

SUMMARY OF REPORT ON
GOVERNANCE FOR SOUTH AFRICA –
2009 (King iii)

KING COMMITTEE ON GOVERNANCE

THE NEED FOR KING III

The need for King III should be seen in the context of:

- 1.1. The Companies Act, which is due to become effective in 2010.
- 1.2. The King Committee and its sub-committees being prepared to complete the Report, without any remuneration.
- 1.3. A growing emphasis on the need for comprehensive reporting.

2. THE GOVERNANCE REGIME

The Report explains the Governance Regime as follows:

- 2.1. In the USA, the Sarbanes-Oxley Act was on a “**comply or else**” basis. This forced all companies to comply and made no provision for extraordinary circumstances. It is estimated that the implementation of the provisions of the Sarbanes-Oxley Act has cost the USA, US\$264 billion since 2002.
- 2.2. The “**comply or explain**” basis was used for Codes in the Commonwealth, South Africa, Britain and the EU. This basis allows the Board to explain why it is not appropriate for it to adopt a Corporate Governance measure.
- 2.3. The United Nations Governance Code resulted in a new Code, based on the “**adopt or explain**” principle.

The King III Report is based on an “**apply or explain**” basis. This enables companies to operate for the purposes for which they were intended, without being bound to follow standards which are, by nature, inflexible.

3. CORPORATE GOVERNANCE AND THE FINANCIAL CRISIS

The credit crunch is increasingly presented as a crisis in Corporate Governance. The King III Report points out that the Sarbanes-Oxley Act, with all its inflexibility, has not prevented the collapse of many of the leading companies in the US banking and finance sector.

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4. **THE NEW CONSTITUTION OF COMMERCE**

It is evident that stakeholders cannot be ignored. A survey conducted by KPMG and the United Nations Environmental Programme has, for example, shown that stakeholders are concerned with:

- ❖ The quality of the company's product, or service; and
- ❖ The trust and confidence that stakeholders have in the company.

5. **THE PURPOSE OF A COMPANY**

It is evident that a primary shareholder focus is required of companies. Nonetheless, shareholder interests are not the only interest which directors should address. Accordingly, a trend has developed to report through a mandatory operating and financial review. This increases transparency and is useful to stakeholders. The development of more open and transparent reporting develops cooperation between shareholders and small stakeholders.

6. **THE LINK BETWEEN GOVERNANCE PRINCIPLES AND THE LAW**

The responsibilities of directors and management involve:

- ❖ a duty of care and skill; and
- ❖ fiduciary duties.

A corporate practice, which is generally adopted, is often adopted by the Courts.

The improvement in standards, set by Corporate Governance practices, are therefore of benefit generally to companies.

It is evident that as general practice and standards are set by Corporate Governance, the individual director who does not follow a standard practice, could become liable in law.

7. **LEGISLATION**

Legislation which governs companies falls under many headings. Amongst the legislation is the following:

- 7.1. The Companies Act
- 7.2. The Public Finance Management Act
- 7.3. The Municipal Finance Management Act

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The new Companies Act refers to State-owned companies, whose names will end with “SOC Limited”.

The introduction, in the new Companies Act, of a defence which directors can utilise, provided they have no conflict of interest and acted rationally is also noteworthy.

No exemption from liability is available for a director who acts with gross negligence, wilful misconduct, or breach of trust.

The Corporate Laws Amendment Act, introduced a definition of a “designated auditor”, who is equivalent to the partner responsible for an audit.

All public companies and State-owned companies are now required to appoint an Audit Committee.

8. **KEY PRINCIPLES OF THE KING III REPORT**

The Report places great emphasis on:

- ❖ Leadership;
- ❖ Sustainability; and
- ❖ Corporate Citizenship.

The importance of the concepts of integrated sustainability and social transformation is highlighted.

This leads to a lasting concentration on the effects of business on society and the environment.

The concept of sustainability is linked with the evaluation of ethics and the improvement of ethical standards in business and in the community.

The Minister of Environmental Affairs has pointed out that, unless measures are adopted, greenhouse gas emissions in South Africa will quadruple by 2050. This would result in South Africa becoming a pariah nation.

Sustainability reporting is also emphasised in the need to utilise suppliers from amongst previously disadvantaged people.

The success of companies in the 21st century is likely to involve:

- ❖ The natural environment;
- ❖ The social environment;
- ❖ The political system; and
- ❖ The global economy.

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The King III Report has placed great emphasis on an integrated report, which will evaluate the company's impact on the economic life of the community in which it operates, as well as many other matters.

9. **EMERGING GOVERNANCE TRENDS INCORPORATED IN THE KING III REPORT**

Emphasis is placed on the following:

- ❖ **Alternative dispute resolution**
It is suggested that alternative dispute resolution will enable business to preserve business relationships, by speedily solving problems.
- ❖ **Risk based internal audit**
This will enable companies to place more reliance upon internal controls, which internal audit will verify/assure.
- ❖ **IT Governance**
IT governance is important as it is a major operational risk.
- ❖ **Shareholders and Remuneration**
There is a need for the policy of the remuneration of non-executive directors of the Board, to be authorised by shareholders, before implementation.
- ❖ **Evaluation**
The Board of directors, the Board Committees and individual directors should be evaluated, annually.

10. **NEW ISSUES IN THE REPORT: BUSINESS RESCUE**

There is a need for the Board to follow the business rescue procedures, when it becomes evident that a company is distressed.

11. **LANGUAGE, GENDER AND TERMINOLOGY**

Although the Report may often refer to the male gender, it is made clear that all references apply equally to the female gender.

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12. **APPLICATION OF THE CODE**

It is intended that the King III Report should apply to all entities. Accordingly, all entities are encouraged to report when they do not implement any Corporate Governance measure, recommended by the King III Report.

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BOARDS AND DIRECTORS

ROLE AND FUNCTION OF THE BOARD

Principle 1.1:

The Board should act as the focal point for Corporate Governance

- ❖ The Board should direct, govern and control the company.
- ❖ The Board should provide effective Corporate Governance.
- ❖ The Board is the link between the stakeholders and the company.
- ❖ The Board should exercise leadership, enterprise, integrity and judgment.
- ❖ The Board should identify and take account of the legitimate expectations of stakeholders.
- ❖ Stakeholders should be engaged in such a manner that they have trust and confidence in the company.

Principle 1.2:

The Board should ensure that the company acts and is seen to be a responsible corporate citizen

- ❖ The company should not undermine the sustainability of the social and natural environment.
- ❖ As part of corporate citizenship the company should be sustainable and should enable future generations to meet their needs.

Principle 1.3:

The Board should cultivate and promote an ethical corporate culture

- ❖ Ethical conduct should be promoted.
- ❖ Integrity should permeate all areas of the company.
- ❖ Ethical conduct should be evident in the company's relationship with society and the natural environment.
- ❖ Ethical standards should be involved and followed in all aspects of the company's business.

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Principle 1.4:

The Board should appreciate that strategy, risk, performance and sustainability are inseparable

- ❖ All Directors should participate in strategy. The Board should not merely receive strategy from management.
- ❖ Long and short term strategy should be considered and approved by the Board.
- ❖ Key performance indicators and risk areas should be identified for the financial, ethical standing and sustainability of an enterprise.
- ❖ Strategy should be set in accordance with the purpose of the company.
- ❖ Long term planning should result in sustainable outcomes.

Principle 1.5:

The Board should consider sustainability as a business opportunity

- ❖ The business should result in value being created. This value should include the triple bottom line, namely:
 - Social performance
 - Economic performance
 - Environmental performance
- ❖ The needs of future generations should not be adversely affected by business practices which are not sustainable.
- ❖ Sustainability is a business opportunity, to eliminate or minimise adverse consequences for the company, on the community and the environment and to improve the impact of the company's operations on the economic life of the community.

Principle 1.6:

The Board should appoint the Chief Executive Officer and establish a framework for the delegation of authority

- ❖ The Board should appoint the Chief Executive Officer.
- ❖ Companies listed on the JSE are required, with effect from June 2009, to appoint a Financial Director.
- ❖ A succession plan should exist for the CEO, senior Executives and Board Members.
- ❖ The Board may delegate authority but should not attempt to abdicate its responsibilities.

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- ❖ Levels of materiality should be defined by the Board.
- ❖ The Board should exercise objective judgment; which is independent from that of management.
- ❖ A process should be agreed to provide directors with access to company information and records.

