# PRACTICE NOTES

**30/11/2020**

## The Social and Ethics Committee

# 1. Purpose

The Companies Act, 2008[1] and Companies Regulations, 2011 introduced statutory Social and Ethics Committees (SEC) for State-owned Companies, Listed Companies, and Companies with a public interest score of higher than 500 points in any two of the preceding five years. The requirement of statutory Social and Ethics Committees became effective on 1 May 2012. The King IV Report on Corporate Governance for South Africa, 2016 made recommendations regarding the mandate and composition of the Social and Ethics Committee.

The purpose of this practice note is threefold:

a) To provide guidance on how the statutory mandate and composition of the Social and Ethics Committee can be reconciled with the King IV Principles and recommendations;

b) To provide guidance on how the role and responsibilities of the Social and Ethics Committee should be interpreted within the context of the King IV Code on Corporate Governance as a whole; and

c) To enhance the governance of the social and ethics performance of organisations.

# 2. Reconciling the statutory requirement of the SEC with King IV recommendations

## 2.1 Mandate of the SEC

The statutory mandate of the SEC gives the committee two main responsibilities, viz., a monitoring responsibility and a reporting responsibility. Specific matters within five prescribed areas must (a) be monitored against "any relevant legislation, other legal requirements or prevailing codes of best practice" (Companies Regulation 43(5)) and then (b) reported to the board of directors, and to shareholders at the Annual General Meeting of the company. This mandate is captured in Diagram 1 below:

**Social and Ethics Committee Statutory Mandate**

| Responsibilities | Focus areas | Outcomes |
|---|---|---|
| **<u>Monitor</u>** against:<br>• Legal standards<br>• Codes of Best | **Social and economic development** | |
| | **Good corporate citizenship** | |
| | **Environment, health and safety** | **Compliance** |
| **<u>Report</u>** to:<br>• Board of Directors<br>• Shareholders at AGM | **Consumer relations** | |
| | **Labour and employment** | |

*Diagram 1*

---

[1] Companies Act 71 of 2008

The King IV Report recommends that governing bodies should govern both the ethics (organisational ethics) and the social performance (responsible corporate citizenship) of organisations. This recommendation applies to all organisations, and not only to those companies that are mandated to do so by the Companies Act and Regulations. Governing any aspect of an organisation involves the responsibilities of setting strategy, approving policies, exercising oversight, and reporting and disclosing. The exercise of these governing responsibilities should result in four outcomes, viz., ethical culture, good performance, effective control, and legitimacy. The social and ethics aspects that should be governed are categorised into four categories, viz., economy, workplace, society, and environment. This mandate is captured in Diagram 2 below:

| Social and Ethics Governance in King IV | | |
|---|---|---|
| **Responsibilities** | **Focus areas** | **Outcomes** |
| Setting Strategy | Economy | Ethical Culture |
| Approving Policy | Workplace | Good Performance |
| Exercising Oversight | Society | Effective Control |
| Reporting and Disclosure | Environment | Legitimacy |

*Diagram 2*

## 2.2 Focus areas and matters within SEC mandate

The four focus areas outlined in King IV (Diagram 2) cover all five of the focus areas in the statutory mandate of the SEC (Diagram 1), but also add other matters that should be governed. A combination of the matters that should be governed according to the statutory requirement as well as the King IV recommendations are displayed in Diagram 3 below, where the additional matters that King IV recommends should be added over and above the statutory mandate of the SEC are indicated in *green italics* with an asterisk (*).

## Statutory and King IV Social and Ethics Areas

| Economy | Workplace |
| --- | --- |
| Economic development<br>*Fraud** and corruption<br>Broad-based Black economic empowerment<br>*Responsible and transparent tax practices** | Employment equity<br>Decent work<br>Employee safety and heath<br>Employee relations<br>Education of employees<br>*Fair remuneration**<br>*Organisational ethics** |
| **Environment** | **Society** |
| Environmental impact<br>*Pollution**<br>*Waste disposal**<br>*Biodiversity** | Community development<br>Donations and sponsorships<br>Public health and safety<br>Advertising<br>Consumer protection<br>Consumer relations<br>Human rights<br>*Stakeholder relations** |

**King IV additions to statutory mandate of SEC*

*Diagram 3*

Although climate change is not explicitly mentioned in the 'Environment' focus area in Diagram 3, it is a matter of material concern that should be considered as implied in the responsibilities of the committee.

## 2.3. SEC membership

King IV addresses the composition of the Social and Ethics Committee under Principle 8. The statutory requirement for the membership of the SEC states that:

*"A company's social and ethics committee must comprise not less than three directors or prescribed officers 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." (Companies Regulation 43(4))*

Since the above formulation allows for the possibility that a SEC can comprise of a majority of executive directors or prescribed officers, which is not conducive to independent oversight of management, King IV recommends that:

> *King IV, Principle 8, paragraph 70:*
>
> *"The social and ethics committee should, subject to legal provision, have executive and non-executive members, with a majority being non-executive members of the governing body."*

## 2.4. Responsible governance structure

The Companies Act and Regulations assigns the responsibility for the governance of social and ethics matters to the SEC. King IV recommends that all organisations (and not only companies mandated to establish a SEC) should govern their social and ethics performance. However, King IV follows a flexible approach and recommends that in case of organisations that are not mandated by the Companies and Act and Regulations to establish a SEC, the governance of the social and ethics performance can be performed by the governing body, or can be assigned to:

> *King IV, Principle 8, paragraph 68:*
>
> *"a dedicated committee or adding it to the responsibilities of another committee as is appropriate for the organisation."*

## 3. Relevant King IV Principles

All principles in the King IV Code on Corporate Governance are relevant for the SEC, but there are certain principles that have particular significance for executing the mandate of the SEC. These specific principles are listed below with a short explanatory note on how each of these principles relates to the role of the SEC.

