



GUIDANCE PAPER

May 2020

RESPONSIBLE LEADERSHIP IN RESPONDING TO COVID-19

*The information contained in this **King IV Guidance Paper** is of a general nature and is not intended to address the circumstances of any particular individual or entity. The views and opinions do not necessarily represent the views of the King Committee and/or individual members. Although every endeavour is made to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. The Institute of Directors in South Africa shall not be liable to any loss or damage whether direct, indirect, and consequential or otherwise which may be suffered, arising from any cause in connection with anything done or not done pursuant to the information presented herein. As copyright subsists in this paper, extracts of this paper may only be reproduced with acknowledgement to the Institute of Directors in South Africa*

Adapting the governing body's focus

As the full impact of the COVID-19 pandemic takes effect around the world, governing bodies and management teams of organisations are facing unprecedented challenges and uncertainty. Now, more than ever, those charged with governance need to be proactive, display strong and ethical leadership and ensure that the right issues and concerns about the impact of COVID-19 on the operations and outlook for their organisations are addressed. Now is the time for governing bodies to engage with foresight and apply seasoned judgement. With every crisis comes opportunity to reinvent, rescale and reposition.

The King IV Report on Corporate Governance (King IV) recognises organisations as integral parts of broader society and defines corporate governance as the exercise of ethical and effective leadership by the governing body towards the achievement of defined governance outcomes: ethical culture, good performance, effective control, and legitimacy.

As the COVID-19 crisis stretches South Africans, their communities and businesses to the limit, governing bodies need to be responsive and responsible in ensuring that good governance principles remain at the core of their thoughts, decisions and actions.

The impact of the COVID-19 pandemic is likely to affect many aspects of the organisation, prompting the need for greater scrutiny and healthy scepticism by the governing body. This paper highlights areas that leadership should be considering in order to ensure the effective application of governance principles and practices during this challenging period, and beyond.

Key points for governing bodies to learn from this guidance are:

- Governing bodies and management should be guiding their organisations through this crisis, and beyond, in a collaborative manner.
- Even though this is the time for measured insight, foresight is critical.
- COVID-19 offers opportunities to reinvent, rescale and reposition.
- Experienced governing body members need to leverage their years of experience and assist in applying seasoned judgment with the governing body collective.

The paper does not remove the responsibility of those charged with governance to conform to the full requirements of King IV or the requirements of the Johannesburg Stock Exchange (JSE) and other regulators. It seeks to draw attention to specific additional areas of focus that may require further thought and attention during this time to assist governing bodies to navigate the current environment, and also consider how to adapt to a post-COVID-19 environment.

The guidance has been developed to support governing bodies. While they should already be familiar with the principles and processes referred to in the guidance, the document serves to remind those charged with governance of important matters to consider and whether it is necessary to approach these principles and practices differently. While it is appreciated that during periods of crisis, temptations might present themselves to deviate from complying with standards, rules and regulations to focus on securing the organisation's continued existence, this should never compromise the governing body's primary objective to lead ethically and effectively.)

Implications of COVID-19 on corporate governance

The discussions and suggestions raised in this paper are meant to be neither exhaustive nor prescriptive. The intention is to illuminate potential implications for business that governing body members may need to reflect on and respond to during the current crisis, as well as in dealing with a future changed work environment or a new normal.

These are arranged under five key pillars, which are broadly derived from the King IV Report on Corporate Governance:

1. Ethical leadership and the roles of the governing body and management
2. Human capital
3. Organisational performance, control, risk, opportunity and crisis oversight
4. Communication in a crisis
5. Strategy and recovery

The guidance also includes a section that covers certain legal considerations.

1. Ethical leadership and the roles of the governing body and management

Consider whether the organisation's current culture and values are appropriate in light of changing market values and priorities.

The priorities of the country are changing to respond to addressing the pandemic, its social impact and the related consequences of managing the crisis. These changes will create significant cultural shifts in terms of what is considered appropriate, socially responsible and supportive of a new economy post-COVID-19.