Principle 1.7:

The Board should be responsible for the process of risk management

- ❖ Risk appetite and risk tolerance levels should be set.
- ❖ Key risk areas should be identified.
- ❖ Key risks should be quantified and monitored. The Board should be involved in this process.

Principle 1.8:

The Board and its Directors should act in the best interests of the company

- ❖ Each director has individual responsibility, despite the Board having a reflective role.
- ❖ Each director has a duty to exercise a degree of care, skill and diligence. Each director also has a fiduciary duty to act in good faith and in the best interests of the company and/or other entity.
- ❖ Failure to exercise his/her duties may render a director personally liable.
- ❖ Directors should be entitled to take independent professional advice, by a process which is clearly set.

Principle 1.9:

The Board and its Directors should manage conflicts of interest

- ❖ The interests of the company should take precedence over the personal interests of a director.
- ❖ Representatives of major shareholders should recognise the potential for a conflict of interest.
- ❖ Conflicts of interest should be disclosed timeously.
- ❖ Dealing in securities/shares should be prohibited during closed periods and in periods in which directors are in possession of price-sensitive information.

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Principle 1.10:

Directors should ensure that there is an effective risk-based internal audit

- ❖ Internal audit should verify/provide assurance of the effectiveness of internal controls.
- ❖ Internal controls should operate in respect of financial, operational, compliance and sustainability matters.
- ❖ Internal audit should be risk centered.

Principle 1.11:

The Board should ensure the integrity of financial reporting

- ❖ Structures should exist to verify and safeguard the integrity of financial reporting.
- ❖ The factual presentation of the company's financial position should be ensured by:
 - requiring the Audit Committee to review financial statements; and
 - ensuring the independence of external auditors.

Principle 1.12:

The Board should report on the effectiveness of internal financial controls

- ❖ The Integrated Sustainability Report should contain a statement from the Board on the establishment of formal policies and frameworks, which will result in effective internal financial controls.
- ❖ A written assessment should be provided by internal audit with regard to the effectiveness of internal financial controls.

Principle 1.13:

The Board should ensure that the company makes full and timely disclosure of material matters concerning the company

- ❖ Effective communication should be maintained with stakeholders.
- ❖ Formal contact with stakeholders is possible through the Integrated Report.
- ❖ The Board should provide commentary on the company's financial results, to enable an investor to assess the company's economic value.
- ❖ The Board should disclose if the company is a going concern.

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- ❖ The Integrated Report should contain:
 - the reason for any directors ceasing to be in office;
 - the names of directors and their attendance at meetings;
 - the age and length of service of each director;
 - each director's list of other directorships.
- ❖ A full explanation should be contained in the Notice of Meeting of every item of special business.
- ❖ Shareholders should be encouraged to attend Annual General Meetings.

Principle 1.14:

The Board should ensure that internal and external disputes are resolved effectively, expeditiously and efficiently

- ❖ A mechanism should exist to resolve disputes.

Principle 1.15:

The Board should ensure that the company implements an effective compliance framework and process

- ❖ The risk of non-compliance should be dealt with as part of the company's risk management programme.
- ❖ Individual directors should have knowledge of relevant laws, regulations and codes.

Principle 1.16:

The Board should commence business rescue proceedings as soon as the company is financial distressed

- ❖ The Board should ensure that a financially distressed company is subject to the business rescue procedure while there is a reasonable prospect of rescuing the company.
- ❖ The consequences of a company not being able to pay its debts should be borne in mind by the Board.
- ❖ The risk of reckless trading should be considered.
Even if liquidation proceedings have commenced, the Report emphasises that business rescue proceedings will result in the suspension of the liquidation proceedings.

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- ❖ A suitably qualified practitioner should be asked to furnish security for the value of the assets of the company.

COMPOSITION OF THE BOARD

Principle 1.17:

The Board should comprise a balance of executive and non-executive directors, with a majority of non-executive directors

- ❖ A balance of executive and non-executive directors, with a majority of non-executive directors should exist in the Board of Directors.
The principal of independence should also be considered.
A minimum of two executive directors should be appointed. This should include the CEO and the Chief Financial Officer / Director.
- ❖ Rotation of non-executive directors should be practiced by public companies. This will ensure that one third of the non-executive directors retire each year, by rotation.
- ❖ The Board should be entitled to remove the CEO as an executive director, without shareholder approval. This requires a suitable amendment of the Memorandum of Incorporation (currently the Articles of Association).

Principle 1.18:

The Board should be led by an independent non-executive Chairman who should not be the CEO of the company

- ❖ The Chairman of the Board should be reappointed on an annual basis.
- ❖ The Chairman of the Board should be an independent non-executive director. His independence should be carefully monitored.
- ❖ The Chairman's ability to add value should be taken into account at his annual evaluation.
- ❖ The maximum tenure of the Chairman should be decided.
- ❖ The Chairman should preside at Board Meetings.
- ❖ Directors with potential conflicts of interest should be asked to recuse themselves.
- ❖ The core functions of the Chairman are:
 - Setting the ethical tone;
 - Providing overall leadership;
 - Participating in the selection of Board members;
 - Overseeing a formal succession plan for the Board;

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- Setting the Board work plan;
 - Being a link between the Board and management;
 - Maintaining an arms-length relationship;
 - Adopting a lead role in removing non performing directors;
 - The Chairman should meet with individual directors, at least once in every year;
 - Mentoring new directors;
 - Ensuring that directors have a knowledge of their duties and responsibilities;
 - Ensuring that good relationships are maintained with major shareholders and stakeholders.
- ❖ The Chairman's responsibility will be focused on social, sustainability and transformation issues.
- ❖ The Chairman should carefully consider the number of additional chairmanships he can manage.
- ❖ The Chairman should meet the CEO prior to Board Meetings, to discuss important issues.
- ❖ Position with additional roles of the Chairman:
- The Chairman of the Board should not be a member of the Audit Committee;
 - The Chairman should not chair the Remuneration Committee;
 - The Chairman should be a member of the Nominations Committee and may also be its Chairman;
 - The Chairman should not chair the Risk Committee, but may be a member of the Risk Committee.

Principle 1.19:

The Board should appoint an effective and ethical Chief Executive Officer

- ❖ The CEO's responsibilities include:
- Achieving financial and operating goals and objectives;
 - Ensuring that a long term strategy is developed;
 - Ensuring that a positive and ethical work climate exists;
 - The CEO should be the chief spokesman of the company;
 - While the CEO should not be a member of Board Committees, he should attend meetings by invitation;

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- The CEO should carefully consider whether or not to accept other non-executive directorships.

BOARD APPOINTMENT PROCESSES

Principle 1.20:

Directors should be appointed through a formal process

- ❖ Shareholders are responsible for the composition of the Board.
- ❖ The Board as a whole would normally appoint directors, assisted by recommendations from the Nominations Committee.
- ❖ The background of all potential directors should be verified before an invitation is extended to join the Board.

DIRECTOR DEVELOPMENT

Principle 1.21:

Training and development of directors should be conducted through formal processes

- ❖ A formal orientation programme is required.
- ❖ The orientation programme may include an introductory programme.
- ❖ New directors should receive development and education in their role. This should be extended into a continuing professional development process for directors. This should include briefings on recent developments.

COMPANY SECRETARY

Principle 1.22:

The Board should be assisted by a competent Company Secretary

- ❖ Public companies are obliged by law to appoint a Company Secretary. The Company Secretary has a pivotal role to play.
- ❖ The Chairman and Board may consult the Company Secretary for guidance on their responsibilities.
- ❖ The Company Secretary should ensure that the Board Charter and the Terms of Reference of Board Committees are regularly updated.
- ❖ The Company Secretary should be a central source of guidance and advice to the Board.
- ❖ Compilation of Board agendas and papers should be a responsibility of the Company Secretary, as should be the preparation of minutes.

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- ❖ The question of the appointment and removal of the Company Secretary is a matter for consideration by the Board.
- ❖ The Company Secretary should ensure that the procedure for the appointment of directors is followed and that induction and development courses are held.

