

# King's Counsel\*

Understanding and unlocking the benefits  
of sound corporate governance





2 September 2009

A code of principles can only ever be as good as one's ability to put it into practice. It is from this standpoint that PricewaterhouseCoopers is committed to engaging the recommendations of the *King Report on Governance for South Africa 2009* and practically supporting our clients in implementing and applying them.

This guide embodies our thought leadership on key elements of the Report at the time of publication and we envisage that it will be revised and updated as our thinking, knowledge and capabilities around corporate governance continue to advance.

We trust that it will assist in providing practical advice and guidance to our clients and all business stakeholders in South Africa.

A handwritten signature in black ink, appearing to read 'Suresh', with a horizontal line underneath.

Suresh Kana  
Chief Executive Officer  
PricewaterhouseCoopers Southern Africa



# Table of contents

Introduction	1
<b>Chapters of the Code</b>	
1. Ethical leadership and corporate citizenship	5
2. Boards and directors	9
3. Audit committees	19
4. The governance of risk	29
5. The governance of information technology	35
6. Compliance with laws, rules, codes and standards	43
7. Internal audit	49
8. Governing stakeholder relationships	55
9. Integrated reporting and disclosure	61
<b>Our view on specific issues raised in the Code</b>	
10. Business rescue	65
11. Alternative dispute resolution	69
12. Internal financial control	73
13. Solvency and liquidity tests	79
14. Remuneration of directors and senior executives	83

### A note on terminology

For the purposes of this guide:

- The third *King Report on Governance for South Africa 2009* is referred to as ‘the Report’.
- The provisions of the Report are based on principles enshrined in the *Code of Governance Principles for South Africa 2009*, referred to as ‘the Code’.
- The Report and the Code are collectively referred to as ‘King III’.
- The Companies Bill, 2008, (which constitutes a revision of the Companies Act, 1973) had not been enacted at the time of the release of King III. Nevertheless, it is referred to as ‘the Act’ both in King III and here.
- King III applies to all entities regardless of the manner and form of their incorporation or establishment. The use of the terms ‘organisation’, ‘company’ and ‘business’ should be interpreted accordingly.
- Although the terms ‘company’, ‘boards’ and ‘directors’ are used, King III refers to the functional responsibility of those charged with governance in any entity.

# Introduction

The release of King III on 1 September 2009 represents a significant milestone in the evolution of corporate governance in South Africa and brings with it significant opportunities for organisations that embrace its principles.

At PricewaterhouseCoopers (PwC), we believe that free enterprise prospers in an environment of good and balanced corporate governance. While we understand that achieving good governance is a complex task, we believe that sound governance practices offer numerous practical benefits and that organisations should integrate such practices into their operational processes.

## The need for King III

King III became necessary because of the anticipated new Companies Act and changing trends in international governance. As with King I and King II, the King Committee endeavoured to be at the forefront of governance internationally and this has again been achieved by focusing on the importance of reporting annually on how a company has both positively and negatively affected the economic life of the community in which it operated during the year under review. In addition, emphasis has been placed on the requirement to report on how the company intends to enhance those positive aspects and eradicate or ameliorate any possible negative impacts on the economic life of the community in which it will operate in the year ahead.

## The benefits of self-regulation

In addressing the link between governance principles and law, the introduction to the Report observes:

“The ultimate compliance officer is the company’s stakeholders who will let the board know by their continued support of the company if they accept the departure from a recommended practice and the reasons furnished for doing so.”

It can be convincingly argued that self-regulation, in which an organisation voluntarily monitors its own adherence to legal and ethical standards, is

far preferable to having an outside agency such as government monitor and enforce those standards. This approach allows organisations to maintain control over the standards to which they are held by successfully self-policing themselves. Apart from the bureaucratic burden that would be imposed by external enforcement, the cost of setting up such a mechanism is also avoided.

## Key principles of King III

King III has broadened the scope of corporate governance in South Africa with its core philosophy revolving around leadership, sustainability and corporate citizenship.

These key principles are given prominence:

- Good governance is essentially about effective leadership. Leaders need to define strategy, provide direction and establish the ethics and values that will influence and guide practices and behaviour with regard to sustainability performance.
- Sustainability is now the primary moral and economic imperative and it is one of the most important sources of both opportunities and risks for businesses. Nature, society, and business are interconnected in complex ways that need to be understood by decision makers. Incremental changes towards sustainability are not sufficient – we need a fundamental shift in the

way companies and directors act and organise themselves.

- Innovation, fairness, and collaboration are key aspects of any transition to sustainability – innovation provides new ways of doing things, including profitable responses to sustainability. Fairness is vital because social injustice is unsustainable and collaboration is often a prerequisite for large-scale change.
- Social transformation and redress is important and needs to be integrated within the broader transition to sustainability. Integrating sustainability and social transformation in a strategic and coherent manner will give rise to greater opportunities, efficiencies, and benefits, for both the company and society.
- King II required companies to implement sustainability reporting as a core aspect of corporate governance. Since 2002, sustainability reporting has become a widely accepted practice and South Africa is an emerging market leader in the field. However, sustainability reporting is in need of renewal in order to respond to:
  - The lingering trust deficit among civil society of the intentions and practices of big business
  - Concerns among business decision makers that sustainability reporting is not fulfilling their expectations in a cost-effective manner.

## Governance framework

King III has opted for an ‘apply or explain’ governance framework. Where the board believes it to be in the best interests of the company, it can adopt a practice different from that recommended in King III, but must explain it. Explaining the different practice adopted and an acceptable reason for it, results in consistency with King III principles.

The framework recommended by King III is principles-based and there is no ‘one size fits all’ solution. Entities are encouraged to tailor the principles of the Code as appropriate to the size, nature and complexity of their organisation. This is good news for companies in South Africa as it avoids some of the pitfalls seen in the United States where a ‘one size fits all’ approach was initially adopted.

## Application of the Code

In contrast to King I and King II, King III applies to all entities regardless of the manner and form of incorporation or establishment. Principles are drafted on the basis that, if they are adhered to, any entity would have practiced good governance.

It is recommended that all entities disclose which principles and/or practices they have decided not to apply or explain. This level of disclosure will allow stakeholders to comment on and challenge the

board to improve the level of governance within an organisation.

“The philosophy of the Report revolves around leadership, sustainability and corporate citizenship” Mervyn King

## New requirements

Some of the requirements introduced by King III include:

- The need for an annual integrated report that focuses on the impact of the organisation in the economic, environmental and social spheres
- A statement by the audit committee to the board and shareholders on the effectiveness of internal financial controls to be included in the integrated report
- The consideration of the strategic role of IT and its importance from a governance perspective
- The positioning of internal audit as a strategic function that conducts a risk-based internal audit and provides a written assessment of the company’s system of internal control, including internal financial controls

- The governance of risk through formal risk management processes.

## Our involvement in the King Committee

Suresh Kana, PwC’s Chief Executive Officer, and Anton van Wyk, our Global Internal Audit Leader, served as members of the King Committee and also chaired the Accounting and Auditing and Internal Audit subcommittees respectively. As a result of our involvement, PricewaterhouseCoopers has deep insight into the recommendations of the King Committee and is well placed to offer practical guidance and encourage debate around implementation to enable the real benefits of good governance to be realised.

Competitive advantage is increasingly being conferred on businesses that create and maintain a culture of integrity-driven performance. However, managing the shift to a higher level of principled business practice raises a number of new challenges. PricewaterhouseCoopers has made a considerable investment in compliance solutions on a global and local scale to help our clients meet these challenges. Our experience and know-how ensures that our investment can be practically applied for the benefit of our clients.



# 1. Ethical leadership and corporate citizenship

## Overview

“Responsible corporate citizenship implies an ethical relationship between the company and the society in which it operates.”

The notion of corporate citizenship is not new, but King III gives it more credence and concrete expression than ever before, while continually highlighting the unbroken chain that links ethical leadership, company strategy and sustainability.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 1. Ethical leadership and corporate citizenship</b>			
Leadership	1.2. The board should ensure that the company is and is seen to be a responsible corporate citizen	<p>The board should:</p> <p>1.2.1. consider not only financial performance but also the impact of the company’s operations on society and the environment</p> <p>1.2.2. protect, enhance and invest in the wellbeing of the economy, society and the environment</p> <p>1.2.3. ensure that the company’s performance and interaction with its stakeholders is guided by the Constitution and the Bill of Rights</p> <p>1.2.4. ensure that collaborative efforts with stakeholders are embarked upon to promote ethical conduct and good corporate citizenship</p> <p>1.2.5. ensure that measurable corporate citizenship programmes are implemented</p> <p>1.2.6. ensure that management develops corporate citizenship policies</p>	Similar to King II

## Implications

The leadership of an organisation, including its directors, boards and committees, will have to review the corporate values that drive their behaviour to ensure that they and the organisation reflect societal norms and accepted governance guidelines. To this end, leaders are expected to support and understand the full implications of the stakeholder inclusive model put forward in the previous King reports and again emphasised in King III.

