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The Social and Ethics Committee

Introduction

King III requirements:

Principle 2.23- *The board should delegate certain functions to well-structured committees but without abdicating its own responsibilities.*

Establishing a Social and Ethics Committee may be required for certain categories of companies (section 72(4) of the Act).

Companies Act requirements:

The new Companies Act No. 71 of 2008 (the Act) which came into effect on 1 May 2011, introduces the requirement of a Social and Ethics Committee for certain companies. This legislative requirement is closely aligned to King III's increased focus on ethics and sustainability.

The intention of the former is to enforce a more structured and focused approach to social and ethical issues, with standardised and comparable performance and information reported upon.

Target audience

This practice note provides guidance to board members on the requirements for a Social and Ethics Committee.

Which organisations are required to have a Social and Ethics Committee?

The Act¹ allows the Minister to prescribe, by regulation, the categories of companies that must have a Social and Ethics Committee, if it is desirable in the public interest, having regard to annual turnover, workforce size, or the nature and extent of the activities of such companies.

The Regulations to the Act prescribe that every state owned company, every listed public company, and any other company that has, in any two of the previous five years, scored above 500 points in terms of the public interest score, must appoint a Social and Ethics Committee.

The public interest score is calculated at the end of each financial year as the sum of the following:

- A number of points equal to the average number of employees of the company during the financial year;
- One point for every R 1 million (or portion thereof) in third party liability of the company, at the financial year-end;

¹Section 72(4)



- One point for every R 1 million (or portion thereof) in turnover during the financial year; and
- One point for every individual who, at the end of the financial year, is known by the company-
 - In the case of a profit company, to directly or indirectly have a beneficial interest in any of the company's issued securities; or
 - In the case of a non-profit company, to be a member of the company, or a member of an association that is a member of the company.

Are there any exemptions?

The one exemption is where a company is a subsidiary of another company that has a Social and Ethics Committee, and the Social and Ethics Committee of that other company will perform the functions required on behalf of that subsidiary company.

Other companies subject to but requiring exemption from the statutory requirement to establish a Social and Ethics Committee may apply to the Companies Tribunal² (Tribunal) for an exemption from the requirement, and the Tribunal may grant such an exemption if it is satisfied that -

- The company is required in terms of other legislation to have, and does have, some form of formal mechanism within its structures that substantially performs the function that would otherwise be performed by the Social and Ethics Committee; or
- It is not reasonably necessary in the public interest to require the company to have a Social and Ethics Committee, having regard to the nature and extent of the activities of the company.

Important to note with regards to the first bullet point is that the exemption may only be granted where legislation requires a similar mechanism and not where a company has voluntarily chosen to establish another committee that fulfils a similar role.

Such an exemption is valid for five years, or such shorter period as the Tribunal may determine at the time of granting the exemption, unless such exemption has been set aside by the Tribunal as noted below.

The Companies and Intellectual Property Commission³ (Commission) may apply to the Tribunal to set aside an exemption on the grounds that the basis on which the exemption was granted no longer applies.

² The Companies Tribunal is a newly established independent state organ and has a dual mandate that entails serving as a forum for voluntary alternative dispute resolution in terms of the Companies Act, as well as to review administrative decisions made by the Commission

³ The newly formed Companies and Intellectual Property Commission (CIPC), was established through the amalgamation of the Office of Companies and Intellectual Property Enforcement (OCIPE) and the Companies and Intellectual Property Registration Office (CIPRO)

What will the composition of this Committee be, and who appoints them?

The Act⁴ allows the Minister to prescribe, by regulation, any rules governing the composition and conduct of Social and Ethics Committees.

A company's Social and Ethics Committee must comprise not less than three directors or prescribed officers⁵ of the company, at least one of whom must be a director who is not involved in the day-to-day management of the company's business, and must not have been so involved within the previous three financial years.

The board of the company must appoint members to the Social and Ethics Committee.