PERFORMANCE ASSESSMENT

Principle 1.23

The performance of the Board, its Committees and individual directors should be evaluated annually

- ❖ Regular and timely appraisals of the Board should be conducted.
- ❖ A prerequisite for evaluation is the regular evaluation by the Board of its own function.
- ❖ The evaluation result should be reviewed by the Nomination Committee, or by the Board.
- ❖ Performance appraisals should be used as the basis for identifying future training needs.
- ❖ The Board should meet at least once per annum to consider the Board appraisal results.

Evaluations should also take place in respect of:

- Board Committees
- Chairmen of Board Committees
- Individual directors
- ❖ Directors should be subject to evaluation before the Board proposes, and shareholders agree, to their reappointment.
- ❖ An independent non-executive director should be appointed to lead the process of the assessment of the performance of the Chairman of the Board.
- ❖ The performance of the CEO and executive directors should be undertaken at periods of at least once every year. This evaluation will concentrate on the CEO's performance, as a director and as the Chief Executive Officer. Their reports should be considered by the Remuneration Committee and then by the Board.

BOARD COMMITTEES

Principle 1.24:

The Board should delegate certain functions to well structured Committees without abdicating its own responsibility

- ❖ Board Committees, with appropriate Terms of Reference, may be appointed.

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- ❖ The King III Report recommends that Board Committees should only consist of directors.
- ❖ A holding company should consider the Terms of Reference of any Board Committee, established by a subsidiary company.
- ❖ An independent non-executive director is required to be the Chairman of the Audit and the Remuneration Committees.
- ❖ The Nomination Committee should only consist of non-executive directors, of whom the majority should be independent.
- ❖ The Remuneration Committee should consist of non-executive directors, of whom the majority is independent.
- ❖ Directors, who are not members of a Committee, may attend meetings to gain information. Such directors would, however, not be entitled to a vote.

GROUP BOARDS

Principle 1.25:

A governance framework should be agreed between the group and its subsidiary Boards. Subsidiary companies, which operate in other countries, may face different legal regulatory requirements. The directors of such subsidiaries will be obliged to act in the best interests of the subsidiary companies at all times.

REMUNERATION OF DIRECTORS

Principle 1.26:

Companies should remunerate fairly and responsibly

- ❖ Remuneration policies should be aligned with the company's strategy.
- ❖ Every endeavour should be made to promote a culture that supports enterprise and innovation.

Principle 1.27:

Shareholders should approve the company's remuneration policy

- ❖ The Remuneration Committee should make recommendations to the Board with regard to the setting of remuneration policies. This is particularly important with regard to the remuneration of senior executives and directors.
- ❖ The mix between fixed and variable pay should be clearly agreed.
- ❖ Shareholders should agree the general company policy of remuneration.
- ❖ Shareholders should approve non-executive fees in advance.

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The Remuneration Committee, like all other Board Committees, should operate according to pre-set Terms of Reference or Charters.

- ❖ Remuneration of executives should be appropriate to the value added by the executive concerned.
- ❖ Annual bonuses should be clearly related to performance objectives.
- ❖ Minimum levels of financial performance may be set for the purposes of receiving bonuses.
- ❖ Contracts should not oblige companies to pay termination bonuses.
- ❖ In the case of early termination, there should be no automatic entitlement to bonuses or share based payments.
- ❖ The Remuneration Committee should periodically evaluate incentive schemes to ensure that they add value.
- ❖ Non-executive directors should limit their shareholdings to a level which will not impair their independence.
- ❖ Incentive awards geared to share prices or corporate performances should not be awarded to the Chairman or non-executive directors.
- ❖ Non-executive directors should not receive share options.
- ❖ Vesting rights for all share based incentives should be linked to performance.
- ❖ Share or option awards should not be granted within a closed period.
- ❖ Share options and other share awards should be related to a performance period of not less than three years, before vesting rights become effective. These rights should also be related to performance objectives.

Principle 1.28:

Companies should disclose the remuneration of each individual director

- ❖ A detailed analysis of directors' remuneration, on an individual basis, should be provided in the annual report.

Principle 1.29:

The Remuneration Committee should issue a Remuneration Report as part of the Integrated Report, to explain the company's remuneration philosophy and how it has been implemented.

The company should explain all its remuneration policies and any extraordinary ex-gratia payment made.

The above should be contained in the Integrated Report.

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NOTE 1: THE DEFINITION OF “INDEPENDENT NON-EXECUTIVE DIRECTOR”

An independent non-executive director is a non-executive director who:

- ❖ does not represent a controlling or major shareholder;
- ❖ does not have a direct or indirect interest in the company;
- ❖ has not been employed by the company in the past three financial years;
- ❖ is not a member of the immediate family of an individual who has, in the past three financial years, been employed by the company in an executive capacity;
- ❖ is not a professional advisor to the company;
- ❖ is free from any business or other relationship with the company;
- ❖ does not receive remuneration which is contingent upon the performance of the company.

NOTE 2: THE LEAD INDEPENDENT NON-EXECUTIVE DIRECTOR (LID)

The appointment of a lead independent non-executive director assists a company in that:

- ❖ It enables the Chairman to hand over control of the meeting, when he has a conflict of interest.
- ❖ The role of the LID is to assist the Chairman.
- ❖ When the question of the Chairman’s performance appraisal and the question of the term of the office of the Chairman are considered, the LID shall be the Chairman of the meeting.

CHAPTER 2

CORPORATE CITIZENSHIP, LEADERSHIP INTEGRITY AND RESPONSIBILITY

CORPORATE CITIZENSHIP, LEADERSHIP INTEGRITY AND RESPONSIBILITY

Principle 2.1:

The Board should ensure that the company acts and is seen to be a responsible corporate citizen.

- ❖ The Board, in addition to being responsible for corporate performance is responsible for the triple bottom line, consisting of:
 - Economic
 - Social
 - Environmental
- ❖ By emphasising the triple bottom line, in addition to operational performance, a company is able to protect and improve its reputation.
- ❖ The triple bottom line enables a company to be relevant to society and the natural environment, in which it operates.
- ❖ It is essential for the business enterprise to be economically, socially and environmentally sustainable.
- ❖ Good corporate citizenship results in the business enterprise being able to protect, enhance and invest in the well being of society and in the natural ecology.
- ❖ A holistic approach to economic, social and environmental issues allows for the effective management of business opportunities and risks.
- ❖ International society encourages voluntary action by the business enterprise, which exceeds the scope of legal compliance, while simultaneously enforcing minimum standards, by legislation.
- ❖ South African companies operating in the rest of Africa should learn to adopt international best practice in their operations outside South Africa.
- ❖ In order to ensure the maximum impact businesses should work together in their ongoing enrichment of society.
- ❖ Businesses are increasingly seeing their responsibility to society, and the environment as a central part of their business strategy. This contrasts with the previous “add-on” approach.
- ❖ Good corporate citizenship should be integrated into the culture of the company.
- ❖ In the context of sustainable development, corporate citizenship considers the rights and responsibilities of companies – these relate to:
 - How effectively the company governs its operations;

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- How the company manages its employees in the workplace;
 - How the company engages external stakeholders;
 - How the company minimises its effect on the environment;
 - How companies help all citizens to become meaningful economic partners;
 - Good corporate citizenship results in a company having comprehensive policies and practices, in respect of society, communities and the environment.
- ❖ Good corporate citizenship transforms relationships in that individual workers and stakeholders are able to communicate openly. This ensures that the business enterprise is aligned to the society in which it operates and that those involved in the operation of the company begin to align their personal and company values.

Principle 2.2:

The company should develop strategies and policies to guide its activities, to fall in line with the actions of good corporate citizenship.

- ❖ Corporate citizenship should be relevant to the national needs of the countries in which it operates. The tangible programmes and results, adopted in South Africa, include:
- Transformation
 - Human rights
 - Human capital
 - Social capital
 - Safety
 - Health
- ❖ Good corporate citizenship programmes require the commitment of leaders and a focus on corporate citizenship, as distinct from public relations.
- ❖ The BEE charters of industries provide a particular context for one aspect of corporate citizenship. These should however be integrated into the full corporate citizenship programme.
- ❖ Aspects such as BEE, with an effect on sustainability, should be emphasised to investors.