Leaders will also have to give due consideration to the full range of material economic, social and environmental dimensions and impacts that the company and its processes have on the community in which it operates, when developing corporate strategy.

## Expert opinion

Entities cannot operate in a vacuum. A licence to operate afforded by a multitude of stakeholders is based on trust, integrity and a solid track record of taking into account a balanced approach to legitimate stakeholder issues.

Corporate citizenship is an ethical concept, which finds expression in sustainable development across the economic, social and environmental aspects of the business.

## Key questions directors should be asking

1. Corporate citizenship, sustainability and stakeholder inclusivity requires judgement, balance and compromise. Does the board have the right composition, skills and reliable data to make these types of judgement calls?
2. Have we assessed the moral and economic imperatives of corporate citizenship? Have we taken this into account when reviewing our corporate strategy?
3. Citizenship and sustainability risks may be obscure or indirect. How do we identify and manage these risks as well as opportunities?
4. Do we have policies in place that will guide every level of the business in terms of expected behaviours and practices and with reference to our interaction with all material stakeholders?
5. Do we measure the impact or lack thereof, of our corporate citizenship initiatives?

## How we can help you

Successful businesses are sustainable businesses. As a cornerstone of sustainability, sound ethics and leadership are increasingly proving their worth as drivers of competitive advantage. We offer a range of services to assist organisations to achieve their corporate objectives:

- Review of corporate values
- Development of values, business principles and key performance indicators
- Sustainable development strategy formulation
- Development of codes and policies in support of ethics, corporate citizenship and sustainability
- Board evaluation to assess composition, skills and other key criteria
- Socioeconomic impact assessments.

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# 2. Boards and directors

## Overview

Boards and directors, acting in the best interests of the company, form the focal point of corporate governance with responsibilities extending to shareholders and other stakeholders: “Companies should be headed by a board that should direct, govern and be in effective control of the company”.

The chapter discusses key governance responsibilities that directors are expected to consider, including:

- The role and function of the board and its committees
- The composition and performance evaluation of the board and its committees
- The board appointment process
- Director development
- Remuneration of directors, senior executives, group boards and company secretaries.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
Role and function of the board	2.1. The board should act as the focal point for and custodian of corporate governance	The board is responsible for ensuring the continued success of the company and is guided by its charter. It is the link between management and stakeholders and should meet at least four times per year.	Similar to King II
	2.2. The board should appreciate that strategy, risk, performance and sustainability are inseparable	The board should inform and approve the company's strategy and satisfy itself that business plans are not encumbered by unexamined risks. In doing so it identifies key performance and risk areas. The board also ensures that the strategy will result in sustainable outcomes and considers sustainability to be a business opportunity.	Greater emphasis on opportunity as opposed to only risk.
	2.3. The board should provide effective leadership based on an ethical foundation	Explained in chapter 1	Refer to chapter 1
	2.4. The board should ensure that the company is and is seen to be a responsible corporate citizen	Explained in chapter 1	Refer to chapter 1
	2.5. The board should ensure that the company's ethics are managed effectively	Explained in chapter 1	Refer to chapter 1

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	2.6. The board should ensure that the company has an effective and independent audit committee	Explained in chapter 3	Refer to chapter 3
	2.7. The board should be responsible for the governance of risk	Explained in chapter 4	Refer to chapter 4
	2.8. The board should be responsible for information technology (IT) governance	Explained in chapter 5	Refer to chapter 5
	2.9. The board should ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes and standards	Explained in chapter 6	Refer to chapter 6
	2.10. The board should ensure that there is an effective risk-based internal audit	Explained in chapter 7	Refer to chapter 7
	2.11. The board should appreciate that stakeholders' perceptions affect the company's reputation	Explained in chapter 8	Refer to chapter 8
	2.12. The board should ensure the integrity of the company's integrated report	Explained in chapter 9	Refer to chapter 9
	2.13. The board should report on the effectiveness of the company's system of internal controls	Explained in section on internal financial controls	Refer to section on internal financial controls

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	2.14. The board and its directors should act in the best interests of the company	Directors act in the best interests of the company by, amongst other actions, disclosing conflicts where they exist, dealing in securities only as allowed by internal policies and by adhering to legal standards of conduct. Where required, they should be permitted to take independent advice.	Similar to King II
	2.15. The board should consider business rescue proceedings or other turnaround mechanisms as soon as the company is financially distressed as defined in the Act	Explained in chapter 10	Refer to chapter 10
	2.16. The board should elect a chairman of the board who is an independent non-executive director. The CEO of the company should not also fulfil the role of chairman of the board	Where the guidelines in the principle are not applied, a lead independent director should be appointed and disclosure provided in the integrated report. The role of the chairman should be formalised and assessed annually and a succession plan put in place. The chairman should consider the number of chairmanships held.	King II did not contain a requirement that the CEO should not become the chairman until three years has elapsed.  Lead independent director concept already introduced in King II and refined in King III.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	2.17. The board should appoint the chief executive officer and establish a framework for the delegation of authority	The board ensures that the role of the CEO is formalised and his performance evaluated against specified criteria. It also makes recommendations regarding senior management appointments and its own assessment of materiality for the company.	Similar to King II
	2.18. The board should comprise a balance of power, with a majority of non-executive directors. The majority of non-executive directors should be independent	The majority of non-executive directors should be independent, with independence assessed annually. As a minimum, the CEO and director responsible for finance should be appointed to the board. The section also deals with the re-appointment, rotation and removal of directors.	King II did not contain a requirement that the CEO and directors responsible for finance be appointed to the board.
	2.19. Directors should be appointed through a formal process	The director appointment process should be transparent and include background and reference checks. It is the responsibility of the nomination committee to identify suitable members.	King II required the board to comprise a balance of executive and non-executive directors, preferably with a majority of non-executive directors of which sufficient should be independent of management.  King II did not suggest that the memorandum of incorporation of the company should allow the board to remove any director from the board, including executives, without shareholder approval.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	2.20. The induction of and ongoing training and development of directors should be conducted through formal processes	New and inexperienced directors should be suitably trained through formal induction and mentorship programmes. Directors should be kept up to date through regular briefings and continuing professional development programmes.	Similar to King II
	2.21. The board should be assisted by a competent, suitably qualified and experienced company secretary	The board appoints and removes the company secretary. The requirements of the Companies Act in relation to the company secretary apply to listed and state-owned companies. King III further elaborates on the duties of the company secretary.	King II did not contain the same level of detail regarding the responsibility of the company secretary.
	2.22. The evaluation of the board, its committees and the individual directors should be performed every year	Annual evaluations of the board, its committees and directors (including evaluations of the chairman, CEO and other executive directors) should be performed by the chairman or an independent service provider. The overview of the process should be disclosed in the integrated report. The performance evaluation of directors assists in identifying their training needs and should be a requisite before reappointment.	King III requires the board to consider whether the evaluation of performance should be done by the chairman or independently by professional service providers.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	2.23. The board should delegate certain functions to well-structured committees but without abdicating its own responsibilities	Committees should be appropriately constituted and should formulate terms of references that are reviewed annually. The need for audit, risk, nomination and remuneration committees is also discussed. Committees (with the exception of the risk committee) should comprise a majority of non-executive directors of which the majority should be independent.	King II required that, at a minimum, companies have an audit and remuneration committee.
	2.24. A governance framework should be agreed between the group and its subsidiary boards	Governance matters related to listed subsidiaries, the nomination of directors to the boards of subsidiaries and the disclosures coupled thereto required in the integrated report, are discussed.	King II did not address interaction with subsidiaries.
	2.25. Companies should remunerate directors and executives fairly and responsibly	Refer to section on remuneration	Refer to section on remuneration
	2.26. Companies should disclose the remuneration of each individual director and certain senior executives	Refer to the section on remuneration	Refer to section on remuneration
	2.27. Shareholders should approve the company's remuneration policy	Refer to the section on remuneration	Refer to section on remuneration

## Implications

The board and its committees must have clear terms of reference in place. These need to be reviewed annually to ensure that there are no gaps or overlaps.

The composition of the board and its committees will need to be reassessed to cover both financial and sustainability roles and responsibilities.

Performance evaluations of executive and non-executive directors are key, not only to assess efficiency and competence, but also to appraise reappointment and training needs.

A formal process for the appointment of directors must be in place and this should be disclosed in the integrated report.

Obtaining sufficiently skilled directors who are non-executive and independent as suggested by King III will require careful recruitment.

## Expert opinion

The role of the board as the focal point of governance is vital to the success of any organisation. As a result, the board must have the appropriate balance of skills and experience within its ranks to fulfil its mandate. The composition and performance of the board and its committees are key factors that will determine the success of the organisation.

In order to maximise the benefit that the company obtains from the board, regular performance evaluations need to be conducted and areas of improvement identified. This is essential not only to improve the efficiency and effectiveness of the board, but also to develop individual directors to enable them to better add value.

The principle that governance, strategy and sustainability are inseparable is one of the fundamental tenets of King III. The interplay between these elements and the manner in which the company incorporates them into its processes will be keenly watched.