Although not expressly covered in the Act or the Regulations, the board should give due consideration to the mix of skills required to fulfil the functions of this committee. For example, a member with a legal background would be beneficial in relation to the compliance aspects of the functions listed below.

What are the timing requirements?

Companies that were incorporated before 1 May 2011 must appoint the committee within 12 months from this effective date (by 1 May 2012) or from the date of determination by the Tribunal of an application for exemption, if the Tribunal has not granted such exemption.

Companies that are incorporated after 1 May 2011 must appoint the committee within 1 year after:

- its date of incorporation, in the case of a state owned company;
- the date it first became a listed public company, or
- the date it first met the public interest score criteria.

What are the consequences if a Social and Ethics Committee is not appointed?

If the board of a company fails to appoint a Social and Ethics Committee (where it is required to have one) the Commission may issue a notice to that company to show cause why the Commission should not convene a shareholders' meeting for the purpose of establishing the committee. The Commission can then proceed to call a meeting of the shareholders for that purpose.

⁴ Section 72(4)

⁵ Despite not being a director of a particular company, a person is a 'prescribed officer' of the company for all purposes of the Act if that person-
Exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company, or
Regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company.

A company could also be subject to a compliance notice issued by the Commission. If a person to whom a compliance notice has been issued fails to comply with this notice, the Commission may either apply to a court for the imposition of an administrative fine or refer the matter to the National Prosecuting Authority for prosecution as an offence.

What are the functions of the Social and Ethics Committee?

- *Refer to Appendix A for template terms of reference for a Social and Ethics Committee.*
- *Refer to Appendix B for useful reference relating to these requirements.*

The Act⁶ allows the Minister to prescribe, by regulation, the functions to be performed by the Social and Ethics Committee.

The Regulations prescribe that a Social and Ethics Committee has the following functions:

- 1) To monitor the company's activities, having regard to any relevant legislation, other legal requirements or prevailing codes of best practice, with regard to matters relating to-
 - Social and economic development, including the company's standing in terms of the goals and purposes of-
 - The 10 principles set out in the United Global Compact Principles;
 - The OECD recommendations regarding corruption;
 - The Employment Equity Act; and
 - The Broad-Based Black Economic Empowerment Act;
 - Good corporate citizenship, including the company's-
 - Promotion of equality, prevention of unfair discrimination, and reduction of corruption;
 - Contribution to development of the communities in which its activities are predominantly conducted or within which its products or services are predominantly marketed; and
 - Record of sponsorship, donations and charitable giving;
 - The environment, health and public safety, including the impact of the company's activities and of its products or services;
 - Consumer relationships, including the company's advertising, public relations and compliance with consumer protection laws; and
 - Labour and employment, including-
 - The company's standing in terms of the International Labour Organisation Protocol on decent work and working conditions; and
 - The company's employment relationships, and its contribution toward the educational development of its employees;
- 2) To draw matters within its mandate to the attention of the Board as occasion requires; and

⁶ Section 72(4)

- 3) To report, through one of its members, to the shareholders of the company's annual general meeting on the matters within its mandate.

Despite the prominence of the word "ethics" in the name of the committee, the Regulations do not address all of King III's specific functions relating to ethics. In companies where the governance of ethics is not already dealt with by another committee (e.g. Governance Committee) it is recommended that the terms of reference of the Social and Ethics Committee include functions related to:

- the implementation of the ethics management programme in the company;
- the values of the company;
- ethical risks and opportunities;
- code of conducts.

Although this list of duties seems long, it needs to be noted that a lot of the duties are probably already covered within the organisation for example, compliance with health and safety, labour relations act and BEE Act.

Important to note that the Committee's role is to "monitor" and not "perform" all of these duties. The Social and Ethics committee would therefore just need to receive reports from management in exercising this oversight duty.