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Principle 2.3:

Corporate Governance requires the Board to ensure that the company is run ethically

- ❖ Companies should be run with integrity and good ethics.
- ❖ A foundation of ethical values should pertain in all aspects of the Board's responsibility for:
 - Internal audit
 - Risk management
 - Managing stakeholder relations
- ❖ Two main functions, which form an integral part of Corporate Governance, for which the Board is responsible, are as follows:
 - Strategic direction
 - Responsibility for the control of the company.
- ❖ Despite the differing opinions in various other countries, the King III Report emphasises the stakeholder model of governance, which emphasises that the Board is accountable, not only to the company, but should take account of the legitimate expectations and interests of its stakeholders, when making decisions.
- ❖ Decisions of the Board and executive management should be based on the following ethical values:
 - Responsibility: The Board is responsible for assets and ensuring that the company follows its strategic plan.
 - Accountability: The Board is accountable to shareholders and other stakeholders.
 - Fairness: The Board should take account of the interests of all stakeholders when making its decisions.
 - Transparency: The Board should make comprehensive disclosure of all matters, in a clearly understandable manner.
- ❖ The King III Report suggests that there are five moral duties, namely:
 1. Conscience: This involves:
 - Intellectual honesty;
 - Avoiding conflicts of interest
 2. Care: Directors are required to exercise care in the affairs of the company.
 3. Competence: Directors should have the knowledge and skill required to be directors of a company.
 4. Commitment: Directors should be diligent.

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CORPORATE CITIZENSHIP, LEADERSHIP INTEGRITY AND RESPONSIBILITY

5. **Courage:** Directors should have the courage to take decisions regardless of the risks.

Principle 2.4:

The Board should cultivate and promote an ethical corporate culture

- ❖ The Board is responsible for creating and implementing an ethical corporate culture.
- ❖ The Board should ensure that an ethical management process exists, which consists of the following:
 - **Ethics, risk and opportunity profile:** Account should be taken of the negative ethical risks as well as the positive ethical risks.
 - **Code of ethics:** The Company should ensure that a code of ethics is developed. This will guide the company in its ongoing relationship with stakeholders.
 - **Integrated ethics:** It is the Board's responsibility to ensure that the ethical standards described in the Code of Ethics are included in the company's strategies and operations.
 - **Ethical performance reporting and disclosure:** The Board is responsible for assessing the company's performance in the implementation of ethics. Ethical performance should be disclosed to stakeholders.
 - **An ethical corporate culture requires:**
 - that all directors follow ethical standards;
 - that the interests of all stakeholders should be taken into account in making decisions;
 - that the conduct of individuals needs to improve moral values;
 - that business activities should be conducted with integrity, fairness and vision;
 - that fair competition practices are followed in all aspects of the business activity;
 - that poor performance is never blamed on the exercise of good ethical standards.

CHAPTER 3

AUDIT COMMITTEES

Principle 3.1:

The company should have an effective Audit Committee.

- ❖ Audit Committees fulfil a vital role in Corporate Governance.
- ❖ Shareholders should, at each Annual General Meeting, elect an Audit Committee.
- ❖ Audit Committee members should:
 - be independent non-executive directors;
 - have a level of financial literacy;
 - not include the Chairman of the Board.

Principle 3.2:

Audit Committee members should be suitably skilled and experienced independent non-executive directors.

- ❖ The Audit Committee should consist of at least three members and all members should be independent non-executive directors.
- ❖ Public companies and State-owned companies are obliged to appoint an Audit Committee.
- ❖ The Audit Committee should have a good understanding of financial risks, financial and sustainable reporting and internal control. Their knowledge should also incorporate corporate law.
- ❖ Audit Committee know-how should extend to international Financial Reporting Standards.
- ❖ Audit Committee members in the public sector should have the financial qualifications specified in the Public Finance and Management Act.
- ❖ In the public sector the relevant executive authority is required to concur with any premature termination of the services of a member of the Audit Committee.

Principle 3.3:

The Audit Committee should be led by an independent non-executive director.

- ❖ The Chairman of the Audit Committee should be an independent non-executive director of the company. He should not be the Chairman of the Board of Directors.
- ❖ The Audit Committee Chairman, in consultation with the Company Secretary, shall decide on the frequency and timing of meetings.

CHAPTER 3

AUDIT COMMITTEES

Principle 3.4:

The Audit Committee should oversee stakeholder reporting.

- ❖ All companies are required to produce an integrated report that conveys information about the operations of the company. The report should include sustainability and financial reporting.
- ❖ The Audit Committee should oversee the assurance function and review aspects of risk and sustainability.
- ❖ The Board of Directors should delegate the responsibility for the review of the integrity of financial reporting to the Audit Committee.
- ❖ Management should report to the Audit Committee important decisions taken in the course of the preparation of financial statements.
- ❖ The Audit Committee, in addition to its responsibility for review of the financial statements, should be responsible for reviewing the following:
 - integrated reports
 - interim reports
 - provisional financial results
 - any financial information which is price-sensitive
 - the review of any prospectus issued by the company
- ❖ The Audit Committee should consider any complaint about the accuracy or relevance of financial information and audit.
- ❖ Management should provide the Audit Committee with a written assessment of whether or not the Board should issue a going concern statement. The Audit Committee should then make an appropriate recommendation to the Board.
- ❖ The Chairman of the Audit Committee should be present at the Annual General Meeting, to answer questions on the Report of the Audit Committee.
- ❖ The Board, by means of a study commissioned by the Audit Committee, should, from time to time, review the needs of the users of financial statements.
- ❖ The Audit Committee should consider whether or not there is a need for internal and external audit to conduct assurance procedures before quarterly or half-yearly financial statements are issued.
- ❖ Users should be provided with comprehensive financial information, contained in both the integrated report and the summarised financial information.
- ❖ The objective of summarised financial statements is to complement the information contained in the financial statements.
- ❖ Where summarised financial information is circulated, the full integrated report should be available on request.
- ❖ The Audit Committee should ensure that the external auditors provide an assurance report on the contents of summarised financial information.

CHAPTER 3

AUDIT COMMITTEES

Principle 3.5:

The Audit Committee should satisfy itself of the expertise, resources and experience of the finance division.

- ❖ The Audit Committee should, on an annual basis, satisfy itself as to the expertise and resources of the finance function. This should include the suitability of the Finance Director, for listed companies.

Principle 3.6:

The Audit Committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities

- ❖ The Audit Committee is responsible for ensuring that significant risks are addressed and are suitably managed.
- ❖ The chief internal auditor should report directly to the Audit Committee, but other internal assurance providers may report to the Audit Committee or another Board Committee, such as the Risk Committee.
- ❖ The Audit Committee should ensure the independence of internal and external auditors, by counterbalancing the opinions of executive management.

Principle 3.7:

The Audit Committee should be responsible for the oversight of internal audit

- ❖ The Audit Committee should ensure that there is as little overlapping as possible between the internal and external audit functions.
- ❖ The effectiveness of internal audit should be assessed, together with the internal report on the adequacy of internal controls, by the Audit Committee, on at least an annual basis.

Principle 3.8:

The Audit Committee should be an integral component of the risk management process.

- ❖ The Audit Committee shall be responsible for financial risk management and controls. The Board may delegate full responsibility of internal control to the Audit Committee.
- ❖ The Audit Committee is responsible for ensuring that the risk management programme is relevant to the company's structure and sector.

CHAPTER 3

AUDIT COMMITTEES

- ❖ The Audit Committee is also responsible for renewing risk arising from legal, operational and financial factors.
- ❖ The Audit Committee should receive a Report, annually, from management, on the relevance of the company's system of internal financial controls. Should management resources not make it possible for management to undertake this task, the Audit Committee may engage internal audit on this review.
- ❖ The Audit Committee should review the appropriateness of policies and procedures to facilitate whistleblowing and the follow-up of information obtained from whistleblowing.
- ❖ The Audit Committee should be briefed on any amendments of the company's Code of Conduct.
- ❖ The Audit Committee should also consider any action involving fraud and any complaints as to the accuracy of accounting practices and audit.
- ❖ IT Risk is an important aspect of the Audit Committee's responsibilities. This should include:
 - IT risks and controls
 - business continuity and data recovery relating to IT
 - information security and privacy
- ❖ Areas which are specifically highly dependent on IT should be appropriately reviewed by the Audit Committee, which should assess whether or not controls are adequate.

