the company to seek court approval.
• Any shareholder who has opposed the resolution has been given consent by a court to have the transaction reviewed by the court.

In other words, if an 85% majority or less is obtained, the company will need to first obtain court approval. If more than an 85% majority is obtained, the company may proceed to implement the transaction, unless a shareholder who opposed the transaction is successful in applying to court to require the company to first obtain court approval to implement the transaction. The Companies Act, 71 of 2008 stipulates time periods within which shareholders must act if they wish to exercise these rights.

The court is only required to review the resolution (and not the terms of the overall transaction) and may only set aside the resolution if the resolution is manifestly unfair to any class of shareholder or the vote was materially tainted by conflict of interest, inadequate disclosure, failure to comply with the Companies Act, 71 of 2008 or Mol or there was any other significant and material procedural irregularity.

Disposal of all or greater part of the assets – s112

The provisions in the Companies Act, 71 of 2008 are similar to s228 of the 1973 Companies Act, except that the post-transaction ratification of a disposal is no longer permitted. If the company wishes to dispose of all or a greater part of its assets, it will need to comply with the requirements relating to fundamental transactions as set out above. The company will not need to comply with these requirements if the disposal is being undertaken as part of a business rescue plan or if the disposal is between a holding company and its wholly owned subsidiary or between wholly owned subsidiaries of the same holding company.

The Companies Act, 71 of 2008 now clarifies that “all or the greater part of the assets or undertaking” of a company means, in the case of the assets of the company, more than 50% of its gross assets fairly valued (irrespective of liabilities) and in the case of the undertaking of the company, more than 50% of the value of its entire undertaking fairly valued (s11).

An amalgamation or merger – s113

The Companies Act, 71 of 2008 has introduced the concept of amalgamation or merger (the Companies Act, 71 of 2008 always refers to these two concepts together) into our company law. The term “amalgamation or merger” is used commonly commercially and has been referred to in our income tax legislation but the term was never expressly referred to in the 1973 Companies Act.

Usually, to effect an amalgamation or merger, companies would either give effect to this through a sale of business or sale of shares (or a combination of both).

The Companies Act, 71 of 2008 now contemplates a process whereby two or more companies can enter into an agreement to amalgamate or merge which will result in:
• Automatic creation of a new company and automatic dissolution of the amalgamating or merging companies or alternatively.
• Survival of one of the companies and the automatic dissolution of one or more of the other amalgamating or merging companies.

To implement an amalgamation or merger, the companies would need to comply with the requirements for a fundamental transaction and meet the solvency and liquidity test. The Companies Act, 71 of 2008 sets out the specific procedures required to effect an amalgamation or merger which includes giving notice of the amalgamation or merger to all known creditors, entering into a written agreement setting out certain specific terms and conditions and ultimately filing a notice of amalgamation or merger with the Commission. The advantage of following this process, as opposed to a traditional sale of business, appears to be that there will be an automatic transfer of assets and liabilities without the need to obtain third party consent. The disadvantage would be successor liability as all existing liabilities or claims will be transferred to the new entity or the entity which survives the amalgamation or merger. There are certain limited exceptions from complying with the requirements if the amalgamation or merger is pursuant to a business rescue plan.
Scheme of arrangement – s114
The provisions in the Companies Act, 71 of 2008 allowing for schemes of arrangement allows greater flexibility in the manner in which schemes of arrangement can be effected between a company and its shareholders. To effect a scheme of arrangement, the company would need to comply with the requirements for approval of a fundamental transaction as set out above and therefore would not automatically require an application to court as was the case in terms of s311 of the 1973 Companies Act. An independent expert must be appointed to prepare a report which must be submitted to all shareholders for consideration prior to them voting on the scheme of arrangement. A company cannot enter into a scheme of arrangement if it is in liquidation or in a business rescue process.

Business rescue – Chapter 6

The Companies Act, 71 of 2008 has similar provisions to section 440K of the 1973 Companies Act, allowing a compulsory “squeeze out” of minority shareholders where 90% or more of the shareholders have accepted an offer to acquire the shares.

Appraisal rights – s164
The Companies Act, 71 of 2008 has introduced a new concept which is referred to as “appraisal rights” for shareholders. The appraisal rights apply where the company has:
• Amended its MoI to change the rights attaching to any class of shares in a manner materially adverse to the rights of a particular shareholder (s37(8)) (Note that the appraisal rights will not apply to the conversion of par value shares to shares without a par value in terms of the Regulations (see Regulation 31) prescribed for such conversion (Schedule 5 item 6(3)) or
• Entered into a fundamental transaction (s115(8)).

The appraisal rights do not apply in the above circumstances if the transaction is pursuant to a business rescue plan that has been approved by the shareholders. If a shareholder (the dissenting shareholder) has given notice to the company that it intends opposing any resolution for a matter referred to above, and thereafter votes against the particular resolution, the dissenting shareholder can require the company to repurchase the dissenting shareholder’s shares at fair value. This right is afforded to the dissenting shareholder irrespective of the majority percentage approval obtained by the company. The Companies Act, 71 of 2008 sets out certain formal requirements that the dissenting shareholder needs to follow in order to enforce its appraisal rights.

Takeovers, mandatory offers and squeeze-outs – Chapter 5: Parts B and C
The Companies Act, 71 of 2008 sets out provisions relating to takeovers and offers. Takeovers will be overseen by the Takeover Review Panel (TRP) (which is a similar body to the previous Securities Regulation Panel) and monitored in accordance with takeover regulations (Chapter 5 of the Regulations).

The TRP and takeover regulations apply to a regulated company. The definition of regulated company is wider than was previously the case under the SRP Code. The Companies Act, 71 of 2008 now provides that a regulated company includes a public company, state-owned company and a private company if the MoI of the private company provides for its application or if 10% (per Regulation 91) or more of the shares of such private company have been transferred within the previous twenty four months. The takeover regulations could apply to private companies irrespective of their size as the test is dependent not on the number of shareholders or the size of shareholder equity, but rather on the percentage of shares transferred over a period.

A number of the provisions relating to the required disclosure of share transactions, mandatory offers, comparable and partial offers, restrictions on frustrating actions and prohibitions before and during an offer, which were dealt with in the SRP Code, are now included in the Companies Act, 71 of 2008.
One of the stated objectives of the Companies Act, 71 of 2008 was to decriminalise company law. The 1973 Companies Act had numerous provisions providing for criminal liability. The Companies Act, 71 of 2008 provides for far fewer offences and the main offences provided in the Act are the following:

- Falsification of accounting records (s214(1)(a)).
- Fraudulently providing false or misleading information (s214(1)(b)).
- Knowingly (which is defined as wider than actual knowledge) being a party to an act by the company to defraud a creditor, employee or security holder of the company or any other act by the company with a fraudulent purpose (s214(1)(c)).
- Being a party to a prospectus containing an "untrue statement" (s214(1)(d)).
- Failure to satisfy a compliance notice by the Commission (under certain circumstances) (s214(3)).

There are other specified offences throughout the Companies Act, 71 of 2008 (e.g. s26(9), 28(3), 29(6), 31(4), 32(5), 213 (1), 214 and 215).

Civil actions

While there may be few criminal offences in the Companies Act, 71 of 2008, there is a greater opportunity for personal liability arising from actions which contravene the MoI of a company or contravene the Companies Act, 71 of 2008.

A director (which for these purposes will include a prescribed officer and a member of a board committee) is personally liable to the company for various acts or omissions as set out in s77. In addition, the Companies Act, 71 of 2008 has a far reaching provision which may give rise to numerous civil claims against directors and persons other than directors. Section 218(2) provides that any person who contravenes any provision of the Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.

Previously for a person to succeed in a civil claim, they would need to have had a contractual relationship with the party against whom they are seeking to claim damages, or alternatively would need to have proved that the person against whom they are seeking damages, owed them a duty of care. Section 218(2) effectively creates a duty of care between any person who contravenes any provision of the Companies Act, 71 of 2008 and any person who has suffered damages arising from that contravention. Time will determine the impact of this provision but on the face of it, the implications appear far reaching.

The Companies Act, 71 of 2008 also allows for class actions (s157) and provides that where in terms of the Companies Act, 71 of 2008 any application or matter can be brought before a court, the Companies Tribunal, the TRP or the Commission, this may be brought by a person acting as a member of, or in the interest of, a group or class of affected persons, or an association in the interests of its members.

The Companies Act, 71 of 2008 also provides for a procedure in terms of which a person may bring a derivative action (s165). A derivative action is an action whereby a person brings an action requiring the company to protect the legal interests of the company. Previously, there was a common law right to bring a derivative action but the Companies Act, 71 of 2008 has now abolished this common law right and replaced it with a right set out in the Companies Act, 71 of 2008. The procedure to be followed is intended to be less complicated and quicker for the individual who would no longer have to automatically apply to court to compel the company to act.
Corporate Governance
Definition

The term corporate governance has many definitions and all reflect the divergent role of companies in society. One of the earlier and popular definitions of corporate governance comes from the 1992 UK Cadbury Report:

“Corporate Governance is the system by which companies are directed and controlled”.

Even the definition adopted by the Organisation for Economic Co-operation and Development (OECD) is not considered decisive. The review of the principles was undertaken by the OECD Steering Group on Corporate Governance under a mandate from the OECD Ministers in 2002.

The OECD description is: “Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.”

In South Africa, King Ill has defined corporate governance “mainly involves the criteria of good governance, governance codes and guidelines. Although the board is accountable to the company itself, the board should not ignore the legitimate interests and expectations of its stakeholders. The inclusive approach to corporate governance adopted in King II dictates that the board should account to the legitimate interests and expectations of the company’s stakeholders in making decisions in the best interests of the company.”

Internationally there are a plethora of governance codes from different countries. Romani Naidoo estimates that there are in “excess of twenty codes of recent vintage since 2004”. This is not surprising given the different national governance environments. Changes in their respective socio-political determinants shape legal frameworks, social institutions, dispersion of shareholders and internal power structures inside organisations. (Refer below from Roe, M. 2003, Political determinants of corporate governance Oxford University Press).

The corporate governance environment

The governance environment dictates directly and indirectly how governance models are formed and differ between countries and markets. In essence, the extent of social democracy impacts upon the nature and form of political and legal institutions, which in turn creates the ‘rules’ by which employers have rights and capital markets function. The organisation responds through degrees of dispersed shareholders versus block, concentrated or institutional shareholders. The board of directors who are appointed by shareholders and who are agents, but not necessarily shareholders, manage the processes and operations of the company. It is this separation of ownership from management of the company that is at the heart of design for many of the internal governance structures and processes. Much of governance is about balancing power and aligning interests between participants – be they the shareholder, the board of directors, management or the employees and managing how they are accountable to their constituencies.

Some countries legislate their governance requirements e.g. The United States and the Sarbannes-Oxley Act of 2002 (SOX), whilst other countries e.g. the Commonwealth and European Union have chosen governance codes on a non-statutory and/or voluntary regime - often referred to as the ‘comply or explain’ approach to governance. South Africa follows an even more flexible approach by way of “apply and explain”, but have also managed to demonstrate the legal requirements within King III through use of language such as “must” for when there is a legal requirement to comply with a governance principle or practice. Other language such as “should”, “could” or “may” reflects the non-legally binding nature of the code which is voluntary.

Shareholder versus stakeholder model of governance

Broadly speaking there are two main types of governance modules for companies:

- The Stakeholder model.
- The Shareholder model.

Indeed our Companies Act, 71 of 2008 has recognised stakeholders other than the shareholders.

Definition of a stakeholder per the Companies Act, 71 of 2008

The Companies Act, 71 of 2008 includes a much broader concept of “stakeholder” than in the 1973 Companies Act. The 1973 Companies Act sought to regulate the relationship between a company, its directors and shareholders. The Companies Act, 71 of 2008 includes a number of rights afforded to trade unions, employees and creditors. By way of example, trade unions have the right to institute proceedings to prevent the company from doing anything inconsistent with the Companies Act, 71 of 2008, have access to financial statements for the purposes of initiating business rescue proceedings and must receive notice of any loan or financial assistance given to directors, prescribed officers or related or inter-related companies. Both trade unions and employees have the right to institute proceedings to have a director declared delinquent or under probation (in accordance with the specific process set out in the Companies Act, 71 of 2008). Trade unions, employees and creditors are all “affected persons” for business rescue proceedings and may therefore participate in the development of a business rescue plan and all three categories may also be protected by the newly included whistleblower provisions. Also note that the term “trade union” appears to refer to any trade union registered in terms of the Labour Relations Act, 1995 and does not require that the trade union must be “recognized” 6.6 does not require the union to have a minimum representativity threshold within the company).

Stakeholder importance is being recognised in statute in South Africa, the Companies Act, 71 of 2008 requires South African companies to have not just a mandatory audit committee, but also a social and ethics committee. The social and ethics committee must comprise at least three directors or prescribed officers of the company.
At least one member of the committee must be a director who is not involved in the day-to-day management of the company’s business and has not been involved in day-to-day management within the previous three financial years.

The social and ethics committee must monitor the company’s activities, having regard to relevant legislation and codes of best practice, in respect of:

- Social and economic development, including the company’s standing in respect of goals and purposes of:
  - The ten principles set out in the United Nations Global Compact Principles.
  - The OECD recommendations regarding corruption.
  - Employment Equity Act.
  - Broad-based Black Economic Empowerment Act.
- Good corporate citizenship, including:
  - Promotion of equality, prevention of unfair discrimination and reduction of corruption.
  - Contribution to the development of those communities in which it operates.
  - The company’s record of sponsorship, donations and charitable giving.
- Environment, health and public safety, including the impact of the company’s activities and its products or services.
- Consumer relationships, including advertising, public relations and compliance with consumer protection laws.
- Labour and employment, including:
  - The company’s standing in terms of the International Labour Organisation Protocol on Decent Work and Working Conditions.
  - Employment relationships and its contribution to the educational development of its employees.

In addition to the above, the social and ethics committee must draw matters within its mandate to the attention of the board as required and report to the shareholders at the AGM. The social and ethics committee is covered in detail in chapter six.

Which model is best?

The question as to which model or mix of models is the best is not a simple question as countries differ in their politics and societal needs, the nature of their legal systems i.e. common law versus civil law, the impact on shareholder protection and property rights, as well as the size of both the countries capital and product markets. In South Africa it is not surprising that we have moved to a stakeholder model because in order to maintain political peace we have had to become more inclusive i.e. move towards the left and social democracy, and adjust as our capital and product markets are relatively small in comparison to mature countries. The move to a more ‘stakeholder’ oriented governance model has now also been included in the Companies Act, 71 of 2008.

Stakeholder versus shareholder governance systems

Under the ‘shareholder model’, which is most commonly referenced to the US and UK governance systems, the main recipient and beneficiary of organisational endeavour is the shareholder by way of revenues through dividends and capital growth in investment. This is not necessarily to the exclusion of other stakeholders, hence the “enlightened shareholder” concept, but the primary goal of the board of directors and management is to focus on and drive the business towards returns for shareholders. The move in South Africa towards the stakeholder model of governance (as is more common in continental Europe) has been necessitated by the need to maintain social peace. For economies to prosper, there has to be political and social peace. Stakeholder inclusion has been driven in part by a reaction to historic colonialist activity and in the case of South Africa, post-apartheid progress. After attaining political freedom, maintaining social peace requires a balance between strong socialism and excessive capitalism. Sharing of political power or democracy, has led to the inclusion of the wider society in economic opportunities and resources within largely free-market systems. This is contributing to Africa being seen as a ‘next frontier’ for investment, growth and development, notwithstanding the continent’s vast natural economic resources.

Under the ‘stakeholder model’ of governance, the organisation recognises and acknowledges the context in which it operates as part of its business goals. The shareholder is a primary stakeholder, but not the only one. The other stakeholders such as employees, suppliers, consumers, general public and the environment are seen as partners to achieving and benefitting from organisational goals. Under the stakeholder governance model, the board and management have to recognise and achieve the “legitimate” aims of the various stakeholders. This necessitates recognising the unique stakeholders relevant to a particular organisation; engaging with them on what the expectations are; deciding or negotiating the legitimate expectations, as many of these will be competing; achieving them and then disclosing or communicating such to all stakeholders. This is becoming more evident in the annual reports of financial institutions, which are supported by leading corporate social responsibility reporting guidelines. In addition, the practice of rating socially responsible behaviour has developed into recognised investment indices.

The King Code of Governance Principles and the King Report on Governance for South Africa 2009

“The third report on corporate governance in South Africa became necessary because of the new Companies Act no. 71 of 2008 (‘The Act’) and changes in international governance trends.”

The Report, referred to as King III, was compiled by the King committee and eleven sub-committees and issued by the Institute of Directors in Southern Africa. Its purpose is to promote the highest standards of corporate governance in South Africa.

Apply or explain

King III has opted for the more flexible “apply or explain” approach to its principles and recommended practices. In the United Kingdom, the UK Governance Code, which is based on the “comply or explain” principle, requires London listed companies to state their compliance with the principles and then explain if there is non-compliance to any of the detailed provisions supporting the principle. In South Africa, under King III, entities are required to make a statement as to whether or not they apply the principles and then to explain their practices. It is relevant too that King III states “Each principle is of equal importance, consequently ‘substantial’ application of this Code and Report does not achieve compliance.”

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Affected organisations

The King committee continues to believe that there should be a code of principles and practices on a non-legislated basis as a result the King III is on an “apply or explain” basis. It applies to “all entities regardless of the manner and form of incorporation or establishment and whether in the public, private or non-profit sectors.”

However, for listed companies, King III became a requirement. In a statement issued by the Johannesburg Stock Exchange Limited (JSE) on 17 February 2010 – Amendments to the Listings requirements stated the following: “The changes relating to the third King report on corporate governance must be complied with in respect of all financial years commencing on or after 1 March 2010. The amendment to the definition of independent director specifically as it relates to such directors participation in share option schemes will only become effective from 1 April 2011. All other changes will become effective on 1 April 2010.”

Quick reference guide for King III

The third South African report on corporate governance (King III) was released on 1 September 2009 and became effective on 1 March 2010. The quick reference guide below contains a summary and extracts of the salient details. However, the reader is encouraged to consult the full King Report and the Code of Governance Principles available from the Institute of Directors in Southern Africa.

Applicability of King III

King III is a non-legislated code that applies to “all entities regardless of the manner and form of incorporation or establishment and whether in the public, private or non-profit sector.” All entities should apply the principles of the Code and consider the best practices. Entities are required to make a positive statement about how the principles have been applied or not, and to explain what has been done. King III states that each principle is of “equal importance” and that “substantial application… does not achieve compliance”.

Board and directors

The board, director and company refers to the functional responsibility of those charged with governance in any entity.

Role of the board

The board should:

- Lead the entity ethically for sustainability in terms of the economy, environment and society taking account its impact on internal and external stakeholders.
- Strategically direct, control, set the values, align management to the latter and promote the stakeholder-inclusive approach of governance.

- Ensure that each director adheres to the duties of a director.
- Ensure that the company is and is seen to be a responsible corporate citizen.
- Ensure the company’s ethics are managed effectively through building an ethical culture, setting ethics standards, measuring adherence and incorporating ethics into its risk management, operations, performance management and disclosure.
- Be the focal point of governance - have a charter, meet at least four times a year, monitor management and stakeholder relations and ensure company survives and thrives.
- Appreciate strategy, risk, performance and sustainability are inseparable.
- Ensure company has an effective and independent audit committee.
- Govern risks.
- Be responsible for IT governance.
- Ensure company complies with laws and considers rules, codes and standards.
- Ensure there is an effective risk based internal audit.
- Ensure integrity of integrated report.
- Report on the effectiveness of internal controls.
- Act in the best interests of the company (including managing conflicts and dealing in securities).
- Consider business rescue proceedings as soon as the company is distressed.
- Elect annually an independent, non-executive director as chairman. If the chairman is not independent or is executive, then a lead independent non-executive director should be appointed and justified in the integrated report. The CEO should not become chairman until after three years, the number of chairmanships should be considered and there should be a chairman succession plan.
- Appoint the CEO, define board’s materiality, establish a delegation of authority, evaluate CEO performance and ensure a succession plan for CEO and senior executives.

Structure and composition of the board

The board should comprise a balance of power with:

- A majority of non-executive directors, of whom the majority should be independent.
- Knowledge, skills, resources, size, diversity and demographics of board to be considered.
- A minimum of two executive directors (CEO and Finance Director).
- The CEO and chairman should be separate.
- One third of non-executives should rotate annually.
- Non-executive directors on the board for longer than nine years must be assessed annually for independence and this should be reported.
- Board should be able to remove any director without shareholder approval.

The King Report provides detailed guidance on the role of the chairman and the CEO.
Appointment, development and performance assessment of directors

- Formal processes should be established for appointment and development of directors.
- A nominations committee should assist identification and recommendation of potential directors to the board.
- Backgrounds and references should be checked before nomination.
- Letters of appointment should be provided to non-executive directors.
- Full disclosure of directors should be made to shareholders (The King Report has details of disclosure e.g. education, experience, age, other directorships etc).
- Directors should receive induction and ongoing training (including changes to laws, rules, standards and codes).
- The performance of the board, its committees and individual directors should be evaluated every year by the chairman or an independent provider. Results should assist training and be disclosed in the integrated report.
- Performance evaluation results should inform re-appointment nomination of a director.

Company secretary

- The board should appoint/remove, empower and be assisted by a competent, qualified and experienced company secretary (who is not a director and who is arms-length).
- The company secretary should assist the nominations committee; facilitate training; provide guidance to the board; keep the board and committee charters current; prepare and circulate board papers; assist communication into and around board meetings; assist drafting workplans; keep minutes and assist evaluations of board, committees and individual directors.

This is not a complete list of responsibilities. Refer to King III chapter two for a detailed listing.

Group boards of companies

A governance framework should be agreed between the group and its subsidiary boards (subject to legal and fiduciary duties of subsidiary directors to the subsidiary company), implementation and adoption of policies, processes or procedures of the holding company should be considered and approved by the subsidiary company and disclosed by the subsidiary company. Where the holding company of a South African subsidiary is listed on another exchange, then King III principles should be applied to the subsidiary.

Committees

Audit, risk, nomination and remuneration committees should be established.

Board committees should have:
- Terms of references approved by the board that are reviewed annually.
- Composition and terms of reference disclosed in the integrated report.
- Composition should comprise a majority of non-executive directors of which the majority should be independent (risk committee may have a mixed composition).

- The CEO should not be a member of the remuneration, audit or nomination committees, but should attend by invitation. CEOs should recuse themselves when conflicts arise or when their performance and/or remuneration is discussed. CEOs should not become a chairman of a company outside the group.
- External advisors and executive directors may attend by invitation. Non-directors serving as members on committees of the board should be aware of s76 of the Companies Act, 71 of 2008 which places same standards of conduct and liability as if they were directors (but without the benefit of a committee vote).
- Committees should be able to take outside professional advice subject to following an approved process.
- Committee chairman should give at least an oral summary of committee’s deliberations at the following board meeting.

Remuneration committees and remuneration

- Companies should remunerate directors and executives fairly and responsibly i.e. align remuneration policies to company strategy and individual performance. Detailed guidance is provided in the report as to what is considered fair and responsible remuneration practices.
- The remuneration committee should assist the board with setting and administering remuneration policies (which should address base pay, bonuses, contracts, severance, retirement benefits, share and incentive schemes).
- Non-executive fees should comprise a base and an attendance fee component. Non-executives and the chairman should not receive share options or other incentive awards. Non-executive fees should be approved by shareholders in advance by way of special resolution at intervals of not more than two years.
- Each individual directors remuneration should be disclosed in detail as well as the three most highly paid employees within the remuneration report in the integrated report. Other information to be disclosed should be base pay policy, participation in incentive schemes, benchmarks used, retention schemes, justifications for salaries above medians, material ex-gratia payments, executive employment policies, maximum potential dilution from incentive awards.
- Shareholders should vote a non-advisory vote on company’s remuneration policy (including share schemes).
- The board should determine executive directors remuneration in accordance with the policy put to shareholders.

Audit committees

The board should ensure that it has an effective and independent audit committee, with an approved terms of reference. The audit committee is an integral part of the risk management process with oversight of financial reporting risks, internal financial controls and fraud and IT risks relevant to financial reporting.

The audit committee should:
- Consist of at least three independent members, all of whom should be independent non-executive directors. The chairman of the board should not be the chairman of or a member of the audit committee. The audit committee chairman should be elected by the board, set the agenda and be present at the AGM.
• Meet at least twice a year (at least once a year external and internal auditors should attend without management).
• Have sufficient qualifications and experience and be up-to-date with relevant developments.
• Be able to consult with specialists subject to a board approved process.
• Oversee integrated reporting (i.e. the integrity of the integrated report, its financial statements and the disclosure of sustainability for consistency with the financial information).
• Recommend engaging an external assurance provider on material sustainability issues.
• Consider the need to issue interim results.
• Review summarised information and engage external auditors to provide assurance on summarised financial information.
• Ensure there is a combined assurance approach for assurance activities to address all significant risks.
• Monitor the relationship between external assurance providers and the company.
• Review annually and satisfy itself on the company’s finance function and disclose such in the integrated report.
• Oversee internal audit (including appoint/dismiss and performance manage the Chief Audit Executive (CAE), approve the internal audit plan, assess internal audit performance, and quality review the internal audit function, ensure properly resourced with sufficient budget).
• Recommend the external audit appointment and oversee the external audit process (nomination, monitoring of terms and remuneration, monitor independence, define non-audit services policy and approve assignments, be informed of Reportable Irregularities and review the quality and effectiveness of the external audit process).
• Report internally to the board and externally to shareholders on;
  - Discharge of its statutory duties.
  - Independence of external auditor.
  - Financial statements and accounting practices.
  - Effectiveness of the internal financial controls.
  - Its role, composition, meetings and activities.
• Recommend the integrated report for approval by the board.

Risk management

The board is responsible for the governance of risk (to be specified in the board charter). The board responsibilities include the following:
• Develop a documented risk management policy and plan approved by the board which policy is widely distributed.
• Comment in the integrated report on the effectiveness of the risk management system and process.
• Review implementation of the risk management plan at least annually and continuous monitoring.
• Determine levels of risk tolerance (annual risk tolerance to be set with risk limits and appetites).
• Appoint a risk committee which considers risk policy, plan and monitoring. The risk committee may comprise a minimum three members from executive, non-executive directors, senior management and independent risk experts. It should meet at least twice a year.

• Evaluate the performance of the risk committee.
• Delegate to management the responsibility for the risk management plan.
• Ensure that risk assessments are performed on a continual basis at least once a year on a top-down approach.
• Receive and review the company’s risk register (quantified where possible).
• Ensure a framework for anticipating unpredictable risks.
• Ensure management continually implements appropriate risk management responses and risk monitoring.
• Receive assurance on the effectiveness of risk management from management as well as a written assessment of the effectiveness of the system of internal controls and risk management from internal audit.
• Disclose its view on the effectiveness of the risk management process and any unusual risks in the integrated report.

IT governance

The board is responsible for Information Technology (IT) governance. The board should:
• Ensure IT is on the agenda; an IT charter exists; IT policies are in place; an IT internal control framework exists and independent assurance on effectiveness of IT controls is obtained.
• Align IT to performance and sustainability objectives of the company.
• Delegate responsibility for implementation of IT governance framework to management (the board may appoint an IT steering committee. The CEO should appoint a suitably qualified Chief Information Officer (CIO)).
• Monitor and evaluate significant IT spend in terms of value and return on investment.
• Ensure protection of intellectual property, information management and security (including personal data) on IT systems.
• Comply with IT laws and standards.
• Observe independent assurance on IT governance and controls on outsourced IT services.
• Management should demonstrate adequate disaster recovery arrangements.
• The risk committee should ensure that IT risks are adequately addressed and get appropriate assurance on controls. The audit committee should consider IT in relation to financial reporting and the going concern.

Compliance

Compliance should form an integral part of the risk management process. The non-compliance should be identified, assessed and responded to in the risk management process. The establishment of a compliance function should be considered.

The board should:
• Ensure the company complies with applicable laws and considers adherence to rules, codes and standards.
• Delegate to management the implementation of an effective compliance framework and processes (this may include an approved compliance policy, code of conduct, structures, training, appointment of a compliance officer, key performance indicators, integration with risk management and ethics programmes).
Monitor compliance and have it as a regular item on the board agenda.

Receive assurance on effectiveness of compliance controls.

Disclose details on how it has established an effective compliance framework and processes, as well as disclose material or repeated instances of non-compliance.

**Internal audit**

The board should ensure that there is an effective risk based internal audit which is governed by an internal audit charter approved by the board, and which adheres to the IIA Standards and code of ethics.

Internal audit should:

- Report functionally to the audit committee (CAE should report functionally to the audit committee chairman) and report at all audit committee meetings.
- Evaluate the company’s governance processes.
- Objectively assess the effectiveness of risk management and the internal control framework.
- Analyse business processes and controls.
- Provide information on fraud and unethical practices.
- Have an internal audit plan that is informed by the strategy and risks.
- Be independent from management and objective.
- Provide a written assessment on the effectiveness of the company’s system of internal controls and risk management to the board.
- Provide a written assessment of the internal financial controls to the audit committee.

The CAE should be able to attend all executive committee meetings, and should develop a quality assurance and improvement programme.

**Stakeholder management**

The board should:

- Appreciate that stakeholder perceptions affect reputation and should seek to manage reputation risk.
- Identify important stakeholders.
- Delegate to management the responsibility to deal with stakeholder relationships.
- Consider publishing stakeholder policies.
- Oversee the mechanisms and processes for the constructive engagement of stakeholders.
- Encourage shareholders to attend the AGM.
- Disclose in its integrated report its stakeholder dealings.
- Strive to achieve balancing of various stakeholders legitimate expectations in the best interests of the company.
- Ensure equitable treatment of shareholders of the same class and protection of minority shareholders.

**Integrated reporting and disclosure**

The board should:

- Adopt communication guidelines for stakeholder communication so that communication is clear, relevant, timely, honest and accessible to stakeholders.
- Consider disclosing in the integrated report the number and refusals to information access in terms of the Act.
- Adopt formal dispute resolution processes.
- Select the appropriate individuals for Alternate Dispute Resolution (ADR) representation.

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CHAPTER 4

The Board of Directors


Introduction

The roles and responsibilities of the board and individual directors as prescribed by the Companies Act, 71 of 2008, the Regulations thereto and common law are the overriding authorities in this area. However, roles and responsibilities must be read together with the company’s Memorandum of Incorporation (MoI), rules and any shareholders agreement. It is noteworthy that under the Companies Act, 71 of 2008 any shareholder agreements must be consistent with the MoI and the Companies Act, 71 of 2008, and that the latter will prevail in the event of conflict.

Purpose and role of the board

The board is ultimately responsible for ensuring that the business remains a going concern and that it thrives in a sustainable manner. The board is the focal point of governance and retains full and effective control over the company. Therefore, it must ensure that it effectively controls the company, governs, directs and controls the management of the company and is involved in all material decisions affecting the company.

King III states that the board is responsible for corporate governance and has two main functions:

Firstly - it is responsible for determining the company’s “strategic direction” and ultimately its performance. Secondly - it is responsible for the “control” of the company.

The key distinction between the board and management is that the latter is responsible for operations and execution, whilst the board is responsible for setting the strategy of the company.

Whilst the Companies Act, 71 of 2008 specifies the responsibilities of the board in various circumstances, King III provides the principles and recommendations. Chapter two in King III sets out more fully the role and functions of the board.

The board should have a board charter that sets out its role, function and responsibilities. The charter should be used for:

- Setting the board’s annual workplan.
- The criteria against which the board measures its own performance.
- The basis for disclosure on the role and responsibilities of the board.

The Institute of Directors of South Africa (IoDSA) practice notes provide an example of a board charter. However, it is advisable that each company devise its own board charter based on its particular needs and regulatory requirements. As a minimum, it is usual for a board charter to cover the following areas:

- Introduction - an explanation as to why the board needs a charter and the main laws that regulate the organisation and impact the board.
- Purpose.
- Composition of the board.
- Role and responsibilities of the board.
- Board committees.
- Meetings and board attendance - frequency, attendance, agenda and minutes, quorum, evaluations.
- Approval - evidence of approval and when it will be reviewed and updated.

Core competencies of the board

In South Africa, the board should collectively be comprised of individuals who together have the necessary skills, experience and competencies to make it effective. Diversity in terms of age, race and gender should also be considered.

The Companies Act, 71 of 2008 Regulation 42 has however, for the first time introduced qualification requirements for the members of audit committees i.e “at least one-third of the members of a company’s audit committee at any particular time must have academic qualifications, or experience, in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resource management”.

In the United States, the National Association of Corporate Directors (NACD) Commission recommends that the board as a whole should have the following core competencies:

- Accounting and finance
  Expertise in financial accounting and corporate finance, including trends in debt and equity markets.
- Business judgment
  A record of making good business decisions.
- Management
  An understanding and the intention to keep abreast of general management ‘best practices’ and their application in complex, rapidly evolving business environments.
- Crisis response
  The ability and time to perform during both short-term and prolonged crises.
- Industry knowledge
  Appropriate industry-specific knowledge and experience with one or more members.
- International markets
  Business experience in international markets.
- Leadership
  A knowledge and understanding of empowerment skills, and a history of motivating high-performing talent.
- Strategy/vision
  An ability to provide strategic insight and direction by encouraging innovation, conceptualising key trends, evaluating strategic decisions and continually challenging the company to sharpen its vision. Many experienced directors consider that risk management, regulatory awareness and knowledge of sustainability matters are other necessary core competencies.

1 The National Association of Corporate Directors (NACD) aims to be the premier organisation for boards and directors of United States business corporations, as an authoritative voice and vital forum on matters of policy and practice.
Board size and composition

There is no optimum size for a board of directors. The Companies Act, 71 of 2008 s66 specifies that a private company or personal liability company requires at least one director. Public companies and non-profit companies require at least three directors, but set no maximum number. The JSE requires a listed company’s MoI to provide that the board appoint a minimum of two executive directors, being the CEO and CFO.

Factors determining the number of seats at the board table include the:

- Evolving circumstances and needs of the company. Shareholders of a small company with a tightly focused business might regard a large board as an expensive luxury, while a large company with diverse and complex operations would almost certainly overstretch the resources of a small board.
- Need to achieve an appropriate mix of executive, non-executive and independent non-executive directors.
- Governance recommendations and JSE Listings Requirements for the minimum number of independent non-executive directors. King III recommends a majority of non-executive directors of which the majority should be independent.
- Establishment of board committees (audit committee, nomination committee, social and ethics committee etc.) becomes impracticable with small boards.
- Absence of a handful of directors can make it impossible for a small board to raise a quorum.
- Existence of too large a board can slow down decision-making and increase the risk of bureaucracy.

Each company needs to determine the appropriate size for its board based on consideration of these and other relevant factors including diversity and demographics.

Note that, in terms of the Companies Act, 71 of 2008 until the first directors are appointed, all subscribers to the memorandum are deemed to be directors. The majority of the subscribers to the memorandum may, in writing, determine the number of directors if this is not specified in the MoI.

Categories of directors

Contemporary best practice in corporate governance calls for a balance of power with majority of independent, non-executive directors on public company boards. Some companies continue to operate with a majority of executive directors, but this runs the risk of alienating investors, who fear that shareholder value could be subordinated to a management agenda, or that the company could be managed in the interests of some shareholders rather than all shareholders. In some instances, investors may doubt the independence of non-executive directors.

An executive director is generally taken to be an individual in the full-time employment of the company with executive functions. On the other hand, the non-executive director should be free from any major business relationship with the company and should fulfil his/her duties at board meetings and any other meetings of the company that he/she is required to attend.

Non-executive directors bring to the board an external judgement on issues of strategy, performance, sustainability, resources, transformation, diversity, employment equity, standards of conduct and an evaluation of performance. Courage, wisdom and independence should be the hallmark of any non-executive director acting in the best interest of the company. The role and function of a non-executive director has become increasingly onerous.

The Companies Act, 71 of 2008 does not draw a distinction between an executive and non-executive director, except to the extent of audit committee criteria under s94(4) of the Companies Act, 71 of 2008. Every director has a legal duty to act independently, in good faith, with due care and skill without fetter or instruction. The labels of executive, non-executive and independent non-executive have evolved in practice.

King III has however, redefined the executive, non-executive and independent director as follows:

- **Executive director**
  
  An executive director is an individual involved in the day-to-day management and/or in the full-time salaried employment of the company and/or any of its subsidiaries.

- **Non-executive director**
  
  A non-executive director is an individual not involved in the day-to-day management and not a full-time salaried employee of the company and/or any of its subsidiaries. An individual in the full-time employment of the holding company and/or any of its subsidiaries, other than the company concerned, would also be considered to be a non-executive director, unless such individual by his/her conduct or executive authority could be construed to be directing the day-to-day management of the company and/or any of its subsidiaries.

- **Independent non-executive director**
  
  A challenging area for many companies is the appointment of sufficient independent non-executive directors, so that the majority of non-executives are independent. A further complication is that the Companies Act, 71 of 2008 and King III differ in their definitions of ‘independence’, with King III having the more onerous requirements. The Companies Act, 71 of 2008, under s94(4) on audit committees, which sets out the characteristics of each member of the audit committee, defines the ‘independence requirements’ as:

  - "Not be;
    - involved in the day-to-day management of the company’s business or have been so involved at any time during the previous financial year.
    - a prescribed officer, or full-time executive employee, of the company or another related or inter-related company, or have been such an officer or employee at any time during the previous three financial years.
    - involved at any time during the previous financial year.
    - a material supplier or customer of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality and objectivity of that director is compromised by that relationship and
    - Not be related to any person contemplated above."

King III defines an independent director as a non-executive director that:

- "is not a representative of a shareholder that has the ability to control or significantly influence management

- has not been employed by the company, or the group of which it currently forms part, in any executive capacity, or appointed as the designated auditor or partner in the group’s external audit firm, or senior legal adviser for the preceding three financial years

- is not a member of the immediate family of an individual that is, or has been, in any of the past three financial years, employed by the company or the group in an executive capacity

- does not have a direct or indirect interest in the company which exceeds 5% of the group’s total number of shares in issues
Appointment of directors

Appointment of directors

Companies in increasing numbers are adopting a more proactive and systematic approach to their board appointments. King III recommends that directors should be appointed through a formal process and the establishment of a board nominations committee with the specific responsibility for identifying suitable candidates for nomination as a director. This is usually done in conjunction with an external advisor, working at least nine to twelve months ahead of anticipated board vacancies.

King III recommends that all companies adopt a process of staggered rotation re-election to ensure a continuity of experience and knowledge and to introduce people with new ideas and expertise (if not already regulated by the company’s MoI or relevant regulation).

The nominations committee or, in the absence of a nominations committee, the chairman of the board should consult with other directors concerning the appointment of new non-executive directors. The formal approval of any new director should be by the full board, assisted by the nominations committee, subject to shareholder approval. Background checks and references should be checked before nomination and before the potential future director is approached.

