Introduction

The purpose of this document is to provide guidance on what director misconduct is and the avenues available to address and/or report this. The need for this guidance note largely stems from occasional queries received by the IoDSA on how director misconduct should be dealt with and who it can be reported to.

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The Companies Act 71 of 2008 ("the Companies Act") does not specifically deal with how director misconduct should be handled, but sets out the standards to which directors should conduct themselves, director duties and liabilities, and actions that can be taken against a director who is either found to be negligent or who has contravened his/her director duties/functions as per the Companies Act.

The King Report on Corporate Governance for South Africa also does not specifically deal with director misconduct, nor the process to follow to deal with director misconduct, however, it does set out the standard at which directors should conduct themselves, which standard is increasingly being referred to by the Courts.

In the absence of clear legislative prescription on how to deal with director misconduct, it becomes incumbent on the board to set the standards expected, the processes to be followed and sanctions that will apply to deal with misconduct within the organisation. Ultimately, what is expected and how misconduct will be dealt with will be dependent on the culture of the board/company and thus the
board needs to be clear on what is expected (or what will not be tolerated) from its directors – and this may differ from board to board.

There is no one set avenue or protocol to follow should you believe a director has or is misconducting him/herself. The main avenue for relief will be based on the board’s policies and procedures for complaints against a director and where applicable the Companies Act (or other relevant legislation applicable to the organisation such as the PFMA/MFMA etc.) remedies available to remove a director.

Disclaimer

This guidance document is strictly intended for information sharing purposes and is not to be construed as a formal legal opinion. The IoDSA remains free from any liability, both direct, indirect or incidental, based on a member or other persons utilising the IoDSA opinions contained in this document. All decisions and conduct by members and persons done in lieu of their reading this document is solely at their own risk.

It is recommended that the sections of the Companies Act mentioned in this guidance note be read in full for completeness and when applying this guidance note.
1. **Defining director misconduct**

Essentially any action by a director that is in breach of his/her role, responsibilities, function, duties or the standard of conduct expected of that director, whether stipulated in terms of legislation, common law or board/company policies, is misconduct. Whether or not the action was wilful, intentional or unintentional will merely affect the degree of sanction required for such misconduct.

In order to determine whether there has been misconduct there needs to be a clear standard of conduct (i.e. behaviours and actions that are expected both in and outside the boardroom) required by a director. It is therefore important to ensure that such standards are clearly outlined in the board charter, performance management documents or other applicable board/company policy and that directors are aware of this standard.

It is important to note that misconduct refers to an individual’s behaviour and not how well he/she performs the job/role. In addition, directors need to realise that misconduct is different at board level. Persons at this level need to consider whether their actions (irrespective of whether personal or not) will bring the company in to disrepute. As a director, i.e. a representative of the company, your actions even if done in a personal capacity can be linked to the company and thus the defence that actions were done in one’s personal capacity will not always stand.

![Set clearly defined expectations for director behaviour](image)

**Note:** Social media training and awareness for directors is thus important, due to the impact that posts on social media through personal accounts (which often still link that individual to the company he or she works or is associated with) can have on the reputation of the company.

2. **General standard for director conduct**

In terms of the Section 76 of the Companies Act, the standard of conduct expected of a director is that he/she must:

(a) *not use the position of director, or any information obtained while acting in the capacity of a director - to gain advantage for the director, or for another person other than the company or a wholly owned subsidiary of the company; or to knowingly cause harm to the company or a subsidiary of the company;*

(b) *communicate to the board at the earliest practicable opportunity any information that comes to the director’s attention, unless the director reasonably believes that the information is either immaterial to the company or generally available to the public or known to the other directors; or is bound not to disclose that information by a legal or ethical obligation of confidentiality; and*

See further section 75 of the Companies Act on a director’s duty to disclose personal financial interest and the IoDSA Corporate Governance Network’s [Position Paper 5 on Conflict of Interest](#)
(c) subject to subsections (4) and (5), a director (when acting in that capacity) must exercise the powers and perform the functions of director:

i. in good faith and for a proper purpose;

ii. in the best interests of the company; and

iii. with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director; and having the general knowledge, skill and experience of that director.

Note: The King Report is often used by the courts as the benchmark against what is reasonably expected of a competent director. In addition, consider the IoDSA’s Director Competency Framework for the competencies required from a director.

See sections 69(8)(iii) and 71(3) of the Companies Act which refers to misconduct and includes instances in which a director who has neglected or been derelict in the performance of his/her functions as a director; dishonesty as well as offences involving fraud or misrepresentation.

In addition to the above there are a number of other director duties, liabilities or functions in terms of the Common Law, the Companies Act and under Principle 2.15 of King III (which states that the board and its directors should act in best interests of the company).

Refer to the IoDSA General Guidance Note on Director Duties for further detailed information.

A company can also have specific additional/higher standards expected of its directors, which may be driven by additional legislative/regulatory requirements (such as in the banking, insurance or public sectors etc.)