Principle 3.9:

The Audit Committee is responsible for recommending the appointment of the external auditor and the oversight of the external audit process

- ❖ The Audit Committee is responsible for advising shareholders on the appointment, reappointment and removal of external auditors. Their advice should include an evaluation of the independence of the external auditor and the qualifications and appropriateness of their expertise. Listed companies should ensure that auditors are approved by the JSE.
- ❖ The planning and execution of the annual external audit should be overseen and reviewed by the Audit Committee.
- ❖ The Audit Committee has a specific responsibility with regard to the terms of engagement and the level of fees applicable to external audit. This responsibility extends to the conditions under which external audit provide non audit services.
- ❖ The Audit Committee should receive, consider and resolve the question of reportable irregularities.
- ❖ After the annual audit, the Audit Committee should review the quality and effectiveness of the audit process.

CHAPTER 3

AUDIT COMMITTEES

Principle 3.10:

The Audit Committee should report to the Board and stakeholders on how its duties have been carried out.

- ❖ The Audit Committee is required to report to both the Board and stakeholders on how it has fulfilled its duties during the financial year.

This report should include:

- A summary of the role of the Audit Committee
 - Whether the Audit Committee has adopted formal Terms of Reference and whether it has complied with these terms
 - The names and qualifications of each member of the Audit Committee
 - The number of Audit Committee meetings held during the year
 - A description of how the Audit Committee carried out its function
 - Whether the Audit Committee is satisfied that the auditor is independent of the company
 - Certify that the Audit Committee is satisfied as to the appropriateness of the accounting practices and internal financial control which have led to the compilation of the financial statements
 - Information regarding any other roles assigned to the Audit Committee by the Board
- ❖ In the public sector the Audit Committee is required, in departments and constitutional institutions, to report on the quality of management and the adequacy of monthly/quarterly reports, submitted in terms of the Public Finance and Management Act, the Municipal Finance and Management Act and the Division of Revenue Act.
 - ❖ Should the accounting officer of a public sector body be involved in fraud, corruption or gross negligence, the Chairman of the Audit Committee is required to promptly report the matter to the relevant executive authority and the Auditor-General.

CHAPTER 4

RISK MANAGEMENT

RISK MANAGEMENT

Principle 4.1

Risk management is inseparable from the company's strategic and business procedures

- ❖ Business involves the undertaking of risk for reward.
- ❖ While risks may be mitigated, a company should decide on its risk appetite and proceed with its business to operate with as little risk as possible.
- ❖ The Board is expected to exercise the duties of care, skill and diligence in identifying and monitoring risks.
- ❖ Risk management is the practice of identifying and analysing the risks associated with the business.
- ❖ Risk management should seek to provide interventions that optimise the balance between risk and reward within the company.

Principle 4.2:

Management is responsible for the implementation of risk management processes.

- ❖ Management, led by the CEO, is responsible and accountable for risk management. The CEO should be at the forefront of all attempts to manage risk.
- ❖ Risk is primarily the responsibility of line management and this should be reflected in letters of appointment and key performance areas. While consultants may be appointed, line management remains responsible for risk management.
- ❖ The risk is mitigated by internal controls.
- ❖ In large companies Chief Risk Officers may be appointed to facilitate and coordinate the development and implementation of risk management.
- ❖ To effectively manage risk requires an inclusive team based approach.
- ❖ It may be necessary to establish a Risk Management Committee.
- ❖ The performance of management in managing risk should be evaluated annually.

Principle 4.3:

Risk management should be practised by all staff in their day to day activities

- ❖ A culture of risk management should be inculcated in the company.

CHAPTER 4 RISK MANAGEMENT

- ❖ Risk management should be as simple as possible, in order to involve all employees of the organisation.

Principle 4.4:

The Board is responsible for the process of risk management

- ❖ The Board must decide on the company's appetite for risk and the company's ability to bear the consequences of risk. Risk should be evaluated in terms of high and low probability and in terms of severity.
- ❖ The Board should ensure that a comprehensive risk assessment is undertaken on a regular basis.
- ❖ The Board's responsibility for risk management should be expressed in the Board Charter and be supported by training and induction processes.
- ❖ The Board should ensure that there is adequate disclosure of risk tolerance and risk management processes in the Annual Report.

Principle 4.5:

The Board should approve the company's chosen risk philosophy.

- ❖ The company's risk philosophy may include:
 - Appetite for risks
 - Downside risk tolerance limits
 - Regulatory compliance
 - Safety and Health
 - Sustainability management
 - Corporate Governance
- ❖ Determining the risk appetite will differ with the business/industry.
- ❖ In the course of considering risk appetite, the Board should consider:
 - Materiality levels
 - Insurance excesses/retention levels

Principle 4.6:

The Board should adopt a Risk Management Plan.

- ❖ The Risk Management Plan:
 - requires annual review

CHAPTER 4

RISK MANAGEMENT

- should not be designed by management
- should not be isolated from the company's strategic plan
- should be approved by the Board
- ❖ In the course of designing the process of risk management, account should be taken of:
 - risk appetite
 - risk philosophy
 - short and long term philosophies
- ❖ The priorities and target dates for implementation of the Risk Management Plan should be specified.
- ❖ Risk management processes should be taken account of when budgeting and preparing the business plan.

Principle 4.7:

The Board may delegate the responsibility of risk management to a Risk Committee.

- ❖ The Board may appoint a dedicated Risk Committee. However, where the risks are predominantly financial in nature, the risk management responsibility may be delegated to the Audit Committee.
- ❖ Although executives may not be members of the Audit or Risk Committees, they should attend the committee meetings in order to make their detailed knowledge available for risk management purposes.
- ❖ Risks that could affect the sustainability of the company should be addressed as a matter of priority.
- ❖ The Risk Committee may, at the discretion of the Board, be delegated the responsibility of evaluating insurances.
- ❖ The Risk Committee may, in addition, be tasked with:
 - overseeing IT strategy
 - reviewing governance matters
 - risk management of a general nature, on behalf of the Board
- ❖ The Risk Committee should be chaired by a non-executive director, with a minimum of three members and should meet at least twice a year.
- ❖ The Risk Committee should evaluate the risk management security of the company.
- ❖ Companies which are not large or complex should delegate the risk management responsibility to the Audit Committee.
- ❖ The responsibilities of the Risk Committee should include:

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RISK MANAGEMENT

- register of key risks
- estimated costs of significant losses
- whether risk management costs are consistent with the risk profile

Principle 4.8:

Risk assessments should be performed on an ongoing basis

- ❖ A realistic perspective of material risks should be available for review by the Board and management. This is facilitated by an ongoing risk assessment.
- ❖ Risk assessment should be conducted at least annually.
- ❖ Risks to be taken into account include:
 - stakeholder risk
 - reputational risk
 - compliance risk
 - ethics risk
 - sustainability risk
 - social risk: This includes social investment, employment equity, BEE, skills development and staff retention.

Principle 4.9:

The Board should approve key risk indicators and tolerance levels

- ❖ Operational risk tolerance levels should be aligned to the company's risk appetite.
- ❖ Indicators should be used to check whether actual results are within the acceptable risk tolerance levels.
- ❖ Risk tolerance levels should be established for each key risk. Tolerance levels are considered against the backdrop of the company's strategy and business objectives.
- ❖ Tolerance levels should be evaluated by studying their potential effect on company objectives.

Principle 4.10:

Risk identification should be directed in the context of the company's purpose

- ❖ Risk identification should be relevant to the company's objectives. They should, however, not be limited to strategic risks.

CHAPTER 4

RISK MANAGEMENT

- ❖ A thorough approach to risk identification may include the use of data analysis, business indicators, market information, loss data, scenario planning and portfolio analysis.

Principle 4.11:

The company should ensure that key risks are quantified and are responded to appropriately

- ❖ The Board should decide which risks are significant.
- ❖ The key risks should be quantified, where practical, to develop a clear understanding of the relevance of risks.
- ❖ An assessment of the company's resilience to risk and loss should be calculated. This should include:
 - risk probability
 - potential effect
 - effectiveness of risk responses
 - capital adequacy
 - solvency liquidity
 - sustainability
 - going concern
 - financial performance
 - values at risk
 - risk bearing capacity
 - mitigation of risk
 - transference of risk
- ❖ The most relevant of the risks should be the subject for immediate action.
- ❖ Many risks could be validated with relevant stakeholders.
- ❖ The risk response option should be carefully evaluated.
- ❖ This may include:
 - avoiding the risk
 - improving the control environment
 - transferring the risk
 - accepting the risk
 - exploiting the risk
 - terminating the activity that gives rise to the risk

CHAPTER 4

RISK MANAGEMENT

- integrating a series of risk responses
- ❖ The company should review a register of the company's key risks on a regular basis.
- ❖ Management should report to the Board on the significant risks and the effectiveness of internal controls.