## Key questions directors should be asking

1. Do we have the right people in place to lead and manage all aspects of our business?
2. Is the board sufficiently independent of management?
3. Do we need to get external expert advice?
4. Will we get greater value from board and committee evaluations if we employ an independent service provider?
5. Are we comfortable that we have satisfied our overarching responsibilities adequately where we have delegated functions to subcommittees?
6. Are we spending our time efficiently in meetings and dealing only with material issues?
7. Is there a need to revise our board and committee charters?
8. In which committee should we deal with sustainability issues?
9. Are the current roles and structures of our subsidiary boards adding value?
10. How do we incorporate strategy, risk, performance and sustainability into our decision making philosophy?

## How we can help you

The Sustainable Business Solutions group within PwC offers a range of integrated solutions to assist boards and directors to meet the demands and expectations of their stakeholders. Tailored and relevant to your needs, these embrace:

- Independent, comprehensive board and committee evaluations
- Thorough independent individual evaluations of office bearers including directors, CEOs, CFOs, chairmen and company secretaries
- Review and development of board and committee documentation
- Review and development of board and committee systems and processes
- Governance and director training.

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# 3. Audit committees

## Overview

“An independent audit committee fulfils a vital role in corporate governance. The audit committee is vital to, among other things, ensure the integrity of integrated reporting and internal financial controls and identify and manage financial risks.”

In order to carry out their mandate to the full extent, audit committees should be suitably skilled and qualified to deal with their responsibilities of overseeing integrated reporting and co-ordinating the activities of the various assurance providers.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
	<p>3.1. The board should ensure that the company has an effective and independent audit committee</p>	<p>While listed and state-owned companies are required by law to establish audit committees, all other companies should also establish this committee and define its composition, purpose and duties in the memorandum of incorporation. The terms of reference of the committee should be approved by the board.</p> <p>The audit committee should meet as often as is necessary, but at least twice a year, and meet with internal and external auditors at least once a year without management being present.</p>	<p>King II required ‘affected’ companies to establish audit committees.</p> <p>King II did not address the frequency of meetings nor discussions with internal audit without management being present.</p>

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
	3.2. Audit committee members should be suitably skilled and experienced independent non-executive directors	The audit committee should consist of at least three members, all of whom should be independent non-executive directors. It should not be chaired by, nor have as a member, the chairman of the board. The committee as a whole should have sufficient qualifications and experience to fulfil its duties, with members keeping up-to-date with developments. An agreed process should be in place to allow the committee to consult with specialists. Should vacancies arise, these should be filled by the board.	King II did not address the minimum number of members required for the audit committee and required that only the majority of members should be independent non-executive directors.  Audit committees at subsidiary level were not addressed in King II.  King III specifies minimum areas over which audit committees should have sufficient expertise, while King II only required the majority of members to be financially literate.
	3.3. The audit committee should be chaired by an independent non-executive director	The board should elect the chairman of the audit committee. The chairman of the audit committee should participate in and agree the agenda of the committee and should be present at the AGM.	King II required the audit committee to elect the chairman of the audit committee.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
	3.4. The audit committee should oversee integrated reporting	<p>The audit committee should review the financial statements included in the integrated report and should have regard to all factors and risks that may impact on the integrity of the integrated report. It should also review the disclosure of sustainability issues in the integrated report to ensure that it does not conflict with the financial information. Where there are material sustainability issues, it should recommend to the board whether to engage an external assurance provider.</p> <p>The audit committee should consider the need for summarised information and engage external auditors to provide assurance on the summarised results.</p>	<p>King II did not discuss the audit committee's responsibility for sustainability in the detail that King III does.</p> <p>King II did not address summarised sustainability information.</p>
	3.5. The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities	The audit committee should monitor the relationship between the external assurance providers and the company and should ensure that combined assurance is given to address all the significant risks facing the company.	Combined assurance was not discussed in King II in the level of detail contained in King III.
	3.6. The audit committee should satisfy itself of the expertise, resources and experience of the company's finance function	The review of the finance function should be performed annually and the results thereof disclosed in the integrated report.	King II did not require a review of the finance function.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
	3.7. The audit committee should be responsible for overseeing of internal audit	The audit committee should be responsible for the performance management of the chief audit officer, approve the internal audit plan and ensure the internal audit function is subject to an independent quality review as and when the committee deems appropriate.	King III did not address an independent quality review of the internal audit function.
	3.8. The audit committee should be an integral component of the risk management process	Guided by its charter, which should set out its responsibilities regarding risk management, the audit committee should specifically have oversight of financial reporting risks and internal financial controls as well as fraud and IT risks as they relate to financial reporting.	Responsibilities defined in the new Companies Act have been incorporated into King III.  King II did not specifically assign oversight of IT risk as it relates to financial reporting to the audit committee.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
	<p>3.9. The audit committee is responsible for recommending the appointment of the external auditor and overseeing the external audit process</p>	<p>The audit committee:</p> <p>3.9.1. must nominate the external auditor for appointment</p> <p>3.9.2. must approve the terms of engagement and remuneration for the external audit engagement</p> <p>3.9.3. must monitor and report on the independence of the external auditor</p> <p>3.9.4. must define a policy for non-audit services provided by the external auditor and must approve the contracts for non-audit services</p> <p>3.9.5. should be informed of any Reportable Irregularities identified and reported by the external auditor</p> <p>3.9.6. should review the quality and effectiveness of the external audit process.</p>	<p>King II did not address reportable irregularities.</p>

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
	<p>3.10. The audit committee should report to the board and shareholders on how it has discharged its duties</p>	<p>The audit committee should report internally to the board on its statutory duties and duties assigned to it by the board.</p> <p>The audit committee must report to the shareholders on its compliance with its statutory duties, the independence of the external auditor; its view on the financial statements and the accounting practices; and whether the internal financial controls are effective.</p> <p>It should also recommend the integrated report for approval by the board and provide details of its role, composition, number of meetings and activities.</p>	<p>King II did not contain reporting responsibilities to shareholders for the audit committee.</p> <p>King II did not assign responsibility for recommending sustainability reporting for approval by the board to the audit committee.</p>

## Implications

The board and management of any company, regardless of size, should be fully committed to the goal of supporting and maintaining an effective audit committee:

- Responsibility of the audit committee has been extended beyond financial reporting to include sustainability reporting
- The constitution, size and sufficiency and appropriateness of the skills set of the audit committee may need to be reconsidered by the board
- An assessment of in-house skills and the qualifications/track record of external assurance providers should be performed
- Audit committees are to coordinate the utilisation of appropriate assurance providers in the assurance model to provide assurance on the identified risks
- Increased time and resource commitments are needed for audit committees, management and internal audit to adequately review internal financial controls.

## Expert opinion

The need for summarised information, the assessment of internal financial controls and effectiveness and the assessment of the integrated report will all be areas where the audit committee will be required to apply its mind in arriving at the most efficient and effective governance solution. This will be unique to every company and audit committees will need to ensure that they have the appropriate blend of skills and experience in order to discharge their responsibilities.

The audit committee takes primary responsibility for and has the ultimate decision-making ability regarding its statutory responsibilities in terms of the Companies Act. This may result in conflicts with the board should differences of opinion arise regarding these matters. The board should devise a mechanism for resolving such differences of opinion.

## Key questions directors should be asking

1. Does the audit committee have the appropriate blend of skills to discharge its responsibilities, specifically the skills required to oversee integrated reporting?
2. Has a process been approved by the board to allow the audit committee to consult with specialists or consultants to assist the audit committee with the performance of its functions?
3. Is there effective communication and coordination of the board's oversight activities to ensure that the audit committee is informed of all significant actual or potential financial and non-financial risks?
4. Does the internal audit function have appropriate skills and resources to deliver on expectations regarding the review of internal financial controls?
5. Does a mechanism exist for resolving differences of opinion between the audit committee and the board regarding the audit committee's statutory responsibilities should such differences arise?

## How we can help you

A primary function of the audit committee will be to oversee the integrity of the organisation's integrated report and to assess its continuing ability to operate as a going concern, assumptions and conclusions relating to which should be formally recorded. It should also ensure that there is sufficient cooperation between the organisation's various assurance providers, including the external auditor, the internal audit function, the risk officer and compliance officer. The internal audit function should annually review the organisation's internal control system and should specifically report its findings on internal financial controls to the audit committee. It should place particular emphasis on internal financial control and the effect that information technology has on processes and internal controls. The audit committee should ensure that all pertinent risks are covered by audit activities and, specifically, should monitor the effectiveness of the internal audit function. PwC has specialists in all these areas and we offer specific expertise in:

- External audit
- Internal audit
- Risk management
- Internal financial control
- Forensics
- Embedded compliance
- Audit committee structures and charters.