In order to deal with these duties it is advised that the Committee's formulate annual work plans setting out what they will deal with and when. Some of the functions could be dealt with on a rotational basis. Some of the duties could also be phased in over a period of time.

What are the rights of the Social and Ethics Committee?

A Social and Ethics Committee of a company is entitled to-

- Require from any director or prescribed officer of the company any information or explanation necessary for the performance of the committee's functions;
- Request from any employee of the company any information or explanation necessary for the performance of the committee's functions;
- Attend any general shareholders meeting;
- Receive all notices of and other communication relating to any general shareholders meeting; and
- Be heard at any general shareholders meeting or any part of the meeting that concerns the committee's functions.

A company must pay all the expenses reasonably incurred by its Social and Ethics Committee, including, if the Social and Ethics Committee considers it appropriate, the costs or the fees of any consultant or specialist engaged by the Social and Ethics Committee in the performance of its functions.

What is the legal position and liability of members of the Social and Ethics Committee?

A member of any board committee will have the same duties and liabilities as a director but limited to that board committee. A member who is a prescribed officer is in much the same position - the Act creates the same regime in respect of prescribed officers as in respect of directors.

The board has ultimate responsibility for the acts (and omissions) of the Social and Ethics Committee. In this regard, section 72(3) of the Act states that the creation of a committee, delegation of any power to a committee, or action taken by a committee, does not alone satisfy or constitute compliance by a director with the required duty of a director to the company.

What if a current committee fulfils a similar function?

It may well be that some larger companies already have a committee in place that fulfils a similar function to the Social and Ethics Committee, for example, Governance, HR/Transformation or Sustainability Committees. Such companies would need to either convert their current committees to meet all of the legislative requirements for a Social and Ethics Committee (i.e. change the name to "The Social and Ethics Committee", include all of the statutory duties of the Social and Ethics Committee in the terms of reference, ensure that the membership and all other requirements are in line with the Act), or if applicable, apply to the Tribunal for an exemption as discussed earlier.

On strict interpretation of the Act, there should be one committee (the Social and Ethics Committee) that fulfils the statutory functions required. The board could expand this committee's mandate to also include other areas of responsibility as it deems appropriate, as long as all of the statutory duties are fully covered.

Some existing companies may have various committees across which the duties of the Social and Ethics Committee are spread (for example an Audit Committee may deal with ethics and a Sustainability Committee with the environment). In this instance there are 2 options:

- Either move all of these functions to the "Social and Ethics Committee" or
- Leave these functions where they are with a reporting line (in addition to a reporting line to the board) from the relevant committee to the "Social and Ethics Committee". In this instance the relevant committee is expected to continue reporting to the board on all of its areas of responsibility on a continuous basis, but in addition, is expected to report to the Social and Ethics Committee on the relevant duties to enable the Social and Ethics Committee to report to the shareholders as envisaged by the Act.

Relationship with other committees?

- *Refer to King III Practice Note - "Improving board functioning through the performance of the sustainability, risk and audit committees"*

A certain amount of overlap/cooperation between the Social and Ethics Committee and the Risk Committee (if the company has one) is inevitable. Sustainability risks must also be considered by the Risk Committee as part of the overall risk assessment process. Therefore, in practice, the information concerning sustainability risks would need to be transferred to the Social and Ethics Committee in order for it to fulfil its broader sustainability oversight role. This interaction is crucial to ensure adequate coverage as well as to minimize duplication.

In relation to the Audit Committee, the Social and Ethics Committee forms the platform for some of the tasks that the Audit Committee undertakes, similar to the Risk Committee. The Social and Ethics Committee deals with sustainability issues at the onset, whilst the Audit Committee should obtain assurance over sustainability disclosure in the integrated report, as well as the internal controls in place to mitigate sustainability risks.

Each of the above committees would need to deal with sustainability matters to a greater or lesser extent and the focus of each is different.