Governing bodies should oversee that organisations remain true to the principles and practices of responsible and ethical leadership in terms of support to employees, communities, doing responsible things, and the treatment of suppliers.

Ensure clarity regarding the roles of the governing body and management in ensuring adequate oversight and setting policy and direction.

Maintaining a balance and separation of roles between the governing body and management throughout a crisis is key. As such, the organisation must demonstrate agility and responsiveness without sacrificing good governance and due process.

Reassess whether the management team has the skills, competency and experience to deal with the crisis; and determine whether additional resources or strategic counsel are required.

The current pandemic and unprecedented steps taken by government are so unique that there may be inherent weaknesses in the management team as it grapples with such unique scenarios and fundamental changes to the business environment, and for which members may have no relevant point of reference.

In the absence of relevant experience, governing bodies should encourage management to seek out best practices, locally and globally, newly available resources and guidance issued by regulators, and external advice where appropriate, in order to strengthen management's ability to address the consequences of the pandemic on the business.

Points to consider:

- Whether the organisation's response is in line with the fundamental culture and values of the organisation and demonstrates responsible leadership
- The appropriateness of the tone at the top displayed by the governing body and management in the changed circumstances
- The manner in which it engages with employees, customers, suppliers, the community, government and other stakeholders and the extent to which the organisation can support such stakeholders
- The extent to which the current governance process and structures are working or need to be revisited – including delegation, additional crisis committee/structures, ethics management and culture, policies and procedures and establishing whistleblowing channels
- The governing body should ensure that a proper record is kept of its deliberations, especially the key matters considered, key decisions and the reasons therefore
- Whether the governing body is satisfied with the adequacy of reporting and that the balance between the necessity of management to deal expeditiously with the crisis and the accountability of the governing body is acceptable
- Reassess internal operational resilience and financial resilience focusing on scenario analyses and the impact on cash flow and profitability
- Consider a programme to assess and address societal impact

2. Human capital

Ensure an understanding of the impacts on the organisation's human capital, both in the short-term and long-term, and consider whether fundamental changes or improvements are required to adapt to current and post-COVID-19 requirements to ensure organisational resilience.

The national lockdown, its extensions and phased relaxation will have a significant impact on employees. Preservation of human capital, in terms of key skills, experience, and institutional knowledge is key to the organisation's ability to demonstrate resilience through the current and in a post-COVID-19 environment.

Short-term interventions should focus on health and wellbeing, and adapting to modes of interaction that still allow for productivity. Certain business processes may be required to be modified in order to incorporate new ways of achieving productivity.

Points to consider:

- Health and safety of employees, as well as customers interacting with the workforce
- Succession plans for senior management, governing body members and others affected by the crisis
- Multi-skilling, cross-skilling and upskilling
- Technological support and adaptive methods of working, including methods of employees staying connected while working from home
- Executive oversight, productivity measures and clear output requirements

3. Organisational performance, control, risk, opportunity and crisis oversight

Ensure an understanding of the impact on the organisation and its ability to manage the impact and risks.

The advent of an entirely new set of risks has arisen, not only relating to going concern, but also to health and welfare of staff, security of staff income, and security of supply chains both up and downstream. The knock-on effect of regulations, as they are imposed or relaxed, means that risks are changing daily.

Governing bodies are encouraged to conduct a thorough re-evaluation of the opportunities and risk scenarios across various aspects of the business. While some may be short-term and easily mitigated, some may be long-term and require fundamental revisions to mitigation plans.

Ensure an understanding of the trading conditions during this period, and the economic impact on the organisation.

The COVID-19 outbreak could have a significant impact on some organisations' economic conditions, such as disruption to business operations, interrupted supply chains, uncertainty around asset valuation, etc. This will have an impact on the cash flows and/or projected financial information and cash flows of the organisation, which in turn could affect the assessment of its ability to continue as a going concern.