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# 4. The governance of risk

## Overview

The essential focus of the Code is that the board should “exercise leadership to prevent risk management from becoming a series of activities that are detached from the realities of the company’s business.” In this context, risk is positioned as a cornerstone of corporate governance and risk governance is substantially different to the requirement to implement risk management. Greater emphasis is placed on the board to ensure that it is satisfied with the management of risk.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 4. The governance of risk</b>			
The board's responsibility for risk governance	4.1. The board should be responsible for the governance of risk	This responsibility must be demonstrated.	No difference
	4.2. The board should determine the levels of risk tolerance	The board should understand the risk levels that it has the ability to tolerate versus the risk that it is willing to take (risk appetite).	No requirement to articulate risk appetite/tolerance
	4.3. The risk committee or audit committee should assist the board in carrying out its risk responsibilities	The board can delegate the responsibility to a committee of the board.	No difference
Management's responsibility for risk management	4.4. The board should delegate to management the responsibility to design, implement and monitor the risk management plan	The risk management plan requires specific activities to be completed.	No requirement in respect of a risk management plan
Risk assessment	4.5. The board should ensure that risk assessments are performed on a continual basis	The board should ensure that risk assessments are performed on a continuous basis (minimum annually) using a top-down approach.	Minimum of annual assessment
	4.6. The board should ensure that frameworks and methodologies are implemented to increase the probability of anticipating unpredictable risks	Risks should be prioritised and ranked to focus the responses and interventions on those risks outside the board's risk tolerance limits.	No explicit requirement on the adoption of frameworks and methodologies
Risk response	4.7. The board should ensure that management considers and implements appropriate risk responses	Annual risk management plan approval, implementation and monitoring.	No requirement in respect of a risk management plan

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 4. The governance of risk</b>			
Risk monitoring	4.8. The board should ensure continuous risk monitoring by management	Annual risk management plan approval, implementation and monitoring.	No requirement in respect of a risk management plan
Risk assurance	4.9. The board should receive assurance regarding the effectiveness of the risk management process	Combined assurance requires active consideration of the assurance the board receives on the risks to which the organisation is exposed.	No requirement
Risk disclosure	4.10. The board should ensure that there are processes in place enabling complete, timely, relevant, accurate and accessible risk disclosure to stakeholders	The board should disclose how it has satisfied itself that risk assessments, responses and interventions are effective as well as any undue, unexpected or unusual risks and any material losses.	Disclosure only on how risk management is applied

## Implications

The requirement to disclose how the board has satisfied itself that risk assessments, responses and interventions are effective will need to be effectively evidenced. Due care and diligence will need to be exercised and disclosed.

This due care and diligence is achieved through:

- The structures of governance – risk/audit committee
- Adoption and implementation of an annual risk management plan
- Effective risk management practices through the application of recognised frameworks, methodologies, continuous assessments and monitoring
- Applying risk considerations into the decision-making frameworks (appetite and tolerance) and on specific decisions
- Ensuring that the board receives adequate assurance on the effectiveness of the risk management process and on the management of specific risks
- Disclosing how the board is satisfied with the effectiveness of risk management.

## Expert opinion

Corporate governance requires active consideration of risk management. This should be the last reason for applying risk management into a business or organisation. The future is uncertain and risk management deals explicitly with uncertainty. Effective risk management is a fundamental requirement for businesses and organisations to succeed and survive.

There are now a significant number of authoritative globally relevant guidelines (e.g. ISO 31000, COSO and rating agency ERM criteria) on how effective risk management can be applied. While King III sets out the principles, the challenge is to make the principles real and practical through reference to these global guidelines.

Combined assurance should be based on identified risks and how assurance is achieved and reported to the board. This will be one of the biggest challenges facing businesses and organisations in adopting King III. However, it offers tangible benefits that extend well beyond proving compliance, including:

- Coordinated and relevant assurance efforts focussing on key risk exposures
- Minimised business/operational disruptions
- Comprehensive and prioritised tracking of

remedial action on identified improvement opportunities/weaknesses

- Improved reporting to the board and committees, including reducing the repetition of reports being reviewed by the different committees
- Possible reduced assurance costs.

## Key questions directors should be asking

1. Do we understand how risk appetite and tolerance is applied in our organisation?
2. How do we know that the biggest risk exposures to our organisation are being adequately managed?
3. When last did we participate in a risk assessment activity?
4. How often have we considered the same risk-related issue in the various management and governance meetings?
5. Is ICT risk actively considered in our risk management process?
6. Do we specifically consider compliance risk and, if so, how satisfied are we that it is effectively covered?
7. Are risks prioritised and ranked to focus the responses and interventions on those risks outside the board's risk tolerance limits?

8. Do we have an approved annual risk management plan?
9. Who assures non financial risks, such as plant availability, staff capacity and competency, the impact of legislative changes on the business/organisation etc? And to which management or board committee is the assurance provided? Are we satisfied that this assurance is reliable?
10. Do we have a fraud risk plan to consider our fraud exposure and prevention?
11. Does our disclosure on the effectiveness of risk management reflect the actual position of our business/organisation?

### How we can help you

PricewaterhouseCoopers has invested substantially, in risk management solutions both locally and globally. Our experience and hands-on expertise ensures that this investment can be practically applied for our clients' benefit and in a number of ways:

- Advising on risk governance and risk management plans
- Articulating risk appetite and tolerance
- Linking performance and risk management

- Developing effective risk management frameworks and methodologies
- Facilitating risk assessments
- Benchmarking risk and risk mitigation activities
- Addressing ICT risk management
- Advising and providing solutions on compliance risk
- Assisting in embedding risk management
- Assessing the effectiveness of risk management
- Assessing current assurance providers – existence and effectiveness
- Developing a combined assurance profile and risk governance reporting framework
- Creating a fraud risk response plan together with management.

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# 5. The governance of information technology

## Overview

King III recognises that information technology (IT) has become an integral part of doing business today, as it is fundamental to the support, sustainability and growth of organisations. IT cuts across all aspects, components and processes in business and is therefore not only an operational enabler for a company, but an important strategic asset which can be leveraged to create opportunities and to gain competitive advantage.

As well as being a strategic asset to the company, IT also presents organisations with significant risks. The strategic asset of IT and its related risks and constraints should be well governed and controlled to ensure that IT supports the strategic objectives of the organisation.

King III stipulates that in exercising their duty of care, directors should ensure that prudent and reasonable steps have been taken with respect to IT governance.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 5. The governance of information technology</b>			
	5.1. The board should be responsible for information technology (IT) governance	<p>IT has an important role to play in many organisations and should be directed and controlled effectively by the board through the establishment of an IT governance framework.</p> <p>The IT governance framework supports effective and efficient management and decision making around the utilisation of IT resources to facilitate the achievement of the company's objectives and the management of IT-related risk. It includes a charter, policies, decision-making structures, accountability framework, IT reporting and an IT internal control framework.</p>	Was not part of King II
	5.2. IT should be aligned with the performance and sustainability objectives of the company	IT should be exploited in a way that most effectively supports and enables the business strategy, delivers value and improves performance. The board should ensure that the IT strategy is integrated into the company's strategic and business processes and that IT adds value.	Was not part of King II

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 5. The governance of information technology</b>			
	5.3. The board should delegate to management the responsibility for the implementation of an IT governance framework	<p>Responsibility for the implementation of IT governance should be assigned to the CIO, as appointed by the CEO.</p> <p>The CIO should act as an intermediary between the board and management on IT-related issues and should be the bridge between IT and business. IT should report to the board on the performance of the IT function.</p>	Was not part of King II
	5.4. The board should monitor and evaluate significant IT investments and expenditure	<p>Value delivery and return on investment of IT should be monitored by the board.</p> <p>The board should ensure that the information and intellectual property contained in the information systems are protected.</p> <p>The board should require independent assurance over IT governance controls supporting outsourced IT services.</p> <p>The board is responsible for ensuring good governance principles are in place for the acquisition and disposal of IT goods and services.</p> <p>IT management should ensure good project management principles are applied.</p>	Was not part of King II

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 5. The governance of information technology</b>			
	5.5. IT should form an integral part of the company's risk management	<p>The board should ensure that IT risk is considered as part of the company's risk management activities.</p> <p>IT risk management should include disaster recovery planning, IT legal risks, compliance to laws, rules, codes and standards.</p> <p>The board should evaluate how IT can be used to aid the company in managing its risk and compliance requirements.</p>	Was not part of King II
	5.6. The board should ensure that information assets are managed effectively	<p>The board should ensure that processes have been established to ensure a formal information security management system is in place to ensure:</p> <ul style="list-style-type: none"> <li>• The confidentiality, integrity and availability of information</li> <li>• That company information is adequately protected</li> <li>• That personal and sensitive information has been identified and is protected according to relevant laws and regulations.</li> </ul>	Was not part of King II

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 5. The governance of information technology</b>			
	5.7. A risk committee and audit committee should assist the board in carrying out its IT responsibilities	<p>The risk committee should measure and understand the company's overall exposure to IT risks and ensure proper processes are in place to manage these.</p> <p>IT as it relates to financial reporting and the status of the company as a going concern should be the responsibility of the audit committee.</p>	Was not part of King II

## Implications

The requirement to disclose how the board has satisfied itself that IT governance is effective will need to be positively evidenced. Due care and diligence will need to be exercised and disclosed.