Principle 4.12:

Internal audit should provide independent assurance on the risk management process

- ❖ The internal audit function should review and comment on the level of risk management maturity.
- ❖ Internal audit should not share reporting lines with risk management. Risk management should be independent from the internal audit function.
- ❖ Changes to the internal and external environment may give rise to new or changed risks. This should be advised to the Board.
- ❖ Management should report on how a risk management culture is being inculcated in the organisation.
- ❖ The level of unacceptable risk probability should be disclosed to the Board.
- ❖ The Board should disclose material joint ventures and associations, as part of the risk management disclosures.
- ❖ Consideration should be given to combining the ethics and compliance functions.

Principle 4.13:

The Board should report on the effectiveness of risk management

- ❖ The Board should assess the company's risk management maturity and disclose its findings in the annual report.
- ❖ The report should indicate the system used to identify and evaluate risk.
- ❖ The Board should disclose material losses suffered in the period under review.
- ❖ If the Board is unable to make the disclosures with regard to risk, it should explain why this is the case.
- ❖ The G3 guidelines of the Global Reporting Initiative should assist management in ensuring that they have addressed all possible risks.

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RISK MANAGEMENT

Principle 4.14:

The Board should ensure that the company's reputational risk is protected.

- ❖ External perceptions of the company's standing and its reputation are affected by the level of risk and the manner in which the company manages this risk.
It is evident that effective risk management can improve the company's credit rating.
- ❖ Reputation can be regarded as the **sum of the images that can be equated to the performance and behaviour of the company over time** as well as how this is communicated to the various stakeholders.
- ❖ A company's reputation is based on many factors, including the value of the company to the community and the trust that exists with stakeholders.
- ❖ Adding value to the reputation of the company is equal to adding value to the company.
- ❖ The vulnerability of companies to reputational damage should be noted.

Principle 4.15:

The Board should determine the extent to which risks relating to sustainability are addressed and reported on.

- ❖ The essence of sustainability risk management is to protect the value of the company's intangible assets by combining various elements of risk management into a sustainable and economic enterprise risk management system.
- ❖ The question of whether or not a company is a going concern has an effect on the economic value of the company.
- ❖ A stakeholder risk assessment involves:
 - establishing an appropriate process and accountable person
 - determining stakeholder perceptions
 - determining the company's risk profile in relation to the relevant stakeholders
 - assessing perceptions of the company's reputation and risks relating to its reputation
- ❖ An ethics risk assessment should be undertaken to consider:
 - accountability for managing risk
 - the identification of tactical risk, through engagement with stakeholders
 - establishing a process of identifying perceptions on ethics
 - determining the company's ethics risk profile
- ❖ The company should conduct an assessment of its environmental risk.

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RISK MANAGEMENT

- ❖ An environmental impact assessment should include:
 - activities of the company which effect the environment
 - an assessment on whether or not the company falls into a high or low impact sector
- ❖ The risk assessment should pay due significance to:
 - energy use
 - greenhouse gas emissions
 - sequestration
 - compensation
 - vulnerability to risk
- ❖ It is important that the company should adopt policies and procedures to develop, retain and manage human capital in an effective manner.
- ❖ It is necessary for a company to continuously evaluate whether or not it has sufficient skills and expertise to develop the sustainability of the business.
- ❖ An analysis is required of how the business operations and strategy could change.

Principle 4.16:

The Board should ensure that IT is aligned with business objectives and sustainability

- ❖ Information technology is essential to manage the transactions information and knowledge necessary to initiate and sustain economic and social activities. Accordingly, it is necessary to manage the risks and constraints of IT and to identify the strategic importance of IT.
- ❖ It is recommended that IT governance be placed on the Board Agenda.
- ❖ IT governance is essential to the achievement of corporate objectives and information resources, such as people, funding and information.
- ❖ IT governance should focus on four key areas, namely:
 - strategic alignment with the business and sustainability
 - optimising expenses and improving the value of IT
 - addressing the safeguarding of IT assets, to ensure disaster recovery and continuity of operations
 - resource management: optimising knowledge and IT infrastructure
- ❖ As IT governance is the responsibility of the Board:
 - Board members should be active in IT strategy and governance

CHAPTER 4

RISK MANAGEMENT

- the CEO should provide organisational structures to support the implementation of IT strategy
- Chief Information Officers should provide a bridge between IT and the business
- All executives should become involved in IT Steering Committees
- ❖ It is important that business and IT plans are linked.
- ❖ The overall objective of IT governance is to understand the issues and strategic importance of IT.
- ❖ The importance of IT in driving and supporting the company's objectives is emphasised.
- ❖ The Board should take ownership of IT governance. This could be done by:
 - placing IT on the Board Agenda
 - challenging management's activities with regard to IT
 - aligning IT initiatives with real business needs
 - insisting that IT performance is measured and reported on
 - establishing an IT strategy committee
 - insisting that there be a management framework for IT governance
- ❖ The importance of IT security is emphasised. This includes the components of confidentiality, integrity and availability.

Principle 4.17:

The risk of uncertainty

- ❖ Uncertainty is a key factor on every strategic decision.
- ❖ Decisions are often taken knowing that circumstances could change.
- ❖ Trends should therefore be monitored.

CHAPTER 5

INTERNAL AUDIT

INTERNAL AUDIT

Principle 5.1:

The Board should ensure that there is an effective risk based internal audit.

- ❖ The company should establish an effective internal audit function.
- ❖ Should the Board decide not to establish an internal audit function, the reason for this decision should be disclosed in the company's Integrated Report.
- ❖ Internal audit should have the following key responsibilities:
 - Performing reviews of the company's governance process, including ethics
 - Performing an objective assessment of the adequacy and effectiveness of risk management
 - Systematically analysing and evaluating business processes
 - Providing a source of information with regard to fraud, corruption and unethical behaviour.
- ❖ An Internal Audit Charter should be formalised after review by the Audit Committee and then referred to the Board, for final approval.
- ❖ Internal Audit should follow the professional practice and code of ethics set by the Institute of Internal Auditors.

Principle 5.2:

Internal audit should provide the Board with a written assessment of the effectiveness of the company's system of internal control, performance and risk management.

- ❖ The company should maintain an adequate and effective governance, risk management and internal control framework which should include:
 - a clear accountability between the Board, management and internal audit
 - a risk management framework between role players
 - an explanation of how risk management and internal controls contribute to improved performance
 - consideration of the value added by the respective role players in business performance
- ❖ Management of the company should specify the elements of a control framework, which identifies a clear link between the company's risk management and the independent assurance processes.

CHAPTER 5

INTERNAL AUDIT

Principle 5.3:

Internal audit should assist the Audit Committee in fulfilling its duties

- ❖ The Audit Committee should consider the company's changing risk profile.
- ❖ The risk based internal audit plan should be developed and approved by the Audit Committee. The plan should:
 - address the full spectrum of risks
 - show areas of high priority
 - indicate how assurance will be provided
 - reflect the linkage between the plan and the assessment of risk maturity
 - any changes in the internal audit plan should be presented to the Audit Committee, for its approval
- ❖ The internal audit function should provide independent and objective assurance to the Audit Committee, that risk management and internal controls are effective.
- ❖ The internal audit function should be evaluated by the Audit Committee, not less than once every year.

Principle 5.4:

Internal audit should follow a risk based approach in its plan

- ❖ The internal audit function should follow business performance and risk. Accordingly, the scope of internal audit should be amended, as the environment changes.
- ❖ It is emphasised that risk is always accompanied by opportunities and that it is important for internal audit and the Audit Committee to identify such opportunities.
- ❖ The internal audit plan should take the form of an assessment of the company's strategic, financial, IT, human resources, environmental and other matters which could endanger the operation of the company.

Principle 5.5:

Internal audit should be strategically positioned to achieve its objectives

- ❖ Internal audit should report at the level in the company which enables it to remain independent and objective in performing its duties.