The governing body should therefore consider the going concern assumption, which is the organisation's ability to continue in operation for the foreseeable future. While foreseeable future technically refers to the next 12 months, additional consideration should be given to the potential impact of COVID-19 on the organisation's going concern status during this period, and potentially over a shorter period as well.

During its assessment of the going concern assumption, the governing body should also consider whether the assets of the company, fairly valued, are equal to or exceed the liabilities of the company (solvency) and whether the company is able to pay its debt as it becomes due in the ordinary course of business for a period of 12 months (liquidity).

Ensure an understanding of whether current performance metrics are appropriate and relevant; identify new key metrics and support the active monitoring of short-term metrics, including leading indicators that will contribute to a meaningful organisational health assessment and improve the ability of the organisation to manage variances and respond rapidly with mitigating actions.

The usual metrics of organisational performance and health may no longer produce meaningful or useful data that can provide an accurate bird's-eye view of the impact of the pandemic and government interventions on the business. It is also key to assess whether focus is placed on the correct priorities.

Governing bodies are encouraged to request management to review performance priorities and metrics, and implement metrics that respond directly to the impacts of the crisis. Although some metrics may be short-term to weather the current changing scenarios, this enhances organisational response, adaptability and planning.

Points to consider:

- CEO (and other executives) performance and additional KPIs related to crisis management, innovation, business continuity and rolling out adaptive business processes and the impact on incentives, bonuses and other rewards
- A revision of the risk register with the addition of identifiable new risks focusing on those risks that have increased in priority

Points to consider continued:

- Assessing opportunities for growth, adaption or diversification arising out of the current crisis and ensuring this is dealt with in strategy and recovery plans (this is addressed in more detail in section 5)
- The current control environment, level and frequency of scrutiny and whether controls and oversight need to be strengthened if necessary
- A live crisis management plan and an impact assessment of the organisation's response on its stakeholders, which is reviewed regularly as scenarios change
- The organisation's current state of compliance with regulations and the need to re-evaluate as regulations change
- The alignment of business processes as regulations change or are amended, imposed or relaxed
- The risk of not being a going concern and inappropriate working capital management, and whether there is adequate disclosure in the financial statements on going concern
- IT risks raised by remote working and whether to strengthen oversight to address potential cyber intrusions
- Consider whether performance measures around financial performance, liquidity and sustainability issues, supply chain, customer interaction, and product quality metrics are appropriate.

4. Communication in a crisis

Ensure an understanding of the effectiveness of communication and stakeholder interaction, with a view to ensuring honest, transparent and timely communication that demonstrates integrity and empathy, and fairly addresses any unknowns that may impact stakeholder decisions.

In any crisis, the honesty, quality, frequency and effectiveness of communication can make or break the success of the organisation. Building trust between the organisation and its stakeholders is never more important than in the midst of a crisis, and honest communication brings about collaboration and mutual support throughout the value chain.

Governing bodies should encourage management to implement crisis communication programmes that ensure that the market and all stakeholders are adequately and timeously informed of key matters that affect their interaction with the organisation or their decisions with regard to interactions. Organisational reputation should be monitored as part of the risk register.

Points to consider:

- Effective, transparent, regular and sustained communication to stakeholders, both internal and external, including SENS announcements
- Clear communication of the organisation's commitment to complying with the health guidance issued by government
- Reassessment of communication and stakeholder engagement strategy/policy
- The Integrated Report should provide information on the impact of COVID-19 on the organisation in the short, medium and long term and on the organisation's outlook

5. Strategy and recovery

Ensure an understanding of whether the current strategy and model continues to be relevant in the current and post-COVID-19 environment.

The economy and traditional markets are undergoing significant changes and current business models may no longer function in the way in which they were intended, and the environment may challenge the continuation of certain methods of sustainable value creation and business growth.

Consider how sustaining value creation in the current crisis might reveal opportunities for the organisation to re-invest in recovery.

Governing bodies are encouraged to actively discuss business models and strategies with management to test whether previous assumptions on the way in which the business operated continue to be valid. Governing bodies should actively discuss how the business vision, mission, values and culture may need to adapt to take advantage of opportunities that could lead to sustained growth.