This due care and diligence is achieved through:

- An IT governance framework, which includes:
  - Decision structures for IT decisions
  - Accountability structures for IT
  - IT governance processes
  - IT reporting structures
  - IT policies and standards
  - IT compliance
  - IT controls and risk mitigation
- Information security management practices
- Business and disaster recovery
- Information technology strategy as part of the strategic business planning process
- Project management practices
- IT benefits realisation processes
- IT value and performance measurement processes

- IT acquisition and disposal processes
- IT strategy
- Understanding the current state of IT governance and determining improvements required in an IT governance plan
- Effective IT governance practices through the application of recognised frameworks, methodologies, continuous assessments and monitoring
- Reporting on the state and initiatives of IT governance and IT in general to the board
- Ensuring that the board receives adequate assurance on the efficiency and effectiveness of the IT and IT governance processes and on the management of specific IT-related issues
- Disclosing how satisfied the board is with the effectiveness of IT governance.

## Expert opinion

Corporate governance now requires active consideration of IT governance. Due to the critical nature of IT in enabling business processes, and the intellectual property and other information resources that are exposed through technology channels, IT governance is an essential component in ensuring the efficient and secure operation of the business.

While King III sets out principles, the challenge is to implement them in a practical way. A combination of the most relevant best practices can be utilised to achieve this and a significant number of authoritative and globally relevant guidelines is already available. Any well-run and formalised IT environment should already have such practices in place. The task will now be to report on these and make them understandable to the board.

It is recommended that organisations start by performing a current state assessment against King III and determining areas for improvement. This should be translated into an improvement programme, which should be presented and approved by the board. Subsequent progress against it should be on the board's agenda, in addition to reporting on the general state of IT and IT governance.

While King III may appear daunting to some, it offers tangible benefits that extend well beyond proving compliance. These include:

- Clarified decision-making and accountability
- Improved understanding of overall IT costs and their input to ROI cases
- Improved risk management, security, efficiency and effectiveness of IT and making this visible (i.e. IT will deliver value)

- Enhancement and protection of reputation and image
- Positioning of IT as a business partner and clarifying IT's role in the business
- Improved and more professional relationships with key IT partners (vendors and suppliers)
- Improved responsiveness to market challenges and opportunities
- Clear identification of whether an IT service or project supports 'business as usual' or is intended to provide future added value
- A focus on performance improvement that will lead to the attainment of best practices
- Avoidance of unnecessary expenditure as spending can be demonstrably matched to business goals
- Enabling an integrated approach to meeting external legal and regulatory requirements.

### Key questions directors should be asking

1. Do we understand how IT decisions are taken and who is accountable?
2. Do we have an IT governance framework in place which defines and supports decision models, governance structures, accountability and governance processes?
3. Is IT involved in strategic business decisions and planning?
4. Is the investment in IT understood?
5. Is our intellectual property, company and client information properly protected?
6. How do we ensure compliance of IT with laws, rules, codes, standards and regulations?
7. How is the value delivered by IT measured?
8. Is the approach towards IT risks facing the organisation clear? (Risk avoidance vs. risk taking)
9. Is the board regularly briefed on IT risks to which the enterprise is exposed?
10. Is IT a regular item on the agenda of the board and is it addressed in a structured manner?
11. Does the board have a clear view on the major IT investments from a risk and return perspective?
12. Does the board obtain regular progress reports on major IT projects?
13. Is the board getting independent assurance on the achievement of IT objectives and the containment of IT risks?

### How we can help you

PwC has invested substantially in IT governance solutions both locally and globally. Our methodologies, experience and hands-on expertise ensure that we can accelerate and reduce the cost of your King III IT governance programme.

PwC can support you by:

- Providing an assessment of your current IT governance arrangements against King III and other best practices such as ITIL, CobiT, ISO 38500, ISO 17799, Val IT
- Supporting you in determining the King III principles to apply within your organisation
- Developing an IT governance implementation programme aligned to King III requirements and implementing the required IT governance improvements
- Supporting the implementation of improvements in IT governance by utilising PwC's proprietary ICT governance framework and methodologies.

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# 6. Compliance with laws, rules, codes and standards

## Overview

Companies must comply with all applicable laws. Laws should be understood not only in terms of the obligations that they create, but also for the rights and protection that they afford. The board is responsible for the company's compliance with applicable laws and with those non-binding rules, codes and standards with which the company has elected to comply. One of the most important responsibilities of the board is to monitor the company's compliance with all applicable laws, rules, codes and standards.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 6. Compliance with laws, rules, codes and standards</b>			
	6.1. The board should ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes and standards	A strongly linked ethical responsibility that must be demonstrated and disclosed – including the extent of adoption of non-binding rules and standards.	The board is now to ensure legal and regulatory compliance as part of its risk management and internal control activities.
	6.2. The board and each individual director should have a working understanding of the effect of the applicable laws, rules, codes and standards on the company and its business	The board must ensure that the applicable laws (and changes thereto) are identified and understood.	As above
	6.3. Compliance should form an integral part of the company's risk management process	A systematic risk management approach to compliance is recommended, understanding that compliance is compulsory.	As above

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 6. Compliance with laws, rules, codes and standards</b>			
	<p>6.4. The board should delegate to management the implementation of an effective compliance framework and processes</p>	<p>A legal compliance policy should be established and monitored.</p> <p>Compliance should be achieved through integration with business/ organisational processes, ethics and culture.</p> <p>Disclosure is required as to how effectively compliance has been achieved and of significant fines and penalties paid.</p> <p>A delegated compliance function/ officer is recommended.</p>	<p>As above</p>

## Implications

The compliance with laws, rules, codes and standards has always been an explicit statutory/legal requirement. King III now provides recommended principles and practices to adopt to ensure that compliance is achieved.

Compliance can be achieved by:

- Identifying the laws and regulatory obligations that are applicable, including the non-binding rules and standards to which an entity/organisation wishes to comply
- Ensuring that the board and board members understand the requirements and are updated on the changes. This can be part of the board's continuing education programme
- Implementing a comprehensive compliance policy and regularly monitoring compliance to the policy through the governance structures and inclusion on the board agenda
- Managing compliance risk through the risk management process adopted
- Embedding compliance in the operations and process, ethical conduct and culture of the business/organisation

- Appointing a compliance officer or establishing a compliance function to assist in the management of compliance
- Disclosing how effective compliance has been achieved and any significant fines and penalties paid.

## Expert opinion

Legal and regulatory compliance is a statutory obligation and an accepted corporate governance requirement. King III has devoted a chapter to this to emphasise the importance of compliance and how, by applying the principles, the board can demonstrate that it has achieved effective compliance.

The key aspects of King III are that it recommends proactive consideration of compliance, how the compliance risk is managed and how it is integrated into an organisation's operations. There are many organisations that only consider compliance when there is a breach with specific consequences such as fines paid for contraventions of the competition laws.

Highly regulated organisations, such as banks, have very mature compliance approaches and have been proactively managing compliance for years.

King III has raised the level of awareness of the importance of being able to demonstrate compliance. This can be achieved through:

- Regularly (annually) reviewing the compliance universe and determining which laws, regulations and non-binding rules and standards apply to the business/organisation
- Assessing the basis of how compliance is achieved to these laws and regulations
- Receiving assurance through the risk management and assurance processes that compliance is achieved
- Designing specific compliance activities to evidence the actions taken to ensure compliance – for example annual declarations, records of compliance-related training completed and monitoring of remedial action where compliance breakdowns have or could potentially occur
- Embedding compliance activities into the operational processes where applicable, for example controls required to be evidenced when opening an account in terms of the National Credit Act.

### Key questions directors should be asking

1. What are the key statutory and regulatory obligations to which our organisation needs to comply?
2. Are we in compliance with these requirements? If so, how have we received this assurance and are we satisfied that the assurance is credible?
3. When last did we consider compliance at the board?
4. Are we aware that many Acts, such as the National Credit Act, can impact our organisation even though we are not a financial institution?
5. How are we appraised of changes in the legal and regulatory landscape?
6. Do we have sufficient evidence to defend our organisation in court or to prove to a regulator that we have complied with a specific act?
7. Does our disclosure on the effectiveness of compliance reflect the actual position in our business/organisation?

### How we can help you

Regulatory compliance and reporting should be a natural extension of the governance duties shouldered by boards and directors. The exercise of good governance can ensure that compliance is aligned with the company's business objectives and risk management strategies. In this way compliance can add real value and not just be a cost to the organisation.

PricewaterhouseCoopers has made a considerable investment in compliance solutions on a global and local scale. Our people can help you at the strategic level to maximise competitive advantage from regulation and at the operational level to minimise costs and disruptions to your business.

Our range of compliance services includes:

- Advising on what laws and regulations are applicable
- Recommending approaches on how to achieve effective compliance
- Benchmarking the compliance responses to specific acts/regulations – nationally and globally
- Developing specific compliance databases to evidence compliance

- Hosting of compliance databases through our Enterprise Compliance Portal (ECP) – PwC uses this to manage its own global compliance
- Facilitating compliance risk assessments
- Assisting in embedding specific compliance requirements into the business and operational processes
- Assuring the effectiveness of compliance achieved
- Providing a gap analysis of compliance to specific laws and regulations.