The Audit Committee provides assurance on sustainability matters to ensure credible integrated reporting. The Risk Committee assists the board to fulfil its role with regard to the identification of sustainability risks. The Social and Ethics Committee should assist the board to achieve better performance on sustainability related matters.

Due to the close correlation and interrelationship of these areas, there should be provision for extensive co-operation and liaison between these various board committees either through overlapping membership and/or a process for sharing of information.

The terms of reference of each of the committees will also have to be carefully drafted to minimise duplication. There should also be a sound understanding of the nature and extent of interdependencies concerning information requirements and formal structures need to be agreed to meet these requirements.

Conclusion

Directors are encouraged to familiarise themselves with the requirements for a Social and Ethics Committee and start considering whether the companies on which they serve fall within the requirements to appoint one. If so, plans will need to be put in place to get the process of appointing such a committee started.

Sources

- The Companies Act No. 71 of 2008 and related Companies Regulations
- Social and Ethics Committees Alert April 2011 - DLA Cliffe Dekker Hofmeyr
- King III Practice Note - "Improving board functioning through the performance of the sustainability, risk and audit committees"

Appendix A

Template terms of reference for a Social and Ethics Committee**Introduction**

The Social and Ethics Committee (the Committee) is constituted as a committee of the Board of the [insert company name] (the Company) in terms of section 72(4) of the Companies Act no. 71 of 2008 read with Regulation 43 of the Companies Regulations, 2011.

The duties and responsibilities of the members of the Committee as set out in this document are in addition to those duties and responsibilities that they have as members of the Board. The deliberations of the Committee do not reduce the individual and collective responsibilities of Board members in regard to their fiduciary duties and responsibilities, and they must continue to exercise due care and judgment in accordance with their legal obligations.

These terms of reference are subject to the provisions of the Companies Act, the Company's Memorandum of Incorporation and any other applicable law or regulatory provision.

Purpose of the terms of reference

The purpose of these terms of reference is to set out the Committee's role and responsibilities as well as the requirements for its composition and meeting procedures.

Composition of the Committee

The Committee comprises at least three directors of prescribed officers of the Company, of whom at least one is an independent non-executive director, to be appointed by the Board.

The members of the Committee must collectively have sufficient qualifications and experience to fulfil their duties.

The Committee is chaired by a non-executive Board member who is not the Chairman of the Board. The Board elects the Chairman of the Committee from the elected members.

The Committee members are required to keep up-to-date with developments affecting the required skill-set.

Role

The Committee has an independent role with accountability to the Board. The Committee does not assume the functions of management, which remains the responsibility of the executive directors, officers and other members of senior management.

The role of the Committee is to assist the Board with the oversight of social and ethical matters relating to the Company.

Responsibilities

The Committee performs all the functions as are necessary to fulfil its role as stated above and including the following statutory duties:

- 1) Monitoring the company's activities, having regard to any relevant legislation, other legal requirements or prevailing codes of best practice, with regard to matters relating to-
 - Social and economic development, including the company's standing in terms of the goals and purposes of-
 - The 10 principles set out in the United Global Compact Principles;
 - The OECD recommendations regarding corruption;
 - The Employment Equity Act; and
 - The Broad-Based Black Economic Empowerment Act;
 - Good corporate citizenship, including the company's-
 - Promotion of equality, prevention of unfair discrimination, and reduction of corruption;
 - Contribution to development of the communities in which its activities are predominantly conducted or within which its products or services are predominantly marketed; and
 - Record of sponsorship, donations and charitable giving;
 - The environment, health and public safety, including the impact of the company's activities and of its products or services;
 - Consumer relationships, including the company's advertising, public relations and compliance with consumer protection laws; and
 - Labour and employment, including-
 - The company's standing in terms of the International Labour Organisation Protocol on decent work and working conditions; and
 - The company's employment relationships, and its contribution towards the educational development of its employees;
- 2) Drawing matters within its mandate to the attention of the Board as occasion requires; and
- 3) Reporting, through one of its members, to the shareholders of the company's annual general meeting on the matters within its mandate.