Some examples of director misconduct may include:

- Disclosing confidential information (including information relating to boardroom discussions) without authorisation.
- Acting or speaking on behalf of the company without appropriate authorisation.
- Failing to disclose conflict of interests and acting upon such conflict.
- Competing with the business of the company.
- Taking any action which would be a breach of a fiduciary duty.
- Violating a law.
- Failing to abide by the rules of the company and board policies (such as code of conduct and ethics).
- Engaging in disruptive or inappropriate behavior in the board room or in interactions with management and employees.
- Unduly interfering with the operations of the business.

Extracted and adapted from “The challenge of director misconduct” by Holly J Gregory, October 2013 on www.practicallaw.com
3. **Before reporting an allegation of director misconduct**

Allegations of director misconduct can have serious ramifications for the individual concerned. Not only can they be removed or prevented from acting as a director in future, but it also affects the individual’s reputation. Allegations of misconduct should therefore not be taken lightly and should be dealt with in an independent and confidential manner (until such time as an investigation and determination has been reached). It is thus important to ensure that you have all the correct facts as well as evidentiary support to corroborate an allegation, before one is made on a mere whim, perception or suspicion.

4. **Mechanisms and strategies available to deter director misconduct**

Ensure that the following (among other things) is in place to assist with identifying the standard of conduct required from directors and the complaints, investigation and disciplinary procedure to be followed for alleged director misconduct in the organisation:

- The **Board Charter** (which is a private document) and/or **MOI** (which is a publically available document) should clearly set out the roles and responsibilities of the board of directors, any additional grounds applicable for a person to be disqualified from acting as director as well as minimum qualifications required for a person to serve as a director;

- A **Directors Code of Conduct** should be in place setting out the ethical values, the conduct and behaviour expected of all the directors (i.e. both executive and non-executive directors) serving on the board and how any breach of such code (i.e. director misconduct) will be dealt with by the Board. This document could be publically available so that stakeholders can hold directors accountable against such Directors Code of Conduct. It is thus recommended that the Directors Code of Conduct be a separate document to that of the Board Charter;

- **Executive director employment contracts and non-executive director agreements/letters of appointment** should place an obligation on the director to comply with the Directors Code of Conduct and/or any other company policies with regards to standard of conduct and should include investigative/disciplinary procedures to deal with a breach of such standard etc. In addition it can also set out any specific rules applicable to directors in respect of misconduct procedures such as for example with regards to suspension;

**Note:** Executive directors will be covered by the company’s internal code of conduct and policies and procedures for complaints as they are employees of the company and bound by such employee contracts. Non-executive directors on the other hand will not be subject to these internal policies and procedures unless specified as such, and thus it is important to ensure that NED agreements include compliance with the Directors Code of Conduct and/or those internal company policies that cover how to deal with director misconduct and the complaints and disciplinary process (if not in the Directors Code of Conduct). Non-
directors and/or alternate directors serving as members on committees of the board should be aware of section 76 of the Companies Act which places the same standards of conduct and liability on such individuals as if they were directors.

- Specific company policies and procedures to deal with allegations of director misconduct (such as the process for lodging complaints/allegations, how to handle complaints, as well as the investigative and disciplinary hearing (if applicable) process).

For guidance on how to draft an appropriate disciplinary procedure consider The Disciplinary Procedure for Misconduct published by Labour Guide, which is accessible via [http://www.labourguide.co.za/discipline-dismissal/765-workplace-discipline-and-dismissal](http://www.labourguide.co.za/discipline-dismissal/765-workplace-discipline-and-dismissal). Whilst this procedure is intended for internal purposes (i.e. employees) it can still be used as useful guidance with drafting the disciplinary procedure for directors.

- A fraud hotline should be established (if necessary or applicable) for the lodgement of complaints;

- Appropriate whistle blowing policies or procedures should be created (where applicable and necessary) to protect employees in accordance with section 159 of the Companies Act; and

- Adequate training (and induction programmes) should be provided to directors (especially if new on the board) on their roles, responsibilities and duties etc. so as to raise awareness of the conduct/behaviour expected.

Performance evaluations of the board/governing body and individual directors can also assist with identifying areas that require attention/training and thus can potentially prevent future misconduct.

Refer to the IoDSA King III Practice Note: Individual director evaluation questionnaire and Governance Matters Q1 2015 on Board Evaluations for further information and examples.

Essentially the board should ensure pro-active engagement with directors to ensure that they are aware of the standards expected of them, what would be considered misconduct as well as the consequences of misconduct.

5. **Addressing possible director misconduct**

Once director misconduct is suspected the following options are available:

**Option 1: Follow board/company policies and procedures**
Check whether there are board/governing body and/or internal company policies or procedures in place which cover the process for laying a complaint (i.e. allegation of misconduct) against a director of the company. If there are such policies, the process as outline in the policy should be followed. This would apply to both internal and external complainants.
In the event no such policies or procedures exist:

- Complaints/allegations of misconduct (together with all supporting evidentiary documentation) should be raised with the chairman of the board, company secretary of the company or other company representative as per any relevant board/company policies.

- If the chairman’s behaviour is in question, the lead independent director (LID) or either the Deputy chairman or the Social and Ethics or Audit committee chairman (if no LID exits) should be contacted in respect of the allegation.