The appointment process should be based on a careful analysis of the existing board’s strengths and weaknesses, its skill and experience gaps, diversity, its current age range and gender composition, and its ambitions for the future. Letters of appointment should be provided to non-executive directors covering expectations, code of conduct, remuneration and liability insurance. In addition, it is advisable that companies do not issue employment contracts to executive directors in their capacity as executive directors, but seek to separate their appointment letters as directors and their employment letters as managers. This allows for an executive to function as an employee and not as a director, should the board consider this appropriate. There is also varying interpretation regarding director remuneration and the necessary shareholder approvals regarding directors remuneration and director fees.

The Companies Act, 71 of 2008 s24 requires companies to keep details for at least seven years of the directors name, identity number, nationality and passport number (if the director is not a South African), occupation, date of most recent election, name and registration of all companies of which the director is a director and any other prescribed information such as the address for service for that director, and for companies that are required to have an audit committee, any professional qualifications and experience necessary to be able to sit on the audit committee.

Full disclosure of directors should be made to shareholders (King III has details of disclosure e.g. education, experience, age, other directorships etc).

Appointment of directors and prescribed officers under the Companies Act, 71 of 2008 – s66, s69 and s70

A private company or personal liability company requires at least one director and a public company and a non-profit company requires at least three directors in addition to the minimum number of directors that may be required for the audit committee or social and ethics committee where the company is required to have such committees. If a single director is able to serve on more than one committee, this reduces the actual minimum number required.

Only a natural person with full legal capacity is eligible to be a director. The MoI may also set out minimum qualifications for directors.

A person is disqualified from being a director of a company for various reasons including if a court has prohibited that person from being a director, or declared the person to be delinquent, or the person has been removed from an office of trust or convicted of certain specified crimes or is an unrehabilitated insolvent or is prohibited by public regulation.

A profit company must allow for shareholders to elect a minimum of 50% of the directors and the alternate directors. The remaining directors may be appointed by any other person stipulated in the MoI.

If the number of directors is below the minimum required by the Companies Act, 71 of 2008 or the MoI, this does not limit or negate the authority of the board, or invalidate anything done by the board or the company.

The board is obliged, within forty business days, to convene a shareholders meeting to elect directors (s67), if the number of directors falls below the minimum.

Tenure

The term of office is normally specified in the company’s MoI and is usually established as a three year term. King III recommends every non-executive director classified as “independent” should undergo an annual evaluation of his/her independence by the chairman and the board. Those directors who have served on the board for longer than nine years should have a “particularly rigorous” review of their independence. This should be disclosed specifically in the integrated report.

Induction of directors

King III states that a formal induction programme should meet the needs of the company and the individual director. If the board does not lay down formal training requirements, including strict timelines for induction, new directors will attain their knowledge only through exposure to boardroom discussions. It will in fact mean that the board will always be deliberating issues without meaningful input from the one or more members who are not fully functional yet as regards the company’s business.

King III recommends that the formal induction programme should include an introduction to members of senior management as well as what their duties, responsibilities, powers and potential liabilities are as directors.

The chairman should play an active role in ensuring that strict induction requirements are enforced.

Election of the chairman

Outside of North America, accepted best practice now favours the appointment of a non-executive, preferably independent, chairman for company boards. This separates the functions of the CEO and board chairman, which many believe is necessary to avoid giving too much power to the CEO. King III endorses this view by recommending that an independent non-executive director chairs the board.

If the chairman is not independent but is non-executive, the company should provide reasons and justifications for his/her appointment in the integrated report.
Boards impacted by personal conflicts rarely work well. Honest, open debate will be frustrated, In any consultation that the LID might initiate. Ensuring that a copy of the company’s annual financial statements is sent to every person who is Certifying in the company’s annual financial statements whether the company has filed required External presenters should be used to enhance both board and management’s understanding of Good boards exhibit a degree of creative tension. Differences are not suppressed, and issues are Ensuring a person is responsible for compliance by the company with the transparency and The chairman and CEO play a key role in setting a board’s style. In any consultations that any other director or executive might initiate with the LID. Ethical leadership. Effective boards tend to attract capable people. The ability to meet immediate performance targets without neglecting longer-term growth Strategic vision. At any board meeting or at any other meeting of the board. Providing the directors of the company with guidance as to their duties, responsibilities and powers. Good boards have the courage to take difficult decisions. Individuals stick by these collective High level business judgment. At any meeting the chairman may initiate with the LID. Making the directors aware of any law relevant to or affecting the company. • The CEO should be formalised and should include: Ethical leadership. Strategic vision. High level business judgment. The ability to meet immediate performance targets without neglecting longer-term growth opportunities. • CEO’s role in succession The CEO’s views on the succession question should be sought. However, CEO selection is ultimately a board responsibility, and specifically that of the non-executive directors.

Appointments of the company secretary – s86
The Companies Act, 71 of 2008 requires all public companies and state-owned companies to appoint a company secretary who is knowledgeable or experienced in the relevant laws. The company secretary must be a permanent resident of the Republic, and must remain so while serving in that capacity. Duties of the company secretary – s88
A company secretary’s duties include, but are not restricted to:
• Providing the directors of the company with guidance as to their duties, responsibilities and powers.
• Making the directors aware of any law relevant to or affecting the company.
• Reporting to the company’s board any failure on the part of the company or a director to comply with the MoI, rules or the Companies Act, 71 of 2008.
• Ensuring that minutes of all shareholders meetings, board meetings and the meetings of any committees of the directors, or of the company’s audit committee, are properly recorded in accordance with the Companies Act, 71 of 2008.
• Certifying in the company’s annual financial statements whether the company has filed required returns and notices in terms of this Companies Act, 71 of 2008.
• Ensuring that a copy of the company’s annual financial statements is sent to every person who is entitled to it.

• Ensuring a person is responsible for compliance by the company with the transparency and accountability provisions set out in s33(3) relating to annual returns.

Boardroom styles
Every board is unique, it has its own way of going about its business. Board styles are shaped by the complex interaction of company traditions, personalities and the pressure of events. There is no optimum boardroom style. What works for one board will not necessarily work for another. Nevertheless, the following generalisations can be made:
• Boards impacted by personal conflicts rarely work well. Honest, open debate will be frustrated, and personal agendas may override a director’s responsibility to shareholders.
• The chairman and CEO play a key role in setting a board’s style.
• Effective boards tend to attract capable people.
• Good boards exhibit a degree of creative tension. Differences are not suppressed, and issues are argued out with vigour and passion. Differing opinions are respected and individual contributions encouraged. However, there is an underlying harmony driven by a collective understanding of the board’s stewardship.
• External presenters should be used to enhance both board and management’s understanding of particular or emerging issues.
• Good boards have the courage to take difficult decisions. Individuals stick by these collective decisions, even when they may have personally opposed them. Boards can improve their style and their effectiveness by engaging in critical self-examination (i.e. evaluating their own performance).
Boardroom cultures

Like the companies for which they are responsible, boards tend to exhibit distinct cultures. The internal dynamics of boards reflect shared values and beliefs, which influence how boards approach their duties and reach decisions. The culture of an effective board is likely to exhibit the following qualities:

- Independence of thought.
- An ability and desire to learn.
- An openness to new ideas, and a tolerance for unconventional views.
- A clear understanding of the distinct roles of directors and managers.
- A sense of collegiality – recognising that an effective board is more than a collection of different individuals.
- A creative tension in which individual directors are prepared to raise and debate important issues.
- An appreciation of the company’s history and traditions.
- A professional approach to board duties, including an appropriate commitment of time and effort.
- A determination to uphold the company’s values coupled with a thoughtful approach to the ethical issues that might be faced by the organisation.
- The courage to take and stand by the “tough” decisions.
- Loyalty to the interest of shareholders.
- A commitment of responsibility to all stakeholders.
- A commitment to the notion of stewardship.

Despite increasing concern over issues of corporate governance, and the consequent interest in board structures, composition and processes, board culture appears to have a decisive influence on performance. Many factors influence board culture, such as the following:

- Board cultures tend to perpetuate themselves. Director selection and nomination practices appear the main cause of this phenomenon however, the role of the chairman is perhaps the most critical and sets the tone for the rest of the members.
- The ratio of executive to non-executive directors clearly affects board dynamics. Executive directors often act as a management bloc. Where executive directors constitute a majority of directors, there is a risk that boards become extensions of management, unable or unwilling to provide independent and detached oversight. In extreme cases, the non-executive minority is largely ignored, providing little more than a veneer of independence. This is an unsatisfactory (and potentially dangerous) situation for the directors concerned.
- Executive directors other than the CEO can find themselves in an invidious position. They may be reluctant to depart from the management ‘line’ fearing the consequences of opposing the CEO, however obliquely.
- A similar situation can arise in the presence of so-called nominee directors: individuals nominated by a major shareholder, presumably to advance or protect the interest of that shareholder. The presence of nominee directors in the boardroom can inhibit the open and frank discussion of company affairs.
- The personal ‘chemistry’ between individual board members can have unpredictable consequences.

The board culture reflects the blend of skills and experience brought to the company by the directors.

Agendas

Careful preparation of the agenda enhances board productivity, and strengthens its strategic and supervisory role. At every regular board meeting, directors should:

- Review outstanding major action items from previous meetings.
- Discuss emerging issues that could affect the business.
- Receive reports from the CEO on operational and performance matters and strategic issues.
- Monitor management’s performance and its explanations for variances.
- Review operations for the previous month, year-to-date and forecasts covering the remainder of the relevant accounting period.
- Review and decide on stewardship issues.
- Review and ratify reports from committees.

All of these matters should be documented in the board papers, with discussion focusing on strategic points of particular interest and concern.

A range of other matters that should be periodically included on the board agenda, include the following:

- Business planning.
- Benchmarking against competitors.
- Debate the need to review strategy.
- Management structures.
- Monitoring budgets.
- Strategy formulation and planning (including sustainability).
- Stakeholder relations.
- Formulating and monitoring company policies.
- Evaluating management performance.
- Risk profile and anticipated management actions.
- Reporting controls.
- Code of governance.
- Internal controls - regulatory compliance, general accounting, internal audit, external audit and fraud.
- Funding.
- IT governance.
- Acquisitions, mergers, divestments and takeovers.
- Investor and stakeholder relations.
- Reporting systems.
- Review of delegations.
- Compliance (with laws, rules, codes and standards).
This appears a formidable list of duties, and some of these matters need only be looked at annually or semi-annually. Many of them will be presented to the board in the form of management reports. However, directors should ensure that:

- These reports are read.
- Any issues of concern arising from these reports are queried.
- Problems identified are dealt with in an appropriate manner.

Directors should also be mindful that the agenda minutes and reports may in the future be used as evidence that the individual director has fulfilled his or her fiduciary duties in terms of the business judgement rule.

**Frequency of board meetings/time for deliberation**

The board should meet regularly, at least once a quarter if not more frequently as circumstances require. It should also adopt efficient and timely methods for informing and briefing board members before meetings. The information needs of the board should be well defined and regularly monitored. Each board member should be allowed to play a full and constructive role in its affairs and has a responsibility to be satisfied that the board has been furnished with all the relevant information before making a decision. While boards have traditionally met at least once a quarter, there is increasing evidence that this is no longer sufficient given the substantial demands now placed on directors and particularly non-executive directors. The result is that boards of larger and more complex organisations meet as often as six to eight times a year – based on up to five formally scheduled meetings and another two or so special ones convened to consider specific matters.

In addition to typical directors’ meetings, the Companies Act, 71 of 2008 makes provisions for board meetings to be held by electronic communication and for decisions of the board to be taken by “round robin”, provided all the directors have received notice of the meeting. The majority required for a “round robin” decision does not differ from that of a meeting, unless the MoI provides differently.

**Board meetings**

**Board papers**

A complete record of the resolutions adopted by the board is the best evidence that the board acted with due care. The company secretary should attend all board meetings and should be responsible for maintaining a complete set of board papers (i.e. minutes, agendas, discussion papers, proposals etc.). In terms of s73(6) of the Companies Act, 71 of 2008 the company is required to maintain minutes of all board meetings in the appropriate manner.

**Voting at board meetings**

Each board member including the chairman is entitled to one vote unless otherwise provided for in the MoI. The personal interest of a director, or persons closely associated with the director, must not take precedence over those of the company and its shareholders. A director must not improperly use his/her position to gain a personal advantage or an advantage for someone else, or to cause detriment to the company. Where an opportunity presents itself, and is within the scope of a company’s objectives and activities, directors must seek to obtain any benefit for the company and not for themselves. For further discussion on the common law duties of directors, refer to chapter fourteen of the Toolkit.

In the event of a deadlock, provided the chairman has not already voted, the chairman has a casting vote in terms of s73 of the Companies Act, 71 of 2008. This is not deemed an additional vote, but the same vote he would be entitled to exercise as a director.

In terms of the Companies Act, 71 of 2008 the board has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that the Companies Act, 71 of 2008 or the company’s MoI restricts this power. It is therefore important for the board to familiar with the provisions of the MoI to ascertain whether or not any particular powers of the board have been restricted in the MoI. Further, the Companies Act, 71 of 2008 stipulates certain specific actions which require shareholder approval, either by way of a special resolution of shareholders or an ordinary resolution of shareholders. The matters requiring a special resolution or ordinary resolution are set out below.

**Resolutions – s65**

Ordinary resolutions must be approved by more than 50% of the voting rights exercised in respect of the resolution. Special resolutions must be approved by 75% of the voting rights exercised in respect of the special resolution. The MoI may provide for a higher percentage for ordinary resolutions and for a higher or lower percentage for special resolutions provided that there is at least a 10% difference between the percentage approval required for ordinary and special resolutions. Different percentages may be prescribed in the MoI for resolutions pertaining to different matters.

**The need for special resolutions**

Special resolutions are required to:

- Amend the MoI or ratify a consolidated revision of the MoI.
- Ratify actions by the company or directors in excess of their authority.
- Approve an issue of shares or grant of rights to directors and related companies.
- Approve an issue of shares or securities in excess of 30% of the voting power of the shares or securities in that class.
- Authorise the board to grant financial assistance to directors or prescribed officers or related or inter-related companies.
- Authorise the board to provide financial assistance for transactions in connection with the securities of the company or related or inter-related companies.
- Approve the acquisition by the company of its own shares in certain circumstances.
- Authorise the basis for compensation of directors of a profit company.
- Approve a voluntary winding-up.
- Approve the winding-up of a solvent company by the court.
- Approve the transfer of the company’s registration to a foreign jurisdiction.
- Fundamental transactions.
- Revoke a previous special resolution that gave rise to appraisal rights.
- Such other matters that the MoI requires a special resolution.

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2 Some of these transactions only require shareholder approval by special resolution in certain circumstances as detailed in section 65(1).
The need for ordinary resolutions

Ordinary resolutions are required:

- To approve rules adopted by the board.
- To elect at least 50% of the directors.
- To remove directors.
- To approve a contract in which the director has a personal financial interest, where only one director.
- To approve a contract in which a director has not made prior disclosure of a personal financial interest.
- To appoint the auditors, where required.
- To appoint the audit committee, where required.
- To give certain directions to a liquidator in a voluntary winding up of a solvent company.
- To vary an agreement attached to a prospectus.
- To approve a contract in which a director has not made prior disclosure of a personal financial interest.
- To remove directors.
- To give certain directions to a liquidator in a voluntary winding up of a solvent company.
- To vary an agreement attached to a prospectus.
- To approve a business rescue plan to the extent it alters the rights of the shareholders.
- To appoint the audit committee, where required.
- To remove directors.

In addition, the MoI can require shareholder approval for any matter that the Companies Act, 71 of 2008 does not specifically require shareholder approval.

Board committees

Section 72 of the Companies Act, 71 of 2008 provides that the board can appoint any number of committees to assist it in the discharge of its duties, except to the extent the MoI provides otherwise. Chapter six of the Toolkit provides more information on board structures and processes.

Monitoring and overseeing executive management

In managing and overseeing executive management, the board has to strike a balance between excessive interference or meddling and abdicating its primary responsibilities. In this context the board should take certain initiatives:

- Create a reliable and timely system of performance measurement. Key Performance Indicators (KPIs) might include comparison of actual to budget, segmented data and KPIs benchmarked against competitors’ or industry standards.
- Establish the appropriate level of detail to be provided. Many boards are hindered in their supervisory role because they are swamped by excessively detailed and unnecessary information, yet lack simple, aggregated data.
- Consider both short-term and longer-term performance.
- Encourage the chairman to avoid CEO and management domination of board discussions.
- Arrange to hear directly from managers that report directly to the CEO. This helps the board obtain additional information, gain a different perspective on certain issues, and prevent too much power being concentrated in the CEO’s hands.

Board relationships with managers other than the CEO

How should boards manage their relationships with managers other than the CEO?

There are no hard-and-fast rules. Customary practices in individual companies and common sense are a good place to start. The following other points should be considered:

- Where boards contain executive directors other than the CEO (e.g. COO, CFO, general counsel, etc.), these managers will become well-known to their non-executive board colleagues. Executive directors should be expected to exercise autonomous judgment, and not just follow a pre-determined management ‘line’ (which, in practice, might well be the CEO line). This is a potentially difficult issue. Non-executive directors should try to reach an understanding with the CEO concerning the role of executive directors, particularly their duty to speak up in the shareholders’ interest, even if in so doing they discomfort their management colleagues.
- Some boards ratify certain designated senior management appointments. Issues of CEO succession and management development are relevant here.
- Senior managers, while not members of the board in their own right, may attend board meetings on a regular basis, and will therefore advise the board on matters for which they are responsible or in which they have special expertise. Other managers will make occasional board presentations regarding particular proposals.
- Given their statutory responsibilities, boards should have unfettered access to management. Such access should be exercised discreetly, with non-executive directors conscious of not appearing to be meddling in management matters. Approaches of this kind would normally be for the purpose of obtaining information. Boards may find it useful to develop protocols covering their access to management. These protocols would be most usefully developed in collaboration with the CEO.
- Individual directors should seek informal contact with a cross section of their company’s managers and non-management employees through site visits, social functions and similar events. The purpose of these activities is to help non-executive directors gain an appreciation of the company’s operations, culture and climate.

King III provides that non-executive directors should have access to management and may even meet separately with management, without the attendance of executive directors. This should, however, be agreed collectively by the board, usually facilitated by the non-executive chairman or lead independent non-executive director.

It is interesting that the UK Corporate Governance Code proposes that the chairman should hold meetings with the non-executive directors without the executives present. Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman’s performance and on such other occasions as are deemed appropriate.
The individual director’s perspective

Being offered a seat on the board of a company often is regarded as an honour, recognising an individual’s skills and experience, and a measure of respect for that person’s standing in the business community.

Nonetheless, an individual should think carefully before accepting a board appointment, and consider the following:

- Are you familiar with the responsibilities and obligations of a company director?
- Are you aware of a director’s rights, obligations and duties under the company’s constitution?
- Are you comfortable about assuming a director’s responsibilities and obligations?
- Are you prepared to make a sufficient commitment of your time to do justice to the job?
- Can you add value to the board by virtue of your personal qualities, professional skills, or industry expertise?
- Are there any potential conflict of interest issues?
- Are you familiar with the company – its operations, its performance, its values and its aspirations?
- Have you met the company’s existing directors on the board and do you believe you can work co-operatively and constructively with these people?
- Are you satisfied with the board’s structure and composition (size, mix of executive and non-executive directors, the existence or otherwise of appropriate board committees, etc.)?
- Are you comfortable about assuming a director’s responsibilities and obligations?
- Have you made an assessment of the abilities and integrity of the chairman, the CEO and the other directors?

Prospective directors are advised to undertake their own due diligence on the companies where they are invited to join the board.

Role and function of individual directors

Company directors have a general statutory duty and are expected to act honestly, and with the degree of care, skill and diligence that may reasonably be expected of that person and that function, in discharging their duties. They must act in good faith and for proper purpose in the best interest of the company and must not use their position or the information they gain as a director to the advantage of themselves or others, or to cause harm to the company. Directors failing to meet these obligations may incur personal liability and may, in certain circumstances face criminal liability.

Standards of directors conduct – s76

The Companies Act, 71 of 2008 restates certain common law duties and certain additional statutory duties of directors.

A director (including prescribed officers and board committee members) must:

- Not use the position of director, or any information obtained while acting in the capacity of a director, to:
  - To gain an advantage for himself or any person other than the company or a wholly-owned subsidiary of the company.
  - To knowingly cause harm to the company or a subsidiary of the company.

- Communicate to the board any information that comes to the director’s attention, unless the director reasonably believes that the information is immaterial to the company or generally available to the public or known to the other directors or the director is bound not to disclose that information by reason of confidentiality.

A director of the company, when acting in that capacity, must exercise the powers and perform the functions of director:

- In good faith and for a proper purpose.
- In the best interests of the company.
- With the degree of care, skill and diligence that may reasonably be expected of a person;
  - Carrying out the same functions in relation to the company as those carried out by that director.
  - Having the general knowledge, skill and experience of that director.

These duties effectively re-state a director’s common law fiduciary duties and the duty of care and skill.

The Companies Act, 71 of 2008 includes the “business judgment test” which effectively provides that if the director has taken reasonable steps to be informed, has no material financial interest (or disclosed such financial interest) and has a rational basis to believe the decision was in the best interests of the company, the director will not be liable for a breach of duty, unless the director acted in bad faith or for an improper purpose.

A director is entitled to rely on the information or advice of employees, professional advisors, experts and board committees, provided that the person appears reliable. The Companies Act, 71 of 2008 sets out criteria for each class of persons that must be met prior to a director relying on such person.

Without detailing each of these the general approach appears to be that the person must be qualified in respect of the particular matter and must merit confidence.

Liability of directors and prescribed officers – s77

A director, prescribed officer and a member of a board committee may be held liable for any loss suffered by the company:

- For a breach of fiduciary duty.
- Arising from breaches of the Act or the Ml.
- As a consequence of the director;
  - Acting without the necessary authority.
  - Acquiescing to the company carrying on business recklessly.
  - Being present or participating in a decision or failing to vote against a decision which contravenes the Companies Act, 71 of 2008.
  - Being party to any act or omission intended to defraud.
  - Signing or authorising the publication of any false or misleading financial statements.

The above list is not exhaustive of the provisions of s77 which includes a comprehensive list of acts or omissions which could give rise to liability. In addition, directors could also be liable to third parties, for example to shareholders for fraudulent acts or acts of gross negligence (s206B) or to any third person who has suffered loss by virtue of the directors breaching the Companies Act, 71 of 2008 (s218D(i)).
While the Companies Act, 71 of 2008, to a large extent, has removed many of the criminal offences which were prevalent in the 1973 Companies Act, the potential for civil claims against directors in terms of the Companies Act, 71 of 2008 appears far greater. It is also important to note that members of board committees and prescribed officers will have the same liability as directors under s77 even if the members of the board committees or prescribed officers are not directors and even though they have no right to vote on any matters considered at board committees.

**Indemnification and directors’ insurance – s78**

A company may not indemnify a director against liability arising from:

- Wilful misconduct or breach of trust by the director.
- The director acting without the necessary authority.
- Reckless trading.
- Fraudulent acts of the director.
- A fine related to an offence committed by the director unless the fine was based on strict liability. (There are limited exceptions to the prohibition on payment of fines).

Other than the specific instances mentioned above, a company may indemnify a director in respect of any liability, including the liability arising from a directors’ negligence. A company may also purchase insurance to protect a director or the company against any liability in respect of which the company is permitted to indemnify a director.

**Number of directorships**

King III states that executive directors should be encouraged, in consultation with the chairman of the board, to take other non-executive directorships, provided these are not detrimental to their immediate responsibilities as an executive director of the company.

On the other hand, non-executive directors should be judicious in the number of directorships they accept, in order to ensure that they do full justice to their onerous responsibilities.

**Director’s rights**

To assist directors in the effective performance of their duties, directors have the following rights:

- To receive timely, balanced reports on performance.
- Separate meetings by non-executive with management, provided board approval given and chaired by the chairman.
- Access to necessary independent advice at company expense.
- Unrestricted access to information relating to the company.

**Removal of directors – s71**

A director may be removed by an ordinary resolution passed by shareholders. The director concerned must be given notice of the meeting and be afforded reasonable opportunity to make a representation on the matter before a vote is taken by the shareholders. The board may remove a director whom it has determined is ineligible, disqualified, incapacitated, negligent or guilty of dereliction of duty. Nothing in the Companies Act, 71 of 2008 precludes a director who has been removed from claiming damages for loss of office.

**Register of directors**

Every company must keep a register recording certain prescribed particulars of its directors (s24(3) and s24(6)). There is no obligation to keep a register of prescribed officers.

**Director resignation**

On written notice to the board, a director may resign from his position as a director. Alternately if he decides he will not be standing for re-election, where his/her term of office is due to expire, this constitutes a resignation.

Section 69 of the Companies Act, 71 of 2008 sets out the grounds for when a person is ineligible or disqualified to be a director. A person is disqualified from being a director of a company for various reasons including if a court has prohibited that person from being a director, or declared the person to be delinquent, or the person has been removed from an office of trust or convicted of certain specified crimes or is an unrehabilitated insolvent or is prohibited by public regulation.

**Appointment and election of directors**

A profit company must allow for shareholders to elect a minimum of 50% of the directors and alternate directors. The remaining directors may be appointed by any other person stipulated in the MfO.
Directors and Prescribed Officers
5

Introduction
Leadership in the corporate governance context deals with who leads the company and how such leadership is encouraged to achieve its objectives. This includes succession, remuneration, appointment, roles and functions of directors and management.

Definition of directors and prescribed officers
The definition of “director” includes alternate directors and de facto directors. Generally, where the Companies Act, 71 of 2008 deals specifically with the duties, liabilities etc of directors, these provisions also apply to board committee members and prescribed officers, even though these persons are not directors.

A “prescribed officer” is a person who exercises (or regularly participates to a material degree in the exercise of) general executive control over and management of the whole or a significant portion of the business or activities of the company (Regulation 38).

Directors and prescribed officers
A private company or personal liability company requires at least one director and a public company and a non-profit company requires at least three directors in addition to the minimum number of directors that may be required for the audit committee or social and ethics committee where the company is required to have such committees. If a single director is able to serve on more than one committee, this reduces the actual minimum number required.

Only a natural person with full legal capacity is eligible to be a director. The MoI may also set out minimum qualifications for directors.

A person is disqualified from being a director of a company for various reasons including if a court has prohibited that person from being a director, or declared the person to be delinquent, or the person has been removed from an office of trust or convicted of certain specified crimes or is an unrepatriated insolvent or is prohibited by public regulation.

A profit company must allow for shareholders to elect a minimum of 50% of the directors and the alternate directors. The remaining directors may be appointed by any other person stipulated in the MoI.

If the number of directors is below the minimum required by the Companies Act, 71 of 2008 or the MoI, this does not limit or negate the authority of the board, or invalidate anything done by the board or the company.

The board is obliged, within forty business days, to convene a shareholders meeting to elect directors (s67), if the number of directors falls below the minimum.

Chairman
All boards should be subject to the firm and objective leadership of a chairman that brings out the best in each director.

The chairman’s primary function is to preside over meetings of directors and to ensure the smooth functioning of the board in the interest of good corporate governance. The chairman will usually also preside over the company’s shareholder meetings.

The role and function of the chairman should be formalised even though it is influenced by such matters as the size or particular circumstances of the company, the complexity of its operations, the qualities of the CEO, the management team, and the skills and experience of each board member.

There are a number of common, core functions performed by the chairman, which are listed in the King III report and they generally include:

• Ethical leadership of the board, company and directors.
• Director succession, performance and training.
• Running effective board meetings.
• Ensuring sound stakeholder relations.

While recognising that there may be circumstances justifying the combination of the roles of chairman and CEO, in principle it is better that these two distinctive functions are kept separate. This is also a King III principle. The chairman is primarily responsible for the working of the board. This position is made more onerous by the complex environment in which many modern companies now operate. The CEO’s task is to run the business and to implement the policies and strategies adopted by the board.

The board should appraise the performance of the chairman on an annual basis. If the roles of chairman and CEO are combined, the independent deputy chairman or the lead independent director must play a leading role in the evaluation process.

Chief Executive Officer (CEO)
The role of the CEO is seen as critical to the performance of public companies. CEOs are expected to provide:

• Leadership.
• Strategic vision.
• High-level business judgement and wisdom.
• The ability to meet intermediate performance targets without neglecting longer-term growth opportunities.

Clearly, CEOs are responsible for more than just the day-to-day running of the business and passing on the board’s instructions. Indeed, in most modern organisations, few major decisions are taken without CEO input, and this input is often decisive. CEOs wield considerable delegated authority in their own right, and they set the ‘tone’ of their organisations.

King III has noted the critical and strategic role the CEO plays in the operational success of the company’s business. For this reason, as already indicated, the role of the CEO should be separate from that of the chairman.
Some of the important functions that a CEO fulfils are usually to:

- Develop and recommend to the board the long-term strategy and vision for the company that will generate satisfactory levels of shareholder value and positive, reciprocal relations with relevant stakeholders.
- Develop and recommend to the board annual business plans and budgets that support the company’s long-term strategy.
- Strive consistently to achieve the company’s financial and operating goals and objectives, and ensure that the day-to-day business affairs of the company are appropriately monitored and managed and are in compliance with all relevant laws and governance principles.
- Ensure continuous improvement in the quality and value of the products and services provided by the company, and that the company achieves and maintains a satisfactory competitive position within its industry.
- Ensure that the company has an effective management team that actively participate in the development of management and succession planning (including the CEO’s own position).
- Formulate and oversee the implementation of major corporate policies.
- Serve as the chief spokesperson for the company.
- Develop and recommend to the board the long-term strategy and vision for the company that serves as the company’s principal servant and (usually) its highest-paid employee.
- Ensure that the day-to-day business affairs of the company are appropriately monitored and managed and are in compliance with all relevant laws and governance principles.
- Develop standards and processes for evaluating CEO performance.
- Negotiate appropriate CEO compensation.
- Incorporate the CEO as part of the board team whilst respecting his/her position as the company’s principal servant and (usually) its highest-paid employee.
- Serve as the chief spokesperson for the company.

Succession planning

There are no hard-and-fast rules for CEO succession planning. Each company’s needs are unique and they change over time, as does the available pool of talent from which a new CEO can be drawn. However, the NACD Commission identifies five core principles of succession planning that it believes will help boards choose a succession process that best meets their circumstances.

1. The right leader at the right time

Not only do companies’ leadership needs change, CEO performances can change, as can their commitment to and passion for the job. As the Commission noted, “Well-timed transition to new leadership enhances long-term shareholder confidence and value.” This means that directors should not allow themselves to be locked into distant, pre-determined CEO retirement dates – they must be prepared to make a change earlier if they believe it is in the best interests of the organisation. Boards should drive the succession process, although in collaboration with the incumbent CEO. There should be no question of a CEO having an unlèfted right to choose his/her successor.

2. Continuous process

Boards should know how long their present CEO can or should continue in the position. They should know what steps are necessary to find a successor and who could step in should the CEO depart suddenly and unexpectedly.

3. Talent-rich organisation

Boards need to satisfy themselves that the incumbent CEO is building a talent-rich organisation by attracting and developing the right people. By following this policy, companies increase their chances of finding high-calibre internal candidates for the CEO position.

4. Driven by corporate strategy

Boards should align CEO selection criteria with their companies’ strategic directions, and understand what their strategy calls for in terms of executive leadership.

Boards need to think through how they can approach the difficult issues associated with CEO succession planning.

5. Internal or external?

Some boards prefer to find a new CEO internally (i.e. from within their companies’ existing management ranks). Internal successors can assume the role without a lengthy familiarisation and learning process. Moreover, boards unable to source their CEOs internally risk being accused of neglecting their management development and succession planning responsibilities.

However, there are circumstances when an outside CEO might be preferred, such as when directors want a major and rapid reorientation in a company’s culture and strategy, or when deteriorating finances demand radical restructuring. Responsible boards might also want to benchmark internal CEO candidates against the available outside talent, although in practice this can be difficult.

When to name a new CEO

Boards sometimes select a CEO heir – apparent well in advance of the incumbent CEO’s planned departure. This is not always a wise move – it can unleash complex psychological forces that cause problems for the CEO, the successor, the board and other top managers. Other boards choose to identify a pool of potential CEOs (internal and/or external), delaying selection of a specific successor until relatively late in the process.

CEO’s contract of service

The agreement will usually define the selected CEO’s powers, prescribe remuneration and other benefits, and prohibit the CEO from having an interest in any competing company.
CEO’s role in succession
CEO’s views on the succession question should be sought. However, CEO selection is ultimately a board responsibility, and specifically that of the non-executive directors. Boards should have a say in all senior management appointments, not just that of the CEO (usually through the nominations committee).

Reluctant departures
Boards should reach a firm understanding with their CEOs on the timing of their eventual retirement/departure, and this should then become a non-negotiable deadline around which succession planning revolves.

Former CEOs as directors
It is no longer common practice for retiring CEOs to remain on their boards in a non-executive capacity, or for retiring CEOs to assume the chairman’s role and certainly not within three years (King III). The main difficulty is that the new CEO feels he/she is being ‘second guessed’ by a predecessor, fearing that the former CEO is influencing the board to meddle in management matters. It can also be difficult for a new CEO to recommend necessary changes in strategic direction if these can be seen as rejecting strategies introduced by a former CEO that continues to wield influence in the boardroom.

Chief Financial Officer (CFO)

Role and function of the CFO
The role of the CFO has changed significantly over time. Much research has been conducted on the effects of the global financial crisis on the roles and responsibilities of CFOs. KPMG state that CFOs can be categorised into six profiles: internal growth leaders, cost cutters, external growth leaders, business transformers, finance specialists and risk moderators.

In 2008, SAICA developed a model for the key focus areas of CFOs, which identified four roles:

1. Planner and strategist
Providing financial leadership through financial planning and strategies aligned with business strategies.

2. Compliance and transaction officer
Taking responsibility for transactional and financial reporting, compliance and strategy implementation.

3. Growth and innovation catalyst
Continuously finding new ways of creating shareholder value by looking outside of the organisation.

4. Corporate governance, citizenship and people manager
Helping to build corporate governance structures, taking up responsibilities of the organisation as a good corporate citizen and nurturing relationships inside and outside the organisation.

Chief Operating Officer (COO)
Companies today want to position themselves for renewed growth while staying lean and mean. As COO, it’s their job to make that happen. COOs are expected to improve their company’s inventory and working capital management, manufacturing capacity, return on assets and product lifecycle. They’re also on the hook for increasing global operations and tapping emerging markets and low-cost supply sources. All while staying current on business issues ranging from operations risk and international tax to environmental sustainability.

Compliance Officer (CO)
King III states that “compliance should form an integral part of the risk management process”. The risk of non-compliance should be identified, assessed and responded to in the risk management process. The establishment of a compliance function should be considered as this may provide assistance to the board and management in complying with applicable laws, rules, codes and standards.

The compliance function is an independent function, which is associated with all aspects of compliance, including the monitoring of the compliance risk process. It is imperative that the CO has the necessary rights and powers to fulfill this role impartially and effectively. The Compliance Institute of South Africa has divided the compliance officers’ responsibilities into the following areas:

1. Standard setting
Set standards for achieving compliance with the relevant regulations.

2. Providing advice
Providing a central point of reference and expertise in compliance-related matters and, in particular, advise on the policy and strategic decisions that might have compliance implications.

3. Monitoring
The implementation of the entire compliance process and the subsequent monitoring of the level of compliance within the business.

4. Maintaining external relations
The CO must strengthen the working relationship with the Regulators.

5. Resolving issues of non-compliance
The CO is not only responsible for the reporting of issues of non-compliance through to the monitoring process, but is also required to resolve issues of non-compliance efficiently and effectively.

6. Training
As part of the responsibility to enhance a compliance culture, responsibility for promoting an effective compliance system through appropriate training interventions and awareness campaigns is part of the responsibilities of the CO.

7. Assisting with ad-hoc investigations
The CO may be requested to become involved in multi-disciplinary projects.

Chief Risk Officer (CRO)

As management, and specifically the CEO is accountable to the board for designing, implementing and monitoring the risk management process, as well as providing assurance that the process is in place and working, many companies have introduced CROs (CROs are dealt with in more detail in chapter ten of the Toolkit).

Company secretary

Section 86 of the Companies Act, 71 of 2008 requires all public companies and state-owned companies to appoint a company secretary who is knowledgeable or experienced in the relevant laws. The company secretary must be a permanent resident of the Republic, and must remain so while serving in that capacity.

Company secretary duties – s88

A company secretary’s duties include, but are not restricted to:

- Providing the directors of the company with guidance as to their duties, responsibilities and powers.
- Making the directors aware of any law relevant to or affecting the company.
- Reporting to the company’s board any failure on the part of the company or a director to comply with the Companies Act, 71 of 2008.
- Ensuring that minutes of all shareholders meetings, board meetings and the meetings of any committees of the directors, or of the company’s audit committee, are properly recorded in accordance with the Companies Act, 71 of 2008.
- Certifying in the company’s annual financial statements whether the company has filed required returns and notices in terms of this Companies Act, 71 of 2008.
- Ensuring that a copy of the company’s annual financial statements is sent to every person who is entitled to it.
- Ensuring a person is responsible for compliance by the company with the transparency and accountability provisions set out in the Companies Act, 71 of 2008.

King III – company secretary responsibilities

King III states that the appointment and removal of the company secretary is a matter for the board and that the company secretary ideally should not be a director of the company.

King III goes wider than the Companies Act, 71 of 2008 in recommending the responsibilities of the company secretary and in addition to the Companies Act, 71 of 2008 recommends that the company secretary:

- Assist the nomination committee with appointments and the board with all the performance appraisals.
- Assist with director induction, training and education.
- Keep the board charter and committee terms of reference up to date.
- Be responsible for board documentation/papers, compilation and circulation.

The public sector and directors of state owned enterprises

The South African public sector, not unlike many other public sectors, is very regulated, which obviously directly influences the roles of directors in the public sector.

With reference to the public sector, the term director in this Toolkit is used to generally refer to the member of a board, and not to the term director as opposed to chief director or director general or director, commonly used in government departments.

The term public sector furthermore includes all public entities as listed by National Treasury in terms of Section 47(1) of the PFMA (latest update December 2010) and also municipal entities as defined in Section 1 of the MFMA and Section 1 of the Municipal Systems Act, Act 32 of 2000. In practice, this means that the term director refers to a member of a board of a public entity at any of the three spheres of government, i.e. national, provincial and local.

Two pieces of legislation are core to the functioning of the public sector, and specifically the responsibilities of boards and directors in the public sector, namely:

- The Public Finance Management Act, Act No 1 of 1999 (PFMA), affecting specifically the national and provincial spheres of government.

The roles and responsibilities of directors are clearly dealt with in these Acts, supported by further legislation, as will be highlighted in the paragraphs to follow.

The “basic values and principles governing public administration” can be found in Section 195 of the Constitution. These nine principles provide clear guidance for all stakeholders and all role-players in all organs of state (thus also all public entities and public institutions at all three spheres of government, and although not an exhaustive list, it is imperative to closely scrutinise and understand these principles as the guiding and even mandating parameters for all boards and all directors of such boards.