> Principle 2: The governing body should govern the ethics of the organisation in a way that supports the establishment of an ethical culture.

**Explanatory note:** Responsible organisational conduct should be anchored in an ethical culture. This principle thus informs the way in which the organisational ethics mandate (as proposed under Principle 8) should be executed. The recommended practices below this principle set out the structural and procedural arrangements through which this can be achieved.

> Principle 3: The governing body should ensure that the organisation is and is seen to be a responsible corporate citizen.

**Explanatory note:** Whereas Principle 2 outlines the organisational ethics mandate of the SEC, this principle outlines the social mandate of the SEC that flows from an ethical organisational culture. It also identifies additional responsibilities beyond the statutory responsibilities that the SEC should govern (see 2.2 above). Furthermore, Principle 3 categorises the social responsibilities of the SEC mandate in four distinct areas, namely (a) workplace, (b) economy, (c) society, and (d) environment. These categories are helpful in structuring the disparate responsibilities listed in the regulatory mandate so that SECs can meaningfully incorporate these in their workplans.

> Principle 4: The governing body should appreciate that the organisation's core purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process

**Explanatory note:** The priorities and workplan of the SEC should be aligned to the purpose and strategy of the organisation. The SEC should ensure that it contributes to the development of a sustainable organisational strategy, but it should also monitor the impact of the execution of organisational strategy on the economic, social and environmental context within which the organisation operates.

> Principle 5: The governing body should ensure that reports issued by the organisation enable stakeholders to make informed assessments of the organisation's performance, and its short, medium and long-term prospects.

**Explanatory note:** The SEC has an important role to play in providing information on the social and ethics performance of the organisation to the governing body for inclusion in organisational reports to stakeholders, such as integrated or sustainability reports. The committee also has a crucial role in ensuring the integrity of such information. Specific guidance on what should be reported on the social and ethics performance of organisations can be found in the practice guidance under Principles 2, 3 and 8 of the King IV Code on Corporate Governance.

Principle 8: The governing body should ensure that its arrangements for delegation within its own structures promote independent judgement, and assist with balance of power and the effective discharge of its duties.

**Explanatory note:** The SEC should be composed in a manner that ensures a balance of power in favour of non-executive members of the governing body, as well as independence in the governance of social and ethics performance (see 2.3 above). Paragraphs 68 to 70 under Principle 8 deal specifically with the SEC and recommends that (a) in organisations that are not required to have a statutory SEC, the responsibility for the governance of social and ethics performance can be delegated to a dedicated committee, an existing committee, or can be retained by the governing body, and (b) organisational ethics, responsible corporate citizenship, sustainable development, and stakeholder relationships be included in the responsibilities of the SEC (see principle 3 above).

Principle 11: The governing body should govern risk in a way that supports the organisation in setting and achieving its strategic objectives.

**Explanatory note:** In its oversight role the SEC should identify social and ethics risks and opportunities that might be material to the organisation achieving its purpose and strategic objectives. Reporting to the SEC must therefore be risk-based so that the committee is able to spend its time wisely on those ethics and social risks that are material to the organisation. Such risks and opportunities should be brought to the attention of the governance structure(s) responsible for the governance of risk in the organisation (e.g. Risk Committee).

Principle 13: The governing body should govern compliance with applicable laws and adopted, non-binding rules, codes and standards in a way that supports the organisation being ethical and a good corporate citizen.

**Explanatory note:** Compliance with social and ethics related legal prescripts, as well as leading practice standards should be overseen by the SEC. The SEC should ensure that the organisation's compliance with such laws and standards is being done in a manner that contributes to the ethical culture of the organisation as well as to its responsible corporate citizenship.

Principle 15: The governing body should ensure that assurance services and functions enable an effective control environment, and that these support the integrity of information for internal decision-making and of the organisation's external reports.

**Explanatory note:** The SEC can be a significant contributor to combined assurance by overseeing the integrity of information regarding the social and ethics performance of the organisation reported to the committee. Furthermore, the SEC should also collaborate with the relevant governing structure(s) (e.g. Audit Committee) in assuring the integrity of the social and ethics aspects of external reports.

Principle 16: In the execution of its governance role and responsibilities, the governing body should adopt a stakeholder-inclusive approach that balances the needs, interests and expectations of material stakeholders in the best interests of the organisation over time.

**Explanatory note**: The SEC should ensure that the organisation uses a stakeholder-inclusive approach in assessing its social and ethics risks and opportunities. Furthermore, the SEC should ensure that material stakeholders are included in assessing both the positive and negative impacts of the organisation on the economy, workplace, society and environment.

**Acknowledgment**
This practice note was drafted in conjunction with The Ethics Institute, and with the assistance of the IoDSA Social and Ethics Committee Forum, the SEC subcommittee of the King Committee on Corporate Governance for South Africa and subject matter experts serving on the King Committee.