Ensure an understanding of recovery strategies and ramp up initiatives post-COVID-19, through maximising organisational resilience and focusing on areas of maximum short-term impact.

Those organisations that have adequately planned and prepared for recovery by focusing on the ways in which they can be most resilient will be those that take early advantage of the re-opening of the economy.

While understanding that in the midst of a crisis it is difficult to also plan for an uncertain future, governing bodies should encourage management to draw up recovery plans addressing different scenarios and approve these in advance. A clear mandate on how to respond will enable management to take advantage of key opportunities timeously.

Points to consider:

- The business model, organisational fitness and sustainability and strategy for continued relevance and practical value-creation in light of changed circumstances. This may require revisiting the SWOT analysis for the organisation given the changed environment.
- Trends and changes in the industry, and the need to evaluate management assumptions in light of changes
- Impact on capital investment strategies, cost reduction efforts, and dividend cancellation
- Key and critical post-lockdown actions
- Information and technology leverage has become key
- How management can mitigate future risks, including learnings from lockdown that could be implemented and adopted as new ways of working where it has improved performance
- Whether possible windows of opportunity have been identified and whether management is prepared to take advantage of opportunities

Legal considerations

The content set out below is not intended to be a substitute for specialised and competent legal advice the governing body will take, but is an aid to assisting the governing body on legal issues that should be focused upon.

Included in these are:

- The governing body ensuring on a regular basis that the organisation is a going concern and does not trade recklessly, as it is prohibited. Regard should be given to the solvency and liquidity test as set out in the Companies Act ("the Act"), as well as the provisions relating to Business Rescue. Ensuring the organisation always remains a going concern will help to avoid the

Directors and/or prescribed Officers and/or the Committee Members (“the affected individuals”) from being sued and potentially held liable on a joint and several basis. If there is a concern that the organisation is trading recklessly, expert opinion should be taken from the organisation’s financial or legal advisors.

- It is imperative that the organisation ensures that it follows applicable laws, rules and regulations, especially the fast-paced evolving new regulations relating to the COVID-19 pandemic, as breaching laws such as the Disaster Management Act carry draconian consequences and potentially reputational harm.
- The governing body should understand the impact of the pandemic on the performance of contractual obligations by the organisation and third parties, and mechanisms available to properly address areas of non-compliance.
- The governing body should understand the nature and extent of specific litigation arising from the COVID-19 pandemic. Alternative dispute resolution mechanisms are to be considered to resolve legal disputes.
- The governing body should be aware of the insurance cover the organisation has and insurance cover that is available but the organisation does not yet have. Expert advice should be taken to ensure that business interruption claims are formulated in accordance with the policy.
- The governing body should consider the need for external expert advice on:
 - Legal obligations and duties of the governing body and management
 - Contractual and other legal obligations
 - Compliance with laws
 - Possible expiry of licences, permits or authorisations
- The governing body should review the organisation’s compliance with the rules of the Johannesburg Stock Exchange, if applicable, and/or King IV and/or the internal policies in order to ensure that the organisation is not only focusing on compliance, but is ethical in its behaviour.

Conclusion

This guidance note has highlighted particular areas of concern where more diligence should be exercised by governing bodies and management. It is a reminder of additional work to be done in considering the pandemic situation. Foresight and seasoned judgement are key, as are ethical leadership and a commitment to responsible survival, rather than survival at any cost.

Not every area of concern will apply to every business and some businesses by their nature may experience less impact than others depending on the business- and value-creation model.

The King Committee encourages that adequate thought and discussion goes into the exercise of oversight and that above all, governing bodies and management lead and manage in a responsible and ethical manner in adopting and implementing measures to respond to the crisis. Much of what is learnt in this process will also help businesses to build resilience and weather any future crises.

Acknowledgment

This Guidance Paper was drafted with the assistance of the Independent Regulatory Board for Auditors (IRBA), PwC and members of the King Committee.