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# 7. Internal audit

## Overview

King II effectively dispensed with the notion of compliance-based, cyclical auditing and embraced risk-based auditing. As this approach has matured over time, the imperative to appropriately position risk-based auditing is a central focus of King III. The repositioned risk-based approach directs internal audit to address strategic, operational, financial and sustainability issues in its quest to deliver value to the organisation. Value is now seen to vest in the relevance of a function. As such, the head of internal audit needs to understand the organisation's strategy and to direct the function accordingly.

Governance is underpinned by an acceptance of accountability and responsibility for action. Accordingly, the chief audit executive is required to provide an annual assessment of an organisation's control environment. This reflects the congruence of introspection from the internal audit fraternity and the call for improved governance in general – highlighting calls for internal audit to rise and deliver on its contribution to effective governance!

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 7. Internal audit</b>			
The need for and role of internal audit	7.1. The board should ensure that there is an effective risk-based internal audit	<p>The board should demonstrate how adequate assurance was obtained on an effective governance, risk management and internal control environment; in the event of the absence of an internal audit function.</p> <p>Evaluation of governance processes, including ethics, especially 'tone at the top'.</p> <p>A senior or executive or director to be responsible for internal audit where internal audit is fully outsourced.</p>	<p>Board to demonstrate how effective internal control, processes and systems assurance were obtained</p> <p>Ethics not specifically mentioned</p> <p>No mention of custodian function in an outsourced scenario</p>
Internal audit's approach and plan	7.2. Internal audit should follow a risk-based approach to its plan	<p>Internal audit planning should be informed by the strategy of the organisation.</p> <p>The chief audit executive should discuss the adequacy and resources of skills available to address risk identified with the audit committee.</p>	<p>Not a requirement in King II</p> <p>Not a requirement in King II</p>

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 7. Internal audit</b>			
	7.3. Internal audit should provide a written assessment of the effectiveness of the company's system of internal controls and risk management	Internal audit should form an integral part of the combined assurance model and should provide a written assessment of the effectiveness of the company's system of internal control and risk management.	Not a requirement in King II
	7.4. The audit committee should be responsible for overseeing internal audit	Internal audit pay, bonus and benefits to be determined separately to process undertaken for the rest of the business to ensure appropriate independence.  Internal audit to perform the pivotal role of effecting combined assurance.	Not a requirement in King II  Only mention of the avoidance of duplication of assurance effort in King II
Internal audit's status in the company	7.5. Internal audit should be strategically positioned to achieve its objectives	The chief audit executive to have a standing invitation to attend EXCO as an invitee to protect independence.  Internal audit to report functionally to the chairman of the audit committee.  Internal audit should establish and maintain a quality assurance and improvement programme.	Not a requirement of King II  Internal audit should report to an appropriate level in the organisation  Not a requirement of King II

## Implications

The challenge that the board faces is how it concludes that an effective internal audit function was operational for the period covered by the integrated report. While the execution of a risk-based plan would have been sufficient for this purpose in the past, King III requires a more holistic approach that is related to other areas as well. Practically, this means a challenging of the norms and exploration of concepts that will move internal audit in the direction of real progress. These include:

- Annual report disclosure in the event that an effective internal audit function was not maintained
- An organisational custodian function in situations where internal audit is outsourced
- Reviewing organisational ethics
- Cost optimisation and the prevention of assurance fatigue
- An assessment of the control environment
- The relationship between internal audit and audit committees
- The role and attributes of a chief audit executive
- The implementation of an internal audit quality assurance and improvement programme

- The interdependency between internal audit and other assurance providers such as risk management

## Expert opinion

Adequacy of suitable skills and an understanding of the true absorbed cost of internal audit will be instrumental in the assessment of the potential of internal audit to deliver value to organisations as envisaged in King III. In this environment, diligent audit committees will ask the difficult questions and more assurance than in a compliance-based quality review will be required to provide committees with a reasonable level of comfort.

The maturity of other functions such as ethics and risk management with which internal audit is expected to interact may be cause for some concern. Immature functions that form part of a combined assurance view are likely to complicate assessments of control environments, even where internal audit has been effective.

Leadership, strategic inquisitiveness and other attributes will need to drive the expectations of the chief audit executive. This, coupled with strong analytical skills and the ability to interact at the highest levels of the organisation, are fundamental to internal audit using the opportunities it is afforded in King III to reach a level that populists conclude is

internal audit's rightful place. Appropriate technology leverage in the performance of internal audit becomes non-negotiable.

Ultimately, internal audit will have to make combined assurance work and help organisations realise the benefits of cost optimisation, prevention of assurance fatigue and a business partner relationship that adds real value by sifting through the irrelevant and focusing on the critical.

## Key questions directors should be asking

1. Is internal audit aligned to strategy and does its plan focus on areas that are most likely to impact stakeholder value?
2. Is internal audit effective and frequent enough in its communications with the audit committee and us?
3. When last was an objective assessment done to ascertain whether internal audit has the appropriate level of technical and analytical skills required to address the industry risk and risk requirements of our business?
4. Is our internal audit function poised to lead a combined assurance initiative?
5. Is there sufficient assurance of our ethics and risk management programmes?

6. Does internal audit utilise technology in its processes and use existing systems and data effectively in the performance of its work?
7. What were our most recent loss events and what comfort did internal audit provide us with on these?
8. How does our internal audit function compare against its peers in benchmark studies?
9. Is our chief audit executive subjected to a robust annual assessment based on key attributes relevant to our business?
10. What is our true absorbed cost of internal audit?
11. Is our internal audit agile enough to address emerging business issues?
12. Does the internal audit function have the necessary and diverse skills required to give assurance to the audit committee on internal financial control?

### How we can help you

We have a team of professionals that are ready and able to assist you with the implementation of the requirements of King III in all its aspects. These include:

- Strategic assurance reviews that go beyond a quality assurance checklist and align to your organisational strategy
- Assistance in the formulation of a control environment assessment

- Assistance in the implementation of a combined assurance model
- Assessment of internal audit technology leverage
- Development of appropriate performance metrics for your internal audit function
- Benchmarking your internal audit function against a community of peers (industry, headcount and revenues)
- Awareness and training
- Conducting an effective audit of an ethics function
- Formulation of governance frameworks, including reporting protocols
- Optimising the form and content of internal audit communications.

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# 8. Governing stakeholder relationships

## Overview

The stakeholder-inclusive approach to corporate governance is not a new concept in the King reports and effective stakeholder engagement is recognised as essential to good corporate governance. The days when boards could merely pay lip service to concerns such as corporate responsibility, ethical business practices and sustainability are over.

Stakeholder relationships provide a platform for the board to take into account the concerns and objectives of the company's stakeholders in its decision making, which is fundamental to the process of integrated reporting

King III provides guidance and recommendations on how stakeholder relationships should be dealt with.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 8. Governing stakeholder relationships</b>			
	<p>8.1. The board should appreciate that stakeholders' perceptions affect a company's reputation</p>	<p>8.1.1. The gap between stakeholder perceptions and the performance of the company should be managed and measured to enhance or protect the company's reputation</p> <p>8.1.2. The company's reputation and its linkage with stakeholder relationships should be a regular board agenda item</p> <p>8.1.3. The board should identify important stakeholder groupings</p>	<p>Similar to King II</p>

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 8. Governing stakeholder relationships</b>			
	<p>8.2. The board should delegate to management to proactively deal with stakeholder relationships</p>	<p>8.2.1. Management should develop a strategy and formulate policies for the management of relationships with each stakeholder grouping</p> <p>8.2.2. The board should consider whether it is appropriate to publish its stakeholder policies</p> <p>8.2.3. The board should oversee the establishment of mechanisms and processes that support stakeholders in constructive engagement with the company</p> <p>8.2.4. The board should encourage shareholders to attend AGMs</p> <p>8.2.5. The board should consider not only formal, but also informal, processes for interaction with the company's stakeholders</p> <p>8.2.6. The board should disclose in its integrated report the nature of the company's dealings with stakeholders and the outcomes of these dealings</p>	<p>Similar to King II</p>

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 8. Governing stakeholder relationships</b>			
	8.3. The board should strive to achieve the appropriate balance between its various stakeholder groupings, in the best interests of the company	8.3.1. The board should take account of the legitimate interests and expectations of its stakeholders in its decision-making in the best interests of the company	Similar to King II
	8.5. Transparent and effective communication with stakeholders is essential for building and maintaining their trust and confidence	<p>8.5.1. Complete, timely, relevant, accurate, honest and accessible information should be provided by the company to its stakeholders whilst having regard to legal and strategic considerations</p> <p>8.5.2. Communication with stakeholders should be in clear and understandable language</p> <p>8.5.3. The board should adopt communication guidelines that support a responsible communication programme</p> <p>8.5.4. The board should consider disclosing in the integrated report the number and reasons for refusals of requests of information that were lodged with the company in terms of the Promotion of Access to Information Act, 2000</p>	<p>Similar to King II</p> <p>New requirement</p>

## Implications

King III proposes a host of interventions that companies and boards should be making:

- Identifying material stakeholders and assessing the related risks and opportunities they present
- Developing and implementing stakeholder strategies and policies
- Developing a mechanism for constructive stakeholder engagement with all of their material stakeholders
- Adopting communication guidelines for stakeholders covering the content of the report, publishing policies and the nature of the interaction with stakeholders.