CHAPTER 5

INTERNAL AUDIT

Principle 5.6:

Internal audit, through the chief audit executive, should have a direct relationship with the Audit Committee, Corporate Governance Committee and Risk Committee

- ❖ The degree of interaction between the Audit Committee and Risk Committee with internal audit should ensure an optimal level of control oversight.
- ❖ The Audit Committee should be ultimately responsible for the appointment and/or dismissal of the chief audit executive or outsourced internal audit service provider.
- ❖ The internal audit function should be provided with an appropriate budget.
- ❖ The independence of the internal audit function is emphasised.
- ❖ The internal audit function should report at all Audit Committee meetings and, if necessary, meet with the Audit Committee Chairman prior to, and immediately after, each Audit Committee meeting.
- ❖ The chief audit executive should report to the Audit Committee on all matters of substance, including the scope of future work.
- ❖ The scope of the internal audit plans should be reviewed by the Audit Committee.
- ❖ The internal audit function should be subject to independent quality review at periods of at least once every three years.

Principle 5.7:

The internal audit function should be staffed with a competent, independent team.

- ❖ The internal audit function should be appropriately manned and funded, in order to be able to perform its duties.
- ❖ Internal auditors should have appropriate technical and business skills.

CHAPTER 6

INTEGRATED SUSTAINABILITY REPORTING AND DISCLOSURE

INTEGRATED SUSTAINABILITY REPORTING AND DISCLOSURE

Principle 6.1:

Effective communication with stakeholders is essential.

- ❖ Effective reporting should be proactive and transparent. The communication with stakeholders should include reporting on economic, social and environmental issues.
- ❖ Communication with stakeholders should be relevant and material and should be well presented. It should also avoid jargon.

Principle 6.2:

Sustainability reporting should be focused on substance over form and should transparently disclose information that is material, relevant, accessible, understandable and comparable with past performance of the company and the performance of others.

- ❖ Transparent reporting should enable stakeholders to understand the key issues and the standing of the company, with regard to economic, social and environmental issues.
- ❖ Honest and open engagement should result in the exchange of information on a trust basis.
- ❖ Good communicating could, in more difficult times, result in obtaining support from stakeholders. This may be evident when obtaining the approval of authorities and in obtaining the confidence and loyalty of customers.

Principle 6.3:

Sustainable reporting and disclosure should be formalised as part of the company's reporting processes.

- ❖ Sustainability reporting, as outlined in the Global Reporting Initiative's third report, emphasises the principle of materiality, which links sustainable issues more closely to strategy.
- ❖ Sustainability is also emphasised in ISO Standard (26 000) on Social Responsibility.
- ❖ The Global Reporting Initiative's guidelines have become the accepted international standard for sustainability reporting.

CHAPTER 6

INTEGRATED SUSTAINABILITY REPORTING AND DISCLOSURE

Principle 6.4:

Effective reporting should take place on a regular basis.

- ❖ Regular engagement with stakeholders, on a basis more frequent than once a year is essential. Such engagement should focus on the needs of different stakeholders.
- ❖ Each individual company should determine the most effective means of engagement with stakeholders.
- ❖ Sustainability reporting may be built on a number of different examples, such as:
 - the Global Reporting Initiative Guidelines
 - AA 1000 Framework and Stakeholder Engagement Standard
 - OHSAS 18000 Occupational Health and Safety Standard
 - ISO 9000 Quality Management Assurance Standard
 - ISO 14000 Environmental Standard

Principle 6.5:

Sustainability reporting and disclosure should have independent assurance

- ❖ A formal process of assurance by an independent party is essential for impartial sustainability reporting.
- ❖ Sustainability reports should clearly state the name of the assessor.
- ❖ Integrated reporting should be assisted by the Audit Committee.
- ❖ Sustainability reporting is a Board responsibility.
- ❖ Sustainability reporting is designed to add value by providing a credible account of the company's economic, social and environmental impact.

CHAPTER 7

COMPLIANCE WITH LAWS, REGULATIONS, RULES AND STANDARDS

COMPLIANCE WITH LAWS, REGULATIONS, RULES AND STANDARDS

Principle 7.1:

Companies must comply with applicable laws and regulations

- ❖ Companies should comply with the applicable laws and regulations.
- ❖ Exceptions which are permitted by law should be handled in a responsible manner.

Principle 7.2:

Companies should consider adherence to applicable rules and standards

- ❖ The provisions of non-binding industry standards and codes vary from company to company and often depend on the size and nature of the company's operations.
- ❖ Companies should disclose the rules and standards to which they adhere, on a voluntary basis.

Principle 7.3:

The Board and each individual director should be aware of the laws, rules and standards applicable to the company.

- ❖ The Board of Directors should identify the laws, rules and standards which are applicable to a company.
- ❖ Individual directors should be informed of relevant laws, rules and standards, including changes in these as part of their induction and continuing professional education.
- ❖ Risk management processes should consider the laws, rules and standards which are applicable to the company.

Principle 7.4:

The Board is responsible for the company's compliance with laws and regulations.

- ❖ In order that the Board is in a position to assess the company's compliance with laws and applicable rules and standards, it is necessary that individual directors should be briefed on the content of these laws, rules and standards.

CHAPTER 7

COMPLIANCE WITH LAWS, REGULATIONS, RULES AND STANDARDS

- ❖ Compliance with laws, rules and standards should be a standing item on the agenda of the Board of Directors.

Principle 7.5:

The Board should ensure that the company implements an effective compliance framework and process.

- ❖ The company's compliance policy and procedures should be developed by management and approved by the Board.
- ❖ A culture of compliance amongst employees should be encouraged by the company adopting codes of practice which ensure corporate compliance.
- ❖ Key performance indicators should concentrate on the risk of non-compliance factor.

Principle 7.6:

Compliance should form part of the risk management process.

- ❖ Non-compliance with legislation and regulation could result in the reputation of the company and the reputation of stakeholders of the company being adversely affected.
- ❖ Accordingly, the risk of non-compliance should be identified and addressed through the risk management process.
- ❖ The compliance function should have adequate resources to discharge its responsibility.

CHAPTER 8

MANAGING STAKEHOLDER RELATIONSHIPS

MANAGING STAKEHOLDER RELATIONSHIPS

Principle 8.1:

The Board should take account of the legitimate interests of stakeholders in its decisions.

- ❖ The stakeholders should be identified.
- ❖ Stakeholder expectations need to be managed and this could effectively be done by an appropriate procedure.

Principle 8.2:

The company should proactively manage the relationships with its stakeholders.

- ❖ Once the shareholders have been identified, a strategy should be developed to communicate with stakeholder groups.
- ❖ The company should consider whether it is appropriate to publish a list of stakeholder groupings and stakeholder policies.
- ❖ If this is done, it is necessary to decide whether the processes are restricted to formal processes only or extended to informal processes such as direct contact and websites.
- ❖ On an annual basis the company should consider reporting on its dealings with stakeholders.
- ❖ A close shareholder relationship may enable companies to anticipate, understand and respond to external changes. This should enable it to react more rapidly to an eventuality, when it occurs.

Principle 8.3:

The company should identify mechanisms and processes that will promote enhanced levels of constructive stakeholder engagement.

- ❖ Constructive engagement with stakeholders should be to the mutual benefit of all parties.
- ❖ Companies should guard against using legal or other processes to frustrate engagement with stakeholders. Nonetheless the company's right to take legal action should not be restricted.
- ❖ In the course of discussion with stakeholders, the company should be aware of not releasing price-sensitive information. Accordingly, engagement should be

CHAPTER 8

MANAGING STAKEHOLDER RELATIONSHIPS

avoided during times in which a closed period exists (the period between the date of the end of the financial period and the results being published) and at times that acquisitions and mergers are under discussion.

Principle 8.4:

The Board should strive to achieve the correct balance between its various stakeholder groupings, in order to advance the interests of the company.

- ❖ The company should strive to attain a balance between the interests of its various stakeholders, in the interests of the company.
- ❖ Decisions on balancing the interests of stakeholders should be guided by advancing the best interests of the company.

Principle 8.5:

Companies should ensure the equitable treatment of shareholders.

- ❖ The principle of constructive engagement with all shareholders should be particularly considered.
- ❖ Equitable treatment of the holders of the same class of shares is necessary.
- ❖ The company should protect minority shareholders from abusive actions by the controlling shareholder.
- ❖ Stakeholders and shareholders should be made aware of the danger of damaging the reputation of the company by making uninformed public statements.
- ❖ The possibility of reducing confrontations by a structured process of engagement should be borne in mind by management and directors.