Subsection 195(1) reads as follows:

“(1) Public administration must be governed by the democratic values and principles enshrined in the Constitution, including the following principles:

(a) A high standard of professional ethics must be promoted and maintained
(b) Efficient, economic and effective use of resources must be promoted
(c) Public administration must be development-oriented
(d) Services must be provided impartially, fairly, equitably and without bias
(e) People’s needs must be responded to, and the public must be encouraged to participate in policy-making
(f) Public administration must be accountable
(g) Transparency must be fostered by providing the public with timely, accessible and accurate information
(h) Good human-resource management and career-development practices, to maximise human potential, must be cultivated
(i) Public administration must be broadly representative of the South African people, with employment and personnel management practices based on ability, objectivity, fairness, and the need to redress the imbalances of the past to achieve broad representation.”
The public sector is very dynamic and changes are frequent and sometimes far-reaching. The sections below address the situation as at the date of writing, and thus does not incorporate imminent changes, such as the changes that may flow from the Presidential Review Committee led by Prince Riyyah Phiyega currently reviewing important aspects of public entities at all three spheres of government.

**Responsibilities in terms of the PFMA and the MFMA**

There is a fundamental difference in approach between these two Acts, directly and clearly affecting the roles and responsibilities of boards in the national/provincial spheres of government, as compared to the local (municipal) sphere of government.

The PFMA places the responsibilities of the ‘accounting authority’ in the hands of (usually) the board, while the MFMA places similar responsibilities in the hands of the CEO. The responsibilities for members of boards of public entities (including state-owned enterprises, public enterprises and similar terms used) at the provincial and national spheres would thus be quite different to the responsibilities for board members at municipal entities.

<table>
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<tr>
<th>Core responsibilities for public entities, municipal entities, “parastatals” and state-owned enterprises rest with:</th>
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<tbody>
<tr>
<td>PFMA – thus for national and provincial entities</td>
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<tr>
<td>MFMA – thus for municipal entities</td>
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</table>

In Section 1 of the PFMA, “accounting authority” is described as “a body or person mentioned in section 49.” The latter indicates firstly that “(e)very public entity must have an authority which must be accountable for purposes of this Act”. It continues that if such public entity “has a board or other controlling body, that board or controlling body is the accounting authority for that entity” or if it “does not have a controlling body, the CEO or the other person in charge of the public entity is the accounting authority for that public entity unless specific legislation applicable to that public entity designates another person as the accounting authority”.

A third alternative is that the relevant treasury (i.e. National Treasury for a national public entity (as listed in Schedules 1, 2 and 3 of the PFMA) or the provincial treasury (for Schedule 3C and 3D provincial public entities)) “may approve or instruct that another functionary of a public entity must be the accounting authority for that public entity”.

Since most national and provincial public entities do have boards as their controlling bodies, the members of such boards collectively serve as the “accounting authority”.

The MFMA takes a different approach for municipal entities. The term “accounting authority” is not used at all, but the Act describes “accounting officer” of a municipal entity to mean “the official of the entity referred to in section 93”. Section 93 then determines that “(t)he Chief Executive Officer of a municipal entity appointed in terms of section 93J of the Municipal Systems Act, Act 32 of 2000 (as amended) is the accounting officer of the entity”.

Section 90J of the Municipal Systems Act reads as follows:

“(1) The board of directors of a municipal entity must appoint a Chief Executive Officer of the municipal entity.

(2) The Chief Executive Officer of a municipal entity is accountable to the board of directors for the management of the public entity.”

It is clear that the MFMA holds the CEO of the municipal entity responsible for matters and issues in such Act, while the PFMA assigns similar responsibilities to (mostly) the boards of public entities. Members of boards at the national and provincial spheres are expected to be more hands-on and are legally bound to be more direct and active participation, than is the case with board members of municipal entities.

Constitutional Institutions (also known as Schedule 1 institutions) are dealt with similarly to government departments. Schedule 3A (national) and 3C (provincial) entities are also similar to the “centre”, while Schedule 3B (national) and 3D (provincial) public entities have more freedom, and are similar to Schedule 2 (Major Public Entities) somewhat distant from the state and especially the budget of the state.

Treasury Regulations (TR) in terms of the PFMA have been published in March 2005 as a single set. The applicability of such regulations can be summarised as follows (as per TR 1.2.1):

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<th>Departments</th>
<th>Regulations 1 to 24 and Regulation 26</th>
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<tr>
<td>Constitutional Institutions</td>
<td>Regulations 1 to 22</td>
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<tr>
<td>Public entities in Schedules 3A and C</td>
<td>Regulations 6.1.2, 16, 16A, 24 to 28, and 30 to 33</td>
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<tr>
<td>Public entities in Schedules 3B and D</td>
<td>Regulations 6.1.2, 16, 24, 25, 27 to 29, and 31 to 33</td>
</tr>
<tr>
<td>Public entities in Schedule 2</td>
<td>Regulations 6.1.2, 24, 25, 27 to 31, and 33</td>
</tr>
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</table>
Chapter 6 of the PFMA deals with public entities specifically, while Part 2 of this chapter specifically refers to “Accounting authorities for public entities”. Chapter 6 consists of three parts, dealt with as follows:

Part 1: Application of this chapter

Section 46 Application

Section 47 Unlisted public entities (see also TR 25 (“Application and Listings”))

Section 48 Classification of public entities

Part 2: Accounting authorities for public entities

Section 49 Accounting Authorities

Section 50 Fiduciary duties of accounting authorities

Section 51 General responsibilities of accounting authorities

Section 52 Annual budget and corporate plan by Schedule 2 public entities

Section 53 Annual budgets by non-business Schedule 3 public entities

Section 54 Information to be submitted by accounting authorities

Section 55 Annual report and financial statements

Part 3: Other officials of public entities

Section 56 Assignment of powers and duties by accounting authorities

Section 57 Responsibilities of other officials

Sections 58 to 62 Repealed by the Public Audit Act

All sections of this part of chapter six are important, but the core of the responsibilities of board members are dealt with in sections 50 and 51, which will be looked at in some detail.

Section 50 (“Fiduciary duties”) can be summarised as follows:

(1) The Accounting Authority must:

(a) exercise duty of utmost care to ensure reasonable protection of the assets and records of the public entity

(b) act with fidelity, honesty, integrity and in the best interests of the public entity in managing the financial affairs of the public entity

(c) on request disclose the Executive Authority or Parliament/the legislature all material facts which in any way may influence the decisions or actions of the Executive Authority or Parliament or the legislature

(d) seek to prevent any prejudice to the financial interests of the state.

(2) A member of an Accounting Authority or the Accounting Authority (if not a board or other body) may not:

(a) act in a way which is inconsistent with the responsibilities assigned to an Accounting Authority in terms of this Act

(b) use the position or privileges of, or confidential information obtained as, Accounting Authority for personal gain or to improperly benefit another person.

(3) A member of an Accounting Authority must:

(a) disclose to the Accounting Authority any direct or indirect personal or private business interest that that member or any spouse, partner or close family member may have in any matter before the Accounting Authority

(b) withdraw from the proceedings of the Accounting Authority when that matter is considered, unless the Accounting Authority decides that the member’s direct or indirect interest in the matter is (i) trivial or (ii) irrelevant (provisions quite similar to the situation with municipal entities, as captured in section 90H of the Municipal Systems Act).

“General responsibilities of accounting authorities” (section 51) can be summarised as follows:

(1) The Accounting Authority:

(a) must ensure that the public entity has and maintains (i) effective, efficient and transparent systems of financial and risk management and internal controls, (ii) a system of internal audit under the control and direction of an audit committee, (iii) an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective (verbatim repetition of the wording of Section 217 of the Constitution of the Republic of South Africa, 1996), and (iv) a system for properly evaluating all major capital projects prior to a final decisions on the project

(b) must take effective and appropriate steps to (i) collect all revenue due to the public entity, and (ii) prevent irregular, fruitless and wasteful expenditure, losses resulting from criminal conduct and expenditure not complying with the operational policies of the PE, and (iii) manage available working capital efficiently and economically

(c) is responsible for the management, including the safeguarding, of the assets and for the management of the revenue, expenditure and liabilities of the public entity

(d) must comply with any tax, levy, duty, pension and audit commitments as required by legislation

(e) must take effective and appropriate disciplinary steps against any employee who (i) contravenes or fails to comply with a provision of the PFMA, (ii) commits an act which undermines the financial management and internal control system of the public entity, or (ii) makes or permits an irregular expenditure or a fruitless and wasteful expenditure
(f) is responsible for the submission of the public entity of all reports, returns, notices and other information to Parliament or the provincial legislature and to the relevant executive authority or treasury, as may be required by the PFMA

(g) must promptly inform National Treasury on any new entity which that public entity intends to establish or in the establishment of which it takes the initiative, and allow National Treasury a reasonable time to submit its decision prior to formal establishment, and

(h) must comply, and ensure compliance by the public entity, with the provisions of the PFMA and any other legislation applicable to the public entity.

(2) If an accounting authority is unable to comply with any of the responsibilities of this part (thus sections 93A to 95A), the accounting authority must promptly report the inability, together with reasons, to the relevant executive authority and treasury.

Boards of municipal entities

The fact that the PFMA and the MFMA place final responsibility for certain aspects of the two Acts on the shoulders of different bodies (i.e. boards for national and provincial entities) and the CEO for municipal entities, should not be construed to assume that the role of directors in municipal entities would imply a total lack of and/or limited responsibility. This part provides a general overview of the responsibilities of and related issues around directors at municipal entities.

In Part 6 of the Municipal Systems Act, and specifically in Section 93E, it is determined as follows (“Appointment of directors”):

“(1) The board of directors of a municipal entity:

(a) must have the requisite range of expertise to effectively manage and guide the activities of the municipal entity

(b) must consist of at least a third non-executive directors

(c) must have a non-executive chairman.

(2) The parent municipality of a municipal entity must, before nominating or appointing a director, establish a process through which:

(a) applications for nomination or appointment are widely solicited

(b) a list of all applications and any prescribed particulars concerning applicants is compiled

(c) the municipal council makes the appointment or nomination from such list.”

Section 93F deals with “Disqualifications”:

“(1) A person is not eligible to be a director of a municipal entity if he or she;

(a) holds office as a councillor of any municipality

(b) is a member of the National Assembly or a provincial legislature

(c) is a permanent delegate to the National Council of Provinces

(d) is an official of the parent municipality of that municipal entity

(e) was convicted of any offence and sentenced to imprisonment without the option of a fine, and a period of five years since completion of the sentence has not lapsed

(f) has been declared by a court of law to be of unsound mind

(g) is an unrebuilt insolvent.

(2) If a director of a municipal entity during that person’s term of office becomes disqualified on a ground mentioned in subsection (1), such person ceases to be a director from the date of becoming disqualified.”

Section 93G is headed “Removal or recall of directors”:

“The parent municipality of a municipal entity may remove or recall a director appointed or nominated by that municipality:

(a) if the performance of the director is unsatisfactory

(b) if the director, either through illness or for any other reason, is unable to perform the functions of office effectively

(c) if the director, whilst holding office;

(i) is convicted of fraud or theft or any offence involving fraudulent conduct

(ii) has failed to comply with or breached any legislation regulating the conduct of directors, including any applicable code of conduct.”

Section 93H then goes on to deal directly with the important aspect “The duties of directors”:

“(1) The board of directors of a municipal entity must:

(a) provide effective, transparent, accountable and coherent corporate governance and conduct effective oversight of the affairs of the municipal entity

(b) ensure that it and the municipal entity comply with all applicable legislation and agreements

(c) communicate openly and promptly with the parent municipality of the municipal entity

(d) deal with the parent municipality of the municipal entity in good faith.

(2) A director must:

(a) disclose to the board of directors, and to the representative of the parent municipality, any direct or indirect personal or business interest that the director or his or her spouse or partner may have in any matter before the board, and must withdraw from the proceedings of the board when that matter is considered, unless the board decides that the director’s direct or indirect interest in the matter is trivial or irrelevant

(b) at all times act in accordance with the Code of Conduct for directors referred to in section 93L.”

Section 93L deals with the matter of “Meetings of board of directors”, and specifically in two subsections:

“(1) Meetings of the board of directors of a municipal entity must be open to the municipal representatives referred to in section 33D(1)(a).” In the latter it is stated that the council of a parent municipality “must designate a councillor or an official of the council of a parent municipality, or both, as the representative or representatives of the parent municipality ... to represent the parent municipality as a non-participating observer at the meetings of the board of directors of the municipal entity concerned.”

Subsection (2) of section 93L reads as follows:

“Municipal representatives referred to in section 33D(1)(a) have non-participating observer status in a meeting of the board of directors of a municipal entity.”

Also refer to Sections 93K (“Establishment of and acquisition of interests in corporate bodies disallowed”) and 93L (“Code of Conduct for directors and members of staff of municipal entity”). The latter highlights that “the board of directors ... may investigate and make a finding on any alleged breach of a provision of this Code by a director” or “establish a special committee to investigate ... or to make appropriate recommendations to the board of directors”. It furthermore gives the board four options if the board or the committee finds that a director has breached a provision of this Code, namely to:

- Issue a formal warning to the director.
- Reprimand the director.
- Fine the director.
- Recommend to the parent municipality that the director be removed or recalled (in terms of Section 93G).

It also requires that the board must inform the parent municipality of “any action taken against a director”.

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Board Structures and Processes
Corporate governance process

The corporate governance process set in place and carried out by the board is critical to the protection of all aspects of stakeholders’ interests.

The Organisation for Economic Co-operation and Development (OECD) in its 2004 statement OECD Principles of Corporate Governance summarised the minimum standards required in corporate governance and, in defining the responsibilities of the board, stated:

“The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.”

Delegation

King III speaks about boards defining levels of materiality, reserving specific matters to itself and delegating other matters to management with the necessary written authority. Without reducing the directors’ responsibilities, there are also certain tasks that are commonly delegated to various board committees.

Due regard should be taken, though, of directors’ statutory and fiduciary responsibilities to the company and, more especially, of their responsibility to monitor and evaluate the tasks delegated to management on a regular basis. The challenge in this area is striking the right balance between excessive involvement in executive management and abdication of the board’s duties.

The following matters should be addressed:

- The establishment of a reliable and timely system of performance measurement, which the board and management accept, including:
  - Regular comparisons of achieved levels of revenue, costs, profit and returns on assets and shareholders’ funds, with budgets.
  - Benchmarking of performance against relevant competitors in the specific industry.
- The level of detail provided. Many boards are hindered in their supervisory role by having excessive unnecessary information, and not enough simple, aggregate information (e.g. financial trends that drive cash flows).
- The provision of timely and accurate information to directors.
- The balance between the short-term and long-term elements of the business. This includes performance in the area of market development and market share, product development and research, management and organisational development, labour relations, productivity and techno-logical development, share market status and market capitalisation.
- The measurement and optimal use of the capacities of all the board members. An important duty of directors is to ensure that the chairperson is a person sufficiently skilled in this area. The chairperson should maintain control of board meetings, particularly during debates, and where it is necessary for majority decisions to be taken in difficult circumstances.

The board should regularly meet with those people that report directly to the CEO to enable further information to be obtained and to avoid all power being concentrated in the CEO’s hands. This enables a wider perspective of information to be obtained.

The duty of care, skill and diligence/business judgement rule

Directors are required by law to exercise the necessary care, skill and diligence in the performance of their duties.

The practical aspects of this requirement are:

- “Care” is not synonymous with “caution”. Risks are an essential part of business and, as such, the Courts have attempted to preserve the board’s ability to be innovative by focusing on the behaviour and mental condition of directors at the time decisive action was taken, and placing less weight on the actual outcome of decisions. Individual directors should therefore be most concerned about the manner by which they and their colleagues reach decisions.
- In order for directors “reasonably to believe” that their actions are in the best interests of the company, they must be adequately informed on the matter under consideration. The nature and extent of the information to be considered by the directors will vary according to the complexity and importance of the matter at hand, and directors should apply their judgement to specific situations.

When making decisions, directors must reasonably believe that they are acting in the company’s best interests and must act with the care that an ordinarily prudent person in a like position would exercise under similar circumstances.

The terms “ordinarily prudent” and in a “like position” imply that directors are expected to act with the same good sense, judgement and attention to detail that would be expected of a hypothetical director with similar attributes under similar circumstances. Directors will therefore be evaluated in the light of both the particular circumstances they faced when making a decision and any special expertise they possess.

Directors must exercise care, skill and diligence in carrying out their duties. The Companies Act, 71 of 2008 s76 states that a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director:

- In good faith and for a proper purpose.
- In the best interests of the company.
- Having the general knowledge, skill and experience of that director.

These duties effectively re-state a directors common law fiduciary duties and the duty of care and skill.

The courts have provided guidance in this regard, and the principles summarised by Judge Margo in Fisheries Development Corporation of SA Ltd v Jorgensen [1980 4 SA 156(W)] as follows:

- The extent of a director’s duty of care, skill and diligence depends to a considerable degree on the nature of the company’s business and on any particular obligations assumed by or assigned to him. There is a difference between the full-time or executive director who participates in the day-to-day management of the company’s affairs and the non-executive director who has not undertaken any special obligation. The latter is not bound to give continuous attention to the affairs of the company.
- A director’s duties are of an intermittent nature, to be performed at periodical board meetings and at any other meetings, which may require his attention. He is not, however, bound to attend all such meetings, though he ought to whenever he is reasonably able to do so.
- A director is not required to have special business acumen or expertise, or singular ability or intelligence or even experience in the business of the company. He is, however, expected to exercise the care, which can reasonably be expected of a person with his knowledge and experience.
- A director is not liable for mere errors of judgement.
- In respect of all duties that may properly be left to some other official, a director is, in the absence of specific grounds for suspicion, justified in trusting that official to perform such duties honestly. He is entitled to accept and rely on the judgement, information and advice of the management, unless there are proper reasons for questioning such. Obviously, a director exercising reasonable care would not accept information and advice blindly. He would accept it, and he would be entitled to rely on it, but he would give it due consideration and exercise his own judgement accordingly.
In the Companies Act, 71 of 2008 and King III, the “business judgement rule” is recognised as a separate and distinct concept whilst being complementary to the duty of care. The rule essentially protects directors against being held accountable for business decisions, however unwise they subsequently turn out to be, if they were made on an informed basis, in good faith and without any conflict of interest, and if the decision was rational at the time in the circumstances. This rule originated in the United States.

Common law and statutory obligations aside, directors wishing to make a worthwhile contribution to their companies and shareholders will need to keep themselves well informed across a range of matters, including:

- Their company’s business.
- Their company’s product lines.
- Risk assessment processes (i.e. the major risks faced by the company and the controls and policies put in place to manage these risks within the limits set by the board).
- The delegation of board authority to management.
- Acquisitions, mergers and takeovers.
- Economic and business issues (local and global) facing their company.
- Committee and board evaluations.
- Internal and external audit functions.
- Human resources policies.
- IT dependency and requirements.
- Internal controls (including financial controls).
- Long-term or scenario planning and strategy.
- Specific problems affecting the business at any particular time.
- Environmental and stakeholder issues (sustainability issues).
- The values, ethics and culture of the company.
- Short-term and long-term finance arrangements.

Generally, directors are expected to have at least a basic knowledge of financial reports and be capable of reading and interpreting them.

**Considering complex transactions**

A good test of any board’s mettle is the way it handles complex and significant transactions, such as new share issues, large foreign exchange exposures or transactions that might lead to a change in control of the company. As these kinds of transactions sometimes result in litigation, boards are well advised to proceed with great care.

Unless a company’s constitution provides otherwise, the directors of a company may delegate any of their powers to a committee, a director or, an employee of the company. In these circumstances, boards can delegate to management the maximum value of any transaction or the maximum level of risk associated with any transaction that management may incur. Any transaction exceeding these delegations must be referred for decision.

The board’s response to complex/significant transactions (e.g. an issue of new shares to the public, foreign currency transactions, transactions that change the control structure of the company) requires:

- Details of the proposed transaction.
- Consideration of alternatives.
- Due diligence – use of independent experts (e.g. accountants, bankers, financial advisors and lawyers).
- Complete records of the board’s deliberations.

In the event of a majority decision, it may be relevant, where the matter is significant, for a dissenting minority to require that their dissent be recorded in the board minutes. In certain circumstances, the dissent may be so significant that it may result in the resignation of the dissenting board members.

Directors of public companies that resign in these circumstances should advise the committee of the JSE Securities Exchange, and the audit engagement partner, of their resignation and the circumstances that gave rise to it.

**Independent professional advice**

No matter how well qualified and diligent they might be, there will be times when directors will seek outside advice and counsel. Such activity should not be confused with second guessing management – in certain circumstances directors are obliged to obtain independent, expert and objective advice on matters before them. Indeed, failure to seek external advice may expose directors to risk of legal action by regulators and/or disgruntled shareholders. Mergers, acquisitions and divestments are a case in point.

In other circumstances, resort to outside counsel may not be obligatory, but is nevertheless highly desirable.

In King III, there is a recommendation that a board should have an agreed procedure whereby directors may, if necessary, take independent professional advice at the company’s expense.

**Directors personal financial interests – s75**

The Companies Act, 71 of 2008 sets out procedures that are required to be followed for a director (including prescribed officers and board committee members) to disclose a financial interest of that director or of a person related to that director in respect of any matter to be considered by the board.

A director may also disclose any personal financial interest in advance, by delivering to the board, or the shareholders (in certain circumstances), a written notice setting out the nature and extent of that interest.

If a director of a company has a personal financial interest in respect of a matter to be considered at a meeting of the board, or knows that a person related to that director has a personal financial interest in the matter, the director must make certain specified disclosures and must leave the meeting immediately after making the disclosures and may not take any part in the consideration of the matter.

Where there are common directors on boards of companies who contract with each other, these provisions must be carefully considered. A director could be regarded as having a personal financial interest if the director sits on both boards of the contracting companies.

A decision made in contravention of the procedures in this section can be ratified by an ordinary shareholders resolution or by the court, failing which such decision will not be valid.
Conflict of interests

In addition to the obligations set out in s75 of the Companies Act, 71 of 2008, directors have a common law duty, which is part of their fiduciary duties to avoid conflicts of interest.

Complete and timely information

The board has a right to expect that it will be kept fully advised of all material corporate developments by management, and that such information will be provided on a timely basis. The board should receive full documentation on all proposals submitted for its consideration.

The directors are responsible for the content of the published financial statements. Although only two directors sign the published financial statements, these statements reflect the position of the board as a whole.

Providing accountability to shareholders is one of the board’s most important functions. In meeting these responsibilities, the board’s link with the independent external auditors is vital and, in this respect, the audit committee of the board plays an important role.

A board should not merely accept the board papers given to it by management if the papers provided are unsatisfactory. The board should specify the amount, type, and presentation of the information it requires and then work with management to refine the board information pack and upgrade it.

Communication to and from the board should not be confined to papers. An active board participates in presentations and discussions involving management. It meets industry leaders, key suppliers, distributors, customers and bankers.

Conscientious directors keep up with broad business trends through reading relevant industry and business publications (including relevant internet sites), attending conferences and exhibitions, and conversing with legislators, bureaucrats, financiers, overseas business people, technical experts, journalists and anyone else that might be the source of useful information. These activities provide directors with business intelligence independent of the company’s management.

Board committees

The board may choose to delegate responsibilities to committees that comprise a smaller number of its members.

The exception to this is where a company is required to or chooses to have an audit committee and a social and ethics committee in terms of the Companies Act, 71 of 2008. Where a company is required to or chooses to have an audit committee or a social and ethics committee, such committees will have specified duties prescribed by the Companies Act, 71 of 2008 or the Regulations. The creation of committees does not, however, reduce the board’s overall responsibilities.

Where responsibilities are delegated to committees, all the directors should be aware of the committees’ activities and should be satisfied with the competence of the members that perform the delegated tasks. The committees should ensure that the board is kept informed of all material matters.

Board committees allow a smaller group to deal with issues. The committees can act as a filter in discussing and summarising complex issues, and may provide an independent check and balance in areas where some board members (e.g. executives) could have a conflict of interest.

Board committees can add to the effectiveness of corporate governance by reinforcing the role played by non-executive directors and by monitoring company activities.

Board committees provide non-executive directors with an opportunity to gain a better understanding of the company’s activities and issues than would generally be obtained through discussion at a board meeting.

Although a director may rely on the information and advice from board committees in the absence of any doubts or information to the contrary, it is important that all members of a board are well briefed on the membership, activities and goals of the various board committees. An executive dominance on committees should be avoided and is indeed legislated against for companies that have or elect to have an audit committee.

Board committees with formally determined terms of reference, life span, role and function constitute an important element of the process and should be established with clearly agreed upon reporting procedures and written scope of authority. Board committees should be free to take independent outside professional advice as and when necessary.

As a general principle, there should be transparency and full disclosure from the board committee to the board, except where the committee has been mandated otherwise by the board.

All board committees should preferably be chaired by an independent non-executive director, whether this is the board chairman or some other appropriate individual. Exceptions should be a board committee fulfilling an executive function. The table below reflects the different types of board committees, the composition options and where/if the chairman and CEO can be a member or a chairperson of a committee.

<table>
<thead>
<tr>
<th></th>
<th>Audit committee</th>
<th>Remuneration committee</th>
<th>Nominations committee</th>
<th>Risk committee</th>
<th>Social and ethics committee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Composition of the committee</strong></td>
<td>Minimum 3 independent non-executive directors</td>
<td>Majority non-executive directors</td>
<td>Majority non-executive directors</td>
<td>Mixed</td>
<td>At least three directors/ prescribed officers of which one must be a non-executive</td>
</tr>
<tr>
<td><strong>Chairman of the board can be:</strong></td>
<td>Member = NO</td>
<td>Member = YES</td>
<td>Member = YES</td>
<td>Member = YES</td>
<td>Member = YES</td>
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<td></td>
<td>Chairman = NO</td>
<td>Chairman = NO</td>
<td>Chairman = YES</td>
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<td>Chairman = YES</td>
</tr>
<tr>
<td><strong>CEO can be a:</strong></td>
<td>Member = NO</td>
<td>Member = NO</td>
<td>Member = NO</td>
<td>Member = YES</td>
<td>Member = YES</td>
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<td></td>
<td>Attendee = YES</td>
<td>Attendee = YES</td>
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<td>Attendee = YES</td>
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</tbody>
</table>

The social and ethics committee must comprise at least three directors or prescribed officers of the company, at least one of whom must be a director, who is not involved in the day-to-day management of the company’s business, and must not have been involved within the previous three financial years.

Committee composition, a brief description of its remit, the number of meetings held and other relevant information should be disclosed in the integrated report. The chairpersons of the board committees should attend the company’s AGM.

Board committees should be subject to regular evaluation by the board to ascertain their performance and effectiveness.
Other committees
More information is included below on the following committees, some of which may be board committees:

- Audit committee.
- Nomination committee.
- Remuneration committee.
- Risk committee.
- Social and ethics committee.
- Special purpose committee.

1. Audit committee – s94
The Companies Act, 71 of 2008 has transformed the audit committee from being a committee of the board, to being a statutory committee with specific statutory responsibilities.

In addition to its statutory responsibilities, the overall function of the audit committee is to assist the directors in discharging their responsibilities relating to the safeguarding of assets, the operation of adequate and effective systems and control processes, the preparation of fairly presented financial statements in compliance with all applicable legal and regulatory requirements and accounting standards, and the oversight of the external and internal audit appointments and functions.

Which entities need to appoint an audit committee?
Section 94 of the Companies Act, 71 of 2008 requires the following entities to appoint a statutory audit committee:

- Public companies.
- State-owned companies except if granted exemption by the Minister.
- Any company that has voluntarily determined in its MoI to have an audit committee.

This does not apply where a company is a subsidiary of another company that has an audit committee and the audit committee of that holding or parent company will perform the functions on behalf of that subsidiary.

King III recommends that all other entities should voluntarily appoint an audit committee.

Other committees
Other committees, such as the Banks Act, Long Term Insurance Act and Short Term Insurance Act, also make provisions for audit committees.

Composition
The shareholders of a public company and a state-owned company must elect the members of an audit committee at each AGM.

The board must appoint a person to fill any vacancy on the audit committee within forty business days after the vacancy arises. Such appointment must be ratified by the shareholders at the subsequent AGM.

The audit committee must consist of at least three directors who are:

- Involved in the day-to-day management of the company’s business or has been so involved at any time during the previous financial year.
- A prescribed officer, or full-time employee, of the company or another related or inter-related company, or have been such an officer or employee at any time during the previous three financial years.
- A material supplier or customer of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship.
- Related to any person who falls within any of the criteria above.

The size of the committee may vary depending upon legislative requirements, the needs and culture of the company and the extent of delegated responsibilities to the committee. The objective is to allow the committee to function effectively, all members to participate, and an appropriate level of diversity of experience and knowledge.

The nomination committee and the board should evaluate whether collectively the audit committee has an understanding of:

- Integrated reporting, which includes financial reporting.
- Internal financial controls.
- External audit processes.
- Internal audit processes.
- Corporate law.
- Risk management.
- Sustainability issues.
- IT governance as it relates to integrated reporting.
- The governance processes within the company.

Because of the audit committee’s responsibility to oversee integrated reporting, there is a clear need for this committee to collectively have an understanding of International Financial Reporting Standards, South African Generally Accepted Accounting Practice, Global Reporting Initiative guidelines and any other financial or sustainability reporting standards, regulations or guidelines applicable to the company.

The Regulations to the Companies Act, 71 of 2008 also requires at least one-third of the members of a company’s audit committee at any particular time must have academic qualifications, or experience, in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resources management.

Terms of reference and meetings of the audit committee
In addition to addressing responsibilities prescribed by legislation, the terms of reference should address the audit committee’s key recurring responsibilities as well as its responsibility over significant transactions and unusual events.

The board should approve written terms of reference for the audit committee which should inform its agenda and work plan to ensure that all the audit committee’s responsibilities are addressed in each financial year.

Once established, the terms of reference should be reviewed and updated regularly, first by the committee itself and then by the full board. It should be seen as a living document, changing as the organisation’s internal and external environment changes.

The audit committee should establish a plan for each year to ensure that all relevant matters are covered by the agendas of the meetings planned for the year.

The audit committee should meet as frequently as is necessary to perform its functions, but should meet at least twice per year.

The audit committee should also periodically meet privately with management, as well as at least once a year with the external and internal auditors without management being present.
Responsibilities
In executing its responsibilities, the audit committee is allowed to consult with specialists or consultants engaged by the audit committee to assist it with the performance of its functions, subject to a board approved process.

Statutory duties of the audit committee
The audit committee must:
- Nominate for appointment a registered auditor who in the opinion of the audit committee is independent of the company.
- Determine the fees to be paid and the terms of engagement of the auditor.
- Ensure that the appointment of the auditor complies with the Companies Act, 71 of 2008 and other relevant legislation relating to the appointment of auditors.
- Determine the nature and extent of any non-audit services that the auditor may provide to the company, or that the auditor must not provide to the company, or a related company.
- Pre-approve any proposed agreement with the auditor for the provision of non-audit services to the company.
- Prepare a report, to be included in the annual financial statements for that financial year;
  - Describing how the audit committee carried out its functions.
  - Stating whether the audit committee is satisfied that the auditor was independent of the company.
  - Commenting in any way the committee considers appropriate on the financial statements, the accounting practices and the internal financial control of the company.
- Receive and deal appropriately with any concerns or complaints, whether from within or outside the company, or on its own initiative, relating to;
  - The accounting practices and internal audit of the company.
  - The content or auditing of the company’s financial statements.
  - The internal financial controls of the company.
  - Any related matter.
- Make submissions to the board on any matter concerning the company’s accounting policies, financial control, records and reporting.
- Perform such other oversight functions as may be determined by the board.

In addition, for listed entities, the JSE Listings Requirements state the audit committee must consider, on an annual basis, and satisfy itself of the appropriateness of the expertise and experience of the FD and the applicant issuer must confirm this by reporting to shareholders in its annual report that the audit committee has executed this responsibility.

Delegated duties of the audit committee
In addition to its statutory duties, the board may also delegate the following duties to the audit committee.

1. Financial statements
The audit committee will review the annual financial statements, the interim and preliminary announcements, the accompanying reports to shareholders and any other announcements regarding the company’s results or other financial information to be made public, prior to submission and approval by the board.

2. Integrated reporting
The audit committee shall oversee integrated reporting, including integrated reports, financial information, sustainability, interim results and summarised information.

3. Combined assurance
The audit committee ensures that a combined assurance model is applied to provide a coordinated approach to all assurance activities, and in particular the committee shall:
- Ensure that the combined assurance received is appropriate to address all the significant risks facing the company.
- Monitor the relationship between the external assurance providers of the company.

4. Risk oversight
The audit committee is an integral component of the risk management process and specifically the committee shall oversee:
- Financial reporting risks.
- Internal financial controls.
- Fraud risks as it relates to financial reporting.
- IT risks as it relates to financial reporting.

5. Internal audit
The audit committee is responsible for overseeing internal audit, and in particular, the committee shall:
- Ensure that internal audit is independent and has the necessary resources, budget, standing and authority within the company to enable it to discharge its functions.
- Be responsible for the appointment, performance assessment and dismissal of the CAE.
- Approve the internal audit plan, as well as oversee the staffing and objectives of the internal audit function.
- Encourage co-operation between external and internal audit.
- Ensure that the function is subjected to an independent quality review.

6. Compliance with laws and regulations
The audit committee must consider the legal and regulatory requirements to the extent that it may have an impact on the financial statements.

7. Finance function
The audit committee shall review the expertise, resources and experience of the company’s finance function, and disclose the results in the integrated report.

8. Interaction with external auditor
The audit committee plays a key role in the oversight of the external audit process, and as such, the interaction between the audit committee and the external auditor is critical.
9. Independence
In assessing the independence of the external auditor, the audit committee must:

- Ascertain that the auditor does not receive any direct or indirect remuneration or other benefit from the company except:
  - As auditor.
  - For rendering other permitted services.
- Consider whether the auditor’s independence may have been prejudiced;
  - As a result of any previous appointment as auditor or
  - Having regard to the extent of any consultancy, advisory or other work undertaken by the auditor for the company.
- Consider compliance with other criteria relating to independence or conflict of interest as prescribed by the Independent Regulatory Board for Auditors (IRBA).

The annual financial statements should include a description of non-audit services rendered by the external auditor, including the nature and extent thereof.

10. Other
The audit committee should also:

- Ensure that the audit engagement partner is rotated every five years, with a two year cooling off period or in accordance with any other relevant requirements.
- Ensure that there is a process for the audit committee to be informed of any Reportable Irregularities (as required by the Auditing Professions Act, 2005) identified and reported by the external auditor.
- Review the quality and effectiveness of the external audit process, and evaluate the performance of the auditor.

11. Reporting
The chairman (or, in his/her absence, an alternate member) of the audit committee must:

- Report all significant matters arising from audit committee meetings to the board timeously.
- Attend the AGM to answer questions, through the chairman of the board, on the committee’s activities and its responsibilities.

The audit committee is also required to prepare a report to the shareholders to be included in the company’s annual financial statements.

Education and evaluation of the audit committee
Audit committee members collectively should keep up to date with key developments affecting their required skill set.

New committee members should be inducted through a formal process to ensure that they understand their responsibilities.

A structured and formal performance evaluation of an audit committee’s performance, both collectively and at an individual level can help to ensure the committee delivers on its mandate and enable the committee to enhance its contribution to the board continuously. The evaluation may be a self-evaluation or involve facilitation or review by an external party.

Remuneration of the audit committee
Audit committee members must be adequately compensated for their services. The board, on recommendation of the remuneration committee (where applicable), should determine the fees for audit committee members, taking into consideration the complexity of the entity and the amount of time spent. Where applicable, these fees are subject to shareholder approval.

When calculating the overall remuneration of directors, an allowance should be made for the considerable skill committee members are expected to bring to their role on the audit committee and the time allocated for meeting preparation and attendance.

2. Risk committee
As management, and specifically the CEO, is accountable to the board for designing, implementing and monitoring the risk management process, as well as providing assurance that the process is in place and working, many companies have introduced CROs, and are managing risks through risk committees, or similar vehicles.

The risk committee should at least review the following:

- Risk management progress and maturity.
- Risk management effectiveness.
- Key risks.
- Remedial action.

In practice companies often allocate risk responsibility to the audit committee. King III cautions that although it is permissible, the board should carefully consider the resources available to the audit committee.

In order to provide sound risk management oversight the designated committee should possess the following:

- In-depth operational knowledge and understanding of the company.
- A solid appreciation for the risk management process.
- An appropriate balance in composition to provide objectivity in oversight.

Lacking any of these requirements may result in the inability to challenge management’s risk assessment, their remedial actions taken and/or the adequacy of the risk management process.

3. Nominations committee
The principal responsibility of the nomination committee is to devise criteria for board membership and board positions and, with the assistance of external advisors, to identify specific individuals for nomination. The perceived independence and stature of its nominees will be enhanced if the committee comprises only non-executive directors. King III further recommends that the CEO should not be a member of the nominations committee but should attend by invitation. However, the CEO should also be fully involved in the process. The full board should be encouraged to submit names to the nomination committee. Final approval for a board appointment must be made by the full board.

King III recommends, through the nominations committee, a critical self-evaluation of the board as a whole, the chairman, its committees and the contribution of each individual director on an annual basis.

King III recommends the board consider whether the evaluation should be done in-house or conducted by independent service providers, subject to legislative requirements.

It might also periodically review and make recommendations regarding the size of the board, committee structure, director assignments, the effectiveness of board meetings and the scheduling of meetings.
King III defines the duties of a nomination committee in its model terms of reference, which deal with:

- Its constitution.
- Recommended membership.
- Recommended terms of reference.
- Meetings and recommended procedures.
- Suggested remuneration for the service on the committee.

Performance assessments

Effective boards and directors should be conscious of their own culture, strengths and weaknesses and the possibilities for constructive change. King III recommends that the assessment should be performed annually on a self-assessment basis for the board and its committees and on an individual contribution basis for each director by the chairman or independent provider. In practice, the nominations committee can play a role in ensuring the performance assessments take place.

Key to the assessment is the establishment of appropriate mandates and assessment criteria for the board, its committees and directors. King III states that “effective and meaningful evaluation is only possible once the board has determined its own functions, duties and identified the key roles and performance standards for directors”. Key roles for executive and non-executive directors would be different.

4. Remuneration committee

Remuneration

Directors’ remuneration is one of the most critical areas of corporate governance. This is where the director’s value to the company is rewarded and accountability ultimately recognised. Levels of remuneration should be sufficient to attract, retain and motivate executives of the quality required by the board.

Due to its critical importance, King III has recommended that a remuneration committee governs the remuneration process and recommends the amounts to be paid. Disclosure of individual remuneration is required in the integrated report, together with a Statement of Remuneration Policy that sets out how remuneration is determined. King III further recommends that companies should disclose the remuneration of the three most-highly paid employees who are not directors of the company.

Board remuneration

Directors’ remuneration is one of the most critical areas of corporate governance. This is where the director’s value to the company is rewarded and accountability ultimately recognised. Levels of remuneration should be sufficient to attract, retain and motivate executives of the quality required by the board.

Due to its critical importance, King III has recommended that a remuneration committee governs the remuneration process and recommends the amounts to be paid. Disclosure of individual remuneration is required in the integrated report (forms part of the remuneration report), together with its remuneration policies that sets out how remuneration is determined with a special focus on executive management, and the strategic objectives it seeks to achieve.

The Companies Act, 71 of 2008 (s66) requires directors’ remuneration be approved by a special resolution of the shareholders approved within the last two years.