In addition, the Committee performs the following duties, delegated by the Board:

- [include additional duties relating to social and ethics that have been delegated by the Board].

Authority

The Committee acts in accordance with the delegated authority of the Board as recorded in these terms of reference.

It has the power to investigate, at the cost of the company, any activity within the scope of its terms of reference.

The Committee, in the fulfilment of its duties, may call upon the Chairmen of the other Board committees, any of the executive directors, Company officers or assurance providers to provide it with relevant information.

The Committee is entitled to reasonable access to the Company's records, facilities and employees necessary to discharge its duties and responsibilities.

The Committee may form, and delegate authority to, subcommittees, one or more designated members of the Committee and to one or more members of the executive to perform certain tasks on its behalf.

The Committee has the right to obtain independent outside professional advice to assist with the execution of its duties, at the company's cost, subject to prior approval by the majority of the members.

Meetings and Procedures

Frequency

The Committee holds sufficient scheduled meetings to discharge all its duties as set out in these terms of reference and its annual work plan, but subject to a minimum of two meetings per year.

Attendance

The Chief Executive Office, Chief Operations Officer, other assurance providers, professional advisors and Board members may be in attendance at Committee meetings, by invitation only, at the discretion of the Chairman.

Committee members must attend all scheduled meetings of the Committee, including meetings called on an ad hoc-basis for special matters, unless prior apology, with reasons, has been submitted to the Chairman or Committee Secretary.

If the elected Chairman of the Committee is absent from a meeting, the members present must elect one of the members present to act as Chairman for the duration of that meeting.

Agenda and minutes

The Committee establishes an annual work plan for each year to ensure that all relevant matters are covered by the agendas of the meetings planned for the year.

A detailed agenda, together with supporting documentation, is circulated, at least one week prior to each meeting to the members of the Committee and other invitees.

Committee members must be fully prepared for Committee meetings in order to provide appropriate and constructive input on matters discussed.

The minutes are completed as soon as possible after the meeting and circulated to the Chairman and members of the Committee for review thereof. The minutes must be formally approved by the Committee at its next scheduled meeting.

Minutes of the meeting, signed by the Chairman, are sufficient evidence that the matters referred to therein have been fully discussed and agreed, whether by way of a formal meeting or otherwise.

Quorum

The quorum for meetings is a majority of members present.

Individuals in attendance at Committee meetings by invitation may participate in discussions but do not form part of the quorum for Committee meetings and accordingly may not vote on any matter.

Evaluation

The Committee shall perform a self-evaluation of its effectiveness every year and report the results thereof to the Board.

Approval of these terms of reference

These terms of reference were recommended to the Board for approval by the Chairman of the Committee on [insert date].

Chairman of the Committee

These terms of reference were approved by the Chairman of Board on [insert date] and will be due for review on [insert date].

Chairman of the Board

Appendix B

Useful references

- The 10 principles set out in the United Nations Global Compact Principles - <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html>
- The Employment Equity Act - <http://www.labour.gov.za/downloads/legislation/acts/employment-equity/Act%20-%20Employment%20Equity.pdf>
- The Broad-Based Black Economic Empowerment Act - <http://www.info.gov.za/view/DownloadFileAction?id=68031>
- Occupational Health and Safety Act - <http://www.info.gov.za/acts/1993/a85-93.pdf>
- Consumer Protection Act - <http://apps.thedti.gov.za/ccrd/cpact09.pdf>

As of the date of releasing this practice note, the King Committee have not obtained clarity on exactly what documents/guidance the following two requirements relate to.

- International Labour Organizations Protocol on decent work and working conditions - <http://www.ilo.org/global/topics/decent-work/lang--en/index.htm>
- The OECD recommendations regarding corruption - http://www.oecd.org/findDocument/0,3770,en_2649_34135_1_119820_1_1_1,00.html