## Expert opinion

Although stakeholder management is recognised by many as being an important aspect of business – especially with regard to corporate citizenship and reputation – companies on the whole have struggled with aspects of implementation, tending to respond in a crisis mode especially when interactions fall outside of the traditional scope of employees, customers and investors.

A comprehensive strategy for broad-based stakeholder engagement should be developed, based on a sound understanding of stakeholder issues. Practical management of stakeholder issues will in turn need to be based on reliable management information and the ability of corporate leaders to make sound, balanced judgement calls, when responding to legitimate concerns.

Mechanisms for effective stakeholder engagement need to be developed to support:

- Comprehensive risk and opportunity assessments
- The development of a business strategy that supports the long-term sustainability of the company
- The company's ability to meet the objectives of the integrated report.

## Key questions directors should be asking

1. Do we have a stakeholder strategy and policies in place? If so, are they adequate or do they need revamping? If not, do we have the in-house knowledge to draft documents that will deliver value?
2. Have we identified our material stakeholders?
3. Do we know and understand the issues, risks and opportunities associated with our various stakeholders?
4. Are our current forms of stakeholder communication effective?
5. Do we have the necessary reliable information to make informed judgement calls when balancing the legitimate interests of various stakeholder groupings?
6. How do we actually engage with all our stakeholders in practice?

## How we can help you

Integrating stakeholders' concerns and opportunities within the decision-making process has become a strategic necessity in business. PwC brings together specialists from different disciplines, including from the social and environmental fields, to offer tailored stakeholder advisory services to meet the specific requirements of individual clients.

Our services include:

- Socio-economic impact assessments
- Facilitation of stakeholder dialogue
- Development of stakeholder strategy and policy documents
- Development of stakeholder communication guidelines
- Report writing
- Report assurance – combination of ISAE3000 and AA1000AS, the latter of which deals specifically with stakeholder concerns.

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# 9. Integrated reporting and disclosure

## Overview

The board should ensure that appropriate systems and processes are put in place in order to produce a report to stakeholders that gives a complete picture of a company's financial and non-financial profiles in such a way that the report is holistic and reliable.

In order to comply with the recommendations of the Code “reporting should be integrated across all areas of performance, reflecting the choices made in the strategic decisions adopted by the board, and should include reporting in the triple context of economic, social and environmental issues. The board should be able to report forward-looking information that will enable stakeholders to make a more informed assessment of the economic value of the company as opposed to its book value.”

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 9. Integrated reporting and disclosure</b>			
Transparency and accountability	9.1. The board should ensure the integrity of the company's integrated report	<p>9.1.1. A company should have controls to enable it to verify and safeguard the integrity of its integrated report</p> <p>9.1.2. The board should delegate to the audit committee to evaluate sustainability disclosures</p> <p>The integrated report should:</p> <p>9.1.3. be prepared every year;</p> <p>9.1.4. convey adequate information regarding the company's financial and sustainability performance; and</p> <p>9.1.5. focus on substance over form.</p>	<p>King II did not specifically assign oversight of sustainability reporting to the audit committee.</p> <p>While King II required that sustainability reporting should be repeated at least annually, it did not require the preparation of an integrated report.</p>

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 9. Integrated reporting and disclosure</b>			
	<p>9.2. Sustainability reporting and disclosure should be integrated with the company's financial reporting</p>	<p>9.2.1. The board should include commentary on the company's financial results</p> <p>9.2.2. The board must disclose if the company is a going concern</p> <p>9.2.3. The integrated report should describe how the company has made its money</p> <p>9.2.4. The board should ensure that the positive and negative impacts of the company's operations and plans to improve the positives and eradicate or ameliorate the negatives in the financial year ahead are conveyed in the integrated report.</p>	<p>Similar to King II</p>
	<p>9.3. Sustainability reporting and disclosure should be independently assured</p>	<p>9.3.1. General oversight and reporting of sustainability should be delegated by the board to the audit committee</p> <p>9.3.2. The audit committee should assist the board by reviewing the integrated report to ensure that the information contained in it is reliable and that it does not contradict the financial aspects of the report</p> <p>9.3.3. The audit committee should oversee the provision of assurance over sustainability issues.</p>	<p>New requirement</p>

## Implications

One of the essential principles of King III is the view that governance, strategy and sustainability are inseparable. In line with the Code's recommendations, good practice requires that economic, social and environmental issues be included in corporate strategy, management, reporting and assurance throughout the year, in the same way as financial matters are dealt with.

## Expert opinion

Comprehensive, forward-looking information is the new benchmark in corporate reporting. Internally, the benefits of managing on the basis of holistic data are measurable, while the external integrated report allows the company to reflect its management practices and impacts.

Human, social, natural, manufactured and economic capital are tangible asset bases and each should be managed over time to encourage net added value.

Materiality is essential. Sustainability data, used as management information should form the framework for the non-financial information contained in the integrated report.

Key aspects of the integrated report should be independently assured to confirm reliability internally and to build trust externally.

## Key questions directors should be asking

1. Does the company have a sustainability strategy and policy?
2. Is sustainability considered part of ongoing business activities?
3. Are sustainable development issues integrated into business management systems and departments such as risk, environmental, legal and financial?
4. Have sustainability criteria been built into individual performance agreements?
5. Does the company have a suitably qualified director/s and executive/s with the responsibility for sustainable development?
6. Who in the company is the custodian of the content and assurance of the integrated report?
7. Do we have to follow the GRI G3 guidelines?

## How we can help you

PwC's Sustainable Business Solutions team can assist with the following:

- Director and specialised management training in sustainable development
- Sustainability strategy and policy formulation
- Sustainability systems and process development
- Integrated report writing
- Integrated report assurance using a methodology based on a combination of ISAE3000 and AA1000AS assurance standards

- Facilitation of the stakeholder engagement process
- BEE strategy and implementation
- Technical health, safety and environmental services:
  - Climate change strategy development, carbon footprints and life cycle assessments
  - Health and safety and environmental compliance, ISO certification (9001, 14001, 18001).

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# 10. Business rescue

## Overview

In determining the role and function of the board, King III is keen to emphasise the importance of the board acting as both the focal point and custodian of corporate governance. In the context of business rescue, King III recognises that this is both a change of culture and a significant change in legislation.

The importance of this is to ensure the board (and directors individually) recognise their new obligations both to conform with chapter six, Business Rescue, proceedings in the Companies Act and to accept that this is emerging legislation and requires a change in culture from corporate liquidation to commercial renewal and recovery. Additionally, the board and directors must understand the risks and abuse that could arise, given the absence of precedents to support actions and early stages of the legislation and its supporting regulations.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 10. Boards and directors</b>			
Business rescue proceedings	2.15. The board should consider business rescue proceedings or other turnaround mechanisms as soon as the company is financially distressed as defined in the Act	<p>The board should ensure that:</p> <p>2.15.1. the solvency and liquidity of the company is continuously monitored</p> <p>2.15.2. its consideration is fair to save a financially distressed company either by way of workouts, sale, merger, amalgamation, compromise with creditors or business rescue</p> <p>2.15.3. a suitable practitioner is appointed if business rescue is adopted</p> <p>2.15.4. the practitioner furnishes security for the value of the assets of the company</p>	Was not part of King II

## Implications

Boards (and individually directors) will need to understand how crucial it is to act independently, quickly and decisively, in line with the obligations and regulations of the Companies Act in distressed trading situations.

It is paramount that the board (and directors) recognise that early intervention and action protects against exposure to reckless trading allegations and also, crucially, demonstrates the fulfilment of their obligations to all stakeholders.

The board and directors must explore all turnaround opportunities proactively, prior to the company being financially distressed (as per the Act) and recognise that business rescue proceedings (and decisions around commencement thereof) offer a final and formal consideration after other avenues have been vigorously pursued prior to this.

The board and directors must be fully conversant with both their obligations to commence business rescue proceedings and conversely, the actions required of them if other 'affected parties' (shareholders, creditors, unions and employees) instigate such proceedings first, or if liquidation proceedings have already been commenced.

They must also be cognisant of the role and authority of the 'business rescue practitioner', including their own responsibility in the selection of this

individual and/or right and obligation challenge of this individual's appointment (if proceedings were commenced by other affected parties).

The board and directors must fully understand the need to co-operate with the practitioner in the fulfilment of their duties in preparing and executing a 'business rescue plan'. In so doing, they must recognise and support the practitioner's authority (as a court official within the context of the Act) and control of the company in substitution for its board and pre-existing management.

The board must understand the fundamental aspects and intentions of the business rescue proceedings. These include, but are not limited to:

- Temporary supervision of the company
- A temporary moratorium on the rights of claimants
- The development and implementation of a plan to rescue the business.

Furthermore, the board and directors must understand, comply with and manage the consequences of key principles within the business recovery proceedings surrounding trading restrictions, post-commencement finance and employee contracts.