Approval and disclosure of board remuneration

Waiver of remuneration

It is not considered sufficient to record a resolution in the company minute book if a director waives remuneration. If a director waives remuneration payable to him, the director should do so in writing and must be signed by that director.

Base pay and bonuses

King III recommends that non-executive director fees comprise a base and an attendance fee component.

Share-based and other long term incentive schemes

Non-executive directors and the chairman should not receive share options or other incentive awards as recommended in King III. However, the Companies Act, 71 of 2008 allows for share options for executive directors.

Restrictions on financial assistance and benefits

There are various provisions restricting financial assistance and benefits to directors. The board of a company may not authorise any financial assistance unless it is:

- Consistent with the Mol.
- For an employee share scheme.
- Pursuant to a special resolution for specific recipients.
- To the satisfaction of the board that the company will still be solvent and liquid and that the terms of the financial assistance is fair and equitable to the company.

As stated above, the Companies Act, 71 of 2008 (s66) requires directors’ remuneration be approved by a special resolution of the shareholders approved within the last two years.

In terms of the Companies Act, 71 of 2008 (s45) companies granting financial assistance to directors must give written notice of the resolution to each shareholder and any trade union representing the company’s employees within ten business days of the resolution (if the value of the assistance exceeds 1% of the company’s net worth), or within thirty business days of the end of the financial year.

Composition of the remuneration committee

The chairman and the majority of the members of the remuneration committee should be independent non-executive directors. Remuneration decisions should preferably be made by those that do not personally benefit from their recommendations. Members of the committee should, however, have experience in negotiating extremely complex reward packages, which are a matter of concern to shareholders, and they should not be seen to be excessive.

In determining directors’ remuneration, the committee must remember that directors’ remuneration is a reward for enterprise. Directors’ packages should be structured so that there is an incentive for superior enterprising performance and, correspondingly, their failure should not be rewarded. This is, however, a particularly sensitive issue, and remuneration committees must be able to motivate remuneration decisions fully, if requested to do so at the AGM.

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King III recommends and the remuneration policy

King III recommends that every year the company’s remuneration policy be tabled to the shareholders for a non-binding advisory vote.

The King III requirements are set out as follows:

- Companies should provide full disclosure of director remuneration on an individual basis, giving details of earnings, bonuses, share options, restraint payments and all other benefits. (This includes the three most highly-paid employees who are not directors).
- Performance-related elements of remuneration should constitute a substantial portion of the total remuneration package of executives in order to align their interests with those of the shareholders, and should be designed to provide incentives to perform at the highest operational standards.
- Although permitted by the Companies Act, 71 of 2008, King III recommends that the chairman and other non-executive directors should not receive share options or any other incentive awards geared to share price or corporate performance. Because of the apparent dilution of independence, in some international markets, the view is that non-executive directors should preferably receive shares rather than share options.
- In regard to the allocation of share options, boards should be mindful of the following:
  - A vesting period in relation to the allocation of share options to non-executive directors should be applied to dissuade short-term decision taking, and should also have regard to the possibility or consequences of the removal or resignation of such directors prior to the vesting period maturing, and any perceived impact on their independence.
  - Where it is proposed to reprice share options, this should be the subject of prior shareholder approval. Details of the share options of each executive and non-executive director that stands to benefit from any such proposal should be provided and should be subject to prior shareholder approval individually for each director.
  - If share options are to be issued at a discount to the ruling price, shareholders should vote separately on this clause in the trust deed at its inception. Any subsequent amendments proposed to an existing trust deed that would permit allocations of share options at a discount must be subject to the specific approval of shareholders.
- The overriding principle of full disclosure by directors, on an individual basis, should apply to share schemes and any other incentive schemes proposed by management.
- It is not considered appropriate that an executive director’s fixed term service contract, if any, should exceed three years. If so, full disclosure of this fact with reasons should be given, and the consent of shareholders should be obtained.
- Companies should establish a formal and transparent procedure for developing a policy on executive and director remuneration, which should be supported by a Statement of Remuneration Policy in the integrated report.
- The remuneration or such other similar board committee should play an integral part in succession planning, particularly in respect of the CEO and executive management.
- The remuneration committee should consider, and recommend to the board, the fees to be paid to each non-executive director. The proposed fees, as confirmed by the board, should be submitted to the shareholders in a general meeting for approval prior to implementation and payment. The practice of paying non-uniform fees to non-executive directors should also be carefully considered. The level of fees should preferably be determined according to the relative contributions of each non-executive director and their participation in the activities of the board and its committees.

Functions of the remuneration committee

The functions of a remuneration committee generally include:

- Annual review of policies for senior executives’ and directors’ remuneration.
- Annual review of the basis of calculation of senior executives’ and directors’ remuneration to ensure that it appears reasonable.
- Review of current industry practice and professional executive recruitment organisations’ publications.
- Review of different methods of remunerating senior executives and directors.
- Review of existing or proposed share option schemes.
- Review of retirement and termination payments.
- Review of fringe benefits.
- Review of related party transaction disclosure, if any, in the financial statements.

Communication with major shareholders and institutional investors to gauge their views on remuneration packages.

King III defines the duties of a remuneration committee in its model terms of reference, which deal with:

- Its constitution.
- Recommended membership.
- Recommended terms of reference.
- Guidelines for components of remuneration.
- Shareowner acceptance.
- Meetings and recommended procedures.
- Suggested remuneration for service on the committee.

Management remuneration

As noted above, CEO remuneration is usually negotiated directly with the board in line with the remuneration policy put to shareholders. The board will often also approve the remuneration of other key executives.

Boards should take a general interest in their companies’ management remuneration policies since:

- Management remuneration is usually a significant portion of operating costs.
- Remuneration policies affect management performance and morale.
- Remuneration policies influence companies’ ability to attract and retain high-calibre managers.

Increasingly, companies are trying to link management remuneration to the creation of shareowner wealth, although the problems of definition and measurement can be complex. Nevertheless, the potential gains from performance-linked remuneration can be substantial.

More companies are now making equity an important element of management remuneration packages. These include:

- Issue of ‘free’ shares.
- Issue of shares at a discount to market value.
- Granting of share options with an exercise price that encourages managers to improve performance and lift the company’s share price, thus putting their options ‘in the money’.
Obviously these schemes should align management and shareholder interests. However, equity-linked remuneration schemes need to be designed with great care as they can send inappropriate signals to managers. By way of example, if large numbers of share options become exercisable at a particular time, senior managers could have a strong incentive to boost short-term performance at the expense of longer-term considerations. The principles of such schemes should also be acceptable within the context of ‘market practice’, and the views of significant shareholders should not be ignored in this context:

- Boards should accept that there is no one-size-fits-all approach to performance-based management remuneration.
- Companies must be prepared to experiment to get the right mix of incentives for their particular circumstances.
- Remuneration issues can be major obstacles to the extraction of full value from mergers and acquisitions. The reconciliation of different remuneration policies and philosophies needs to be handled with great care.
- Boards should not only establish the general principles of management remuneration, but also closely monitor the implementation of these principles, and encourage innovation and experimentation.

5. Social and ethics committee – s72 (4) (Regulation 43) of the Companies Act, 71 of 2008

Obligation to appoint

All state-owned companies (SOC Limited), listed public companies and any other company with a public interest score above 500 in any two of the previous five financial years is required to appoint a social and ethics committee.

How to calculate the public interest score (Regulation 26)

The Regulations state that every company must calculate its public interest score (PI score) at the end of each financial year.

The PI score is calculated as the sum of the following:

- A number of points equal to the average number of employees of the company during the financial year.
- One point for every R 1 million (or portion thereof) of third party liability of the company at the financial year end.
- One point for every R 1 million (or portion thereof) of turnover during the financial year, one point for every beneficial shareholder (profit company) or member of the company (non profit company) at the end of the financial year.

“Employee” is defined in the Labour Relations Act, 1995 as:

(a) “Any person, excluding an independent contractor, who works for another person or for the State and who receives, or is entitled to receive, any remuneration.

(b) Any other person who in any manner assists in carrying on or conducting the business of an employer.”

“Turnover” is not defined in the context of the PI score, but is defined in Regulation 164 as the gross revenue derived from the sale of goods, the rendering of services or the use by other persons of the company’s assets yielding interest, royalties or dividends. There is no authority that Regulation 164 may be applied for purposes of the PI score.

A company that meets the above criteria is obliged to appoint a social and ethics committee within twelve months from 1 May 2011, unless it has applied to the Companies Tribunal for an exemption. A company which would otherwise require a social and ethics committee is exempted from having such a committee if its holding company has a social and ethics committee which will fulfil the required functions on behalf of the subsidiary company.

The Companies Tribunal may exempt any company from the requirement to appoint a social and ethics committee on the grounds that:

- The company has another formal mechanism, in terms of other legislation, that performs substantially the same function.
- It is not reasonably necessary in the public interest, considering the nature and extent of the company’s activities, to require the company to have a social and ethics committee.

An exemption by the Companies Tribunal will generally be valid for five years.

Composition of the social and ethics committee

The social and ethics committee must comprise at least three directors or prescribed officers of the company.

At least one member of the committee must be a director who is not involved in the day-to-day management of the company’s business and has not been involved in day-to-day management within the previous three financial years.

Prescribed officer (Regulation 38)

A “prescribed officer” is a person who exercises (or regularly participates in the exercise of) general executive control over and management of the whole or a significant portion of the business or activities of the company.

Rights of the social and ethics committee

The committee is entitled to:

- Require any information or explanation necessary for the performance of its functions from any employee of the company, any director or prescribed officer.
- Attend any general shareholders meeting and to receive all notices and other communications in respect thereof.
- Be heard at any general shareholders meeting on any part of the meeting that concerns the committee’s functions.

Expenses of the social and ethics committee

A company must pay all expenses reasonably incurred by the social and ethics committee, including the costs of consultants and specialists engaged by it.
Functions and scope of the social and ethics committee

The social and ethics committee must monitor the company’s activities, having regard to relevant legislation and codes of best practice, in respect of:

- Social and economic development, including the company’s standing in respect of goals and purposes of:
  - The ten principles set out in the United Nations Global Compact Principles.
  - The OECD recommendations regarding corruption.
  - Employment Equity Act.
  - Broad-based Black Economic Empowerment Act.
- Good corporate citizenship, including:
  - Promotion of equality, prevention of unfair discrimination and reduction of corruption.
  - Contribution to the development of those communities in which it operates.
  - The Company’s record of sponsorship, donations and charitable giving.
- Environment, health and public safety, including the impact of the company’s activities and its products or services.
- Consumer relationships, including advertising, public relations and compliance with consumer protection laws.
- Labour and employment, including:
  - The Company’s standing in terms of the International Labour Organisation Protocol on Decent Work and Working Conditions.
  - Employment relationships and its contribution to the educational development of its employees.

The social and ethics committee must draw matters within its mandate to the attention of the board as required and report to the shareholders at the AGM.

Stakeholders and the social and ethics committee

On closer examination of the function and scope of the social and ethics committee, it can be seen that this new committee fully supports the stakeholder governance model. In fact, if one organises the scope of ‘oversight’ responsibilities one can see that it corresponds to a simple stakeholder model reflected below.

Evolution of the social and ethics committee

In discharging its oversight and reporting responsibilities, it is envisaged that the compliance function will play an increasingly important role. Organisations will progress to their desired level of maturity over a period of time. We anticipate the following evolution in the social and ethics committee and function maturation:

How to implement the social and ethics committee requirements?

Many organisations may already have addressed some or most of the Companies Act, 71 of 2008 requirements within their organisations, albeit in a fragmented or dispersed manner. The following roadmap to implementation is suggested:

1. Social and ethics committee charter

A social and ethics charter should be developed and approved by the board.

2. Composition

The social and ethics committee must be appointed. The composition of the committee must be in accordance with the Companies Act, 71 of 2008 (i.e. not less than three directors or prescribed officers with at least one director who is not involved in the day-to-day management of the company and not involved in the previous three financial years).

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3 Companies Act, 71 of 2008

4 The Department of Trade and Industry has confirmed that this document does not exist.
3. Workplan for the committee
A workplan for the committee should be developed aligned to the committee’s charter.

4. Agendas
Careful preparation of the agenda enhances the committee’s productivity and strengthens its advisory and reporting role.

5. Creation of a social and ethics committee framework
A cohesive social and ethics framework should take into consideration the stakeholders, Acts, codes and reporting (including reporting to the board and at the AGM) requirements of the organisation.

6. Information needs
The social and ethics committee will have to identify the information needs of its stakeholders and the board. This will require coordination with any stakeholder management functions within the organisation.

7. Information providers
The social and ethics committee will have to obtain information from many sources including management, internal audit, compliance and risk functions.

8. Coordination within a governance framework and structure
A fundamental part of the social and ethics committee role will be ensuring appropriate liaison with the other governance committees, thereby ensuring that there is no duplication of effort or omission of responsibilities.

9. Ethics assurance and whistle-blower information
It is possible that the social and ethics committee will want access to the audit committee’s ethics assurance and any whistle-blower information.

10. Compliance function
The compliance function will play an increasingly important role in accordance with the Compliance Institute of South Africa (CISA) standards and best practices. The social and ethics committee are likely to make use of the reports prepared by compliance in line with the Acts mentioned above as they pertain to stakeholders and their oversight and reporting responsibilities.

11. Combined assurance framework
The King III recommendation for a combined assurance framework will be of relevance to the social and ethics committee. It is essential that the assurance resources are efficiently used for risk, control, management and compliance purposes.

12. Reporting to the board
The social and ethics committee should report to the board on a regular basis on its oversight results and how it has fulfilled its mandate.

13. Report in the integrated report and at the AGM
In line with King III and developments in integrated reporting, the social and ethics committee should report in the integrated report on how it has fulfilled its mandate. At the AGM, the social and ethics committee should also report its activities in line with the integrated report.

In summary, organisations have until 1 May 2012 to constitute their social and ethics committee. This is a new requirement of the Companies Act, 71 of 2008 and Regulations and will take time for organisations to evolve. It is likely that there will be increased emphasis on the need for combined assurance framework and an effective compliance function.

Consequently awareness of and commitment from the board and management will be essential for the establishment and effective and efficient operation of the social and ethics committee.

6. Special purpose committee
Special purpose committees may be established to gather and evaluate specific information and report to the board on particular matters. These matters may include the following:

- Mergers and acquisitions or divestments.
- Environmental issues, which can be particularly important for mining and processing businesses.
- Compliance with laws, regulations, industry codes and organisational standards.
- Credit approvals above predetermined levels.
- Strategic planning with the objective of developing strategic plans for consideration by the board.
- Other special purpose matters such as IT (in the event an IT steering committee is not specifically established).

Special purpose committees, having been established to consider a specific matter, will sometimes have a limited life. However, a committee’s terms of reference or charter should still be approved by the board.

Although the board is able to delegate some of its functions to committees, the board cannot delegate its ultimate power and responsibility. The use of board committees brings a number of benefits to the board and provides a better opportunity for non-executive directors to use their skills and experience. In addition, committees add to the effectiveness of corporate governance by monitoring company activities and generally strengthening the role of the non-executive director. In essence, however, board committees should not make decisions that require the full consideration of the board. They should rather examine issues and recommend decisions to the board.
Shareholder Interaction and Stakeholder Management
Introduction
The trend towards increasing transparency and disclosure has gained significant momentum over the past decade, a fact borne out by KPMG’s international surveys on sustainability reporting. Reporting is now the norm, not the exception, among the world’s leading companies. KPMG’s latest sustainability reporting survey shows that 80% of the largest two hundred and fifty companies in the world produce a sustainability report. This is approximately up by 50% in 2005 showing that sustainability reporting has gone main stream.

South African companies have also embraced sustainability reporting with 86% of South African companies including some level of sustainability reporting in their annual reports or in a stand-alone report. This reflects the influence of the King Code for Corporate Governance and increasing legislative and voluntary reporting requirements.

One of the biggest changes between King I and King II was the substantially increased emphasis in the later on sustainability reporting. King III takes sustainability reporting a step further and advocates integrated reporting in order to provide stakeholders a holistic and long term picture of the organisation. King III states “In buying a share on any stock exchange, the purchaser makes an assessment of the economic value of a company. The assessment considers the value of matters not accounted for, such as future earnings, brand, goodwill, the quality of its board and management, reputation, strategy and other sustainability aspects... The integrated report... should have sufficient information to record how the company has both positively and negatively impacted on the economic life of the community in which it operated during the year under review, often categorised as environmental, social and governance issues (ESG). Further, it should report how the board believes that in the coming year it can improve the positive aspects and eradicate or ameliorate the negative aspects, in the coming year.”

Stakeholder/shareowner control
Annual general meetings and general meetings (shareowners’ meetings)
For many public companies, the AGM is a major part of shareowner communication and investor relations. AGMs offer shareholders a unique opportunity to question boards, express their views on company performance, and suggest changes to company governance and operations. AGMs can be both a positive and a difficult experience for boards, and a source of positive and negative publicity for companies. The following preparations can lead to a positive outcome:

- A hostile AGM is rarely the result of spontaneous combustion. Boards in touch with shareowner concerns will anticipate and embrace debates on contentious issues.
- Boards and management should spend time trying to anticipate specific shareowner questions, and developing appropriate responses. Speakers should be identified to respond on specific issues, and be well prepared to deal with those issues.
- Likely difficult questions can sometimes be short-circuited by raising and answering them in the annual report, or in the formal chairmen’s address to the AGM.
- Shareowners can be invited to submit questions prior to the AGM (perhaps by means of a reply-paid card distributed with the annual report).
- Chairman – who are normally responsible for the conduct of the AGM – should be thoroughly familiar with their AGM agendas and meeting procedures, and have developed an approach for dealing with difficult or hostile responses from the floor of the meeting. Their aim should be fairness and firmness in equal measure.
- The chairman of the audit, remuneration and social and ethics committees should attend the AGM and be prepared to answer questions.
- The chairman of an AGM must allow a reasonable opportunity for members as a whole to ask questions about the management of a company.

Stakeholders – Companies Act, 71 of 2008
The Companies Act, 71 of 2008 includes a much broader concept of “stakeholder” than in the 1973 Companies Act. The 1973 Companies Act sought to regulate the relationship between a company, its directors and shareholders. The Companies Act, 71 of 2008 includes a number of rights afforded to trade unions, employees and creditors. By way of example, trade unions have the right to institute proceedings to prevent the company from doing anything inconsistent with the Companies Act, 71 of 2008, have access to financial statements for the purposes of initiating business rescue proceedings and must receive notice of any loan or financial assistance given to directors, prescribed officers or related or inter-related companies. Both trade unions and employees have the right to institute proceedings to have a director declared delinquent or under probation (in accordance with the specific process set out in the Companies Act, 71 of 2008). Trade unions, employees and creditors are all “affected persons” for business rescue proceedings and may therefore participate in the development of a business rescue plan and all three categories may also be protected by the newly included whistleblower provisions. Also note that the term “trade union” appears to refer to any trade union registered in terms of the Labour Relations Act, 1995, and does not require that the trade union be “recognised” (i.e. does not require the union to have a minimum representative threshold within the company).

Stakeholder activism
At present, shareholders often do not attend AGMs or, when they do attend these meetings, they generally either do not ask questions or else ask questions that are fairly superficial in nature. This trend is changing, however, and shareholder activist groups, which are growing in size and influence internationally, will no doubt eventually become significant in South Africa.

The primary focus of the questions and proposals put forward by these groups will be directed at providing shareholders with a greater say in corporate matters.

King III recommends several actions to encourage shareholders to become more active. These include the following:

- That the professional bodies controlling institutional sharelook to the steps taken by similar international bodies in setting benchmark standards expected of companies in respect of conformance with good corporate governance.
- That institutional investors make their voting policies publicly available.
- That the Investment Analysts’ Society of Southern Africa be encouraged to rate corporate governance performance in their analysis of companies.
- That definitive guidelines regulating the communication between companies and investors be provided.
- That pension fund trustees and such institutions managing pension funds indicate in their own statements of investment principles the extent to which good corporate governance is recognised in their investment decisions.
- That financial journalism be developed as much as possible.
- That institutional investors be more transparent in their dealings with companies.
- That legal procedures be amended to allow for contingency fees and a more liberal use of class actions.
Shareholders meetings

Annual general meetings – s61

AGMs shall be held no later than fifteen months after the previous AGM. Only public companies and state-owned companies are obliged to have an AGM.

The AGM convened by public and state-owned companies shall consider:

- The directors’ report.
- The audited financial statements.
- The audit committee report.
- Election of directors.
- Appointment of the auditor.
- Appointment of the audit committee.

In terms of the 1973 Companies Act, the audit committee was appointed by the board, whereas in terms of the Companies Act, 71 of 2008, the audit committee is now to be appointed by the shareholders.

As an auditor can only be appointed at an AGM, all companies which are required to be audited, whether in terms of their MoI or the Regulation, will be required to hold AGMs (s90). However, such company will not necessarily have to deal with matters other than the appointment of the auditor, as is required for public and state-owned companies.

Shareholders meetings – s61

A quorum of 25% of the votes represented at a general meeting of members/shareholders is required, provided that if the company has more than two shareholders, there must be at least three shareholders present to constitute a quorum. The MoI can raise or lower the percentage required for a quorum (but not the requirement of three shareholders where applicable). The Companies Act, 71 of 2008 makes provision for the postponement of a meeting if a quorum is not present.

The minimum notice period of meetings of shareholders of a public company is fifteen business days and of a private company is ten business days. These notice periods apply irrespective of whether the meeting is held to consider ordinary or special resolutions. The Companies Act, 71 of 2008 also allows for waiver of notice of meetings.

The Companies Act, 71 of 2008 allows for shareholders’ decisions to be taken by way of “round robin” resolution (s60), thereby alleviating the need to hold a formal meeting. This is permitted for all matters other than matters for which the Companies Act, 71 of 2008 specifically indicates that the decision must be taken at an AGM.

A public company must allow for reasonable access by electronic participation by shareholders at every shareholders’ meeting of the company.

Resolutions – s65

Ordinary resolutions must be approved by more than 50% of the voting rights exercised in respect of the resolution. Special resolutions must be approved by 75% of the voting rights exercised in respect of the special resolution. The MoI may provide for a higher percentage for ordinary resolutions and for a higher or lower percentage for special resolutions provided that there is at least a 10% difference between the percentage approval required for ordinary and special resolutions. Different percentages may be prescribed in the MoI for resolutions pertaining to different matters.

Special resolutions are required:

- To amend the MoI or ratify a consolidated revision of the MoI.
- To ratify actions by the company or directors in excess of their authority.
- To approve an issue of shares or grant of rights to directors and related companies.
- To approve an issue of shares or securities in excess of 30% of the voting power of the shares or securities in that class.
- To authorise the board to grant financial assistance to directors or prescribed officers or related or inter-related companies.
- To authorise the board to provide financial assistance for transactions in connection with the securities of the company or related or inter-related companies.
- To approve the acquisition by the company of its own shares in certain circumstances.
- To authorise the basis for compensation of directors of a profit company.
- To approve a voluntary winding-up.
- To approve the winding-up of a solvent company by the court.
- To approve the transfer of the company’s registration to a foreign jurisdiction.
- For “fundamental transactions”.
- To revoke a previous special resolution that gave rise to appraisal rights.
- For such other matters that the MoI requires a special resolution.

The need for ordinary resolutions

Ordinary resolutions are required:

- To approve rules adopted by the board.
- To elect at least 50% of the directors.
- To remove directors.
- To approve a contract in which the director has a personal financial interest, where only one director.
- To approve a contract in which a director has not made prior disclosure of a personal financial interest.
- To appoint the auditors, where required.
- To appoint the audit committee, where required.
- To give certain directions to a liquidator in a voluntary winding up of a solvent company.
- To vary an agreement attached to a prospectus.
- To approve a business rescue plan to the extent it alters the rights of the shareholders.

In addition, the MoI can require shareholder approval for any matter that the Companies Act, 71 of 2008 does not specifically require shareholder approval.

1 Some of these transactions only require shareholder approval by special resolution in certain circumstances as detailed in section 66(11)
Obligations of institutional shareholders

A Code for Responsible Investing in South Africa (CRISA) was released in 2011 by the Committee on Responsible Investing by Institutional Investors. The framework relates to the governance role of boards of companies, institutional shareholders and the ultimate beneficiaries. It is a voluntarily framework that recommends the following principles:

- "An institutional investor should incorporate ESG considerations into its investment analysis and activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries."
- An institutional investor should demonstrate its ownership approach in its investment arrangements and activities.
- Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of this Code and other codes and standards applicable to institutional shareholders.
- Institutional investors should recognise the circumstances and relationships that hold a potential for conflicts of interest and should proactively manage these.
- Institutional investors should be transparent about their policies how the policies are implemented, and how the Code is applied to enable stakeholders to make informed assessments.
- Institutional investors and service providers should adopt CRISA on an ‘apply or explain’ basis and the effective reporting date is 1 February 2012."

Stakeholder engagement

Businesses are influenced by people within and outside their company, and they in turn influence the circumstances of people both inside and out. These are known as ‘stakeholders’ and companies communicate with them on a daily basis through the normal course of business. Customers, suppliers, regulators, neighbours, employees, providers of capital, and many others, all have a stake in the way companies conduct themselves. Understanding the way a company impacts the economic, environmental, and social circumstances of its stakeholders, and vice versa, is at the heart of corporate responsibility. In order to develop a proactive, strategic approach, and a workable management and reporting system that will help change circumstances for the better for all parties, stakeholders should be part of the process. Identifying and prioritising stakeholders, and being transparent about which groups and individuals a company is engaging with, is a key part of building credibility and trust.

A recent KPMG International Survey of Corporate Responsibility Reporting³ sampled over 2200 companies includes the Global Fortune 250 (G250) and the hundred largest companies by revenue (N100) in twenty two countries.

Many G250 companies engage in both informal and structured forms of dialogue with stakeholders. 54% reported that they engaged in informal stakeholder dialogue, whereas 62% say they conduct formal or structured stakeholder engagement. This represents a doubling since 2005, up from 33%, of companies involved in formal engagements. The N100 are slightly less likely to engage, with 35% involved in informal dialogues and 42% taking structured approaches to stakeholder relations. In their corporate responsibility reports, 65% of G250 companies disclose details of who their stakeholders are and how they are engaged. This trend is on the rise, up from 57% in 2005, indicating greater transparency and implying greater comfort in relation to stakeholders. Less than half of the N100 companies disclosed information about whom they considered to be their stakeholders in their corporate responsibility report (47%), leaving them well behind their larger counterparts.

Higher purpose

Of the G250 that utilise formal stakeholder engagement techniques, the majority (59%) say they do so to better understand stakeholder expectations. This is an important step in the right direction, considering that the historical data show structured stakeholder engagement to be a fairly new phenomenon and good stakeholder relationships are known to take time to forge. Only 37% of the G250, and 20% of the N100, say they use stakeholder dialogue to help define their corporate responsibility strategy. Therein lies an enormous opportunity for companies to better harness the information and insights they gain from these dialogues, especially to seek to reduce risks and exploit new creative business opportunities with corporate responsibility.

Stakeholder dialogue is an important element in the elaboration of corporate responsibility reports. 25% of G250 and 14% of N100 companies claim to use stakeholder feedback for reporting purposes. From one perspective these figures may be seen as positive, as they may indicate the company is engaging with a wider set of stakeholders for a wider set of purposes (i.e. not just for the preparation of a corporate responsibility report).

³ Survey presents historical data, drawing from 5 previous surveys conducted by KPMG firms since 1993.
CHAPTER 8

Tone at the Top
Internal ethics management

The management of ethics has become increasingly important with every King report. In King III the priority afforded ethics management is demonstrated by the simple fact that it forms the first chapter, namely on ethical leadership and corporate citizenship.

This emphasis on corporate ethics flows from a specific understanding of the nature and purpose of companies, as outlined in King III. Business, or economic activity, is not primarily viewed as a right given to us in free democratic societies, but as an opportunity allowed by society as long as companies act as responsible corporate citizens. This is required because companies have "the greatest pools of human and monetary capital" in the world today. The increased social influence accompanying such "pools of capital" brings along the obligation to gain the trust and confidence of stakeholders, specifically by taking their legislative interests and expectations seriously. Consequently, only by running a company ethically does a board earn its 'licence to operate' within a community.

What this means for directors is the added responsibility of ensuring "that the company’s ethics are managed effectively", and of "building and sustaining an ethical corporate culture in the company". There are several reasons for embarking on this process. The first could be described as the 'negative' motivation of preventing unethical conduct. Ethics initiatives represent a collection of soft controls for preventing costly transgressions, for instance fraud, corruption and bribery. Stricter legislation and multiplying hard controls is no longer deemed a sufficient approach to preventing misconduct. King III therefore opts for a values-based approach that supplements hard controls and regulation with shared values, shared responsibilities or ownership, and a moral sensibility on the part of all employees.

The second reason for managing ethics is the ‘positive’ motivation of building a reputable, sustainable and successful business. Already in the 1980s organisational researchers began emphasising the importance of culture in building companies that last. A corporate culture grounded in a shared value system, so it is argued, increases trust and productivity and fosters the kind of reputation or legacy that companies, as outlined in King III. Business, or economic activity, is not primarily viewed as a right given to us in free democratic societies, but as an opportunity allowed by society as long as companies act as responsible corporate citizens. This is required because companies have "the greatest pools of human and monetary capital" in the world today. The increased social influence accompanying such "pools of capital" brings along the obligation to gain the trust and confidence of stakeholders, specifically by taking their legislative interests and expectations seriously. Consequently, only by running a company ethically does a board earn its 'licence to operate' within a community.

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Ethical leadership

No aspect of internal ethics management receives more attention than that of ethical leadership. It is the cornerstone of, as well as a necessary condition for, an ethical corporate culture.

Ethical leadership starts with the board, but should not be limited to the decisions and behaviours of the board. Ethical leadership must trickle down from the board to all levels of management, as staff are more frequently influenced by the role modelling of direct managers and supervisors.

According to King III, ethical leadership from the board and (in relation to the governance of internal ethics) entails the following:

- Not being satisfied with mere legislative or regulatory compliance.
- Valuing personal and corporate institutional fitness.
- Ensuring that management actively cultivates a culture of ethical conduct and sets the values to which the company will adhere.
- Ensuring that integrity permeates all aspects of the company and its operations and that the company’s vision, mission and objectives are ethically sound.
- Aligning the board and management’s conduct with the values that drive the company’s business.
- The above responsibilities require, as part of the objective of building and sustaining an ethical corporate culture, a cultural approach to governance and management that includes an internal ethics programme that is aimed at both formal and informal cultural systems within an organisation.
- Intervening in these formal and informal cultural systems requires four phases or steps, which the board must take responsibility for. The steps are: (i) assessing ethics risk, (ii) developing a code of ethics, (iii) integrating ethical standards, and (iv) reporting on ethics performance. Simply put, an ethics management programme consists of the basic steps of “plan, do, implement, and learn”.

In addition to ensuring that an ethics management programme is in place and managed effectively, directors must also actively contribute to the programme by:

- Acting as role models for the company’s stakeholders by making ethics explicit.
- Legitimising ethics discourse.
- Encouraging ethical conduct in others and holding others accountable for the ethics of their conduct.
- Being seen to support the company’s ethical standards and taking measures to achieve adherence to them.
Assessing ethics risks

Ethics risk refers to “potentially detrimental or beneficial outcomes caused by unethical or ethical conditions of behaviours”10. King III emphasises the importance of a focus on both negative and positive ethics risk. This means that companies should also take cognisance of the opportunities that become available when investing in a positive ethical reputation, rather than only focusing on the potential disadvantages of ethical misconduct (for instance, loss due to fraud or corruption).

When assessing ethics risk, one is essentially assessing one of two things:

1. The adequacy and effectiveness of programme elements (or ethics controls).
2. Perceptions within the company regarding ethics.

Internal audit normally takes responsibility for the first form of risk assessment. By testing adherence to, for instance, gift, training or conflict of interest policies, internal audit verifies the effectiveness of ethics control measures, and simultaneously identifies risks involved in non-compliance.

The second form of risk assessment can be conducted by internal audit, an ethics office, or a compliance office 11. It involves testing:

- Knowledge and awareness of ethics expectations, codes, standards and policies.
- Comfort levels, within the organisation, when discussing ethical matters, or reporting on ethical misconduct.
- Perceptions of management and the extent to which they represent positive ethical role models.
- Stakeholders’ experience of the extent to which ethical standards are consistently and fairly enforced.
- Stakeholders’ perceptions regarding the feasibility of ethical objectives within the company.

In assessing ethics risks, companies can make use of questionnaires or surveys, interviews, focus group discussions, benchmarking and document analyses.

Developing a code of ethics

A code of ethics, if properly embedded in the culture of a company, is potentially a powerful instrument. It expresses what a company stands for, and what stakeholders can expect from it. A comprehensive code of ethics includes four elements 12:

- A mission and vision.
- A set of core values.
- Obligations towards stakeholders.
- Norms and rules.

Different company codes are different combinations of these key elements, depending on the purpose of the code and on the specific ethics risks a company faces. A mission and vision, as well as a core set of values, constitute the aspirational content of a code (sometimes referred to as the code of ethics). Its aim is to provide a values-based framework staff can aspire to. In addition, it allows for discretion, and provides guidance even in situations where no specific rule exists. Finally, it is instrumental in gaining reputational capital. Basing one’s behaviour and decisions on a set of core values contributes to the reputation of being an ethical and trustworthy company. In the long run, this kind of reputation is a form of capital, as “business misconduct can lead to direct costs of legal fees, monetary fines, sanctions and operational recovery”13. On the other hand, a reputation for ethical conduct increases stakeholder goodwill and contributes to lasting and mutually beneficial relationships with employees, customers, suppliers, communities and shareholders 14.

The obligations towards stakeholders, as well as norms and rules, constitute the directional component of a code of ethics (sometimes referred to as the code of conduct). The directional component gives clear and specific guidance on matters that could cause confusion, or that represent the greatest risk for a company (for instance gifts, conflicts of interest and political contributions). Although it does not allow for employee discretion, it is a useful tool in preventing unethical conduct.

David Murray lists the following critical success factors for the development of a code 15:

- There has to be a clear purpose – the board and senior management should know why they want to develop a code and what the benefit will be. To do it simply to comply with corporate governance requirements could result in insufficient focus. There has to be development process – this has to involve participation from employees at all levels, as well as the inclusion of all stakeholders in the process.
- There is a need for an understanding of predecessor codes (if applicable) – e.g. if a previous code is outdated there should be clarity on why this is the case and, if there is an industry specific code, care should be taken that there is no conflict between the two.
- There must be a clear understanding of existing values and principles – the code has to be based on these existing values, otherwise employees will not be able to associate with or endorse the contents.

Finally, in developing the code, a board should not underestimate the importance of tone or language use. Language use determines the difference between a code that is informational (primarily factual), instructional (action-orientated), transformational (change-orientated) or relational (seeking trust) 16. A code that frequently formulates obligations in an us/them fashion, for instance ‘Management expects that all employees should...’, is less likely to gain support than an inclusive code that favours formulations like ‘We as Company X have a responsibility to...’.

11 At present, in South Africa, ethical risk assessments are mostly conducted through external service providers
15 For more information, see Stevens, B. 1996. “Using the Comparing Values Framework to Assess Corporate Ethical Codes” in The Journal of Business Communication 33 (1)
Integrating ethical standards

The board is also responsible for integrating the company’s ethical standards into its culture. A so-called ‘paper code’ that has not been integrated will not only be ineffective, but may even represent a risk to the company. As Muel Kaptein argues¹:

“[A badly embedded code] may... have a counterproductive effect if people see through it and regard the code as a façade, containing empty promises and false expectations, or even as cunning and guile. As more companies adopt a code, more attention is paid to the manner in which it is introduced, implemented, internalised and institutionalised. Having a code is no longer a distinguishing feature. Companies that do not embed the code properly or at all are increasingly the object of criticism. The risk therefore increases that the code is used against the organisation.”

Best practice when integrating ethical standards requires a focus on strategies and operations, as well as on formal and informal cultural systems. According to King III, integrating ethics into a company’s strategy involves:

- Ensuring that there is ethics expertise on the board.
- Making ethics part of the identity of the company.
- Having ethical thinking precede all decision making.
- Providing the resources necessary for managing ethics internally.
- Integrating ethics into a company’s operations typically includes:
  - Creating ethics structures and functions, for instance an ethics board committee, an ethics office, and appointing an ethics officer and ethics champions.
  - Communicating to all stakeholders the company’s ethics strategy and expectations.
  - Ongoing ethics training to support the ethics strategy.
- From a cultural systems perspective, integrating ethics means aligning the formal (or visible) cultural elements with the informal (or invisible) cultural elements that together constitute the organisation’s culture. In order to achieve this, companies can consider the following:
  - Effective two-way communication on ethics to internal and external stakeholders.
  - A safe reporting line (or whistle-blowing hotline) to assist in preventing and detecting misconduct.
  - Integrating ethics into management practices, for instance pre-screening of employees, awareness campaigns, ethics training, and consistent disciplinary and reward systems that includes integrity as a feature of performance appraisals.

Through these measures, along with effective ethical leadership, companies should strive to align its formal cultural elements and messages with its informal cultural elements, including the message sent by its heroes and role models, its informal norms, its corporate rituals, its company lore (myth and stories that circulate through the grapevine) and its language.²

Reporting ethics performance

In South Africa, reporting on ethics performance (or ethics management) is not well developed. Most companies do not report on ethics management, or report only in a vague manner. Consequently, ethics reporting frequently remains limited to expressions of commitment (for instance, ‘We as Company X are committed to upholding the values of...’ or ‘negative’ ethics reporting (for instance, ‘No material cases of fraud or misconduct were reported in this financial year’)). But much more is involved in ethics reporting. King III suggests that organisations should be reporting in three distinct ways, namely internally through the ethics function, internally through internal audit, and externally through an independent external assessor. The ethics function reports to management on the following:

- The ethics risk identification and assessment process.
- Any code development, review or modification of the existing code.
- Steps taken to prevent misconduct.
- Reporting mechanisms, and any trends regarding reporting.
- Information on enforcement of ethical standards, i.e. rewards for ethical behaviour and disciplinary actions as a result of unethical behaviour.

Internal audit reports on:

- The ethical culture of the company.
- The effectiveness of the ethics strategy.
- The risks attached to the ethics strategy.
- The adequacy and effectiveness of ethics controls.
- Compliance with specific ethics policies and procedures.

Finally, an independent external assessor provides:

- Information on the effectiveness of the company’s ethics management programme.
- Independent verification of the information on ethics management provided by the board.

The report of the independent external assessor is presented as a formal, written assurance statement. This statement should be included in the integrated report.

The motivations for reporting and disclosing on ethics performance are as follows:

- To provide, to the board and management, information concerning the effectiveness of the internal ethics management programme.
- To enhance the credibility of information provided to internal and external stakeholders.
- To improve the organisation’s ethical culture.

Ethics reports not only allow stakeholders to form an accurate picture of the governance of ethics within an organisation, it also facilitates learning inside the organisation. By having business units or departments within a company account for their ethics performance, management learns what ethical concerns exist within the company, and can recognise and correct shortcomings within its ethics management programme. By reporting on organisational integrity externally, a company also demonstrates its willingness to reveal vulnerability, which could encourage stakeholders to make contributions.