- In all instances look to the Companies Act and/or other specific legislation (such as the PFMA or MFMA) governing the organisation for possible recourse (if any).

The chairman and company secretary of the board, upon receipt of an allegation of director misconduct should conduct an investigation. The director concerned should be informed of the allegation and the investigation to be undertaken in order to prepare a response.

For more information on the role of the chairman refer to paragraph 40 under Principle 2.16 of King III.

For more information on the role of the audit committee in respect to fraud oversight, see the Audit Committee Forum Position Paper 10: Guidelines for the audit committee’s assessment and response to the risk of fraud.

It is recommended that directors should not be suspended unnecessarily, unless the alleged misconduct is a serious offence which warrants suspension or if it is believed that the individual would interfere with the investigation of the alleged misconduct. In addition, reputational risk needs to also be considered carefully by the Board around suspension or not doing same. However note that in terms of section 69(4) of the Companies Act, in the event that the board has made a determination/decision that a director is disqualified or ineligible to act as director (due to misconduct) and such director has taken the board’s determination to court for review, then during this time the director shall be suspended from office. Since the matter in essence has not closed during such time, the vacancy on the board does not become available until the court has made a judgement on the application for review.

**Note:** All allegations of misconduct should be properly investigated by the board/governing body of the organisation before any decision is made in respect of the director accused of misconduct. Failure by the board to properly address an incident of director misconduct can have significant consequences/impact on the board and the company, such as for example creating the perception that such inappropriate behaviour is acceptable and therefore can continue; and breaking the trust between board members.

If uncertainty exists or if the other board members are not all in agreement, it may be worth considering taking legal advice from a corporate lawyer/legal advisor.

For more information on the role of the chairman refer to paragraph 40 under Principle 2.16 of King III.

For more information on the role of the audit committee in respect to fraud oversight, see the Audit Committee Forum Position Paper 10: Guidelines for the audit committee’s assessment and response to the risk of fraud.
**Option 2: Lay complaints with the professional body which has authority over the director**

If the director is a member of a professional body, and the misconduct in question amounts to a breach of the professional body’s code of conduct for members, then a complaint of misconduct can also be lodged with that professional body. This will however not remove the director from the board of the company upon which he/she sits, but may only remove the director as a member of such professional body, depending on that professional body’s code of conduct for members and validity of the allegation.

For example:

- IoDSA - Complaints against IoDSA members, who have breached the IoDSA Member Code of Conduct, can be raised via the IoDSA Member Complaints Policy.
- SAICA - The disciplinary and complaints process against persons who are subject to SAICA’s professional authority can be found on the SAICA website via the following link.
- SAIPA – Complaints against a SAIPA member should follow the specified complaints process as outlined on the SAIPA website via the following link.
- CSSA - The CSSA’s disciplinary process against its members can be found in the Member Handbook via the following link.

**Option 3: Take legal action to remove the director by court application in terms of the Companies Act**

If the director's misconduct falls within the circumstances provided under section 162(5), (7) and (8) and thus warrants legal action in order to remove the director from the board in the best interests of the company – “A company, a shareholder, director, company secretary or prescribed office of a company, a registered trade union that represents employees of the company or another representative of the employees of a company”, “the Companies and Intellectual Property Commission or Takeover Regulation Panel”, and “any organ of state responsible for the administration of any legislation” may apply to court for an order declaring a director of that company delinquent or under probation (in terms of section 162 of the Companies Act). It should be noted that section 162 further provides a window period of 24 months to bring an application to declare an individual as delinquent or on probation based on their actions whilst they were a director from the date such individual ceases to be a director of that company. This provides relief to hold individuals accountable and/or to prevent them from acting as a director for other companies in the future.

In terms of section 162(5)(iv) a court must make an order declaring a person to be a delinquent director if the person while a director acted in a manner that amounted to gross negligence, wilful misconduct or breach of trust in relation to the performance of the director’s functions within, and duties to, the company.
If the director is found to be delinquent or placed in probation it will result in the director being automatically removed from the board due to being disqualified from acting as a director in terms of section 69 of the Companies Act (see further section 66(5) and (6) for more detail).

6. **Actions or consequences of director misconduct**

Apart from the legal ramifications if the matter is taken to court, other consequences of director misconduct will depend on the specific organisations policies and the ultimate decision of the board. Depending on the severity of the misconduct and whether or not the misconduct was intentional, the misconduct could be addressed through the following ways:

1. Provide a formal written warning (if misconduct was not intentional nor severe) together with applicable training/coaching to address the misconduct.
2. Remove the director immediately from office (in accordance with necessary legal requirements) or ask him/her to step down if considered necessary.

   In terms of Section 71 of the Companies Act the shareholder (by way of ordinary resolution) and/or the board (by way of resolution) has recourse to remove a director who has been found to be negligent or not performing in terms of his/her duties or functions. In addition, look at the companies MOI for further authority that may be provided to the board with regards to removal of directors under certain circumstances.

3. If the director cannot be or is not removed immediately, the nominations committee could decide to not nominate the director for re-election when his/her term expires.