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**Purpose**

The purpose of this practice note is to provide clarification on the change of approach from King III™ to King IV™ as it relates to the definition of an independent director/member of a governing body.

It should be pointed out that the term “independence” and being an “independent” member should be understood in two different contexts.

First, all members are required to be independent in the sense that they should act independently in the exercise of their judgment and the fulfillment of their duties, and should not have their discretion fettered in any way. This requires an honest application of the mind by all members on matters presented to the governing body and they should then make decisions in the best interest of the organisation. Members nominated by a shareholder or any other party to a governing body therefore need to ensure that they act in the best interest of the organisation and not in the interests of the shareholder, or any other party, that nominated them when acting in their capacity as a member of that governing body.

Second, the notion of an independent member is a structural or institutional issue that considers the relationship of that member to other parties or his or her relationship to other parties in assessing his/her independence.

This practice note deals with the second notion of independence - namely what we are calling structural or institutional independence.

The definition of independence in King IV covers both aspects of independence as follows:

*Independence generally means the exercise of objective, unfettered judgement. When used as the measure by which to judge the appearance of independence, or to categorise a non-executive member of the governing body or its committees as independent, it means the absence of an interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making. (See also “conflict of interest”).*

**Comparison between King III and King IV Principles and Practice Recommendations**

**King III**

King III sets out criteria which the governing body could use to assess whether a director should be regarded as an independent non-executive director. This was done in emphatic terms in the sense that King III provided that an independent non-executive director is a director who:

67. **An independent non-executive director is a non-executive director who:**

   67.1 is not a representative of a shareholder who has the ability to control or significantly influence management or the board;

   67.2 does not have a direct or indirect interest in the company (including any parent or subsidiary in a consolidated group with the company) which exceeds 5% of the group’s total number of shares in issue.
67.3 does not have a direct or indirect interest in the company which is less than 5% of the group’s total number of shares in issue, but is material to his personal wealth;

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

67.5 is not a member of the immediate family of an individual who is, or has during the preceding three financial years, been employed by the company or the group in an executive capacity;

67.6 is not a professional adviser to the company or the group, other than as a director;

67.7 is free from any business or other relationship (contractual or statutory) which could be seen by an objective outsider to interfere materially with the individual’s capacity to act in an independent manner, such as being a director of a material customer of or supplier to the company; or

67.8 does not receive remuneration contingent upon the performance of the company.

If the criteria were not met, then the director would not be regarded as an independent non-executive director. The purpose of this recommendation was to ensure there was an independent governing body with an appropriate balance of power.

King IV

The definition set out in King III was reviewed in the context of King IV. In keeping with the King IV emphasis on outcomes and principles, it was felt that the emphasis should be on the establishment of a balanced and competent governing body as is set out in Principle 7 (set out below). In addition, King IV also took a more universal approach to cover all types of governing bodies (and not just boards) and thus the change in terminology such as from director to member is used so to highlight the importance and relevance of this concept of independence to not only boards but all governing bodies.

Principle 7: The governing body should comprise the appropriate balance of knowledge, skills, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively.

It was recognised that the key objective of a balanced governing body was to ensure that the governing body could discharge its governance role objectively and effectively. Therefore, the intention is to achieve a well-balanced governing body that is effective. The desired outcome of Principle 7 would not be achieved, if a governing body concentrated solely on the practice of ensuring that the requisite majority of independent non-executive directors are appointed. What is required is for the governing body to apply its mind to all of the relevant considerations (and the balance of executive, non-executive and independent non-executive members is only one such consideration) in achieving an effective board as set out in Principle 7 above. The notion of an independent member therefore needed to be balanced with other needs for an effective governing body, for example, industry knowledge, skills and experience.

It was also felt that a list of determinative criteria was not always useful. There are various complexities and trade-offs to consider and the governing body should therefore be allowed flexibility in determining whether a member is to be regarded as an independent member or not – with the ultimate test being whether the governing body is objective and effective.

The approach in King IV therefore allows the governing body to apply its judgement based on the guidelines provided and the relevant facts in coming to a decision regarding the independence of a
It is hoped that this approach will avoid a tick box approach to determining whether a member is independent and ensure that the governing body applies its judgement to this important issue.

King IV continues to provide guidance on assessing a member's independence under Practice Recommendation 28, but it is imperative to note that this does not constitute a definitive list:

Independence and conflicts

28. The governing body should consider the following and other indicators holistically, and on a substance-over form basis, when assessing the independence of a member of the governing body for purposes of categorisation. The member of the governing body:
   a. is a significant provider of financial capital, or ongoing funding to the organisation; or is an officer, employee or a representative of such provider of financial capital or funding;
   b. if the organisation is a company, participates in a share-based incentive scheme offered by the company;
   c. if the organisation is a company, owns securities in the company, the value of which is material to the personal wealth of the director;
   d. has been in the employ of the organisation as an executive manager during the preceding three financial years, or is a related party to such executive manager;
   e. has been the designated external auditor responsible for performing the statutory audit for the organisation, or a key member of the audit team of the external audit firm, during the preceding three financial years;
   f. is a significant or ongoing professional adviser to the organisation, other than as a member of the governing body;
   g. is a member of the governing body or the executive management of a significant customer of, or supplier to, the organisation;
   h. is a member of the governing body or the executive management of another organisation which is a related party to the organisation; or
   i. is entitled to remuneration contingent on the performance of the organisation.

King IV, similarly as in King III, recommends that the independence of a member who have served for longer than 9 nine years should be assessed yearly (after the nine year period) in order to ensure they are still independent.

In terms of Practice Recommendation 30 the following should be specifically disclosed with regards to the independence of the governing body members:

- whether the governing body is satisfied that its composition reflects the appropriate mix of knowledge, skills, experience, diversity and independence; and
- the categorisation of each non-executive member as independent or not and, when a non-executive member of the governing body has been serving for longer than nine years, a summary of the views of the governing body on the independence of the member.
Conclusion

Having members of the governing body who are independent in appearance is an essential element in most governance codes. King IV seeks to contextualise the relevance of independence correctly, namely that:

- all members of the governing body, whether they are categorised as executive, non-executive or independent non-executive have, as a matter of law, a duty to act with independence of mind in the best interests of the organisation; and
- although important, structural independence is but one consideration in achieving balance in the composition of the governing body.

The overriding concern (as reflected by Principle 7) is whether the governing body is knowledgeable, skilled, experienced, diverse and independent enough to discharge fully its governance role and responsibilities.

Independence is thus not the only factor/quality required on the governing body in order for it to be effective and efficient. Organisations therefore need to look at independence of the governing body from a holistic perspective taking into consideration, amongst others, the total skills, experience and diversity required of the governing body to make it optimal.

There are in addition other factors that may be taken into account when considering whether or not a member is independent. In line with the objective of moving away from a tick box approach King IV does not provide prescriptive guidelines on determining independence, as this determination is a subjective test that needs to be applied by the governing body as a collective based on the prevailing circumstances, the independence of the member in question, conflicts of interest whether perceived or actual and other relevant considerations.