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Key questions

Managing the ethics of an organisation means addressing the above four steps or phases, namely assessing ethics risk, formulating ethical standards, integrating ethics and reporting on ethics performance. As a quick reference guide, and in order to determine the ethics management needs of a company, a director can consider the following questions:

1. What kind of culture characterises the company? Is it an authoritarian culture, centred around strong personalities, or a culture centred around core values? Is the culture uniform across business units and subsidiaries, or is the culture fragmented, consisting of various subcultures? Is it a strong culture in which values matter, or a weak culture in which values are not promoted and reaching targets takes priority?

2. Is the company attending to ethics risk? Does the company conduct ethical risk assessments? And if it does, who conducts it, how and how regularly? Are these risks reported to the board?

3. Does the company have a code of ethics? What is the purpose of the code? Is it mainly aspirational or directional? Is the tone of the code effective in facilitating “buy-in” from stakeholders? How often is the code reviewed?

4. Is the code of the company symbolic (a mere ‘paper code’) or substantive (i.e. integrated into the strategy and operations of the company)? What is being done to integrate the code? Is the code communicated? Do employees receive training on the application of the code? On an informal side, who are the heroes and role-models in the company, and what is being communicated through the so-called grapevines?

5. How is the company reporting on ethics management or ethics performance? Does the company report on specific risks and initiatives, or does it report vaguely and negatively, i.e. professing commitment and reporting on the absence of material incidents of misconduct?

6. What is the reputation of the company? What would we like it to be, and how could ethics initiatives (and communication of ethics initiatives) contribute to the reputation we would like to achieve?

The fact that organisational ethics is increasingly regulated in South Africa is a positive development. It is the recognition that hard controls alone do not guarantee ethical conduct or public trust in business. It also signals a shift in thinking about companies, and about the responsibilities of companies. In addition to its assets, and the profit it generates for shareholders, companies (and its management and directors) are also responsible for the cultures that develop within their walls.

Investing in an internal ethics management programme has its risks, however. Professing a commitment to corporate integrity increases the expectations of stakeholders, and can also increase the damage that results from failing. At the same time, it is an investment that promises great returns, if managed correctly. Investing in the process of ethics management could benefit a company by reducing misconduct, increasing internal and external stakeholder participation and trust, increasing a company’s reputational capital, and in so doing, by contributing to sustainable and successful business.

Strategy and Sustainability (Directors Role)
Introduction

Board members bear ultimate responsibility for the strategic action of the organisation. As such they cannot abdicate or delegate the accountability for strategy. King III is clear in this regard by stating that the board is responsible for corporate governance and has two main functions:

- It is responsible for determining the company’s strategic direction and, consequently, its ultimate performance.
- It is responsible for the control of the company, i.e. the board requires management to execute strategic decisions appropriately.

The board should appreciate that strategy, risk and performance management and the concept of sustainability are inseparable. The realisation of the company’s strategy depends on its ability to take calculated risks in a manner that does not jeopardise the legitimate interests of stakeholders. Sound management of risk will enable it to anticipate and respond to changes in the environment, as well as to enable it to make informed decisions under conditions of uncertainty.

Strategic vision

One possible starting point is for boards and management to formulate jointly a corporate strategic vision. This is simply a statement of what a company wants to become in the future, of what it wants to preserve and of what it wants to change.

The vision should neither be so general that it becomes meaningless in practical terms, nor so prescriptive that it closes off potentially valuable options. Vision should take a medium to long-term view of the company (dependent upon the type and volatility of the industry/market in which it operates), three to five years is a good rule of thumb.

Strategic risk

Risk can be viewed from either a strategic or an operational perspective. Strategic risk concerns the future of the markets in which companies operate, and their evolving competitive position in those markets. It also embraces the ability of companies to implement successfully their business strategies. A strategy may be sound, but if it is poorly implemented it will fail, and shareholder value will be lost. Value is typically lost because:

- Companies persist with inappropriate business strategies long after their failings should have been recognised.
- Problems of implementation are not promptly identified and dealt with.

Directors have a duty to satisfy themselves that an effective strategic risk management plan is in place and is being followed. Such a plan seeks to:

- Identify strategic risks given the organisational context and chosen strategy.
- Set policies and appetite/tolerance thresholds for dealing with risk events/trends.
- Measure what is happening.
- Evaluate specific risk events/trends.
- Take appropriate corrective action.

Strategic risk management also involves short and long-term trade-offs. Boards must try to balance both short and longer-term strategic risk. Strategic risk increases as the time horizon expands – the longer the time frame, the more unpredictable it becomes, and thus the more sophisticated the company’s capabilities need to become. Many companies are developing strategies that deal with a variety of alternative futures and scenarios to mitigate this problem.

The degree of strategic flexibility in response to a risk event must be considered. The robustness of the strategy in the context of the risk assessment findings must be evaluated. Likely, strategic responses to risk and their performance are aspects that must be fully understood.

The board as an ideas factory

Boards (or at least their non-executive components) ought to be strategic ‘idea factories’, taking a longer and wider ‘outsider’s’ view of their companies’ strategic options. They are failing in their duty if they merely rubber stamp the strategies devised by management. Instead, they should seek continually to stretch management thinking by the rigorous probing of strategic plans and investment proposals, by asking ‘what if’ and ‘why not’ questions, and by challenging the assumptions underlying strategy. Collectively and individually, directors add value to strategy formulation when they:

- Question the influence of global emerging trends and technologies.
- Inform themselves of global developments in the relevant industries.
- Translate their personal knowledge of changes in other industries and environments into their companies’ business contexts.
- Keep themselves open to new ways of doing things.
- Understand the linkages between business performance and best-practice benchmarks.
- Encourage a ‘holistic’ approach to all business functions.
- Ask if future customer needs and preferences are being anticipated.

Some of the directors’ strategic thinking will find its way into formal strategy reviews. Much of it will have a more informal influence. Managers will learn to anticipate directors’ questions, and will develop an understanding of directors’ strategic concerns. In this way the strategy formulation process can be ‘opened up’.

Strategy formulation

Those that survive the business battle do so because they enjoy some kind of competitive advantage that cannot be easily replicated. Increasingly, that advantage reflects the existence of a deliberate strategy designed to deliver a competitive edge, and consequently enhanced shareholder value. Most large companies (and many smaller ones) have evolved structures and processes for formulating strategy.

But do boards develop strategy?

Typically this is not the case. For most companies the reality is that their boards would benefit in taking more time to involve themselves in the process of strategy formulation and execution. Generally management develops the strategy under influence from the board. Boards can and should influence strategy formulation in at least six ways:

1. They must ensure that a proper strategic planning process is implemented.
2. They can set the parameters within which management develops strategy, which may include ensuring that short-term and longer-term strategies are balanced and that it provides a platform for sustainability.
Board strategy reviews should be as objective as possible, being based on facts rather than opinions. Boards may consider using external consultants to help structure the review and gather the relevant data. The results of the strategy review should be discussed by non-executive members of the board and the CEO – this is the appropriate occasion to air and resolve any differences between the board and management over strategic direction and implementation.

Remedial actions and new strategic initiatives can also be agreed at this time.

The primary purpose of board strategy reviews is to force both the board and management periodically to step back from day-to-day operational concerns, and re-examine underlying strategic issues. By making the reviews a formal, board-initiated process, boards assert their ultimate responsibility for strategy.

**Sustainability**

Sustainability has evolved from a routine CSI issue in the 1990s into a key strategic imperative for the boards of twenty-first century corporations. Unresolved social, economic and environmental challenges over the last two decades have led to increased regulation, altered market conditions and enhanced stakeholder expectations, presenting unprecedented risks and opportunities for companies. This places sustainability at the heart of a company’s business model and core to board-level decisions on growth, performance and compliance.

Far from being a line function devolved to CSI departments, sustainability today defines a company’s licence to operate and warrants attention at the highest organisational levels. In response, boards need to evaluate the impact of sustainability issues on their organisation and develop strategies to respond to these changes.

**Defining sustainability**

The most widely stated definition of sustainability is that of the World Commission on Environment and Development, which states that “development is sustainable when it meets the needs of the present without compromising the ability of future generations to meet their own needs”. This integrates notions of justice, fairness and equity and embeds sustainability within the pursuit of development.

For the private sector, sustainability is aimed at creating long-term value for the organisation by aligning a company’s financial interests with a positive social, economic and environmental outcome for the context within which it operates. No longer concerned with short-term profits at all costs, boards that embrace sustainability recognise the substantial benefits of meeting today’s key developmental challenges and the pitfalls of not doing so. Seen in this light, sustainability becomes a key driving force for organisational growth, performance and compliance.

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Sustainability and the link to strategy and risk

Embedding sustainability within an organisation requires boards to widen their perception of a company’s boundaries when considering strategy and risk. Shareholders are no longer the only custodian of a company’s fortunes. Rather, success and failure is determined by the company’s ability to meet the expectations of its employees, customers, the government and the communities within which it operates. These multiple priorities can be seen as an imperative for companies to deliver on a triple bottom line of economic, social and environmental performance.

Economic

The emerging sustainability paradigm requires companies to go beyond simply providing adequate financial returns to shareholders. It places economic accountability on the board to create and distribute wealth fairly and equitably, thereby meeting the economic needs of each of its stakeholder groups. This is borne out of recognition that many of the top economic entities in the world (by monetary value) are companies, the power, reach and influence of whom often surpasses that of national governments. For boards considering the economic accountability of their companies, the following issues are relevant:

• Is the company able to create sustainable value for communities beyond the life of its operations?
• Can the company promote local capacity building through its supply chain and support local values-led growth?
• How can the company’s economic contributions be prevented from inadvertently supporting dishonest political regimes and corrupt public governance?
• How can the company’s remuneration structure be protected from unduly exacerbating income inequalities amongst its labour source?

These moral imperatives are increasingly underpinning regulations such as new legal controls on the compensation of employees in the financial services industry. Consequently, by a failure to board to ensure economic accountability may have significant financial implications in the short-run as well as undermine long-term growth prospects through a loss in confidence in the company.

However, seen in a positive light, this new paradigm provides an unprecedented opportunity to address the urgent needs of the bottom billions for whom purely profit-led growth has never ‘trickled down’.

Developing products and services to meet the needs of this rapidly expanding mass provides an opportunity for companies to profit from meeting the world’s most pressing developmental challenges.

Social

The board’s concern with the social impact of the company’s operations is fundamentally linked to creating long-term value for the organisation. This is because supporting social development is as much a business issue as it is a moral imperative, providing a company with a licence to operate for now and the future. Ensuring social cohesion and development can help companies secure property rights and ensure the security of its investments as well as enhance reputation and expand the customer base.

On the contrary, the pursuit of profits at the expense of a degenerating social order detracts from the creation of value in the long-term through direct economic losses, reduced purchasing power of consumers and reputational damage.

Environmental

Environmental stewardship will be a key business driver in the twenty first century and is deeply embedded within company strategy, risk and performance. The attention of the board should be directed towards the risks and opportunities presented by environmental degradation. Increasingly, natural resources such as carbon, water and biodiversity are being priced, forcing them to be included in economic decision making at an organisational level. Where prices currently exist, these will be increased and be expanded to have greater coverage. Where there are no charges today, new pricing systems will be developed. The pricing of free environmental goods and services represents a key commercial risk for companies.

However, the shift to a resource-constrained economy also provides significant business opportunities. Developing products and services to use natural resources more efficiently and reduce wastage can be seen as the ‘next wave of innovation’. The benefits of embracing the drive for environmental sustainability include unprecedented new markets and customer segments, internal operational efficiencies and enhanced brand value.

Through its supply chain, a company can affect the well-being of many individuals and companies on key social indicators such as:

• Gender equality.
• Ethnic and racial integration.
• Community values and ethics.
• Human rights.
CHAPTER 10

Risk Management and Performance
Performance – setting goals

Companies proudly proclaim their role and purpose in the world. They will make declarations of their vision, their mission and their core corporate objectives. Problems can arise when companies fail to live up to their rhetoric.

Boards often approve corporate objectives without considering what these actually mean, how they will be measured or how they will be achieved. But in so doing they create a potentially embarrassing gap between what they say and what they do. They find themselves trying to reconcile the irrecconcilable – something for which there is no quick fix, and can affect the market valuation of the company. When strategic plans are adopted, they need to be specific, limited, realistic and time driven, nominating target dates where possible.

Ultimately, however, in listed companies the corporate vision must be linked to the necessity of preserving and enhancing sustainable shareowner value. This focus on shareowner value must, of course, be balanced with a need for responsibility to other stakeholders. Without the value imperative, companies will eventually wither and die, or they will fall prey to more aggressive and focused rivals. By way of contrast, companies that pursue the notion of shareowner value enjoy such important advantages as:

- Management becomes focused on the pursuit of clearly-defined, measurable objectives.
- Boards are given a disciplined framework within which to make business decisions.
- Boards can use value creation as an objective benchmark for evaluating management and their own performance.
- Shareholders are left in no doubt that their boards are working in their interests.

However, these companies also understand their responsibilities to relevant stakeholders.

Risk and return

Shareholders reward performance, not the avoidance or minimisation of business risk. In practice, directors cannot and should not try to avoid risk – it is an inescapable part of doing business.

This does not mean directors can take a cavalier attitude to business risk. Directors are still expected to make informed business judgements, and they must have a rational belief that their decisions are in the best interests of the company.

Shareholders typically measure performance in financial terms, but is that an appropriate view? The acceptance of risk allows companies to create value, risk management is the way management tries to optimise the balance between the opportunities it unlocks by taking risk, and the cost of protecting the value the company is putting at risk.

Adjusting financial returns to reflect the amount of risk the shareholders faces provides a unique perspective on returns (a clear reflection of management’s effectiveness in balancing the risk/reward trade-off).

In considering strategic risk, directors should therefore remind themselves that an excessive aversion to risk is almost certainly incompatible with the creation of long-term value. Risk aversion will delay, or even paralyse, decision making. In approving the company’s risk management policy, the board should define the level of risk tolerance (i.e. what is acceptable and what is not acceptable).

Sophisticated shareholders make their own risk/reward trade-offs. They accept there is a general relationship between risk and reward: the higher the risk, the higher the potential return required to justify the acceptance of that risk. This is not a simple linear relationship. As such the assessment of the risk is critical for the determination of whether the return would be sufficient.

Boards should periodically review their risk/reward positioning, making as objective a judgment as possible. Problems arise when a board’s own view of its risk/reward status differs significantly from that of the investors.

Investors will accept volatile earnings, particularly if that volatility reflects the nature of a company’s industry. However, investors are less tolerant of unpredictable earnings (i.e. major swings in the level of earnings that have not been previously signaled and explained to shareholders and the market generally). In the eyes of investors, unpredictability increases the risk factor. Perceptions of unpredictability often result from a failure of communication.

Effective value measurement helps companies illuminate the nature of their risk/reward trade-offs. By way of example, boards commonly ‘spread risk’ by allocating capital spending across a portfolio of businesses. More astute boards engage in strategic investment, or value management, allocating most resources only to those projects or businesses likely to earn positive returns after allowing for the cost of capital.

Non-strategic investment practices usually reflect the belief that capital is scarce and must be rationed. Value management holds that capital is not scarce, but that it does have a cost as alluded to earlier. Value-creating investments are scarce, not capital.

It is fair to conclude with the King III view that risk management should be intrusive, its methodology and techniques should be embedded within strategy setting, planning and business processes to safeguard performance and sustainability. The rigours of risk management should provide responses and interventions that strive to create an appropriate balance between risk and reward within the company.

Risk management

Risk management is imperative for the following reasons:

- Risk and strategy are inseparable. Since good risk management aims to create value through the exploitation of opportunities whilst preserving value already in its hands, it could be said that good risk management is nothing other than good management.
- King III is applicable to all companies and risk management is regarded as a central component of good governance.
- The Companies Act, 71 of 2008 burdens the audit committee with very specific risk management responsibilities.
- King III states that “the board should be responsible for the governance of risk through formal processes, which includes the total system and process of risk management.” To this end it “should be able to demonstrate that it has dealt with the governance of risk comprehensively.”

The board should firstly ensure that the appropriate building blocks for risk management are put in place. These building blocks provide a framework within which risk management can be executed, delivering consistent results. They typically include the following:

- Ensuring that responsibility for risk management is clarified and recorded in the board charter and, where applicable, committee terms of reference.
- Approving the risk management policy and plan developed by the executive directors and senior management.
- Setting the company’s appetite and tolerance for risk – those risks it will take and those it will not take in the pursuit of its goals and objectives.
- Ensuring that the company has implemented an effective ongoing process to identify risk, to measure its potential impact against a broad set of assumptions, and then to activate what is necessary to proactively manage these risks.
- Ensuring that appropriate monitoring and reporting structures and processes are put in place.
- Delegating to management the responsibility for designing, implementing and monitoring the system and process of risk management.

Secondly, it should prevent risk management arrangements from becoming a series of activities that are detached from the realities of the company’s business:

- As such the first step is to clearly communicate the risk management policy to all employees so as to ensure that the risk strategy is incorporated into the language and culture of the company.
- Further to this, the board should provide oversight over the risk management process and its consequences. Ultimately, King III says, “the rigours of risk management should provide responses and interventions that strive to create an appropriate balance between risk and reward within the company.” It is a matter of substance and form.
- Lastly, the board should be able to disclose how it satisfied that risk assessments, responses and interventions are effective. This assessment of its effectiveness will be based on the combined assurance received from various assurance providers as well as their own consideration of the management information flowing to them. This assessment of the effectiveness of the company’s risk management processes should be made public in the integrated report.

### The risk universe

There are many different models for categorising risks. Some institutions define and promote generic categories such as strategic, financial, operational and hazard. More specific industry categories have also been defined such as those contained in Basel II (market, credit, operational, strategic and reputation) and Solvency II (insurance, market, liquidity, credit, operational). The naming convention is not important. There are three important considerations when considering the risk universe:

1. **Span of coverage**
   The risk management process should cover the full spectrum of risk across the company’s span of activities.

2. **Depth of coverage**
   The last element is closely related to the span requirement. The process should cover all levels of the organisation.

### 3. Process flexibility

The risk management processes of a company must facilitate the identification, management and monitoring of the risks currently known, yet must remain flexible enough to include emerging risks in the future. The need for such flexibility is paramount because of the dynamic nature of the risk universe.

Since risks are associated with the specific objectives, typical classification protocols often mirror the categorisation of these objective e.g. strategic, business, operational, technical and pure risks.

### Risk assessments

A risk assessment is the process by which the threats to the achievement of organisational goals are identified, described and their significance estimated. Comprehensive identification using a well-structured systematic process is critical, because risks not identified are not further analysed and potentially are not managed.

There are many different processes and methodologies in use by which risks can be identified, i.e. risk workshops, interviews, research, control and risk self assessments. At a minimum, a risk assessment should result in the:

- Identification of relevant risks towards the achievement of objectives.
- The prioritisation of risks, which often necessitates estimating the timing, magnitude and probability of risk occurrence.

This involves the following steps:

**Step One: Strategic objectives**

The most important aspect of risk management is the effective identification of the major risks that may impact on the company achieving its objectives. The risk assessment process should therefore commence with the identification of the company’s strategic intent, which King III suggests should at the very least include the three bottom line (sustainable economical, social and environmental performance). Furthermore, it is imperative to map the strategies it intends to use in its pursuit of the strategic objectives as different strategies may expose the organisation to different types of risk.

**Step Two: Identification**

Comprehensive identification of risks is best achieved through the use of a structured approach focused on the company objectives, its chosen strategies, and exploring all the areas mentioned in the risk universe above.

To ensure appropriate consideration of all potential threats it is imperative that the process of risk identification is separated from that of its quantification. If this is not done potentially catastrophic risk events may be discarded before it is adequately considered simply because of its perceived low probability of occurrence. These events are often referred to as “black swan” events.

The process of risk management should include all risks that threaten the goals of the company, irrespective of whether they are controllable or not.

The following should be formally recorded:

- A description of the unwanted event.
- The root causes or factors that shape the risk.
- A qualitative description of the risk’s potential consequences should it materialise.
- More advanced risk cultures will also profile aggregated risks, correlated and risk concentrations.
Step Three: Risk prioritisation

The next step after identification of the risks is the quantification of their potential effect on the company. Each identified risk should now be assessed in terms of its impact on the company, as well as the likelihood that the risk will materialise at that impact level.

It is important to use a methodology that enables risks to be prioritised in terms of inherent risk and residual risk. Inherent risks are those risks that the company is exposed to before the effect of mitigating management action is taken into account, i.e., the company is exposed to those risks by the mere fact of operating its particular business. Residual risk is the level of exposure remaining after the application of controls. The scoring of the inherent and residual exposure levels allow management and internal audit alike to prioritise the risks and focus their attention and resources.

Further to this, the perspective gained from the analysis of inherent and residual risks will, together with a consideration of the company’s risk appetite and tolerance levels, influence management’s choice of risk response. One of the key drivers that help to direct the efforts and resources to manage risks down to an acceptable level of residual risk.

Risk responses

The company’s risk appetite or tolerance thresholds are the triggers for management to take action. There are four responses to any risk:

1. Tolerating or accepting the risk, as it may fall inside the company’s specific appetite at that time, or may be too costly to reduce or re-insure.
2. The most common response to risk exposure that is in excess of these thresholds is to develop action plans to improve the control structure enhancing residual risk under an acceptable level. Such enhancement of the control structure should reduce the likelihood that a risk might materialise, or reduce the severity of its impact should it occur, or may reduce to a residual level. This highlights the importance of documenting both the root causes and the consequences of risks during the identification phase.
3. Terminating or avoiding the risk, i.e. getting out of a specific market or country, as the risk may not be manageable or control may be too expensive to implement.
4. Transferring the risk exposure. This is typically done through insurance products but alternatives do exist such as entering into a joint venture.

Ultimately, the response to risks depends on the organisation’s risk appetite, what it is trying to achieve and the resources it has available to implement controls.

Having considered response options for identified risks prudent management calls for contingency planning for those risks that have not been identified. These are surprise events that may hold significant repercussions for the company. A company’s ability to respond to such surprise events must be assessed and measures developed. Post-event measures include crisis management capabilities, emergency planning, business continuity plans and contingency planning. These responses should incorporate planned measures that cover the basic types of managerial response, such as operations, finance, employees, technology and stakeholders.

The criteria for post-event capability will include:

- Speed of response
- Comprehensive response
- Degree of readiness

The company’s risk appetite or tolerance thresholds are the triggers for management to take action.

Accountability and responsibility structure

A successful risk management programme is dependent on introducing an effective accountability and responsibility structure.

Risk structures

The purpose of a company’s risk management structure is to align clearly all parts of the business in a common approach to risk management, supporting the creation of a single and consistent view of risk management across the business.

As management is accountable to the board for designing, implementing and monitoring the risk management process, as well as providing assurance that the process is in place and working, many companies have introduced chief risk officers (CRO), and are managing risks through risk committees, or similar vehicles. This provides specific assurance that there are forums or times of focus and feedback on risks, controls and risk management per se. This is in direct contrast to the top that many companies fall into, of asserting that risks are discussed, in any event, at management and executive meetings.

The risk committee should at least review the following:

- Risk management progress and maturity.
- Risk management effectiveness.
- Key risks.
- Remedial action.

In practice companies often allocate risk responsibility to the audit committee. King III cautions that although it is permissible the board should carefully consider the resources available to the audit committee.

In order to provide sound risk management oversight the designated committee should possess the following:

- Depth in operational knowledge and understanding of the company.
- A solid appreciation for the risk management process.
- An appropriate balance in composition to provide objectivity in oversight.

Lacking any of these requirements may result in the inability to challenge management’s risk assessment, their remedial actions taken and/or the adequacy of the risk management process.

Risk management and policy and procedure

King III requires the board of directors to approve annually a risk management policy and plan as part of their governance of risk responsibility. The development of such a policy and plan is typically delegated to management.

The risk management policy should set the tone for risk management in the company and should indicate how risk management will support the company’s strategy, according to King III. This policy should be widely distributed to provide the platform for a common risk understanding throughout the company.

The risk management plan aims to bridge the gap between the current maturity of the company’s risk management arrangements and its desired maturity level. At the board level the plan should reflect as a minimum what needs to be improved and the associated timelines. More detailed project plans should be developed at a managerial level.

Although the board is charged with the responsibility to review the risk management plan at least annually, it also needs to ensure that management monitors the implementation of the plan on a continual basis.

The eventual goal is to establish a risk aware culture within the organisation, and for managing risk appropriately on a day-to-day basis.
Risk management tools
Organisations today should demand risk management databases and systems with the ability to represent accurately their business models, operations and structures, with inherent flexibility for change and growth. The increase in globalisation, and at the very least national operations or multiple locations, requires on-line, real-time access to updated risk and control information.

There is a variety of software solutions available to ensure that risk management is supported, in whatever format, the company might require. However, business is cautioned not to equate purchasing a software solution to better risk management.

Performance management and risk management
Performance management can and should be directly linked to risk management, i.e. the expectation is that management and staff should be deployed to manage the risks to which the company is exposed, and be measured and rewarded on the effectiveness of doing so. Risks are managed through actions and controls. The effectiveness of the actions and controls should be measured and continually improved, until the optimal level of residual risk is attained. Residual risk/exposure is the product of inherent risk reduced by control effectiveness.

Based on the value of the residual risk/exposure, members of management will decide whether or not they are willing to accept the identified level of residual risk/exposure. If the residual risk is considered to be too high, then an action plan should be outlined to reduce the risk to a level that is more acceptable to management and the other stakeholders.

Management actions may include the re-examination of the control design and/or the business/quality objective identified earlier in the risk management process.

The action plans must clearly identify:
• The required action.
• The person responsible for implementing the action.
• The expected date of implementation.

The latter should all be incorporated into the performance management system, and forms a good basis for setting and measuring the achievement of targets.

Reporting of risk management
The board should ensure that risks are continually monitored by management and that risk management awareness and activities are embedded into the organisation’s day-to-day operations. To this end the board depends on information flowing to them through the company’s governance structures.

There are two primary reasons for which the board needs information:
Firstly, the board needs to review the effectiveness of the risk management process. Consequently they depend on the assurances provided by various players making up the three lines of defence, the most notable of which is the independent review of the integrity and robustness of the system of internal controls and risk management by internal audit or an appropriately qualified external service provider. The review of the risk management process is not merely a disclosure relating only to internal controls, as this would mean that it is internally focused. As mentioned before, the largest risks often emanate from outside the company, hence the need for a comprehensive risk management process.

Secondly, critical risk information should be communicated in order for the board to take cognisance of it, and its potential repercussions, in its decision making. The information typically reported are:
• Key risks.
• The effectiveness of remedial actions.
• Changes to the risk profile.
• Incidents and losses.

The development of comprehensive assurance structures and activities are paramount. Although the need for the board to express an opinion regarding the effectiveness of risk management is a motivator for assurance activities, it is the need to manage risks effectively that is its prime driver; it is about making sure that risk management becomes a real part of day-to-day activities. The assurance arrangements of the company should provide comprehensive assurance coverage where key players in the company combine to provide assurance to the board that risks are being appropriately managed. This combined approach to assurance normally involves the external auditors, internal auditors and management working together through the company’s committee structure. Other subject matter experts may be utilised to provide assurance regarding specialised categories of risk, such as environmental management and occupational health and safety management. Internal audit’s role needs specific mention here. Notwithstanding its role to assess control effectiveness, it or an external, objective party with adequate expertise, should provide an assessment of the adequacy of the overall risk management process.

Ultimately a successful risk management programme is dependent on introducing an effective accountability and responsibility structure that is formally documented and incorporates appropriate reporting processes.

Minimum disclosure requirements for risk management
King III states that the board is responsible for disclosures relating to risk management and should, at a minimum, disclose:
• Its views on the effectiveness of the company’s risk management processes in the integrated report.
• Any current, imminent or envisaged risk that may threaten the long-term sustainability of the company.
• Any undue, unexpected or unusual risks it has taken in the pursuit of reward as well as any material losses and the causes of the losses.

Following on these required many entities struggle with the issue of whether to disclose the specific contents of risk registers. Ultimately the entity’s philosophy of stakeholder reporting and corporate governance, together with due regard for commercially-sensitive information, should guide decisions relating to risk reporting. Disclosure statements are typically drafted by management and approved by the board after due consideration.

Disclosures in the integrated report should be made based on defensible and formal risk management processes and structures that are in place.
CHAPTER 11

Information Technology Governance
Introduction

A need for a well-governed IT function is becoming more apparent as business leaders are forced to critically evaluate their cost and value chains in challenging economic environments. Additionally, their compliance, audit, risk and security environments are becoming the focus of attention in a world where regulatory compliance can fundamentally impair or enable the operations of a business.

IT governance is a subset discipline of corporate governance focused on IT systems and their risk and performance management. The rising interest in IT governance is partly due to compliance initiatives, for instance Sarbanes-Oxley (SOX) in the USA and Basel II in Europe, as well as the acknowledgment that IT projects can easily get out of control and profoundly affect the performance of an organisation.

A characteristic theme of IT governance discussions is that the organisation’s IT capability can no longer be a black-box to the business. The traditional involvement of board-level executives in IT issues was to defer all key decisions to the company’s IT professionals. IT governance implies a system in which all stakeholders, including the board, internal customers, and in particular departments such as finance, have the necessary input into the decision-making process. This prevents IT from independently making and later being held solely responsible for poor decisions. It also prevents critical users from later finding that the system does not behave or perform as expected.

The discipline of IT governance is supported by a number of reference frameworks to guide its implementation. Of these probably the most prominent are Control Objectives for Information and related Technology (COBIT), the IT Infrastructure Library (ITIL) and ISO27001 (previously ISO17799). IT governance is a framework that is implemented to support a business. Since no two businesses are exactly alike, it stands to reason that their governance frameworks would need to be catered to the specific risk and performance environment that they operate in. As such, reference frameworks should not be taken as verbatim implementation templates for an organisation, but rather as starting points for a guided discussion on the best governance framework for the organisation.

IT governance as it relates to King III

King III states “Information systems were used as an enabler to business, but have now become pervasive in the sense that they are built into the strategy of the business. The risks involved in IT governance have become significant.

We therefore deal with IT governance in detail in King III for the first time. There is no doubt that there are operational risks when one has a service provider because confidential information leaves the company. In IT governance, one seeks confidentiality, integrity and availability of the functioning of the system; possession of the system, authenticity of system information; and assurance that the system is usable and useful. Concerns are unauthorised use, access, disclosure, disruption or changes to the information system.

In exercising their duty of care, directors should ensure that prudent and reasonable steps have been taken in regard to IT governance. Legislation is not the answer. International guidelines such as COBIT or ITIL may be used as a check or audit for the adequacy of the company’s information security, but it is not possible to have one size fits all.”

The importance of IT governance in the corporate governance landscape has clearly been elevated, in line with the more central role that IT has taken in the business value-chain and the associated risk and performance considerations that they present.
Who’s responsibility is IT governance?

King III clearly states that responsibility for IT governance in the organisation ultimately lies with the board, including establishing and promoting an ethical governance culture, as well as gaining independent assurance on the effectiveness of the internal controls. Having said that, the structures, processes and mechanisms that are required and guided by the IT governance framework should be implemented, controlled and monitored by management. King III recommends that the CEO appoint a suitably qualified and experienced CIO to be responsible for the management of IT, however this would only be practical in medium to large organisations.

Principles of King III

Principle 1 – The board should be responsible for IT governance

In terms of King III, the board has the responsibility for:

- Direction.
- Evaluation.
- Monitoring of the use of IT to support the business strategy.

The board can delegate these responsibilities to the CIO who needs to ensure that proper IT governance is in place by:

- Establishing accountability.
- Ensuring that proper processes are defined.
- Building capability.

The board may appoint various governing bodies to assist it in carrying out its responsibilities regarding IT governance. These governance bodies can include:

- An IT steering committee with relevant representation from business and IT to assist with its governance of IT.
- A risk committee and audit committee should assist the board in carrying out its IT responsibilities.

Direction

King III requires ethical leadership from the board based on responsibility, accountability, fairness and transparency. In terms of IT the board should:

- Ensure that IT is placed on the board agenda.
- Clarify business strategies and objectives, and the role of IT in achieving them.
- Delegate responsibility for implementing an IT governance framework to management.
- Determine and communicate levels of risk tolerance/appetite.
- Oversee the development of the information security strategy and delegate its implementation to IT management.
- Assign accountability for the organisational changes needed for IT to succeed.

Evaluation

The board should:

- Ensure that proper IT governance frameworks, policies and procedures are in place.
- Ensure that an internal control framework has been adopted, implemented and is effective.
- Monitor the application of King III governance principles by all parties, at all levels (starting with the Board), at all stages of business operations, across organisational boundaries (including third parties) and for the acquisition and disposal of IT goods and services.
- Obtain project assurance from independent experts that IT management apply all basic elements.
- Obtain independent assurance of the governance and controls supporting outsourced services.

Monitoring the use of IT to support the business strategy

The need for board level oversight of IT activities depends on the strategic importance of IT to the company and the organisational maturity of its IT management processes. In deciding on delegating responsibility, the board should give consideration to the company’s reliance on:

- The importance of cost-effective, uninterrupted, secure, smoothly operating technology systems.
- Any competitive advantage that the organisation might gain through systems that provide new value-added services and products responsiveness to customers.
- The capital expenditure and corporate cost of strategic transformation.
- Innovation and large-scale expenditure on new technology.

King III recommended practices:

- "The board should assume the responsibility for the governance of IT and place it on the board agenda.
- The board should ensure that an IT charter and policies are established and implemented.
- The board should ensure that an IT steering committee with relevant representation from business and IT to assist with its governance of IT is appointed.
- The board should ensure that an IT internal control framework is adopted and implemented.
- The board should receive independent assurance on the effectiveness of the IT internal controls."

Principle 2 – IT should be aligned with the performance and sustainability objectives of the company

Corporate objectives can only be attained if IT resources are managed in an effective and efficient manner. IT plays a support function to business and should assist business in reaching its strategic objectives and goals.

Business goals should be cascaded into IT goals which in turn are translated into IT processes and procedures. Through effective controls, IT ensures that its processes are aligned to the business objectives which in turn ensure that the business operates in a sustainable and well governed manner. This might seem extremely logical, but many businesses fail due to the misalignment between what IT thinks the business needs and what value the business actually expects from IT.
King III requires the board to ensure that the IT strategy is integrated with the company’s strategic and business processes. Management must implement strategic IT planning processes that are integrated with the business strategy development process, and ensures that:

- IT plans are integrated with the business plans and IT operations are aligned with business operations.
- The IT function, roles and reporting lines are structured to reflect the integration of IT with the business operations.
- The effect of IT on the environment is considered.
- There is a process in place to identify and exploit opportunities where IT can create value and avoid the company to gain competitive advantage for the company.
- The IT steering committee contains both business and IT representation.

**Sustainability**

King III states that IT management is to implement a robust process to identify and exploit, where appropriate, opportunities to improve performance and sustainability of the company in line with triple bottom line objectives.

Aligning IT activities with environmental sustainability objectives requires management to consider the environmental aspects and significant impacts of IT and IT activities, including:

- Energy saving.
- Avoidance of wasteful expenditure.
- Avoidance of unnecessary CO₂ emissions.

Direction from the board will ensure that green IT initiatives are aligned with the company’s overall strategy and its corporate social responsibility programme. Green IT principles would be based on the environmental policy established by the board. These principles provide decision makers with predefined preferences when alternative options are available.

**King III recommended practices:**

- “The board should ensure that the IT strategy is integrated with the company’s strategic and business processes.”
- “The board should ensure that there is a process in place to identify and exploit opportunities to improve the performance and sustainability of the company through the use of IT.”

**Principle 3 – The board should delegate to management the responsibility for the implementation of an IT governance framework**

King III states that the board should delegate to management the responsibility for the implementation of an IT governance framework into the organisation, while still retaining accountability for overall IT governance in line with Principle 1. An IT governance framework is a collection of structures, processes, controls and mechanisms and could be said to be business-focused, process-oriented, controls-based and measurement-driven.

**Formulation and implementation**

An IT governance framework is not a “one-size-fits-all” template that can be applied to any organisation. Given the widely ranging size, degree of dependence on IT and regulatory environment of organisations, the process of developing and implementing IT governance should be carried out using reference guidelines and tailoring them to the organisation.

There are well-regarded reference frameworks and standards that can be used in the formulation of an IT governance framework, such as COBIT, ITIL, Calder-Moir (ISO38500) and ISO27001 (previously ISO17798). These can be used to assess the current and desired maturity of IT governance in the organisation as well as to form an implementation roadmap, based on organisational priorities, and a continuous monitoring and reporting framework.

**King III recommended practices**

- “Management should be responsible for the implementation of the structures, processes and mechanisms for the IT governance framework.”
- The board may appoint an IT steering committee or similar function to assist with its governance of IT.
- The CEO should appoint a CIO responsible for the management of IT.
- The CIO should be a suitably qualified and experienced person who should have access and interact regularly on strategic IT matters with the board and/or appropriate board committee and executive management.”

**Principle 4 – The board should monitor and evaluate significant IT investments and expenditure**

Central to the definition of IT governance in King III is the effective and efficient management of IT resources. The board should ensure that the company treats all its resources responsibly and that this performance should be reported on in an integrated report.

Directors have a fiduciary duty to act in the best interest of the company. This requires the board to direct management to focus on ensuring the optimal use of available resources, including knowledge, infrastructure and partnerships.

An important aspect of managing investments in capital expenditure projects relates to the investment in the intellectual property assets that are fit-for-purpose and that supports and/or enhances the current IT environment.

The ITIL defines Software Asset Management (SAM) as “all of the infrastructure and processes necessary for the effective management, control, and protection of the software assets within an organisation, throughout all stages of their lifecycle.”

SAM is not simply an exercise in compliance, but also a means of reducing budgetary surprises in the event of an audit by a software publisher. Good corporate governance dictates that a company is fully aware of where and how its assets are being used.

This is the essence of SAM, which enables an organisation’s IT governance function to implement greater sophistication in the control and management of software deployment.

As far as monitoring and evaluation of significant IT investments and expenditure are concerned, King III states that board responsibilities include:

- “Monitoring and evaluating the extent to which IT actually sustains and enhances the company’s strategic objectives.”
- Monitoring and evaluating the acquisition and use of IT resources to ensure that they support business requirements.
- Monitoring and evaluating the acquisition and appropriate use of technology, process and people.
- Overseeing IT investment to ensure that IT expenditure is in proportion to the delivery of business value.”
Ensuring good governance principles apply to all parties that provide IT resources. This includes suppliers of hardware, software, skills and IT services.

Remaining accountable for ensuring that effective IT governance is in place where a resource has been “outsourced.”

Whilst outsourcing is now common practice the board should be concerned about various aspects of outsourcing. King III therefore recommends that the board should obtain independent assurance on the IT governance and controls supporting outsourced IT services. Over and above getting assurance on the governance and control environment in outsourced services the board should also consider:

- The company’s capability to outsource – is it really the right decision?
- Capability of service providers to provide contracted services.
- The additional risks that the company exposes itself to when outsourcing such as compliance, staff turnover, control of costs. Transferring a risk by outsourcing the activity to which the risk is related does not mean that the board no longer has any accountability for managing the risk.
- The sometimes complex nature of third-party contracts and the considerable expertise needed to manage third party suppliers in an effective manner.
- The adequacy of the service level agreements that should be in place – does the third party supplier really offer the right services within the right timeframe to the organisation?
- Pricing and charging practices of third party suppliers.
- What capability is required at termination of the outsourcing contract?