Principle 8.6:

Transparent and effective communication is important for building and maintaining relationships

- ❖ By providing stakeholders with sufficient relevant, accurate and honest information, stakeholders can enrich the governance process.
- ❖ The need for transparency should be considered in the light of legal requirements, the maintenance of the company's competitive advantage and access to information.
- ❖ Shareholder reports should present a fair and objective assessment of the activities of the company. The question of who amongst stakeholders should be provided with certain of the shareholder information is a matter which the Board should consider.

CHAPTER 8

MANAGING STAKEHOLDER RELATIONSHIPS

- ❖ Because stakeholders are not involved in the business of the company, information should be presented in an easily understandable form.
- ❖ When communicating with stakeholders the Board should recognise its duty to protect the long term sustainability of the company.
- ❖ Shareholders should not be requested to waive their right to receive an Integrated Report.
- ❖ It may be appropriate for the company to release additional information in its Integrated Report, provided this information does not adversely affect the company, or breach its agreements with third parties.

Principle 8.7:

The Board should promote mutual respect between the company and its stakeholders.

- ❖ The company and its stakeholders should adhere to a similar standard of corporate governance, to encourage mutual respect.
- ❖ The quality of corporate governance practice by strategic stakeholders should be monitored.
- ❖ A realisation of mutual dependence between the company and the stakeholders should be encouraged.
- ❖ The company needs to monitor the risk associated with failure to be able to source strategic products and services, as the consequence of a failed supplier.
- ❖ The restriction and non-availability of credit for every day purchases could cause problems for the company.
- ❖ Poor employee relations often result in low morale. In order to ensure a well motivated workforce, it is important to maintain effective communication.
- ❖ It is important to align the employees' best interests with those of the company.
- ❖ It is important for the company to strategically engage its employees.
- ❖ Continuous, respectful and candid employee communications should ensure leadership credibility.
- ❖ The need for the company to communicate effectively with the Government and observe legislative and regulatory provisions should be emphasised.
- ❖ The involvement and discussion of company objectives with the external auditor can, and often does, have a positive effect on the credibility of the company's financial statements.
- ❖ It serves to improve relationships with the external auditor, to have an effective Audit Committee and reliable financial statements.
- ❖ The need to communicate with customers and users of the company's products or services is a matter which should be emphasised to all executives and employees in the company. This information should be provided in both a proactive and reactive mode.

CHAPTER 8

MANAGING STAKEHOLDER RELATIONSHIPS

- ❖ Responses from customers can be expected:
 - when the company reacts irresponsibly
 - when the company takes action which is harmful to the environment
 - employee work conditions are unacceptable
 - when the company does not practice equal opportunity
 - when the company takes action which is harmful to the health of customers
 - when the major shareholder of the company sells its interest
- ❖ It is necessary to promote the sustainability of the industry in which the company operates to ensure that the company continues to be sustainable.
- ❖ The company should ensure that none of its employees acts in an anti-competitive manner.
- ❖ The relationship between the company and local communities is of great importance.
- ❖ The company should take action to improve the social and environmental context in which the local community lives.
- ❖ The broadening of a company's social involvement enables the local community to interact with the company.
- ❖ The relationship with the media requires a degree of mutual respect.
- ❖ Companies should seek to inform and generate accurate and positive media coverage.
- ❖ Regulatory sanctions should be avoided by regular communication and research on the matters which are regulated by law or regulation.
- ❖ An effective communication channel should exist between the companies in a sector and the applicable regulators.
- ❖ The regulators should in turn ensure that companies are aware when compliance is voluntary or mandatory.
- ❖ Communication with existing and potential investors should be encouraged.
- ❖ Clear and transparent disclosure should be ensured at all times.

Principle 8.8:

Companies should establish a formal process to resolve internal and external disputes.

- ❖ It is necessary for companies to resolve disputes and institute procedures to avoid the reoccurrence of disputes.

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MANAGING STAKEHOLDER RELATIONSHIPS

Principle 8.9:

The Board should ensure disputes are resolved as effectively, efficiently and expeditiously as possible.

- ❖ Disputes should be resolved by as rapid and cost effective a manner as possible.
- ❖ Once such means is alternative dispute resolution.
- ❖ The use of a mediator is one means of resolving disputes.
- ❖ In dispute resolutions it should be remembered:
 - that Court proceedings often extend over several years
 - that where principle and precedent is concerned legal action may be the only means
- ❖ Litigation may destroy a business relationship. Accordingly, where differences occur, it may be appropriate to adopt a mediation process rather than relying on a legal action, which could extend over a number of years.
- ❖ Private dispute resolution proceedings may be conducted in confidence.

Principle 8.10:

The Board should select the appropriate individuals to represent the company in alternative dispute resolutions (ADR) processes

- ❖ By the selection of appropriate specialists it is often possible, through mediation, to solve problems.

CHAPTER 9

FUNDAMENTAL AND AFFECTED TRANSACTIONS

FUNDAMENTAL AND AFFECTED TRANSACTIONS

Takeover regulations will be promulgated during 2009, to take effect at a later date.

INTRODUCTION

“Affected transactions” refer to a wide range of transactions, which include the following:

- ❖ A transaction resulting in the disposal, or the greater part of the assets of a company.
- ❖ A merger or amalgamation.
- ❖ A scheme of arrangement.
- ❖ The acquisition of voting rights in a company.
- ❖ The acquisition of a beneficial interest in a company.
- ❖ A mandatory offer.
- ❖ A compulsory acquisition.

Principle 9.1:

Directors must disclose any conflict or potential conflict of interest.

- ❖ A director shall, in respect of an effective transaction, disclose any conflict of interest. Such disclosure should be made immediately he or she becomes aware of such conflict of interest.
- ❖ Directors who are members of the Board of Directors of both the offeree and offeror companies are presumed to have a conflict of interest. A director of an offeree company is presumed to have a conflict of interests if the interests represent a material amount of the director’s net worth or represent a material holding in the offeree company. Any offer to a director of an offeree company to substitute share/option scheme for another scheme should be considered to constitute a conflict of interest.
- ❖ Directors who are partial to the outcome of an affected transaction, because of an increased or decreased future benefit, should be considered to have a conflict of interest.
- ❖ An offeree company director who is related to any other party who has a conflict of interest, would himself/herself be considered to have a conflict of interest.

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Principle 9.2:

Directors involved with affected transactions must be independent

- ❖ In an affected transaction a director with a potential conflict of interest or who is considered to be “non-independent” should recuse himself or herself from the Board, while it considers the offer.
- ❖ An independent Board should comprise a minimum of three independent directors. Should there be less than three independent directors, independent outside parties should be appointed to the independent Board.

Principle 9.3:

Directors’ duties are expanded to include duties to security holders

- ❖ Affected transactions require the expansion of a director’s fiduciary duties to include the general body of the company’s relevant security holders.

Principle 9.4:

Independent Board members should have the requisite knowledge.

- ❖ Each member of the independent Board should confirm that they have all the necessary information to convey to relevant security holders. For this purpose the director must appoint an adviser, adhere to regulatory timetables and ensure that he/she is properly informed of the offeree’s company’s value.

Principle 9.5:

The independent Board must express an opinion to shareholders.

- ❖ The independent Board should do all things necessary to satisfy itself that an offeror is able to perform in terms of the affected transaction.
- ❖ The independent Board should form a clear basis for the expression of an opinion to security holders, in which the consideration for securities is evaluated. In this regard any affected transaction with a consideration per share within a range of values agreed by the independent Board is generally considered to be fair.

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FUNDAMENTAL AND AFFECTED TRANSACTIONS

Principle 9.6:

Offeree companies must appoint independent competent advisers.

- ❖ The independent Board must determine that the offeree company shall appoint advisers who are independent and competent. Such independent advisers should charge a market-related fee which is non variable.

Principle 9.7:

Negotiations should be kept confidential but when confidentiality is breached, relevant information should be disclosed.

- ❖ If there is a reasonable suspicion of material price-sensitive information having become available to outside parties, such information must immediately be disclosed to all security holders of the offeree company.

Principle 9.8:

Offerors must treat all offeree company security holders equitably.

- ❖ The offeror company must treat all offeree company security holders equitably.

Principle 9.9:

Independent directors should drive the process

- ❖ Directors who are independent and have no potential conflict of interest should drive the process.