King III recommended practices:

- “The board should oversee the value delivery of IT and monitor the return on investment from significant IT projects.”
- The board should ensure that intellectual property contained in information systems are protected.
- The board should obtain independent assurance on the IT governance and controls supporting outsourced IT services.”

Principle 5 – IT should form an integral part of the company’s risk management

Each day organisations face not only risk in the form of external onslaughts such as fraud or information security breaches, but also risks related to the use of IT. One of the biggest risks related to IT is the failure of the IT systems that would cause severe disruption in business operations and could prevent the business from reaching their strategic objectives.

King III requires that IT risks form part of the company’s risk management. IT management should regularly demonstrate to the board that the company has a robust risk management process in place. The CIO should use this risk appetite as the basis for implementing a risk management process across the IT function and to establish an IT risk management plan.

Is managing IT related risk different from managing other types of risk?

King III requires risk identification to be directed in the context of the company’s purpose and to focus on strategic and operational risks.

Risk identification should not rely solely on the perceptions of a select group of managers. A thorough approach to risk identification is required. Consideration should be given to reputation risk and IT legal risks.

King III also states that the board should ensure that key risks are quantified and are responded to appropriately. The board is to decide which risks are significant.

It is important that the board and management develop a clear, shared understanding of the risks that are acceptable or likely to become unacceptable and then decide how they will manage the risks and control strategies.

The board should ensure that risks are validated with relevant stakeholders to confirm the:

- Accuracy and validity of risk information recorded.
- Assumptions made in assessment of the risk information provided.
- The need for any additional data or information on the effectiveness of the control environment.

Risks evaluated should be prioritised and ranked to focus risk response measures on those risks outside the board’s risk tolerance limits.

King III recommended practices:

- “Management should regularly demonstrate to the board that the company has adequate business resilience arrangements in place for disaster recovery.
- The board should ensure that the company complies with IT laws and that IT related rules, codes and standards are considered.”

Principle 6 – The board should ensure that information assets are managed effectively

According to King III “Information security deals with the protection of information, in its electronic and paper-based forms, as it progresses through the information lifecycle for capture, processing, use, storage, and destruction. For this reason, information security has to address people, process and technology-related dimensions in order to be truly effective.”

Core principles

The key core principles of information security are encapsulated in the following three components:

1. Confidentiality
   Ensuring that information is accessible only to those authorised to have access.

2. Integrity
   Safeguarding the accuracy and completeness of information and processing methods.

3. Availability
   Ensuring that authorised users have access to information and associated assets when required.

As with all strategic initiatives within an organisation, the information security strategy will need to be driven by the business strategic direction in order to be truly effective. Successful implementation of information security within an organisation will give the board confidence that it is contributing to enabling the business strategy, sustaining normal business operations, managing risk, avoiding unnecessary costs, reduced chance of litigation due to legal liability and meeting compliance requirements.

Information security is a discipline that is not centred on technology, however with many of an organisation’s information assets now being resident in IT systems the two have become strongly intertwined.
Information assets

Information assets can be described as data that is central to the processes of the business. Traditionally, information assets were held in physical document format. With the pervasiveness of technology into the modern business world, the definition for information assets has now been expanded to include documents, files and information stored on file servers, databases and application systems. Additionally, the medium that the assets reside on also form elements that need to be protected as part of information security. These include paper, hard-disk, removable disk, CD-ROM and magnetic tape, as well as network based storage technologies such as Network Attached Storage (NAS) and Storage Area Networks (SAN).

Processes

The widely accepted standard for Information Security is encapsulated in the ISO27000 series as published jointly by the International Organisation for Standardisation (ISO) and the International Electrotechnical Commission (IEC). The standard outlines the following core components which should be contained in the organisation’s information security function:
- Risk assessment.
- Security policy.
- Organisation of information security.
- Asset management.
- Human resources security.
- Physical / environmental security.
- Communications and operations management.
- Access control.
- Information systems acquisition, development and maintenance.
- Information security incident management.
- Business continuity management.
- Compliance.

Additionally, technical change management should be considered an integral process in the organisation’s pursuit of information and system security.

King III recommended practices

- "The board should ensure that there are systems in place for the management of information which should include information security, information management and information privacy.
- The board should ensure that all personal information is treated by the company as an important business asset and is identified.
- The board should ensure that an information security management system is developed and implemented.
- The board should approve the information security strategy and delegate and empower management to implement the strategy."

Principle 7 – A risk committee and audit committee should assist the board in carrying out its IT responsibilities

King III gives extensive guidance in terms of the mandate, composition and responsibilities of the audit and risk committees as they apply to the entire organisation. What follows is an exploration of the committees as they relate to IT:

Audit and risk committee

The audit and risk committee allows the board to obtain independent assurance on IT governance and controls. The role of the risk committee is to ensure that IT risks are adequately addressed and receive appropriate assurance on controls, while the role of the audit committee is to consider IT in relation to financial reporting and the going concern.

The disciplines of IT audit in support of the financial audit and internal IT audit should not be confused and should be treated as having separate purposes, namely assurance of IT systems that support financial processes and assurance on IT governance, respectively.

Assurance

As part of the ongoing assessment of IT governance in the organisation, a clear view should be maintained of the risk and control environment specifically as it relates to IT. The risks that the business faces by virtue of its use of IT, as well as the associated controls used to mitigate those risks, should be assessed and clearly placed in an organisation-wide risk management framework. This framework should be periodically reviewed to ensure continuing relevance of the risks and controls in the organisation’s strategic and operational environment.

Based on this framework, a discipline of continuous auditing should be put in place to provide assurance on the operating effectiveness of the mitigating controls. These outcomes should be reported to the relevant risk and audit committees and action plans put in place for remediation should gaps be identified.

King III recommended practices

- “The risk committee should ensure that IT risks are adequately addressed.
- The risk committee should obtain appropriate assurance that controls are in place and effective in addressing IT risks.
- The audit committee should consider IT as it relates to financial reporting and the going concern of the company.
- The audit committee should consider the use of technology to improve audit coverage and efficiency.”

In conclusion, IT governance has become a matter for the board. Gone are the days when responsibility for IT can be delegated to executive management or the IT gurus, without accountability being part of the directors collective set of duties.
Introduction

A fundamental element of any corporate governance objective is to ensure that there is an appropriate system of internal control embedded within the organisation. Directors should ensure that this system is designed and operates in a manner that mitigates organisational risk and achieves corporate objectives.

Ultimately, the board is responsible for ensuring that a comprehensive system of internal control exists. Having an appropriate control environment assists an organisation set the tone and culture of the company. However, it is prudent that the board receives regular feedback from various assurance providers that the system of internal control works and mitigates risks associated with their corporate objectives and strategy.

Internal control

A system of internal control, in one form or another, is essential to, and is present in all, successful enterprises. The formality and nature of any internal control system will vary with the size, nature and maturity of the company and different forms of stakeholders. Controls should be implemented that are cost-effective in relation to the risks they are mitigating, and in order to assist the company achieve its objectives.

There are many definitions and models of internal control. The South African Institute of Chartered Accountants, in its corporate governance series, provides guidance for its directors: Reporting on internal control.

Paragraph seven of the guidance defines internal control as "a process, effected by a company’s board of directors, management and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the categories of:

- Economy, efficiency and effectiveness of operations.
- Internal financial controls.
- Compliance with applicable laws and regulations.

Various categories of controls, such as operational, internal, and financial and compliance controls are described.

Internal control frameworks and key elements

King III requires that a company maintains an effective risk management and internal control framework that should include:

- Clear accountability and responsibility between the roles of the board, its board committees, management and internal audit as well as other assurance providers.
- Clear understanding of the risk management framework and risk management processes among all players.
- The manner in which risk management and internal controls contribute to and improve business performance.
- Clarification regarding the value added by the respective role players.

Implementation of internal controls

In designing the control framework for the company, it is imperative to focus on the objectives of a process rather than on the purpose of the control, i.e. each control must contribute towards the achievement of an objective.

Controls are any methods, procedures, equipment or other actions implemented by management (either consciously or unconsciously) to provide assurance that the objectives will be achieved.

Reference should be made to internationally developed control models, to develop a control framework that integrates control attributes throughout the organisation, provides a standard against which each objective is evaluated, and sets the parameters for assessment. Examples of these models are the Canadian Institute of Chartered Accountants’ CoCo model and the US Committee of Sponsoring Organisation’s approach (COSO), as well as leading quality frameworks for reporting purposes.

The COSO framework is one that’s more readily used by companies.

The COSO internal control framework (also referred to as COSO) provides detailed internal control criteria and defines five components of internal control: control environment, risk assessment, control activities, information and communication and monitoring.

COSO defines internal control as a process, affected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Reliability of financial reporting.
- Effectiveness and efficiency of operations.
- Compliance with applicable laws and regulations.

The COSO cube represents the five components of COSO applied across the three categories and throughout the entire organisation.

Once the company has taken the decision on the model to be used, this should be documented and applied in the development or improvement of all internal controls.

Assurance providers should provide the board and audit committee feedback on the effectiveness of the design and efficiency of internal controls by linking their findings and recommendations to the control model adopted by the company.

Internal financial control

Any modern internal control framework should include an aspect of internal financial controls. Internal financial controls should not be limited to the controls carried out within the finance department but should rather consider all controls within the business operations that have an effect on finance.

Internal audit should provide a written assessment of the effectiveness of a company’s internal financial controls to the audit committee annually.
Delegations of authority and mandates

It is important that a company, as part of its internal control framework and governance processes, implement appropriate delegations of authority and mandates to effectively allocate clear accountability between the board, committees and executive management. Typically the following committees with terms of reference approved by the board are used in larger companies:

- Audit committee.
- Risk committee.
- Nominations committee.
- Remuneration committee.
- Social and ethics committee.

These committees are supported by a delegation of authority that sets out the nature of activity/transactions, the conditions required and the approval limits through the organisation up to the board.

**Combined assurance**

**Assurance providers**

The board of directors have ultimate responsibility for establishing, maintaining and reporting on an effective system of internal control. However, for the board to assess how effective their overall system of control is, a number of assurance providers are assigned activities to provide the board with feedback or comfort.

King III introduces “combined assurance” as a recommended governance practice to improve assurance coverage and quality through better coordination of the assurance providers. It requires “the audit committee to ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities”.

By explanation, the sum of all assurance providers providing feedback on aspects of the organisation’s control environment without the duplication of effort and in a structured manner that is linked to the risk profile of the company, is considered achievement of combined assurance.

Company directors are also assurance providers, to shareholders and other stakeholders. In order to properly fulfill their responsibilities regarding internal controls, the board of directors should understand their own role regarding internal controls.

**Combined assurance model**

As illustrated, the combined assurance model involves external auditors in partnership with management, internal auditors and other parties such as insurers, risk managers, Compliance Officers, and legal or regulatory advisors to provide assurance, through the audit committee to the board of directors that risks are managed and information can be relied upon.

It is important that the board understands the basis of the assurance it receives, and clearly distinguishes between parties that are part of the financial system and controls, and parties that contribute to these systems and controls.

**Typical assurance providers**

1. **Board of directors**

   The board is responsible for the overall governance of the company and ensuring that there is a proper system of internal control implemented through an approved framework. Typically, the board delegates its responsibility to executive management through approved delegation of authorities and mandates.

   In discharging their responsibilities, the board should spend their time ensuring that executive management:

   - Conduct a risk assessment to identify company risks that relate to the overall strategy and objectives.
   - Implement appropriate internal controls to mitigate risks from occurring and/or implement future action plans to improve the internal control environment.
   - Monitor the control environment by accessing various assurance providers to provide feedback on the effectiveness on internal controls.
   - Reassess on a continual basis the risk profile of the company for new or emerging risks and new or improved internal controls for implementation.

   This is often overseen by a risk and audit committee of the board with regular feedback at board meetings.
2. Audit committee

King III recommends the establishment of an audit committee to assist the board in discharging its responsibility regarding internal controls. This delegation is managed through an audit committee charter that sets out the role and responsibilities of the committee.

In practice, the committee meets at least three times a year. One of which is generally used to deliberate the issues and outcomes of the external audit process, whilst the other meetings are used to discuss internal audit and other assurance providers’ reports, findings and recommendations and challenge the effects on the internal control environment.

In terms of King III, audit committees should consider the following:

- Integrated and financial reporting.
- Internal financial controls.
- External and internal audit process.
- Corporate law.
- Risk management.
- Sustainability issues.
- Information technology governance.
- Governance processes.

3. Risk committee

King III also recommends the establishment of a risk committee. The risk committee is aimed at overseeing the risk governance and management processes of the company. There is a direct relationship between assurance providers reporting on internal controls to the audit committee and the oversight of risk management by the company.

Assurance providers need to link the work they do on internal controls assurance to the risk of the company. Therefore, it is important that findings reported on by assurance providers are also provided to the risk committee and as such updates the risk profiles pertaining to the work performed.

The risk committee should provide feedback to the board on a regular basis, on the implementation of their mandate, progress against work plans, and significant matters that require the board’s attention.

4. Management

Although the board is ultimately responsible for ensuring that a proper system of internal control is implemented, much of the establishment and maintenance of the system of internal control is delegated to management.

The CEO normally has the responsibility to the board to ensure that internal controls are in place. He/she can do this by:

- Providing leadership and direction to his or her executive team and demonstrating accountability by his or her own involvement in shaping the culture and tone of the organisation.
- Meeting with his or her executive team regularly to review their responsibilities and monitoring their activities relating to risk management and internal control processes.
- Monitoring performance and keeping abreast of his or her executive team’s objectives and responsibilities relating to risk management and internal controls and linking these to performance incentives.

Middle and lower level management can be considered as the first ‘line of defence’ regarding the operating of internal controls. It is management that should ensure that designed internal controls are effective to mitigate risks and that such internal control systems are implemented properly and operating efficiently. Managers should not only have the requisite authority for initiating transactions but also be held accountable for their actions.

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In discharging their internal audit requirements, companies may outsource their internal audit function to a service provider, co-source their internal audit function jointly through internal resourcing and with an outsourced service provider or fully resourced their internal audit capacity internally. There are pros and cons for each of these scenarios. However, the board and audit committee together with executive management should consider the following in arriving at their decision:

- Internal audit and specialist skills.
- Internal audit budget.
- Technologies and methodologies.

Irrespective of the model adopted by the company, internal audit should:

- Be independent and objective.
- Report functionally to the audit committee.
- Have the respect of the board and management.
- Attend the executive committee and/or other key meetings as an ‘invitee’.

Internal audit should:

- Evaluate the company’s governance processes.
- Review the effectiveness of the company’s risk management and internal control frameworks.
- Analyse the company’s business processes and internal control.

In carrying out the internal audit plan, internal audit should:

- Follow a risk based approach in crafting an internal audit plan, i.e. performing a risk assessment that identifies key risks linked to business objectives and plan to perform assurance activity on the controls that mitigate these risks from occurring.
- Use the company’s strategy to inform the plan and link the plan to the business performance of the company.
- Consider audit risks and management’s requests for areas of assurance.
- Recommend the plan to the audit committee for approval.

King III also requires internal audit to include as part of their internal audit plan, assurance activity that:

- Provides a written assessment on the effectiveness of the company’s internal control system and risk management processes. Such assessment should be provided to the board on an annual basis.
- Provides a written assessment on the effectiveness of the company’s internal financial controls. Such assessment should be provided to the audit committee on an annual basis.

Internal audit should report administratively to the highest authority within the organisation. Often this is carried out by reporting either to the CEO or CFO. This administrative reporting includes:

- Resource management (people and financial).
- Discussion of key internal audit findings for executive management action.
- Information sharing.

8. External audit

The external auditor is the person with final responsibility for the statutory audit of the company’s financial statements. This term describes those persons in public practice, including a sole practitioner, partnership or corporate body, who are registered members of the Independent Regulatory Board for Auditors (IRBA) and the South African Institute of Chartered Accountants (SAICA), involved in the audit of financial statements.

The annual external audit of the financial statements is an essential part of the checks and balances required, and are one of the cornerstones of corporate governance.

In relying on external auditors, the board should be aware that the extent of attention given to internal control by the external auditors may vary from company to company, and as such, external auditors may often not be in a position to identify all possible internal control weaknesses that may exist. The extent of the financial statement auditor’s interest in the system of internal control is limited to those controls related to the risks that are relevant to the risk of significant misstatement of the financial statements. However, the external auditor may be in a position to comment on the weaknesses observed in the internal control processes that were identified during their audit and provide this to the audit committee and board.

Appointment of auditors – s90

Each year at its AGM, a public company or state-owned company must appoint an auditor.

If a company other than a public company or state-owned company is required to be audited in terms of the Regulations or in terms of its MoI, such company should appoint an auditor at the AGM at which the requirement to be audited first applies.

To be appointed as an auditor of a company, a person or firm:

- Must be a registered auditor.
- Must not be prohibited from being a director of a company.
- Must not be:
  - A director or prescribed officer of the company.
  - An employee or consultant of the company who was or has been engaged for more than one year in the maintenance of any of the company’s financial records or the preparation of any of its financial statements.
  - A director, officer or employee of a person appointed as company secretary.
  - A person who, alone or with a partner or employees, habitually or regularly performs the duties of accountant or bookkeeper, or performs related secretarial work, for the company.
  - A person who, at any time during the five financial years immediately preceding the date of appointment, was a person contemplated above.
  - A person related to a person contemplated above.
- Must be acceptable to the company’s audit committee as being independent of the company.
Rotation of auditor – s92
The same individual may not serve as the auditor or designated auditor of a company for more than five consecutive financial years. The five consecutive years is calculated from 1 May 2011.

If an individual has served as the auditor or designated auditor of a company for two or more consecutive financial years and then ceases to be the auditor or designated auditor, the individual may not be appointed again until after the expiry of at least two further financial years.

Rights and restricted functions of auditors – s93
The external auditor of a company:

• Has the right of access at all times to the accounting records and all books and documents of the company, and is entitled to require from the directors or prescribed officers of the company any information and explanations necessary for the performance of the auditor’s duties.

• In the case of the auditor of a holding company, has the right of access to all current and former financial statements of any subsidiary of that holding company and is entitled to require from the directors or officers of the holding company or subsidiary any information and explanations in connection with any such statements and in connection with the accounting records, books and documents of the subsidiary as necessary for the performance of the auditor’s duties.

• Is entitled to:
  - Attend any general shareholders meeting.
  - Receive all notices of and other communication relating to any general shareholders meeting.
  - Be heard at any general shareholders meeting on any part of the business of the meeting that concerns the auditor’s duties or functions.

An auditor appointed by a company may not perform any services for that company:

• That would place the auditor in a conflict of interest as prescribed or determined by the Independent Regulatory Board for Auditors in terms of section 44(6) of the Auditing Profession Act 26 of 2005.

• As may be determined by the company’s audit committee.

Legislation and regulators
Legislation and regulators affect the internal control systems of many organisations, either through requirements to establish internal controls or through examination of particular organisations. These requirements or examinations provide the impetus for management to ensure that internal control systems meet the minimum statutory and regulatory requirements. Many of the relevant laws and regulations deal only with internal controls over financial reporting, although some regulators now deal with risk management systems and operational controls that are industry specific.

Combined assurance plans
In order to discharge the King III requirement to institute a combined assurance model that demonstrates coordinated assurance efforts, audit committees are requesting assurance plans to be set out in a way that is easily understood and encompasses all identified risks.

This now entails that audit committees require all assurance provider’s plans to be encompassed in a single consolidated view and in a standardised format that links their work to the identified risks.

Fraud and the director’s responsibility in terms of fraud
In a perfect world, there would be no need for watchdogs, no need for directors to be held accountable for various actions or omissions of a company, and no need to manage risks such as fraud. It would simply be a question of identifying and managing opportunities when they arise.

However, this is not the case in our less than perfect modern-day society. Fraud is prevalent in most organisations with the question not necessarily being whether fraud is taking place but rather to what extent. Fraud affects the bottom-line profitability of the company, as it equates to money walking out of the door and as a consequence, has a direct impact on a company’s symbolic assets like: reputation and brand image and investor confidence.

Overseeing the conduct of a large company includes managing the various risks faced in its daily operations. Although directors will normally discharge their responsibility relating to the day-to-day management of the business, they still retain overall responsibility for the prevention and detection of fraud. It is therefore important that directors receive appropriate assurance from management that effective control measures are in place, enforced and adhered to in order to prevent and detect fraud.

The enemy within
KPMG’s “Who is the typical fraudster?” report reveals:

• The typical fraudster commits fraud against his own employer, holds a senior management position, is employed by the company for more than ten years, and works in collusion with another perpetrator.

• Fraud and misstatement of results continue to be growing problems for companies at a time when budgets are stretched.

• The failure to initially respond to red flags and lapses in internal controls were an increasing contributor to enabling fraud to occur.

• With increased economic pressures on individuals, failure to identify or address red flags and the lengthening time lapse between fraud inception and detection, the likelihood is that frauds, currently undetected, will emerge in greater numbers in the next two to three years.

• 35% of all fraudsters held senior management positions.

• Board level perpetrators increased from 11% to 18% between 2007 and 2011.

• Most people involved in committing fraud worked in the finance function (32%) or chief executive or managing director’s office (26%).
Definitions and characteristics

“Fraud” refers to an intentional act by one or more individuals among the directors, management, employees or third parties involving dishonesty or misrepresentation to obtain an unjust or illegal advantage. Fraud involves:
- The motivation to commit the act of fraud - individuals may be motivated to commit fraud, for example, because they are living beyond their means and need some way of meeting new demands.
- Perceived opportunity to do so - a perceived opportunity for fraud may exist when an individual believes internal controls may be circumvented, for example, because the individual is in a position of trust or has knowledge of specific weaknesses in the internal control system.
- Rationalisation - according to Rossouw, D. & Van Vuuren, L. 2004. Business Ethics, “fraudsters tend to rationalise their actions. This explains why or how fraudsters manage to perpetrate fraud repeatedly. Rationalisations include: convincing one that fraud is not serious, and constitutes a victimless crime (an insignificant moral blunder) or shifting the blame (portraying oneself as a small player in the larger scheme of things).”
Fraud may also be related to theft in that it could be the means employed to conceal a previously committed theft. Fraud and theft are not alternative or competing verdicts. The likelihood of detecting an error is usually higher than the likelihood of detecting fraud, since fraud is usually accompanied by acts specifically designed to conceal its existence. The distinguishing factor between fraud and error is whether the underlying action is intentional or unintentional. Unlike error, fraud is intentional and usually involves deliberate concealment of the facts. Fraud can be committed in various ways, by various parties. The differences forms or types of fraud include:

1. Management fraud
Fraud involving one or more of the directors or members of management is referred to as management fraud. Management fraud may include collusion with third parties outside the company.

2. Employee fraud
Fraud involving only employees of the company is referred to as employee fraud, but it may include collusion with third parties outside the company.

3. Fraudulent reporting
Fraudulent reporting involves intentional misstatements or omissions of amounts or disclosures in reports in order to deceive the users of the report. Fraudulent reporting may involve:
- Deception in the form of manipulation, falsification, or alteration of accounting records or supporting documents used to prepare the report.
- Misrepresentation or intentional omission of events, transactions or other significant information in the report.
- Intentional misapplication of accounting practices relating to measurement, recognition, classification, presentation or disclosure.

Fraudulent reporting may be committed because management is under pressure, whether from sources outside or inside the company, to achieve an unexpected and perhaps unrealistic earnings target. This is particularly the case where the consequences to management of failing to meet goals can be significant.

4. Misappropriation of assets
Misappropriation of assets involves the theft of a company’s assets. Misappropriation of assets can be accomplished in a variety of ways, including embezzling receipts, stealing physical or intangible assets causing a company to pay for goods and services not received. The misappropriation of assets is often accomplished by false or misleading records or documents to conceal the fact that the assets are missing. The misappropriation constitutes theft, and concealment thereof constitutes fraud.

5. Third party or external fraud
Third party or external fraud relates to fraud committed by individuals or entities residing outside of the company over which the company does not have direct control. Examples of such instances include the fraudulent application for credit.

Error
An “error” is an unintentional misstatement including:
- A mistake in gathering or processing data.
- An incorrect accounting estimate arising from oversight or misinterpretation of facts.
- A mistake in the application of accounting practices relating to measurement, recognition, classification, presentation or disclosure.

General responsibility of directors and management for fraud
The primary responsibility for the prevention and detection of fraud rests with the directors and management of a company. Their respective responsibilities may vary by company and from country to country.

The directors of a company have oversight responsibility of systems for monitoring risk, financial control and compliance with the relevant legislation. Management, with the oversight of the directors, is responsible for setting the proper tone, creating and maintaining a culture of honesty and ethical values, and establishing appropriate controls to prevent and detect fraud and error within the company. Management is responsible for establishing a control environment, and for maintaining policies and procedures to assist in achieving the objective of ensuring the orderly and efficient conduct of business. This responsibility includes implementing and ensuring the continued operation of accounting and internal control systems designed to prevent and detect fraud and error. Such systems reduce but do not eliminate the risk of fraud or error. Accordingly, management assumes responsibility for any remaining risk.
Effective and continuous monitoring of business risks, including fraud, is an essential part of the overall risk management process for which the directors are responsible. As a director cannot rely solely on management’s monitoring processes embedded within the company, he or she should review timely controls to prevent and detect fraud, including any instances of suspected or actual fraud. The board of directors is responsible for ensuring that a formal fraud risk assessment is performed at least annually for the purposes of reporting to the stakeholders of the company and the external auditors. Such a formal fraud risk assessment should include:

- Suspected incidents of fraud.
- Actual incidents of fraud.
- Overall susceptibility of the company to fraud.
- Fraud prevention strategy and plan.

Fraud risk should be assessed on an ongoing basis, and control activities should be designed to respond to risks throughout the company. Companies should develop a system of risk management and internal control that builds robust business operations. The systems should demonstrate that the company’s key risks are managed in a way that enhances shareholders’ and the relevant stakeholders’ interests. Management is also responsible for reporting to the directors and the external auditors any breakdowns in the control environment and/or the loss or unauthorised use of assets.

The relationship between the director and management for fraud

In discharging the responsibility for managing fraud and other related business risks in the daily operations of the company, the directors should be aware of the various measures put in place by management to manage these risks. As such, the director must enquire from management on its:

- Assessment of the risk of fraud being encountered.
- Accounting and internal control systems in place to manage such risk.
- Knowledge of any known fraud that has affected the company or suspected fraud and the action taken in response thereto.
- Knowledge of any material errors.

The director should supplement his or her own knowledge of the company’s business by making enquiries on management’s own assessment of the risk of fraud and the systems in place to prevent and detect fraud. Since management is responsible for the company’s accounting and internal control systems, it is appropriate for the director to enquire of management how it is discharging these responsibilities. Matters that might be discussed as part of these enquiries include:

- Whether there are specific subsidiary locations, business segments, types of transactions, or account balances where the possibility of error may be high or where the risk of fraud may exist.
- How the issues identified above are being addressed by management.
- The work of the company’s internal audit function, and whether internal audit has identified fraud or any serious weaknesses in the system of internal control.
- How management communicates its view on responsible business practices and ethical behaviour to employees, such as an ethics policy or code of conduct.

The nature, extent and frequency of management’s assessment of such systems and fraud risk vary from company to company. In some companies, management may make detailed assessments on an annual basis or as part of continuous monitoring. In other companies, management’s assessment may be less formal and less frequent. However, in terms of the requirement of an annual formal fraud risk assessment, it is recommended that management performs such assessments on a frequent (preferably quarterly) basis.

It is also important for the director to enquire about management’s knowledge of instances of fraud that have affected the company, suspected instances of fraud that are being investigated and material errors that have been discovered. Such enquiries may indicate possible weaknesses in control procedures, if, for example, a number of errors have been found in certain areas. Alternatively, such enquiries might indicate that control procedures are operating effectively because anomalies are being identified and investigated promptly.

Prevention and Combating of Corrupt Activities Act, 2003

According to this Act, there is a duty to report corrupt transactions. Any person who holds a position of authority or who knows or ought reasonably to have known or suspected that any other person has committed fraud involving an amount of R100 000 or more must report such knowledge or suspicion or cause such knowledge or suspicion to be reported to any police official. If such a person fails to comply, such person is guilty of an offence.

Discussions with the external auditor

In many companies, the corporate governance practices are well developed and the directors play an active role in oversight of how management has discharged its various responsibilities. In such circumstances, the external auditors may seek the views of the directors on the adequacy of accounting and internal control systems in place to prevent and detect fraud and the risk of fraud, and ensure the competence and integrity of management. The external auditor must also be satisfied that the board of directors has been informed of any material weaknesses in internal control related to the prevention and detection of fraud that either have been brought to the external auditor’s attention by management or have been identified during the financial statement audit.

For example, the external auditors may seek the views of the directors during a meeting to discuss the general approach and overall scope of the financial statements audit. This discussion may also provide the directors with the opportunity to bring matters of concern to the external auditor’s attention.

In addition, the external auditor should discuss, where relevant, matters of governance with the directors of the company. Such matters may include, for example the following:

- Concerns about the nature, extent and frequency of management’s assessments of the accounting and control systems in place to prevent and detect fraud.
- Failure by management appropriately to address material weaknesses in internal controls identified during the prior financial statement audit.
- The external auditor’s evaluation of the control environment, including questions regarding management competence and integrity.
The effect of any matters, such as those above, on the general approach and overall scope of the financial statements audit, including additional procedures the external auditor may need to perform.

If the external auditor has identified a material misstatement in the financial statements resulting from error, the external auditor will consider the need to report it to the board of directors. The external auditor will also inform the board of directors of those uncorrected misstatements aggregated during the financial statement audit that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole. The uncorrected misstatements communicated to the board of directors will not include the misstatements below a designated amount.

The external auditor will consider the need to report to the board of directors, if they have:

- Identified any instance of fraud.
- Obtained evidence that indicates fraud may exist.

The Auditing Profession Act, 2005

In terms of this Act, registered auditors are required to report in writing to the Independent Regulatory Board for Auditors (IRBA), if they are satisfied or have reason to believe, that a reportable irregularity has taken place in respect of that company.

- According to the Auditing Profession Act, 2005, a reportable irregularity is defined as "any unlawful act or omission committed by any person responsible for the management of an entity which has caused or is likely to cause material financial loss to the entity or any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealings with that entity, or
- Is fraudulent or amounts to theft.

Represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law applying to the entity or the conduct or management thereof.

Recommendations from King III

Key recommendations from King III include:

- The responsibility for implementing risk management processes lies with management, with oversight by a risk or audit committee. The responsibility of the audit committee includes satisfying itself that fraud risk, among other risks, has been appropriately addressed.
- Management must report, to the audit committee, weaknesses in financial control that has resulted in fraud.
- Arrangements must be made to enable employees and external whistleblowers to report possible improprieties (including fraud) in confidence.
- Management is responsible for monitoring compliance with the company’s code of conduct. The fact that King III makes reference to compliance with a code of conduct, illustrates the increasing focus on a balance between hard controls and soft controls when dealing with fraud. Put differently, fraud risk management relies on appropriate formal procedures or controls, but also on interventions aimed at improving the ethical culture within the organisation.
Chapter 13

Statutory, Regulatory and Compliance

Risks of Non-Compliance • JSE Listings Requirements • JSE Listings • Other Acts • Other Acts • Companies Act

The Commission • The Commission • Companies Tribunal

Legal and Regulatory Universe • Legal and Regulatory Universe • Companies Act 71 of 2008

Statutory, Regulatory and Compliance • Statutory, Regulatory and Compliance • Companies Act 71 of 2008

JSE Listings • JSE Listings

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Introduction

The term “compliance” has moved beyond its narrow meanings. It is a world-wide general tendency to regulate environments more and more. This pushes the importance of compliance gradually up the ladder of importance in any company and entity.

Recently compliance has specifically been moved higher up the agenda of directors due to the developments around and content of King III and the Companies Act, 71 of 2008. King III has included a new chapter (chapter six) dealing with compliance specifically, while the Companies Act, 71 of 2008 refers to the term “compliance” more than sixty times.

Compliance has further been enhanced by the provisions of King III, as also highlighted above. The appropriate four King III principles in the chapter on compliance are as follows:

1. Principle 6.1: “The board should ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes and standards”.
2. Principle 6.2: “The board and each individual director should have a working understanding of the effect of the applicable laws, rules, codes and standards on the company and its business”.
3. Principle 6.3: “Compliance risk should form an integral part of the company’s risk management process”.
4. Principle 6.4: “The board should delegate to management the implementation of an effective compliance framework and process”.

A number of implications for boards flow from this, including two broad categories:

1. That, generally, compliance risk should be an integral part of the company’s risk management process and furthermore that the implementation of “an effective compliance framework and process” should be delegated to management.
2. That, more specifically, boards should (i) ensure compliance with all applicable laws, (ii) consider adherence to non-binding rules, codes and standards, and (iii) collectively and individually have “a working understanding of the effect of the applicable laws, rules, codes and standards”.

It is clear that the role of directors in compliance should not be underestimated. Over and above putting a broad process in place (including a “framework”), personal knowledge (or “a working understanding”) of “the effect of the applicable laws”, as well as considering adherence to non-binding rules, codes and standards are all also required. This clearly goes further than putting a system and/or a process in place and have compliance as a standard item on the board’s agenda – it clearly points to individual board members to continuously undergo training and/or other ways of building “a working understanding” of applicable legal instruments.

Bearing in mind that the JSE mandates the use of King III for listed entities (albeit on the same basis as comply or explain), this is an even more important aspect of the responsibilities of directors of such companies.

A review of the Companies Act, 71 of 2008 clearly also highlights that there has been a change to a higher gear on compliance. An interesting section is s88(2)(ii) where the responsibility is placed on the company secretary to make “the directors aware of any law relevant to or affecting the company”.

The Act thus clearly takes a narrower view than King III, where (ii) “applicable laws and considers adherence to non-binding rules, codes and standards” are brought into the equation and (ii) where a “working understanding” by all directors is required.

Interestingly, a “compliance officer” is required by the Companies Act, 71 of 2008, but s95(1)(bi) only for the company’s employee share scheme.

Why comply?

Non-compliance can result in organisations facing not only the cost of enforcement action, but also damage to their reputations.

The principle in law requires compliance, but there are other reasons for complying namely:

- Penalties.
- Reputational risk.
- Financial loss.
- To avoid audit qualifications.

Non-compliance can occur due to:

- Human fraud or error (people).
- Failure in the control environment (processes).
- Systems failure (systems).
- External factors.
- Lack of knowledge.

How should organisations ensure compliance?

One of the aims of compliance is to provide assurance to the board that the company or entity does indeed comply with all applicable legislation. To ensure that such assurance can be provided, the following five steps seem to encompass the bare minimum:

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<td>Monitor compliance of the organisation to laws and regulations, and report results</td>
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Continuous process
Other Acts

Other Acts which are perceived to be high risk to organisations and indeed directors include:

- Competition Act.
- National Environmental Management Act.
- Consumer Protection Act.
- National Credit Act.

JSE Listings Requirements

Companies listed on the JSE Securities Exchange (JSE) are required to comply with the JSE Listings Requirements. These Listings Requirements comprise general principles and a series of detailed requirements that have the objective of ensuring that the business of a listed entity (referred to as the “issuer”) is carried on with due regard to the public interest. The JSE Rules are written under the auspices of the Securities Services Act no 36, 2004 (SSA) which itself also includes provisions relevant to a listed entity and directors (the Financial Markets Bill currently under comment will replace this Act in time).

Directors of listed companies should ensure that they have a working knowledge of the main Listings requirements and the relevant governing Act to ensure compliance by both the listed entity and the director in his personal capacity. Various training courses are prescribed by the JSE to assist directors to understand their explicit responsibilities. In addition all listed entities are required to appoint a sponsor (or designated advisor for entities listed on the Alternative Exchange) to assist the entity and director with JSE Listings Requirements compliance.

The JSE Rules often extend the requirements of Acts, Regulations or Codes, and therefore it is important that a director understand this extension of responsibility.

Director agreement with JSE and personal liability

A director is required to sign an agreement with the JSE (Schedule 21) that he/she will ensure that the listed entity (and the director in his personal capacity where relevant) complies with the Listings Requirements. This means that both the listed entity and the director in his personal capacity are subject to the censure and penalties imposed by Section 1.20 of the Listings Requirements. The Censure and Penalties include a fine of up to R6 million; public or private censure; disqualification of the director from acting as a director of a listed entity for a period of time; and ordering compensation to any party affected for loss arising as a result of the respective breach.

Directors dealings in securities and false, misleading or deceptive statements

The SA contains important considerations for directors as it governs and affects the information that directors are permitted to disclose and at what time, as well as their dealings on their issuer’s own securities.

Directors dealings in securities

The SSA prohibits insider trading. In particular, Sections 72 and 74 of the SSA define insider information and those parties who should be considered insiders. Section 73 of the SSA addresses the four specific circumstances where an insider commits the offence of insider trading (together with the specific defences).

Section 75 of the SSA notes certain prohibited trading practices in listed securities

In conjunction with sections 72 and 74 of the SSA, directors should, when trading in their own securities, be aware of sections 73 and 75 of the SSA, both in terms of what constitutes violations and circumstances and where they are not in violation.

Dealing in the entity’s listed instruments by a director is also subject to specific JSE rules. These include timeous disclosure of directors’ dealings on the Stock Exchange News Service (SENS). The JSE Rules define parties who are considered “associated” with a director and for which the disclosure and other requirements are equally relevant. The definition of who is considered associated or “acting in concert” is wider than that of the Companies Act, 71 of 2008 and International Financial Reporting Standards. Many of these provisions also apply to the company secretary.

A transaction (or dealing) for these purposes is defined widely and includes trading in warrants, single stock futures and derivatives; acquisition of or disposal of any right whether conditional or unconditional, present or future relating to any security; and donations; irrespective of whether cash or securities flow.

False, misleading or deceptive statements

Section 76 of the SSA covers false, misleading or deceptive statements, promises or forecasts and those circumstances where the director will commit an offense.

JSE Listings Requirements as relate to the Companies Act, 71 of 2008 and the Mol

The Listings Requirements contain specific requirements for the Mol of a listed entity. The explicit requirements are detailed in Schedule 10. The JSE must approve the Mol of the listed entity and its subsidiaries (and any changes thereto). The JSE will not allow the Mol to contain any provisions that are unlawful or will in any way restrict free dealings in securities or may, in the JSE’s opinion, be unreasonable. An overriding requirement is that the Mol may not be in conflict with the Listings Requirements, nor may it prevent the enforcement of any provision of the Listings Requirements. The requirements of Schedule 10 must be included in an Mol notwithstanding the specific choices permitted in the Companies Act, 71 of 2008 (also referred to as the alterable provisions).

The Companies Act, 71 of 2008 requires the harmonisation of the Mol with the Act within two years from 1 April 2011. The JSE Listings Requirements do not modify this requirement, however they do provide that where there is a requirement in the Listings Requirements for a provision to be included in the Mol, and that Mol has not yet been harmonised, the Listings Requirements will apply to the listed entity and its directors notwithstanding the fact that it is not yet provided for in the unharmonised Mol. Some of the more relevant provisions of Schedule 10 include:

- A positive vote of at least 75% of shareholders (present or represented by proxy) is required for the passing of special resolution at either a general meeting or AGM.
- A notice period of fifteen business days is required for all general and special resolutions.
- S60 of the Companies Act, 71 of 2008 which contemplates round robin resolutions, should be precluded in many instances – these include shareholder meetings called for in terms of the Listings Requirements.
- The directors powers to make, amend or repeal rules (related to the governance of a company) as contemplated by Section 15(3) of the Companies Act, 71 of 2008 must be prohibited.
- Securities for which listings is sought must be fully paid up and freely transferable, unless otherwise required by statute.
• That shareholders in general meeting may authorise the directors to issue unissued securities, and/or grant options to subscribe for unissued securities, as the directors at the discretion deem fit, provided that such corporate action(s) has/have been approved by the JSE and are subject to the Listings Requirements.

• The company in general meeting or the directors may declare dividends. However, the company in general meeting must not be able to declare a large dividend than that declared by the directors.

• Borrowing powers of directors in respect of subsidiary companies - directors may, from time to time, at their discretion, raise or borrow or secure the payment of any sum or sums of money for the purposes of the company, provided that the total amount owing by the company in respect of money so raised, borrowed or secured shall not exceed the amount authorised by its listed holding company.

Corporate governance requirements and reporting to shareholders

Issuers must comply with the following specific requirements concerning corporate governance and must disclose their compliance therewith in their annual report:

a) There must be a policy detailing the procedures for appointments to the board of directors. Such appointments must be formal and transparent, and a matter for the board of directors as a whole, assisted where appropriate by a nomination committee. The nomination committee must constitute only non-executive directors, of whom the majority must be independent (as defined in paragraph 3.84(f)(iii)), and should be chaired by the chairman of the board of directors.

b) There must be a policy evidencing a clear balance of power and authority at board of directors’ level, to ensure that no one director has unfettered powers of decision-making.

c) The issuer must have an appointed CEO and a chairman and these positions must not be held by the same person. The chairman must neither be an independent director, or the issuer must appoint a lead independent director, in accordance with King II.

d) All issuers must, in compliance with King III appoint an audit committee. All issuers must in compliance with King II appoint a remuneration committee and if required, given the nature of the business and composition of the board of directors, a risk and nomination committee. The composition of such committees, a brief description of their mandates, and the number of meetings held and other relevant information must be disclosed in the annual report.

e) A brief CV of each director standing for election or re-election at a general meeting or AGM which election or re-election may not take place at a meeting contemplated in s60 of the Companies Act, 71 of 2008 should accompany the notice of the general meeting or AGM.

f) The capacity of each director must be categorised as executive, non-executive or independent, using the following as guidelines to determine which category is most applicable to each director:

(i) Executive directors are involved in the management of the company and/or in full-time salaried employment of the company and/or any of its subsidiaries.

(ii) Non-executive directors are not involved in the day to day management of the business or full-time salaried employees of the company and/or any of its subsidiaries.

(iii) Independent directors are as defined in King III. In addition, it must be noted that any director that participates in a share incentive/option scheme will not be regarded as independent.

The annual report must also include a narrative statement of how the entity has applied the principles set out in King III, providing explanation(s) that enable(s) the shareholders to evaluate how the principles have been applied and a statement addressing the extent of the entity’s compliance with King II (throughout the period) and indicating where, why and for what period there was non-compliance.

Some of these requirements are varied for Alt-X listed Companies i.e. at least three directors or 25% of the directors must be non-executive, whichever is the greater (21.3(h)).

As certain director appointments are mandatory (e.g. the financial director), the JSE must be advised promptly of any change of the functions of a director.

Schedule 10 (dealing with the MoI) also imposes additional rules for directors as follows (Clause 10.16):

• The minimum number of directors shall be four.

• The board of directors through the nomination committee, should recommend eligibility, taking into account past performance and contribution.

• There must be a policy detailing the procedures for appointments to the board of directors. Such appointments must be formal and transparent, and a matter for the board of directors as a whole, assisted where appropriate by a nomination committee. The nomination committee must constitute only non-executive directors, of whom the majority must be independent (as defined in paragraph 3.84(f)(iii)), and should be chaired by the chairman of the board of directors.

• All issuers must, in compliance with King III appoint an audit committee.

• The appointment of a director to fill a casual vacancy or as an addition to the board must be confirmed at the next AGM by the shareholders.

• If the number of directors falls below the minimum provided in the MoI, the remaining directors must as soon as possible and in any event not later than three months from the date that the number of directors falls below the minimum fill the vacancies or call a general meeting for the purpose of filling the vacancies. The failure by the listed company to have the minimum number of directors during the three month period does not limit or negate the authority of the board of directors or invalidate anything done by the board of directors or the company. After the expiry of the three month period the remaining directors shall only be permitted to act for the purpose of filling vacancies or calling general meetings of shareholders.

• A director may be employed in any other capacity in the company or as a director or employee of a company controlled by, or itself a subsidiary of, this company and that in this event, their appointment and remuneration in respect of each other office must be determined by a disinterested quorum of directors.

• The directors shall be paid all their travelling and other expenses properly and necessarily incurred by them in and about the business of the company, and in attending meetings of the directors or of committees thereof; and that if any director is required to perform extra services or to reside abroad or shall be specifically occupied about the company’s business, they shall be entitled to receive such remuneration as is determined by a disinterested quorum of directors, which may be either in addition to or in substitution for any other remuneration.

• In a new company, all the directors are to retire at the first AGM. Thereafter at least one third of non-executive directors must retire at the company’s AGMs or other general meetings on an annual basis, provided that the meeting is not conducted in terms of s60 of the Companies Act, 71 of 2008.

• These retiring members of the board of directors may be re-elected, provided they are eligible. The board of directors through the nomination committee, should recommend eligibility, taking into account past performance and contribution.

The company in general meeting or the directors may declare dividends. However, the company in general meeting must not be able to declare a large dividend than that declared by the directors.

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(iii) Independent directors are as defined in King III. In addition, it must be noted that any director that participates in a share incentive/option scheme will not be regarded as independent.

• All issuers must have an executive financial director. The JSE may, at its discretion, when requested to do so by the issuer, and due to the existence of special circumstances allow the financial director to be employed on a part time basis only. This request must be accompanied by a detailed motivation by the issuer and the audit committee.

• The audit committee must consider, on an annual basis, and satisfy itself of the appropriateness of the expertise and experience of the financial director. The issuer must confirm this by reporting to shareholders in its annual report that the audit committee has executed this responsibility.
Reporting on financial results
The JSE is taking a keen interest in ensuring that the financial statements comply with International Financial Reporting Standards, and relevant South African Interpretations and Circulars, and has recently implemented a review procedure to ensure compliance. The JSE is entitled to refer any suspected non-compliance with the financial reporting standards to the Financial Reporting Investigations Panel (FRIP) for investigation.

The JSE rules contain explicit requirements regarding the timing of financial reporting as well as the audit requirement. Interim reporting at each half year is required, with a deadline of three months from the date of the half-year. At year end, financial information is due to the market within three months of the year end. This information can be in a short form and must at a minimum be reviewed by the company’s auditors. Final audited financial statements are due within six months of the year end. It should be noted that the closed period for trading in the shares will end only once financial information has been released.

The JSE also mandates certain disclosures which must be included in the financial statements. These include the presentation of Headline Earnings per Share, and detailed remunements per director. The scope of these disclosures often extends beyond those required by the financial reporting standards or the Companies Act, 71 of 2008 e.g. the definition of remuneration paid to directors is far wider, and will include remuneration paid by an offshore parent company, even if the remuneration is not paid for services as a director of the listed company.

From time to time the JSE issues guidance on the financial reporting requirements and related audit requirements. It is important that board members and audit committees are aware of the most recent and relevant guidance when planning audit committee meetings and board meetings which consider financial reporting.

Integrated reporting
King III introduces the requirement to prepare an integrated report (or explain why not or what aspects have not been included). The JSE has not imposed any additional requirements over and above those in King III (nor an audit requirement for King III compliance), nor do the Listings Requirements provide any guidance as to how an integrated report should be prepared.

Audit requirements
The listed entity and all of its South African subsidiaries must be audited. Foreign subsidiaries must be discussed with the auditor (so that sufficient audit evidence can be obtained by the auditor to sign the group financial statements).

Only an audit firm which is accredited with the JSE may perform the audit of a listed entity and a major subsidiary. In addition, the audit partner of the listed entity (not the major subsidiary) must be accredited with the JSE. The audit committee is only permitted to consider those audit firms and audit partners accredited with the JSE when recommending the appointment of the auditor.

Regulatory agencies
The Companies Act, 71 of 2008 has altered the existing regulatory bodies and introduced the following:

- The Commission (also referred to as the CIPC) replaced CIPRO - in addition to the normal functions of CIPRO, the Commission will have the functions set out.
- The Takeover Regulation Panel (TRP) has replaced the Securities Regulation Panel - the TRP has similar functions to the previous Securities Regulation Panel.
- The Takeover Regulation Panel (TRP) has replaced the Securities Regulation Panel - the TRP has similar functions to the previous Securities Regulation Panel.
- The Financial Reporting Standards Council (FRSC) has been re-established as an advisory committee to the Minister.
- The Companies Tribunal has been introduced - the Companies Tribunal may issue administrative orders and serve as a forum for voluntary alternative dispute resolution set out in relation to matters arising under the Act and will carry out reviews of certain administrative decisions made by the Commission.

The High Court will remain the primary forum for dispute resolution, as well as the interpretation and the enforcement of the Companies Act, 71 of 2008.

The Commission – Chapter 8 : Part A
A person may file a complaint to the Commission in respect of any act which infringes such person’s rights in terms of the Companies Act, 71 of 2008 or the MoI. The Commission may investigate the matter or refer the matter to the Companies Tribunal to be resolved. The Commission may issue compliance notices requiring any breach of the Companies Act, 71 of 2008 or the MoI to be rectified and if a compliance notice is not complied with, the Commission may apply to court to have a fine imposed or refer the matter to the National Prosecuting Authority for prosecution.

The Commission is also required to promote the reliability of financial statements by monitoring the performance of the Financial Reporting Standards Council and making recommendations to the FRSC for amendments to financial reporting standards.

Functions of the Financial Reporting Standards Council – s204
The FRSC is made up of a number of representatives representing various bodies set out in the Companies Act, 71 of 2008. The FRSC must:

- Receive and consider any relevant information relating to the reliability of, and compliance with, financial reporting standards and adapt international reporting standards to local circumstances.
- Advise the Minister on matters relating to financial reporting standards.
- Consult the Minister on the making of regulations establishing financial reporting standards.

Functions of the Companies Tribunal – s62(2), Chapter 8 : Part B, Schedule 5 Item 2(5)
The Companies Tribunal will function as a forum for alternative dispute resolution. In addition it has a number of roles prescribed by other parts of the Companies Act, 71 of 2008, including:

- A person may apply to the Companies Tribunal for an administrative order exempting an agreement, transaction, resolution etc from any prohibition or requirement established by an unalterable provision of the Companies Act, 71 of 2008.
- During the two years after 1 May 2011, if there is a conflict, dispute or doubt regarding matters such as the preparation of annual financial statements, the filing of documents with the Commission or any other action required by the Act or the company’s MoI, a company may apply to the Companies Tribunal for an administrative order to provide direction on the matter.

The complexity and quantity of laws and regulations necessitates the director to ask of the organisation and management:
1. Are we aware of our regulatory universe?
2. Do we understand the legal and regulatory risks?
3. Do the control systems manage the risks of non-compliance?
4. Does ongoing compliance monitoring and reporting provide sufficient assurance for the board to be satisfied that the organisation complies with all laws and regulations?
Director Conduct and Liability
**Introduction**

The rights and responsibilities of directors arise from various sources, numerous statutes, common law, the company’s MoI and rules, shareholder agreements and the law of contract (where the director is also an employee).

In this section we provide a brief overview of the common law duties and summarise the provisions of the Companies Act, 71 of 2008 that relate to directors’ conduct and liability.

**Common law duties of directors**

Under common law, directors must conduct the company’s affairs with due care, skill and diligence. They also owe the company various other duties that arise from the fiduciary relationship in which they stand towards the company. They need to conduct the company’s affairs honestly and in the interests of the company. These duties are owed to the company, being the general body of shareholders (not to individual shareholders but to all the shareholders, both present and future).

The duties owed by directors apply equally to executive and non-executive directors.

**Duty of care, skill and diligence**

Directors are required to exercise care, skill and diligence in the performance of their duties.

The extent of this duty of care and skill depends to a large extent, on the nature of the company’s business and on any particular obligations assumed by or assigned to the director.

A director is not required to have special business acumen or expertise or singular ability or intelligence or even experience in the business of the company. He/she is, however, expected to exercise the care that can reasonably be expected of a person with his/her knowledge and experience. A director is not liable for mere errors of judgment.

In respect of all duties that may properly be left to another official, a director is, in the absence of specific grounds for suspicion, justified in trusting that official to perform such duties honestly. The director may accept and rely on the judgment, information and advice of the management, unless there are specific reasons for questioning this. A director exercising reasonable care would, however, not accept such information or advice blindly but should give it due consideration and exercise his own judgment accordingly.

If a director does not observe his duties of care and skill, he is liable to the company for damages in delict. If there was a contract between the director and his/her company (as is usually the case with directors employed by the company), he/she would be liable to the company for damages in delict. If there was a contract between the director and his/her company (as is usually the case with full-time executive directors) he/she may also be guilty of a breach of contract.

**Fiduciary Duties**

A director stands in a fiduciary relationship towards the company on whose board he/she serves. This is the result of the fact that directors act in a trustee capacity, being authorised to act on the company’s behalf, and entrusted with the protection of the company’s interests and the custody of the company’s assets. As a result, a director has the duty to act in good faith towards the company, to exercise his/her powers as director for the benefit of the company and to avoid a conflict between his/her own interests and those of the company. Each person who holds the office of director regardless of whether he/she is an executive or non-executive director owes these duties to the company.

There are various categories of fiduciary duties. These categories are not exclusive and may overlap with one another to a certain extent. The fundamental or paramount duty of directors, individually and collectively, is to exercise their powers bona fide in the best interests of the company. If they act illegally, dishonestly, beyond the powers of the company or beyond their own powers they will be liable to the company for damages.

The categories of fiduciary duties are as follows:

1. **Duty to act only under available powers**
   Directors must act within the limits of their authority and within the powers of the company, i.e. the directors must act intra vires. Directors commit a breach of trust if they purport to exercise powers that are non-existent because they are:
   - Beyond the corporate capacity of the company.
   - Beyond the powers conferred upon them by the MoI.

   Where directors act in breach of this duty it is irrelevant whether they believe they do so in the interests of the company. At common law, an act beyond the corporate capacity of the company is incapable of ratification by the general meeting.

2. **Duty to exercise powers for the purpose for which they were conferred**
   Directors must exercise their powers for the purpose for which they were given, namely an authorised business purpose. Accordingly, even if an act fell within the scope of the director’s powers, such power may not be exercised for an ulterior or improper purpose.

3. **Duty to act bona fide in the interests of the company**
   This duty requires the honest exercise by the directors of their judgment as to what is in the company’s interests. A director must exercise his powers for the benefit of the company and not anyone else.

   A court will not inquire into the commercial or financial wisdom of the director’s decisions but would consider whether a reasonable man could have believed that the particular act was in the interests of the company.

   This duty would, by way of example, prohibit directors from entering into unprofitable transactions and from disposing of the company’s shares or assets for inadequate consideration. It is aimed at protecting the company’s interests and overrides any duty which a director may owe to any person who has nominated or employed him.

4. **Duty to exercise an unfettered discretion**
   A director must exercise independent judgment in an objective manner and act positively to protect the interests of the company. This requires that directors exercise their discretion independently. Directors may accordingly not contract to act in a specific manner, e.g. to vote in a certain way at a meeting.

   Although a director may lawfully be elected by a shareholder of the company to represent the latter’s interest, a director may not be a mere dummy or puppet and may not blindly follow the instructions of the shareholder. Directors would be acting unreasonably if they act without any regard for minority shareholders but blindly on the instructions of the majority shareholder who nominated them to the board.
5. Duty to avoid a conflict of interest

A director may not place himself in a position where he has a personal interest conflicting or potentially conflicting with his duty to act in the best interests of the company. Duties that flow from this duty are (1) the duty to disclose any interest in a contract with the company; (2) the duty to account for secret profit; (3) the duty not to misappropriate corporate opportunities; (4) the duty not to improperly compete with the company.

- Duty to disclose any interest in a contract with the company.

Directors have both a common law and statutory duty (s75 of the Companies Act, 71 of 2008) to disclose to the company any interest that they have in a contract with the company. At common law, the rule is that, unless the Mol of a company provide otherwise, a director cannot have an interest in a contract with the company, whether direct or indirect, unless the company in general meeting approves the contract after disclosure to it of his interest and full particulars thereof.

This rule is an addition to the obligations of the director under s76 of the Companies Act, 71 of 2008 to disclose interests in contracts.

- Duty to account for secret profits.

A director must account to the company for all profits acquired by him by reason of his office, unless acquired or attained with the full knowledge and consent of the company. The director’s liability to account for such profit arises from the mere fact that a profit has been made and in no way depends on fraud or the absence of good faith.

- Duty not to misappropriate corporate opportunities.

A director is under a duty to acquire economic opportunities for the company. If, in breach of this duty, he/she acquires such an opportunity for himself/herself, the law will refuse to give effect to his intention and will treat the acquisition as having been made on behalf of the company and the company may consequently claim the opportunity from the director. The company may further claim any profit the director may have made as a result of his breach of duty or damages in respect of any loss caused to the company.

Whether a particular opportunity is one that the director should have acquired for the company depends on the circumstances prevailing at the time. Essentially, it will have been such an opportunity where the circumstances show that he/she had a conflict of interest.

- Duty not to improperly compete with the company.

Since a director is not an agent of the company, a director may, unless prohibited by agreement or the Mol, become a director, officer or employee of a competing company, or may carry on business in competition with the company, provided that he would not thereby place himself in a situation of conflict of interest and duty. This would depend on the circumstances of each case. A director would inevitably be in a conflict situation if he/she purported to be simultaneously managing director of each of two or more companies which are trade competitors.

Failure to comply with one’s fiduciary duties constitutes a breach of trust, which gives rise to a particular form of liability not based on contract or delict. If, as a result of a directors breach of his fiduciary duty the company suffers a loss or the director is benefited thereby, the company may recover any profit the director may have made as a result of his breach of duty or damages in respect of any loss caused to the company.

Where a director acts in breach of a fiduciary duty he/she may, depending on the circumstances, also be in breach of his duty of skill and care.

Standards of directors conduct – s76

The Companies Act, 71 of 2008 restates the common law duties and certain additional statutory duties of directors.

The definition of “director” includes alternate directors and de facto directors. Generally, where the Companies Act, 71 of 2008 deals specifically with the duties, liabilities etc of directors, these provisions also apply to board committee members and prescribed officers, even though these persons are not directors.

A “prescribed officer” is a person who exercises (or regularly participates to a material degree in the exercise of) general executive control over and management of the whole or a significant portion of the business or activities of the company (Regulation 38).

A director including prescribed officers and board committee members must:

- Not use the position of director, or any information obtained while acting in the capacity of a director;
  - To gain an advantage for himself/herself or any person other than the company or a wholly-owned subsidiary of the company;
  - To knowingly cause harm to the company or a subsidiary of the company.

- Communicate to the board any information that comes to the director’s attention, unless the director reasonably believes that the information is immaterial to the company or generally available to the public or known to the other directors or the director is bound not to disclose that information by reason of confidentiality.

A director of the company, when acting in that capacity, must exercise the powers and perform the functions of director:

- In good faith and for a proper purpose.
- In the best interests of the company.
- With the degree of care, skill and diligence that may reasonably be expected of a person;
  - Carrying out the same functions in relation to the company as those carried out by that director.
  - Having the general knowledge, skill and experience of that director.

These duties effectively re-state a director’s common law fiduciary duties and the duty of care and skill.

The Companies Act, 71 of 2008 includes the “business judgment test” which effectively provides that if the director has taken reasonable steps to be informed, has no material financial interest (or disclosed such financial interest) and has a rational basis to believe the decision was in the best interests of the company, the director will not be liable for a breach of duty, unless the director acted in bad faith or for an improper purpose.

A director is entitled to rely on the performance of employees, professional advisors, experts and board committees, provided that the person appears reliable. The Companies Act, 71 of 2008 sets out criteria for each class of persons that must be met prior to a director relying on such person. Without detailing each of these, the general approach appears to be that the person must be qualified in respect of the particular matter and must merit confidence.
Directors personal financial interests – s75

The Companies Act, 71 of 2008 sets out procedures that are required to be followed for a director (including prescribed officers and board committee members) to disclose a financial interest of that director or of a person related to that director in respect of any matter to be considered by the board. A director may also disclose any personal financial interest in advance, by delivering to the board, or the shareholders (in certain circumstances), a written notice setting out the nature and extent of that interest. If a director of a company has a personal financial interest in respect of a matter to be considered at a meeting of the board, or knows that a person related to that director has a personal financial interest in the matter, the director must make certain specified disclosures and must leave the meeting immediately after making the disclosures and may not take any part in the consideration of the matter. Where there are common directors on boards of companies who contract with each other, these provisions must be carefully considered. A director could be regarded as having a personal financial interest if the director sits on both boards of the contracting companies. A decision made in contravention of the procedures in this section can be ratified by an ordinary shareholders resolution or by the court, failing which such decision will not be valid.

Liability of directors and prescribed officers for breach of duties – s77

A director, prescribed officer and a member of a board committee may be held liable for any loss suffered by the company:

- For a breach of fiduciary duty.
- Aising from breaches of the Companies Act 71 of 2008 or the Mol.
- As a consequence of the director:
  - Acting without the necessary authority.
  - Acquiring the company carrying on business recklessly.
  - Being present or participating in a decision or failing to vote against certain decisions which contravenes the Companies Act, 71 of 2008.
  - Being party to any act or omission intended to defraud.
  - Signing or authorising the publication of any false or misleading financial statements.

The above list is not exhaustive of the provisions of s77 which includes a comprehensive list of acts or omissions which could give rise to liability. In addition, directors could also be liable to third parties, for example to shareholders for fraudulent acts or acts of gross negligence (s208B) or to any third person who has suffered loss by virtue of the directors breaching the Companies Act, 71 of 2008 (s218(2)).

While the Companies Act, 71 of 2008, to a large extent, has removed many of the criminal offences which were prevalent in the 1973 Companies Act, the potential for civil claims against directors in terms of the Companies Act, 71 of 2008 appears far greater. It is also important to note that members of board committees and prescribed officers will have the same liability as directors under s77 even if the members of the board committees or prescribed officers are not directors and even though they have no right to vote on any matters considered at board committees.

Duty of directors in relation to the solvency and liquidity test and financial distress

There is no general requirement that a company must be solvent and liquid in order to conduct business in terms of the Companies Act, 71 of 2008.

However, if a company does not meet the solvency and liquidity test (set out in s44), it may not enter into certain corporate actions. Further, if a company is “financially distressed”, it may potentially be obliged to initiate business rescue proceedings or alternatively if it does not initiate such proceedings, it is obliged to furnish a written notice to all affected persons advising them of the fact that the company is “financially distressed” and stating the reasons for not placing the company in business rescue (s129). “Financially distressed” is defined to include either commercial insolvency, inability to pay debts as they fall due or technical insolvency, (liabilities exceeding assets).

If a company is not liquid, it may be required to cease trading (s23(2)). Further, if an independent review is conducted on the annual financial statements of a company, an independent reviewer is obliged to report to the Commission (a so-called “reportable irregularity”) if management of the company causes the company to trade under insolvent circumstances (Regulation 29).

Indemnification and directors insurance – s78

A company may not indemnify a director against liability arising from:

- Willful misconduct or breach of trust by the director.
- The director acting without the necessary authority.
- Reckless trading.
- Fraudulent acts of the director.
- A fine related to an offence committed by the director unless the fine was based on strict liability.
- Wilful misconduct or breach of trust by the director.
- Being a party to a prospectus containing an “untrue statement” (s214(1)(d)).

Other than the specific instances mentioned above, a company may indemnify a director in respect of any liability, including the liability arising from directors’ negligence. A company may also purchase insurance to protect a director or the company against any liability in respect of which the company is permitted to indemnify a director.

Criminal sanction

One of the stated objectives of the Companies Act, 71 of 2008 was to decriminalise company law. The 1973 Companies Act had numerous provisions providing for criminal liability. The Companies Act, 71 of 2008 provides for far fewer offences and the main offences provided in the Companies Act, 71 of 2008 are the following:

- Falsification of accounting records (s214(1)(a)).
- Fraudulently providing false or misleading information (s214(1)(b)).
- Knowingly (which is defined as wider than actual knowledge) being a party to an act by the company to defraud a creditor, employee or security holder of the company or any other act by the company with a fraudulent purpose (s214(1)(c)).
- Being a party to a prospectus containing an “untrue statement” (s214(1)(d)).
- Failure to satisfy a compliance notice by the Commission (under certain circumstances) (s214(3)).

There are other specified offences throughout the Companies Act, 71 of 2008 (e.g. s28(3), 29(6), 31(4), 32(5), 213 (1), 214 and 215).
Civil actions

While there may be few criminal offences in the Companies Act, 71 of 2008, there is a greater opportunity for personal liability arising from actions which contravene the MoI of a company or contravene the Companies Act, 71 of 2008.

A director (which for these purposes will include a prescribed officer and a member of a board committee) is personally liable to the company for various acts or omissions as set out in s77. In addition, the Companies Act, 71 of 2008 has a far-reaching provision which may give rise to numerous civil claims against directors and persons other than directors. Section 218(2) provides that any person who contravenes any provision of the Companies Act, 71 of 2008 is liable to any other person for any loss or damage suffered by that person as a result of that contravention.

Previously for a person to succeed in a civil claim, they would need to have had a contractual relationship with the party against whom they are seeking to claim damages, or alternatively would need to have proved that the person against whom they are seeking damages, owed them a duty of care. Section 218(2) effectively creates a duty of care between any person who contravenes any provision of the Companies Act, 71 of 2008 and any person who has suffered damages arising from that contravention. Time will determine the impact of this provision but on the face of it, the implications appear far reaching.

The Companies Act, 71 of 2008 also allows for class actions (s157) and provides that where in terms of the Companies Act, 71 of 2008 any application or matter can be brought before a court, the Companies Tribunal, the TRP or the Commission, this may be brought by a person acting as a member of, or in the interest of, a group or class of affected persons, or an association in the interests of its members.

The Companies Act, 71 of 2008 also provides for a procedure in terms of which a person may bring a derivative action (s165). A derivative action is an action whereby a person brings an action requiring the company to protect the legal interests of the company. Previously, there was a common law right to bring a derivative action but the Companies Act, 71 of 2008 has now abolished this common law right and replaced it with a right set out in the Companies Act, 71 of 2008. The procedure to be followed is intended to be less complicated and quicker for the individual who would no longer have to automatically apply to court to compel the company to act.

Trading under insolvent circumstances – s22 and s214 and s424 of the 1973 Companies Act

Section 22 of the Companies Act, 71 of 2008 provides that a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose. The is very similar to s424 of the Companies Act 1973 and therefore the various cases over the years in relation to s424 would still be relevant. In summary, the tests generally applied by the courts as regards “reckless trading” is one of commercial insolvency and not merely technical insolvency.

The generally accepted test is that “if a company continues to carry on business and to incur debts when, in the opinion of reasonable businessmen, standing in the shoes of the directors, there would be no reasonable prospect of the creditors receiving payment when due, it will in general be a proper inference that the business is being carried on recklessly.”

In addition, s22 gives the Commission (the Companies and Intellectual Property Commission) the authority to issue a notice to a company to show cause why the company should be permitted to carry on its business or trade, if the Commission has reasonable grounds to believe that the company is unable to pay its debts as they become due and payable in the normal course of business. If a company receives such a notice, the company will have twenty business days to satisfy the Commission that it is able to pay its debts as they become due and payable, failing which the Commission may require the company to cease trading.

There is no specific time period stipulated in s22 for the Commission to determine whether a company is “able to pay its debts as they become due and payable in the normal course of business”.

1 It is also important to note that s424 of the 1973 Companies Act has not been repealed and therefore could still be of application.
Introduction

Strategic conversation is the dialogue process in which companies need to engage with their stakeholders in order to maintain their public licence to operate. In King III, strategic conversation falls largely under the banner of ‘sustainability’. This chapter will define and describe these and related concepts e.g. integrated reporting, sustainability reporting etc – and highlight the requirements of King III on these matters.

It is recognised that this is an area in which companies are still developing and much of this chapter deals with the goals to which companies should aspire when taking a progressive approach to improvement.

Integrated reporting

King III states that integrated sustainability performance and integrated reporting is recommended to “enable stakeholders to make a more informed assessment of the economic value of a company.”

By issuing integrated reports, a company increases the trust and confidence of its stakeholders and the legitimacy of its operations. It can increase the company’s business opportunities and improve its risk management. By issuing an integrated report internally, King III states that a company, “evaluates its ethics, fundamental values, and governance. And externally improves the trust and confidence which stakeholders have in it.”

Following the incorporation of King III into the Johannesburg Stock Exchange (JSE) Listings Requirements, listed companies are required to issue an integrated report for financial years on or after 1 March 2010 (or to explain why they are not doing so).

Similarly the Institutional Investors in South Africa have drafted a Code for Responsible Investing1 which states that institutional investors should incorporate environmental, social and governance considerations into their investment strategies and activities, and this includes an assessment of a company’s integrated report.

King III provides very little guidance on what is expected to appear in an integrated report. As the concept of integrated reporting is a relatively new one and hence there are no universally agreed standards and/or practices.

The International Integrated Reporting Committee (IIRC) is developing a discussion paper on a framework for an integrated report. In South Africa the Integrated Reporting Committee (IRC) was established in May 2010 with the primary objective of developing guidance on good practice in integrated reporting.

The major South African organisations founded the IRC namely:
1. The Association for Savings & Investment South Africa (ASISA).
2. Business Unity South Africa (BUSA).
4. JSE Ltd.
5. SAICA (The South African Institute of Chartered Accountants).

The chairman of the King Committee is also the chairman of the Global Reporting Initiative (GRI), and the deputy chairman of the International Integrated Reporting Committee. As a result the IRC will work with the IIRC to harmonise international standards on integrated reporting.

Its first task was to develop a framework that listed companies and others can use for their integrated reports. This framework was released on 25 January 2011.

**Sustainability reporting**

Sustainability reporting is “… the practice of measuring, disclosing, and being accountable to internal and external stakeholders for organisational performance towards the goal of sustainable development.” A report refers to a single, consolidated disclosure that provides a reasonable and balanced presentation of performance over a fixed time period.

The Global Reporting Initiative (GRI) has issued detailed guidelines for such reports.

The Millennium Development Goals

The Millennium Development Goals (MDGs) are eight goals to be achieved by 2015 that respond to the world’s main development challenges. The MDGs are drawn from the actions and targets contained in the Millennium Declaration. The Declaration was adopted by one hundred and eighty nine nations and signed by one hundred and forty seven heads of state and governments during the UN Millennium Summit in September 2000.

The eight MDGs are:

- **Goal 1** - Eradicate extreme poverty and hunger
- **Goal 2** - Achieve universal primary education
- **Goal 3** - Promote gender equality and empower women
- **Goal 4** - Reduce child mortality
- **Goal 5** - Improve maternal health
- **Goal 6** - Combat HIV/AIDS, malaria and other diseases
- **Goal 7** - Ensure environmental sustainability
- **Goal 8** - Develop a global partnership for development.

These goals have been implemented according to a Road Map, which outlines potential strategies for action. We are now at the midpoint between the adoption of the MDG’s and the 2015 target date. So far, the collective record is mixed. There have been advances in some areas but there have also been significant set-backs.

The United Nations issues a country report (for most countries it is on an annual basis) assessing a country’s progress in respect of each of the 8 MDGs.

The last UN country report on South Africa was in 2005. The progress report below is the latest information – dated 1 November 2007 - on the UN’s MDG Monitor website and is described as “Current status in accordance with national Government reporting”.

South Africa is on track to achieve by 2015, the following MDGs:

- Eradicate extreme poverty and hunger.
- Achieve universal primary education.
- Promote gender equality and empower women.
- Ensure environmental sustainability.
- Develop a global partnership for development.

Trends and developments in South Africa

In the Budget Speech of 2011, announced on 23 February 2011, further reference was made to “environmental taxes”. Funding amounting to R800 million has been set aside by the government over the next three years for ‘green economy’ initiatives. Additional proposed allocations include research into energy-efficient technologies are proposed, efforts to prevent wildlife trafficking and improved air quality, waste disposal and coastline management. A total of R2.2 billion was allocated for environmental employment programmes over the medium term period and funding was provided for hosting the ‘Conference on Climate Change’ in November 2011.

National Treasury has a working group considering the imposition of carbon tax on carbon emissions. A discussion paper entitled Reducing Greenhouse Gas Emissions: The Carbon Tax Option was published for public comment in December 2010. This discussion paper followed the 2008 announcement of an electricity generation levy of 2c per kWh, which was the first explicit carbon tax to be introduced in South Africa. It is believed that government will implement a comprehensive carbon mitigation and adaptation strategy in the 2011/12 fiscal year.

The following are excerpts from the Budget 2010/11 papers.

1. www.mdgmonitor.org
The following ‘green’ deductions/ allowances are among those currently in the Income Tax Act: 8

• Deduction in respect of certain machinery, plant, implements, utensils and articles used in farming or the production of renewable energy. 9
• Deductions in respect of environmental expenditure. 3
• Deductions in respect of environmental conservation and maintenance. 3
• Deduction for research and development costs. 10
• Exemption from normal tax on income derived from a disposal of Certified Emission Reductions. 11
• Special Allowance for Energy Efficiency Savings 8 (proposed and not yet effective – yet to be incorporated in the Income Tax Act).

King III requirements and recommendations

King III highlighted corporate citizenship and integrated sustainability, the so-called triple bottom line, in terms of which companies needed to account not only for economic and financial issues, but also for social and environmental issues (i.e. people, profit and planet).

King III builds on this principle by emphasising sustainability. Directors have accountability to shareholders and an obligation to all stakeholders 12 (including shareholders) to ensure that the company’s resources are utilised so as to ensure the continuing viability of the company. This involves not only environmental sustainability but also issues such as social responsibility (ensuring a positive impact on the community within which the company operates), respect for human rights, and the effective management of stakeholder relationships (including the utilisation of alternative dispute resolution mechanisms to resolve potential disputes efficiently, expeditiously and inexpensively).

Alternate dispute resolution is dealt with in more detail later in this chapter.

A focus on sustainability will not only positively impact a company’s risk management, but also its strategic planning processes. King III states that the ‘board should appreciate that strategy, risk, performance and sustainability are inseparable’ and directors should ensure that the company’s strategy accounts for sustainability issues. Directors also need to ensure adequate sustainability reporting to all stakeholders.

King III also points out that the economic value of a company can no longer be based on the balance sheet only. Rather, the economic value will be impacted by a range of non-financial issues such as brand and reputation, stakeholder relations and goodwill, an evolving and forward looking strategy, environmental sustainability, social responsibility, quality of governance, etc.

Global Reporting Initiative (GRI) sustainability reporting guidelines

The GRI framework identifies performance indicators, and sets out reporting principles and disclosures. The guidelines include:

• Reporting principles.
• Profile disclosures.
• Disclosures on management approach.
• Disclosures on performance indicators.

All organisations (private, public, or non-profit) are encouraged to report against the Guidelines, whether they are beginners or more experienced reporters and regardless of their size, sector or location. The reporting requirements are set up in a way that organisations can start with a ‘level C’ report and build up to a ‘level A’ report.

The GRI attempts to make its guidelines relevant to all users. This can, however, lead to practical questions about how to make reporting both global and local at the same time. These guidelines were updated and released by the GRI on 23 March 2011 and features up to date guidance on human rights, gender and community 15.

The GRI Guidelines are the most widely used in the sustainability reports of global companies. Indeed, they are regarded as the ‘de facto’ standard for sustainability reporting. The King III Report recommends sustainability reporting and refers to the GRI as a guideline.

To support reporters who use both the GRI Guidelines and ISO 26000-Guidance on Social Responsibility, the GRI has developed linkage guidance that highlights synergies between the GRI disclosures and the ISO subject areas 15.

The reporting process

Neither King III nor the GRI guidelines contain much in the way of guidance on the reporting process, especially how to prepare a report. Hence, key steps in the reporting process are included here. A company should:

• Ensure sufficient organisational understanding of the implications of integrated reporting.
• Plan the reporting process and define the report scope, boundary and structure.
• Identify material risks and opportunities that impact on the organisations ability to create and sustain value.
• Implement systems to ensure a responsiveness to view and interests of organisation’s principal stakeholders.
• Establish internal systems to accurately obtain and monitor relevant performance data.
• Develop and implement an appropriate assurance process.
• Compile the integrated report.
• Ensure appropriate sign-off from the relevant governance structure.
• Publicly release the integrated report.

9 Income Tax Act s12b
10 Income Tax Act s37b
11 Income Tax Act s37c
12 Income Tax Act s12d
13 Income Tax Act s12l
14 Income Tax Act s12k
15 Income Tax Act s11d

16 King III Chapter 8 Governing Stakeholder relationships Principle B.1.16, stakeholders include shareholders, institutional investors, creditors, lenders, suppliers, customers, employees, unions, the media, analysts, consumers, society in general, communities, auditors and potential investors.
**Integrated reporting and assurance**

**Sustainability reporting and assurance**

King III recommends independent assurance over material aspects of sustainability reporting. It recommends that the organisation’s board should ensure the integrity of the integrated report allows the board to delegate to the audit committee the evaluation of sustainability disclosure. The audit committee should review the sustainability issues in the integrated report to ensure they are reliable and that there is no conflict with the financial information.

**External reporting**

**Financial statements**

Presentation of information in financial statements is one of the communication channels within the realm of the board. The board, through the functioning of management, is responsible for the preparation and presentation of financial statements to the shareholders.

King III states that the audit committee has a specific responsibility to comment on the financial statements, the accounting practices and the internal financial control of the company and as such the audit committee should keep the board apprised on these matters.

**Annual financial statements**

All companies must prepare accounting records and annual financial statements. A company is responsible for the preparation of annual financial statements for every financial year in one of the official languages of South Africa and presentation thereof to the shareholders at the AGM of the company. The annual financial statements must depict the financial position, results of operations and cash flow information for the period and must consist of:

- Balance sheet.
- Income statement.
- Cash flow statement.
- Statements of changes in equity.
- Notes to the annual financial statements.
- Directors report.
- Company secretary report.
- Auditors report.

In addition, a corporate governance statement and a chairman’s report are also often included. The annual financial statements must be approved by the board and signed on its behalf by two directors in the case of a public company and one director in the case of a private company. If the financial statements are issued and appear to be incomplete, or do not comply with the requirements of the Companies Act, 71 of 2008, the company and every director will be guilty of an offence in terms of the Companies Act, 71 of 2008.
Interim financial statements
Interim financial statements can be defined as financial information, which may be less than annual financial statements, issued at interim dates in respect of a financial period, which are usually half-yearly or quarterly.

Every public company has to prepare interim financial statements fairly presenting the financial position, results of operations and cash flow information for the period or, in the case of a holding company, of the company and its subsidiaries.

Interim financial statements do not require an audit or review by external auditors. The interim financial statements must be approved by the board and signed on its behalf by two directors.

In terms of the JSE Securities Exchange Listings Requirements, a company is required to engage the auditors to review unaudited interim reports where the auditors have modified their audit opinion on the company’s latest annual financial statements.

Communicating in a corporate crisis
A corporate crisis can be defined as an unexpected event that in some way seriously threatens the organisation’s existence or reputation. By definition, a crisis demands an immediate and appropriate response.

Boards are rarely involved in the initial response to a crisis, although individually the CEO and other executive directors almost certainly will be. It is for this reason that boards should ensure their companies have crisis management plans in place, which should also include the board’s role during a crisis. This should be considered as part of a board’s risk-management responsibility.

Boards should also insist that crisis management plans have a robust crisis communications element. Company crises can be newsworthy events, especially if they affect public safety and convenience. People want to know what has happened, and what it means for them. Yet the natural reaction of most companies is to pull down the shutters – to say as little as possible about the crisis, even to pretend that nothing untoward has happened.

Lawyers tend to reinforce this tendency by advising companies to say little or nothing in a crisis. Boards must back management in balancing legal issues with communication considerations. After all, the future of the company depends not only on the ultimate resolution of the legal issues involved in a crisis, but also how the situation plays out in the ‘court of public opinion’ and whether decision making can be transparent and honest. By abdicating its responsibility to communicate, a company in crisis allows the resultant information vacuum to be filled by others.

Without effective crisis communication, companies may inflict additional damage on themselves, including:

- They could lose control of the communications process.
- They could allow facts to be displaced by rumour and speculation.
- They may unwittingly set themselves up to become the news media’s ‘bad guys’.
- They might put employee morale and trust at risk.
- They may alienate shareowners, customers, suppliers and other stakeholders.

The techniques of effective crisis communication are relatively straightforward, but they can take years to implement. This is why board support for strong crisis communication is essential. Authorities in the field believe effective crisis communication will include many, if not all, of the following elements:

- Express immediate concern/sympathy with the issues raised but do not speculate or lay blame.
- Communicate the known facts of the situation as quickly and simply as possible.
- Establish the company as the main source of credible, accurate information about the situation.
- Tell employees what is happening, and tell them quickly.
- Keep board members fully informed as matters develop, and seek their input where appropriate.

Alternate dispute resolution (ADR)
As business become more complex, disputes are more frequent and consume more management time and organisational resources than ever before. If disputes cannot be resolved through negotiation, it can take years to seek redress through our courts. Litigation is expensive and time-consuming, the outcome of which can also have negative consequences for a company’s reputation.

ADR is not a substitute for the formal judicial system. ADR programs are ‘instruments for the application of equity, rather than the rule of law’ and as such cannot be expected to establish legal precedent or implement changes in legal and social norms.

For the first time in South Africa, King III promotes a more responsible and progressive approach to dispute resolution. Chapter eight of King III identifies ADR as an essential component of good governance and recommends that boards and directors should explore more creative methods of dispute resolution.

King III endorses mediation, conciliation and failing that arbitration. The advantages to ADR can include:

- Time saving – a dispute can often be settled or decided much sooner.
- Money saving – when cases are resolved earlier through ADR, the parties may save some of the money they would have spent on attorney fees, court costs, expert fees etc.
- Increase control over the process and the outcome – parties typically play a greater role in shaping both the process and its outcome.
- Preserve relationships – this can be important where the parties have a relationship to preserve.
- Increase satisfaction – ADR can help the parties find win-win solutions and achieve their goals.

Each case should be carefully considered on its merits. King III recommends the following factors should be taken into account:

- Time available for the resolution of the dispute.
- Principle and precedent.
- Business relationships.
- Expert recommendation.
- Confidentiality.
- Rights and interests.

It is the board’s responsibility to select the appropriate individual(s) to represent the company in ADR processes.

### Appendix 1: Doing business in Africa

<table>
<thead>
<tr>
<th>Country</th>
<th>Angola</th>
<th>Botswana</th>
<th>Ghana</th>
<th>Kenya</th>
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<tbody>
<tr>
<td><strong>Regulatory</strong></td>
<td></td>
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</tr>
<tr>
<td>Legal system</td>
<td>Mixture of Portuguese civil law and customary law.</td>
<td>Mixture of Romano-Dutch and English common law.</td>
<td>Civil law based on Common Law, customary law and modified doctrines of equity and general statutes.</td>
<td></td>
</tr>
<tr>
<td>Companies Act</td>
<td>The Companies Law (Law 1/04, 13 February 2004). Defines five types of companies, the most commonly used being:  - Limited Liability Company by Quotas (LLC); usually used for smaller companies  - Joint Stock Company (JSC); usually used for larger companies.</td>
<td>Published in November 2003 and came into force on 3 July 2007.</td>
<td>The Companies Act (cap. 486) Laws of Kenya. It is based on the English Companies Act of 1948. There are three types of companies which can be incorporated under the Act:  - A private limited liability company  - A public limited liability company  - Branch offices of companies registered outside Kenya. A third form of registration can be made through the Business Name Act, 1962 (Act 151).</td>
<td></td>
</tr>
</tbody>
</table>

### Board structure

| Board structure | LLC - minimum capital of $1,000 (in local currency) and a minimum of two shareholders.  - JSC - minimum share capital of $20,000 (in local currency) and minimum of five shareholders. | At least one director who is ordinarily resident in Botswana. | A minimum of two directors, with one director present in Ghana at all times, except for temporary absences. | For public companies, at least two directors. For private companies, at least one director. |

### Mandatory Committees

<table>
<thead>
<tr>
<th>Country</th>
<th>Angola</th>
<th>Botswana</th>
<th>Ghana</th>
<th>Kenya</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LLC</strong></td>
<td>The general assembly representing the shareholders; management responsible for the daily running of the company; and an optional supervisory body.</td>
<td>None specified.</td>
<td>The directors must:  - Conduct all transactions on behalf of the company or with it in good faith  - Act in the best interest of the company to preserve its assets, further the business and promote the purposes for which it was formed  - Have regard for the interest of the employees and members of the company.</td>
<td>Directors duties include:  - Meeting regularly, retaining control and devoting sufficient time to execute their responsibilities  - Selection and removal of directors  - Compilation and communication of company policies and strategies and defining the limits of authority  - Review and approval of strategic plans and determining the resources of the company  - Defining how the board operates  - Ensuring compliance with all statutory requirements  - Monitoring social responsibilities and promulgation of policies consistent with legitimate interests and good business practices  - Be aware of responsibilities to investors, suppliers, creditors, employees and society.</td>
</tr>
<tr>
<td><strong>JSC</strong></td>
<td>The general assembly representing the shareholders; the board of directors in charge of management; and an audit committee.</td>
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</tbody>
</table>

### Director’s liability

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<thead>
<tr>
<th>Country</th>
<th>Angola</th>
<th>Botswana</th>
<th>Ghana</th>
<th>Kenya</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Detailed in the Companies Act.</strong></td>
<td><strong>Limited by shares. The Companies Act places personal civil liability on a director for certain breaches.</strong></td>
<td><strong>Contracts roles are binding and no other regulations, contracts or resolutions relieve them of their role or liability due to breach of the role.</strong></td>
<td>Section 208 of the Companies’ Code 1963, (Act 179) details the liability for a director if they commit any breach of duty.  - Compensate the company for any loss suffered resulting from the breach  - Account for any profit made as a result of the breach  - Resind any contract or other transaction entered into in breach of such duties.</td>
<td><strong>Liable in terms of Criminal and penal laws relevant to companies. Personal liability for fraud, secret profits, corruption and bribery.</strong></td>
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<tr>
<td>Country</td>
<td>Angola</td>
<td>Botswana</td>
<td>Ghana</td>
<td>Kenya</td>
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</tr>
<tr>
<td>Citizenship</td>
<td>No citizenship requirements for directorships.</td>
<td>No citizenship requirements for directorships.</td>
<td>There is no obligation that any of the directors should be Ghanaian.</td>
<td>None specified.</td>
</tr>
<tr>
<td>Ownership of shares</td>
<td>No residency, citizenship or restrictions for share ownerships.</td>
<td>No residency, citizenship or restrictions for share ownerships.</td>
<td>Currently no restrictions on non-Kenyan residents or citizens owning shares in a private limited company. However, the Kenya Investment Authority (KIA) notes there are restrictions on foreign ownership in telecommunications, insurance and the stock exchange. There are restrictions on non-Kenyan residents or citizens owning shares in public companies where shares are offered to the public. A single non-Kenyan resident or citizen cannot own more than 5% of the total number of listed shares (or shares to be listed) of a Kenyan company, or more than 5% of shares which are the subject of a public offer. The total number of shares held by non-Kenyan residents or citizens cannot exceed 40% of the total number of shares in a listed company or 40% of the total number of shares offered by way of a public offer.</td>
<td>None specified.</td>
</tr>
<tr>
<td>Special considerations</td>
<td>None specified.</td>
<td>None specified.</td>
<td>Investment specific laws have taxation provisions. The Ghana Investment Promotion Centre Act provides that enterprises registered under the Act are entitled to all the incentives and benefits under Ghanaian tax law on direct as well as indirect taxation.</td>
<td>None specified.</td>
</tr>
<tr>
<td>Governance Code</td>
<td>No written Corporate Governance Code identified</td>
<td>Companies listed on the Botswana Stock Exchange (BSE) should comply or explain with the BSE Code of Best Practice on Corporate Governance. Other companies are primarily guided by the recommendations of the Code of Governance Principles (King III).</td>
<td>No written Corporate Governance Code identified. However, listed companies comment on Corporate Governance in the Annual Financial Statements.</td>
<td>None specified.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country</th>
<th>Malawi</th>
<th>Mauritius</th>
<th>Mozambique</th>
<th>Namibia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constitution</td>
<td>Multiparty democracy.</td>
<td>Parliamentary democracy.</td>
<td>Multiparty Democracy with a Republican form of Government.</td>
<td>The Republic of Namibia is established as a sovereign, secular, democratic and unitary State founded upon the principles of democracy, the rule of law and justice for all. The main organs of the State are the Executive, the Legislature and the Judiciary.</td>
</tr>
<tr>
<td>Legal system</td>
<td>Mixture of English common law and customary law.</td>
<td>Mauritius enjoys a hybrid legal system. The procedural law both in criminal and civil litigation is mainly English, whilst the substantive law is based on the French Napoleonic Code.</td>
<td>Romano-Dutch.</td>
<td>A mixture of Westminster-style Constitutional law, Roman-Dutch common law and international law. The sources include the Constitution, Customary law, Common law and international law.</td>
</tr>
<tr>
<td>Companies Act</td>
<td>Malawi Companies Act, 1984.</td>
<td>The Companies Division, a government office, falls under the aegis of the Ministry of Finance and Economic Empowerment. It administers the Companies Act 2001, the Business Registration Act 2002 and the Insolvency Act 2009 whereby all companies in Mauritius are regulated. Offshore vehicles can be incorporated in Mauritius and are licensed by the Financial Services Commission.</td>
<td>Commercial Code. approved by Law N:10/2005 of 23 December and by Decree/Law n. 2/2005 of 27 December 2006.</td>
<td>Companies Act, 2004 came into force on 1 November 2010 and provides the definition of a company, the legal requirements for incorporation of companies as well as regulatory and administrative requirements for companies.</td>
</tr>
<tr>
<td>Board structure</td>
<td>Unitary (or one tier) board structure, comprising executive and nonexecutive directors.</td>
<td>Executive, non-executive and independent directors.</td>
<td>Unitary or board structure composed of impair number of director, comprising executive and non executive members.</td>
<td>Every public company must have at least two directors and every private company must have at least one director. The compositions of the board of directors of companies that are owned by the State are subject to the requirements of the State Owned Enterprises Governance Act of 2006.</td>
</tr>
<tr>
<td>Country</td>
<td>Malawi</td>
<td>Mauritius</td>
<td>Mozambique</td>
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</tr>
<tr>
<td><strong>Mandatory Committees</strong></td>
<td>Discretionary in terms of the Malawi Code II.</td>
<td>Mandatory for PIE (in line with King’s report on Corporate Governance).</td>
<td>Public companies, listed and unlisted should have a Fiscal Council, (Audit Committee). All other companies is discretionary.</td>
<td>The board of directors is the ultimate body governing companies. In practice, public companies and some private companies have board committees such as audit, remuneration, risk management and compliance committees for enhanced corporate governance.</td>
</tr>
<tr>
<td><strong>Director’s duties</strong></td>
<td>Detailed in the Companies Act and the Malawi Code II.</td>
<td>The directors are bound by duty towards the company itself, shareholders, employees, creditors, customers, competitors, members of the public, government and other regulatory bodies.</td>
<td>Detailed in the Commercial Code for each one of different types of corporations.</td>
<td>The directors’ duties are set out in the Companies Act, 2004, which deal with directors’ obligations to act in good faith and in the best interests of the company.</td>
</tr>
<tr>
<td><strong>Director’s liability</strong></td>
<td>Limited by shares. The Companies Act places personal civil liability on a director for certain breaches.</td>
<td>Directors may have potential litigation issues owing to: • Failure of supervision • Inaccuracy in statements of financial accounts • Lack of judgement and good faith • Mismanagement of funds • Misstatements in prospectuses • Allotment of shares • Unauthorised loans or investments • Impudent expense resulting in a loss • Using inside information • Unwarranted dividend payment, salaries or compensation • Misleading statements filed with the stock exchange • Misrepresentation in acquisition agreement for the purchase of another company • Wrongful dismissal of an employee. As permitted by its constitution, the company can contract a Directors and Officers Liability Insurance for its directors.</td>
<td>Under the Article of Association, directors can be requested to provide a cash or collateral bond to guarantee his personal civil liability on possible breach of legal duties.</td>
<td>The duties of the director are detailed in the Companies Act. Any provision, whether contained in the Articles of a company or in any contract with a company to exempt any director or officer or the auditor of the company from any liability which by law would otherwise attach to him/her in respect of any negligence, default, breach of duty or breach of trust of which he/she may be guilty in relation to the company or to indemnify him/her against that liability, is void. The above however must not be construed as prohibiting a company from indemnifying any director, officer or auditor in respect of any liability incurred by him/her in defending any proceedings, whether civil or criminal.</td>
</tr>
<tr>
<td><strong>Citizenship</strong></td>
<td>No citizenship requirements for directorships.</td>
<td>Not required.</td>
<td>No citizenship is required for Directors.</td>
<td>No citizenship requirements for directorships.</td>
</tr>
<tr>
<td><strong>Ownership of shares</strong></td>
<td>No residency, citizenship or restrictions for share ownerships.</td>
<td>Allowed except in entities that own property.</td>
<td>No residency, citizenship is required for share ownership.</td>
<td>The Articles of Association may require a director to purchase a required number of shares as a qualification. If a director fails to comply with this requirement within two months or shorter period as indicated in the articles, he/she would be required to vacate their office. Qualification shares need not be obtained, if the Articles of Association do not require this as a condition for directorship.</td>
</tr>
<tr>
<td><strong>Special considerations</strong></td>
<td>Work and residence permits required for non-residents.</td>
<td></td>
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<tr>
<td><strong>Governance Code</strong></td>
<td>Code of Corporate Governance, published in 2001 however, many listed companies comply with other codes such as King III. Malawi introduced a set of overarching provisions, applicable to all organisations, namely Malawi Code II.</td>
<td>The Report on Corporate Governance for Mauritius (the Code) was launched in October 2003 and revised in April 2004. The Code aims at improving ethical conduct of directors and senior level officials in the management of companies. Compliance with the Code is voluntary but nearly all companies support and are committed to the principles.</td>
<td>The Institute of Directors is establishing a Mozambique Corporate Governance Code based on King III.</td>
<td>Companies listed on the Namibian Stock Exchange (NSX) should “comply or explain” with the King III report. The NSX is in the process of developing a governance code which will be more aligned with the requirements of the King III Code on Corporate Governance. Other companies are guided by the recommendations of the King II report and the recently issued King III report.</td>
</tr>
<tr>
<td>Country</td>
<td>Nigeria</td>
<td>Sierra Leone</td>
<td>Swaziland</td>
<td>Tanzania</td>
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<tr>
<td><strong>Regulatory</strong></td>
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</tr>
<tr>
<td><strong>Constitution</strong></td>
<td>Federal Republic, with the President of Nigeria as both head of state and head of government, and of a multi-party system. In terms of the Constitution the Federal Government have exclusive legislative power to create laws for the establishment and administration of companies.</td>
<td>Multi-party constitutional republic.</td>
<td>Constitution of United Republic of Tanzania, 1977, as amended from time to time.</td>
<td></td>
</tr>
<tr>
<td><strong>Legal system</strong></td>
<td>Nigeria is a common law legal jurisdiction by virtue of the adoption of English common law, doctrines of equity and designated English statutes.</td>
<td>House of Parliament of Sierra Leone – one legislative / parliamentary chamber (unicameral).</td>
<td>Mixture of South African Roman-Dutch law in statutory courts, and traditional and customary law.</td>
<td>Mixture of English common law, statutory law, and customary law.</td>
</tr>
<tr>
<td><strong>Companies Act</strong></td>
<td>The Companies and Allied Matters Act Cap C20, LFN (CAMA). Corporate Affairs Commission (CAC) administers CAMA and regulates companies’ affairs.</td>
<td>Companies Act 2009, including PART XVIII – Companies Incorporated Outside Sierra Leone and Carrying on Business Within Sierra Leone.</td>
<td>The Companies Act, 2009 (Act No. 8 of 2009).</td>
<td>Companies Act No. 12 of 2002.</td>
</tr>
<tr>
<td><strong>Director’s duties</strong></td>
<td>(1) A director of a company stands in a fiduciary relationship towards the company and shall observe the utmost good faith towards the company in any transaction with it or on its behalf. (2) A director shall also owe fiduciary relationship with the company in the following circumstances (a) Where a director is acting as agent of a particular shareholder. (b) Where even though he is not an agent of any shareholder, such a shareholder or other person is dealing with the company’s securities.</td>
<td>Subject to the Companies Act, the directors duties are determined by the company’s Memorandum or Articles (S51(2), S230-254).</td>
<td>Detailed in the Articles.</td>
<td>Subject to the provisions of the Act, the Memorandum and the Articles and to any directions given by special resolution, the business of the company shall be managed by the directors, who may exercise all the powers of the company. No alteration of the Memorandum or Articles and no such directions shall invalidate any prior act of the directors which would otherwise have been valid. The powers given by this article shall not be limited by any special power given to the directors by the articles and a meeting of directors at which a quorum is present may exercise all powers exercisable by the directors.</td>
</tr>
<tr>
<td><strong>Committees mandatory</strong></td>
<td>The board may in addition to the audit committee required by the Companies and Allied Matters Act (CAMA) establish a governance/remuneration committee and risk management committee and such other committees as the board may deem appropriate depending on the size, needs or industry requirements of the company.</td>
<td>None specified.</td>
<td>None specified.</td>
<td>None specified.</td>
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<td><strong>None specified.</strong></td>
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</table>
## Director’s duties continued

<table>
<thead>
<tr>
<th>Country</th>
<th>Nigeria</th>
<th>Sierra Leone</th>
<th>Swaziland</th>
<th>Tanzania</th>
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<tbody>
<tr>
<td><strong>(3)</strong></td>
<td>A director shall act at all times in what he believes to be the best interests of the company as a whole so as to preserve its assets, further its business, and promote the purposes for which it was formed and in such manner as a faithful, diligent, careful and ordinarily skillful director would act in the circumstances.</td>
<td>35. The directors may by power of attorney appoint any person to be the attorney or agent of the company for such purposes and on such conditions as they determine, including authority for the attorney or agent to delegate all or any of his powers.</td>
<td>36. All cheques, promissory notes, drafts, bills of exchange and other negotiable instruments, and all receipts for moneys paid to the company, shall be signed, drawn, accepted, endorsed, or otherwise executed, as they case may be, in such manner as the directors shall from time to time by resolution determine.</td>
<td>37. The directors shall cause minutes to be made in books provided for the purpose:— (a) of all appointments of officers made by the directors (b) of the names of the directors present at each meeting of the directors and of any committee of the directors (c) of all resolutions and proceedings at all meetings of the company, and of thdirectors, and of committees of directors.</td>
</tr>
<tr>
<td><strong>(4)</strong></td>
<td>The matters to which the director of a company is to have regard in the performance of his functions include the interests of the company’s employees in general, as well as the interests of its members.</td>
<td>(7) Where a director is allowed to delegate his powers under any provision of this Decree such a director shall not delegate the power in a way and manner as may amount to an abdication of duty.</td>
<td>(8) No provision, whether contained in the articles or resolutions of a company, or in any contract shall relieve any director from the duty to act in accordance with this section or relieve him from any liability incurred as a result of any breach of the duties conferred upon him under this section.</td>
<td>(9) Any duty imposed on a director under this section shall be enforceable against the director by the company.</td>
</tr>
<tr>
<td><strong>(5)</strong></td>
<td>A director shall exercise his powers for the purpose for which he is specified and shall not do so for a collateral purpose and the power, if exercised for the right purpose does not constitute a breach of duty, if it, incidentally, affects a member adversely.</td>
<td>(l) Every director of a company shall exercise the powers and discharge the duties of his office honestly, in good faith and in the best interests of the company, and shall exercise that degree of care, -diligence and skill which a reasonably prudent director would exercise in comparable circumstances.</td>
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<td><strong>(6)</strong></td>
<td>A director shall not fetter his discretion to vote in a particular way.</td>
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<tr>
<td>Country</td>
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</tr>
<tr>
<td><strong>Director’s duties continued</strong></td>
<td>(2) Failure to take reasonable care in accordance with the provisions of section 282 of this Decree shall ground an action for negligence and breach of duty.</td>
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<td></td>
<td>(3) Each director shall be individually responsible for the actions of the board in which he/she participated, and the absence from the board’s deliberations, unless justified, shall not relieve a director of such responsibility.</td>
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<td></td>
<td>(4) The same standard of care in relation to the director’s duties to the company shall be required for both executive and non-executive directors provided that additional liability and benefit may arise under the master and servant law, in the case of an executive director if there is an express or implied contract to that effect.</td>
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</table>

<table>
<thead>
<tr>
<th>Country</th>
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<th>Swaziland</th>
<th>Tanzania</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Director’s liability</strong></td>
<td>CAMA imposes duties on directors enforceable by the company, which they cannot be relieved from or relieved from any liability incurred as a result of a breach thereof. Each director has a responsibility for the actions of the board. A director holding more than one directorship does not exel the director from his fiduciary duty to each company, including the duty not to use the property, opportunity or information obtained in the course of the management of one company for the benefit of the other company, or to his own or other person’s advantage.</td>
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<td></td>
<td>As stated in the Companies Act 2009 (S79) and defined in the Company’s Memorandum, either being limited or unlimited.</td>
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<tr>
<td></td>
<td>Not defined in the Companies Act 2009.</td>
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<tr>
<td></td>
<td>Directors will be held liable if convicted of any offence, fraud conduct in connection with the management of the company.</td>
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</table>

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Citizenship</strong></td>
<td>The directors do not need to be Nigerians.</td>
<td>No restrictions / requirements.</td>
<td>No restrictions / requirements.</td>
<td>Tanzanian nationality law is the law which deals with citizenship and other forms of nationality. A Tanzanian citizen is anyone who is in possession of citizenship to the United Republic of Tanzania. Nationality law is mentioned in the Constitution of Tanzania. The Tanzanian Citizenship Act, No. 6 of 1995.</td>
</tr>
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</tr>
<tr>
<td><strong>Ownership of shares</strong></td>
<td>Foreign investors do not have any restriction on share ownership.</td>
<td>No restrictions / requirements.</td>
<td>No restrictions / requirements.</td>
<td>Foreigners may not own government securities. By law foreign and local investors are treated the same. However, the government approves the lease of real estate. To assist investors, the Tanzania Investment Centre exists in terms of the Tanzania Investment Act of 1997.</td>
</tr>
<tr>
<td>Country</td>
<td>Nigeria</td>
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</tr>
<tr>
<td>Special considerations</td>
<td>None specified.</td>
<td>None specified.</td>
<td>None specified.</td>
<td>None specified.</td>
</tr>
</tbody>
</table>

**Governance Code**

- The Securities and Exchange Committee’s Code of Corporate Governance in Nigeria (2011). The Code applies to the following entities:
  - All public companies whose securities are listed on a recognised securities exchange in Nigeria
  - All companies seeking to raise funds from the capital market through the issuance of securities or seeking Listings by introduction
  - All other public companies.


- No known Corporate Governance Report. Companies listed on the Swaziland Stock Exchange adopt King III.

- No known Corporate Governance Report.

**Company Act**

- The Companies Law (Companies Act, Cap 110 Laws of Uganda 2000):
  - To provide for the formation, management, administration and winding-up of companies
  - To provide for charges over undertakings or properties of companies
  - To provide for the registration of foreign companies doing business in Uganda
  - To provide for matters connected with or incidental to the foregoing.

- Chapter 388 Companies Act 26 of 1994, 6 of 1995, 1 of 2000 is an Act to provide for the formation, management, administration and winding-up of companies:
  - To provide for the registration of charges over the undertakings or properties of companies
  - To provide for the registration of foreign companies doing business in Zambia
  - To provide for matters connected with or incidental to the foregoing.

- Companies Act (Ch 24:03) and Companies Amendment Act, 2006.


**Board structure**

- Minimum of two directors, no specific requirement for citizenship and/or residence in Uganda.

- (1) More than half of the directors of a company, including Residential Company requirements of directors:
  - (a) the managing director, if the company has a managing director; and
  - (b) at least one executive director, if the company has executive directors; shall be resident in Zambia.

<table>
<thead>
<tr>
<th>Country</th>
<th>Uganda</th>
<th>Zambia</th>
<th>Zimbabwe</th>
<th>Rwanda</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Regulatory</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constitution</td>
<td>Republic multi party dispensation.</td>
<td>Presidential representative democratic republic. President is head of state and government. Multi-party system.</td>
<td>Constitution of Zimbabwe, published as a Schedule to the Zimbabwe Constitution Order 1979 (SI. 1979/1600 of the United Kingdom) has been amended by various Acts of Parliament.</td>
<td>Republic. A multi party system is recognised. President is the Head of state and the Prime Minister is in charge of Government affairs.</td>
</tr>
</tbody>
</table>


| Companies Act | | | | |
| General | | | | |

- The Companies Law (Companies Act, Cap 110 Laws of Uganda 2000):
  - To provide for the formation, management, administration and winding-up of companies:
  - To provide for the registration of charges over the undertakings or properties of companies
  - To provide for the registration of foreign companies doing business in Zambia
  - To provide for matters connected with or incidental to the foregoing.

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  - To provide for the registration of charges over the undertakings or properties of companies
  - To provide for the registration of foreign companies doing business in Zambia
  - To provide for matters connected with or incidental to the foregoing.

- Companies Act (Ch 24:03) and Companies Amendment Act, 2006.


- A company shall have at least two directors with one residing in the country.
<table>
<thead>
<tr>
<th>Country</th>
<th>Uganda</th>
<th>Zambia</th>
<th>Zimbabwe</th>
<th>Rwanda</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Mandatory Committees</strong></td>
<td>None specified by the Companies Act however, companies tend to set up committees depending on their needs.</td>
<td>Audit committee and risk management committee are mandatory. Nominations committee and remuneration committee, or a combination of the two, are good practice.</td>
<td>The board of directors is the ultimate body governing the corporation. Directors establish and ensure the effective functioning of board and management committees in key areas and delegate powers. In practice, public companies, both listed and unlisted, have board committees such as audit, remuneration, risk management, compliance, nominations, investment, general purpose, technical, loans review and board credit committees depending on the nature and scope of their activities.</td>
<td>None specified.</td>
</tr>
</tbody>
</table>

| **Director’s duties** | Duties of directors are spelt out in the Articles of Association which give them powers to manage the business of the company. | Directors’ statutory duties fall under Section 215 of the Companies Act Cap 388. | Detailed in the Companies Act. | Detailed in the Companies Act. |

| **Citizenship** | No specific requirement for any of the directors to be a citizen. | The Laws on Zambian Citizenship are governed by Articles 4-10 of the Constitution of Zambia. | No citizenship requirements. | No citizenship requirements. |

| **Ownership of shares** | No residency or citizenship restrictions for ownership of shares. | Ownership of shares in Zambia is governed by the Companies Act Cap 388. S 57(1). There are no specific residential / citizenship requirements. | No information identified although there is a piece of legislation similar to BEE framework in South Africa which prescribes at least 51% ownership of equity by indigenous Zimbabweans in any entity with net asset of US$500,000 or more. | Detailed in the act, however in regards to foreign ownership of shares none has been specified. |

| **Special considerations** | Miscellaneous provisions with respect to insurance companies, and certain societies and partnerships. | None specified. | None specified. | None specified. |

| **Governance Code** | No written Corporate Governance Code identified. However, companies adopt own Corporate Governance practices. | In Zambia, Governance Structures in Companies are primarily prescribed by the Companies Act Cap 388, the Bank of Zambia Act Cap 360 and the Bank of Zambia Corporate Guidelines 2006. | The Institute of Directors in conjunction with the Leadership Forum are establishing a Zimbabwe Corporate Governance Code and the promotion of corporate social responsibility. The Corporate Governance Code will rely on precedents set in the King Report on Governance for South Africa, 2009. | None specified. |
Appendix 2: Comparative analysis of categories of companies

<table>
<thead>
<tr>
<th></th>
<th>Public Company</th>
<th>Private Company</th>
<th>State-Owned Company</th>
<th>Non-Profit Company</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Members (s13)</strong></td>
<td>One with no maximum.</td>
<td>One with no maximum.</td>
<td>One or more person or an organ of state to incorporate, with no maximum.</td>
<td>Three persons to incorporate (no members required but if members no maximum).</td>
</tr>
<tr>
<td><strong>Offer of securities /transferability of securities (s38)</strong></td>
<td>No requirement to restrict the transferability of securities or prohibit the offer of its securities to the public.</td>
<td>Mol must restrict the transferability of its securities and must prohibit the offer of its securities to the public.</td>
<td>No requirement to restrict the transferability of securities or to prohibit the offer of its securities to the public.</td>
<td>NPC has no securities.</td>
</tr>
<tr>
<td><strong>Directors (s66)</strong></td>
<td>Three in addition to the number of directors required for the audit committee and the social and ethics committee.</td>
<td>One.</td>
<td>Three in addition to the number of directors required for the audit committee and the social and ethics committee (note PFMA).</td>
<td>Three in addition to the number of directors required for the audit committee and the social and ethics committee.</td>
</tr>
<tr>
<td><strong>Quorum (s64)</strong></td>
<td>25% and at least three shareholders if the company has more than two shareholders.</td>
<td>25% and at least three shareholders if the company has more than two shareholders.</td>
<td>25% and at least three shareholders if the company has more than two shareholders.</td>
<td>If voting members: 25% and at least three shareholders if the company has more than two members.</td>
</tr>
<tr>
<td><strong>Voting rights (s37)</strong></td>
<td>Each share has one general voting right if the company if provided otherwise.</td>
<td>Each share has one general voting right unless class rights in Mol provides otherwise.</td>
<td>Each share has one general voting right unless class rights in Mol provides otherwise.</td>
<td>May have voting or non-voting members or both.</td>
</tr>
<tr>
<td><strong>AGM (s61(7))</strong></td>
<td>Requires an AGM.</td>
<td>No requirement for an AGM unless required to be audited.</td>
<td>Requires an AGM.</td>
<td>No requirement for an AGM unless required to be audited.</td>
</tr>
<tr>
<td><strong>Electronic participation at shareholder meeting (s61(10))</strong></td>
<td>Required to provide a mechanism for electronic participation of shareholder meetings.</td>
<td>No requirement.</td>
<td>Required to provide a mechanism for electronic participation of shareholder meetings.</td>
<td>No requirement.</td>
</tr>
<tr>
<td><strong>Business to be transacted at AGM (s61(8) and s60(5))</strong></td>
<td>List of prescribed business to be transacted at AGM.</td>
<td>Business specifically required to be conducted at an AGM by Mol or the Act, e.g. appointment of an auditor (if applicable), but list for public companies does not apply.</td>
<td>List of prescribed business to be transacted at AGM.</td>
<td>Business specifically required to be conducted at an AGM by Mol or the Act, e.g. appointment of auditor (if applicable) but list for public companies does not apply.</td>
</tr>
<tr>
<td><strong>Notice for shareholder meetings (s62(11))</strong></td>
<td>Fifteen business days.</td>
<td>Ten business days.</td>
<td>Fifteen business days.</td>
<td>Fifteen business days if voting members.</td>
</tr>
<tr>
<td><strong>Whistleblower provisions (s159)</strong></td>
<td>Public company required to implement a reporting process.</td>
<td>No requirement for reporting process.</td>
<td>SOC required to implement a reporting process.</td>
<td>No requirement for reporting process.</td>
</tr>
<tr>
<td><strong>Governance (s30, s34, Chapter 3 and s(84) – (94))</strong></td>
<td>Require an audit, audit committee and company secretary.</td>
<td>Only require an audit if determined by Regulation.</td>
<td>Only require audit committee and company secretary if stipulated in Mol.</td>
<td>Only require an audit if determined by Regulation.</td>
</tr>
<tr>
<td><strong>Lodging of financial statements with the Commission (s33)</strong></td>
<td>Required to lodge annual financial statements.</td>
<td>Only required to lodge annual financial statements if it is a company that is required to be audited by regulation.</td>
<td>Required to lodge annual financial statements.</td>
<td>Only required to lodge annual financial statements if it is a company that is required to be audited by regulation.</td>
</tr>
<tr>
<td><strong>Disclosure of beneficial interest in securities (s56)</strong></td>
<td>Nominee required to disclose beneficial holder of securities.</td>
<td>No requirement to disclose beneficial interest of securities.</td>
<td>Nominee required to disclose beneficial holder of securities.</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Pre-emptive rights on issue of securities (s59)</strong></td>
<td>No pre-emptive rights unless Mol provides otherwise.</td>
<td>Shareholders have pre-emptive rights in respect of the issue of any new securities (subject to certain limitations) – this may be excluded by the Mol.</td>
<td>No pre-emptive rights unless Mol provides otherwise.</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Application of the takeover regulations and TRP and “affected transactions”</strong></td>
<td>Applies to every public company.</td>
<td>Only applies to a private company if provided for in Mol, or if there has been a transfer of more than 10% of the securities in the last twenty four months.</td>
<td>Applies to every SOC.</td>
<td>N/A</td>
</tr>
</tbody>
</table>
ANNEXURE

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Annexure 3: Audit and independent review requirements

Public Interest Score (Regulation 26)
The Regulations state that every company must calculate its public interest score (PI score) at the end of each financial year.

PI score is calculated as the sum of the following:
- A number of points equal to the average number of employees of the company during the financial year.
- One point for every R 1 million (or portion thereof) of third party liability of the company at the financial year end.
- One point for every R 1 million (or portion thereof) of turnover during the financial year.
- One point for every beneficial shareholder (profit company) or member of the company (non profit company) at the financial year end.

“Employee” is defined in the Labour Relations Act, 1995 as:
(a) Any person, excluding an independent contractor, who works for another person or for the State and who receives, or is entitled to receive, any remuneration.
(b) Any person who in any manner assists in carrying on or conducting the business of an employer.

“Turnover” is not defined in the context of the PI score, but is defined in Regulation 164 as the gross revenue derived from the sale of goods, the rendering of services or the use by other persons of the company’s assets yielding interest, royalties or dividends. There is no authority that regulation 164 may be applied for purposes of the PI score. (It is referred to for guidance and the group concept in Regulation 164 should not be applied).

Financial statements and reporting and audit and independent review requirements
- All companies must prepare accounting records and annual financial statements (s28, s29).
- Public companies and state owned companies must be audited.
- Any other company must be audited if required in terms of the regulations.
- Companies can also choose to be audited voluntarily.
- A private company if not audited (whether by regulation, refer to the decision tree or voluntarily)
- “Independently compiled and reported” means that the AFS statements are prepared:
- Public companies not listed on an exchange IFRS
- Public companies not listed on an exchange or Profit or Non profit companies whose PI score is at least 350 One of:
- Profit or non-profit companies:
- State owned companies or Non profit companies that are required in terms of regulation 28(2)(b) to have their AFS audited IFRS, but in case of any conflict with any requirements in terms of the PFMA, the PFMA prevails
- Profit or non-profit companies: at least 350
- Profit or non-profit companies: whose PI score is less than 100, and whose financial statements are independently compiled One of:
- Profit or non-profit companies whose PI score is less than 100 and whose financial statements are internally compiled The Financial Reporting Standard as determined by the company for as long as no Financial Reporting Standard is prescribed

The Financial Reporting Standards as above apply to every company with a financial year ending on or after 1 May 2011.

Definitions
- “ISRE 2400” means the International Standard for Review Engagements as issued from time to time, by the International Auditing and Assurance Standards Board.
- An “independent review of a company’s annual financial statements must be carried out if the company has a PI score for that particular year of:
  (i) At least 100, by a registered auditor, or a member in good standing of a professional body accredited in terms of section 33 of the Auditing Profession Act.
  (ii) Was less than 100, by a person contemplated in (i) or a person who is qualified to be appointed as an accounting officer of a close corporation in terms of the Close Corporation Act, 1984.
- “Independently compiled and reported” means that the AFS statements are prepared:
  (i) By an independent accounting professional.
  (ii) On the basis of the financial records provided by the company.
  (iii) In accordance with any relevant financial reporting standards.
“Independent accounting professional” means a person who:

(i) Is:
   (aa) a registered auditor in terms of the Auditing Profession Act
   (bb) a member in good standing of a professional body that has been accredited in terms of section 33 of the Auditing Profession Act
   (cc) qualified to be appointed as an accounting officer of a close corporation in terms of the Close Corporation Act, 1984
(ii) Does not have a personal financial interest in the company or a related or inter-related company
(iii) Is not:
   (aa) involved in the day to day management of the business or has been involved during the previous three financial years
   (bb) a prescribed officer, or a full-time executive employee of the company or another related or inter-related company or have been such an officer or employee during the previous three financial years
   (iv) Is not related to any person who falls within any of the criteria set out in clause (ii) or (iii)

Note: The decision tree is applicable to profit and non-profit companies.

Non-profit companies have one additional category that requires an audit.

Any non-profit company, if it was incorporated:

(i) Directly or indirectly by the state, organ of state, a state-owned company, an international entity, a foreign state entity or a foreign company

(ii) Primarily to perform a statutory or regulatory function in terms of any legislation, or to carry out a public function at the direct or indirect initiation or direction of any of the companies mentioned in (i) above or for a purpose ancillary to any such function
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