## Expert opinion

PwC believes that good corporate governance, as supported by the principles and practices of King III, will ultimately bring about the improvement and development of best practice within South African corporate enterprises. This approach builds a robust foundation for avoiding distressed trading situations.

As with all ventures, there are unavoidable and unforeseen situations – financial distress is one of the most significant consequences arising from such circumstances. If avoidance of these risks has not been achieved despite following corporate governance best practice, one can be certain that adherence to the guidelines in provision 2.15 on business rescue, underscored by the sound foundations created, means a dramatic increase in the likelihood of being able to recover from distressed trading circumstances. Best practice and timely action preserves the longevity and value of a company for all stakeholders and ultimately the economy by maximising the strength of a company.

The obligation of boards and directors starts well in advance of the decisions required for a company in financial distress (as defined in the Act) – it starts with behaviours and actions surrounding corporate renewal and turnaround to maximise the chances of successfully changing the fortunes of a company in distress (as a general definition, including non-financial distress factors).

### Key questions directors should be asking

1. Are there signs of a future potential need for business rescue and can we act sooner to avert this and seek assistance to turn the company around?
2. Is the company financially distressed?
3. Are there reasonable prospects of rescuing the company?
4. Is the company or its directors trading recklessly?
5. Should we commence business rescue proceedings?
6. Who should we appoint as the business rescue practitioner?
7. Is this person independent and sufficiently experienced to rescue the business?
8. What are the board's obligations to stakeholders, the courts and appointed representatives?
9. Are we aware of and fulfilling our obligations as a board and individual directors in line with the requirements of the business rescue proceedings?

### How we can help you

PwC has developed a range of services designed to assist businesses in distress. Our view is that while business rescue proceedings herald a welcome change to preservation of companies previously liquidated, it is nevertheless the last chance for such businesses to survive. We have invested in skills and services to support companies to maximise their options for and speed of recovery.

These skills are centralised in our Business Recovery Services (BRS) team. However, we are able to draw on the full range of services and expertise within the firm to ensure specific business issues are resolved, collectively aiding recovery well before insolvency or business rescue proceedings need to be contemplated.

Our services include:

- Independent business reviews
- Turnaround/interim directors
- Cash management
- Financial restructuring
- Lender and debt advisory
- Operational restructuring
- Accelerated M&A – optimised exits

- Working capital management
- Crisis stakeholder management
- Recovery planning and implementation.

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# 11. Alternative dispute resolution

## Overview

As new products and services, further globalisation and an increase in electronic relationships and transactions have succeeded in making business more complex, so the corporate world has become increasingly litigious. Disputes are now more frequent and consume more management time and organisational resources than ever before. If disputes cannot be resolved through negotiation, it can take years to seek redress through the courts. Litigation is an expensive and time-consuming exercise, the outcome of which can be unpredictable and which can also have negative consequences for a company's reputation.

For the first time in South Africa, King III promotes a more responsible and progressive approach to dispute resolution. The Code specifically identifies alternative dispute resolution (ADR) as an essential component of good governance and recommends that, as part of their fiduciary duties, boards and directors should explore more creative methods of dispute resolution.

The Code endorses mediation and conciliation firstly and failing that, arbitration. The two former processes are particularly suited to relationships that have future potential in that they are entirely voluntary. Both involve third-party intervention to assist in exploring the issues and understanding the relative strengths of the opposing argument with a view to arriving at a mutually acceptable way forward. Mediation has traditionally been seen as a mechanism suited to labour disputes but its applications are much wider. Conciliation goes a step further than mediation in that a recommendation is provided by the independent third party.

By resolving past differences, parties can take the opportunity to map their future relationship in a fair way and hopefully arrive at a win-win solution. This could be based on improved productivity, joint-profitability or some other arrangement from which both parties would benefit.

While arbitration may not be seen to be vastly different to traditional litigation, it offers some significant advantages. Notably the parties can choose the adjudicator, focus on the issues and have a private, efficient process.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 11. Governing stakeholder relationships</b>			
Dispute resolution	8.6. The board should ensure that disputes are resolved as effectively, efficiently and expeditiously as possible	8.6.1. The board should adopt formal dispute resolution processes for internal and external disputes  8.6.2. The board should select the appropriate individuals to represent the company in ADR	New requirement

## Implications

Organisations should consider how different approaches might affect the outcome of a dispute, especially where an important relationship is at stake.

## Expert opinion

Resolving disputes outside the rigid confines of the judicial process represents the future of dispute resolution. It is a positive development that organisations can now explore the boundaries of disputes to come up with creative solutions. Uncompromising and dogmatic legal confrontations with adversaries seldom result in an optimal outcome and usually create a winner and a loser. ADR can result in two winners and we endorse King III's view that this approach improves the prospects of a better outcome for organisations and their shareholders.

## Key questions directors should be asking

1. Is our organisation involved in significant disputes?
2. What do these disputes teach us about our customers/suppliers and our own approach to business?

3. Has negotiation failed in these disputes?
4. Can we consider ADR processes? E.g. mediation, conciliation
5. Is there potential value to be added in changing the dispute mechanism from an enforcement of rights process to a 'partnership' approach?
6. Has the organisation considered adopting a dispute response plan?

## How we can help you

Contractual disputes, claims and litigation can be expensive and unproductive. At PwC, we use our in-depth industry knowledge and professional expertise to offer a range of dispute resolution services. These include

- Mediation
- Arbitration
- Independent expert accountant

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# 12. Internal financial controls

## Overview

The purpose of this section is to highlight those areas of King III that apply to an organisation's assessment of internal financial controls and to offer our professional insights as to how entities can practically implement and apply the recommendations of the Code.

King III requires that the audit committee ensure the integrity of integrated reporting and internal financial controls. In addition, the audit committee should have oversight of financial reporting risks. In order to align recommendations with global best practice principles, King III requires:

- A statement from the board on the effectiveness of internal controls to be included in the integrated report
- A statement from the audit committee, also included in the integrated report, on the effectiveness of internal financial controls
- The statement made by the audit committee should be supported by a formally documented annual review of the design, implementation and effectiveness of the company's system of internal financial controls following suitable testing performed by internal audit
- The nature and extent of weaknesses in financial control that are considered material and that resulted in actual material financial loss, fraud or material errors, should be reported to the board and the stakeholders
- The audit committee should determine the nature and extent of the formal documented review of internal financial controls. No external attestation is required to be made on the audit committee's statement on internal financial control.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
Role and function of the board	2.13. The board should report on the effectiveness of the company's system of internal controls	Refer to chapters 7 and 9	Similar to King II but implications are broader considering new King III recommendations
<b>Chapter 3. Audit committees</b>			
Internal assurance providers	3.8. The audit committee should be an integral component of the risk management process	<p>The audit committee should specifically have oversight of:</p> <ul style="list-style-type: none"> <li>• Financial reporting risks</li> <li>• Internal financial controls</li> <li>• Fraud risk as it relates to financial reporting</li> <li>• IT risk as it relates to financial reporting.</li> </ul>	New requirement

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
Reporting	3.10. The audit committee should report to the board and shareholders on how it has discharged its duties	<p>In reporting to the shareholders on its statutory duties, the audit committee must report on (amongst others):</p> <ul style="list-style-type: none"> <li>• The committee's view on the financial statements and the accounting practices</li> <li>• Whether the internal financial controls are effective</li> <li>• The audit committee should recommend the integrated report for approval by the board.</li> </ul>	New requirement
<b>Chapter 4. The governance of risk</b>			
The board's responsibility for risk governance	4.1. The board should be responsible for the governance of risk	<p>A policy and plan for a system and process of risk management should be developed.</p> <p>The board should comment in the integrated report on the effectiveness of the system and process of risk management.</p>	Similar to King II but implications are broader considering new King III recommendations
Risk assurance	4.9. The board should receive assurance regarding the effectiveness of the risk management process	Internal audit should provide a written assessment of the effectiveness of the system of internal controls and risk management to the board.	Similar to King II but implications are broader considering new King III recommendations

Governance element	Principle/s	Summary recommendation/s	Difference to King II
Chapter 7. Internal audit	7.3. Internal audit should provide a written assessment of the effectiveness of the company's system of internal controls and risk management	<p>Internal audit should form an integral part of the combined assurance model as internal assurance provider.</p> <p>Internal controls should be established not only over financial matters, but also operational, compliance and sustainability issues.</p> <p>Companies should maintain an effective governance, risk management and internal control framework.</p> <p>Internal audit should provide a written assessment of internal controls and risk management to the board.</p> <p>Internal audit should provide a written assessment of internal financial controls to the audit committee.</p> <p>Management should specify the elements of the control framework.</p>	New requirement

## Implications

Meeting the internal financial control requirements of King III and putting its principles into practice will require a number of practical interventions. As a minimum, companies should:

- Implement a control framework incorporating internal financial controls that is documented and achieves fair presentation of the financial statement results and disclosures in accordance with generally accepted accounting principles
- Follow a risk-based approach by identifying likely sources of material errors in the financial statements and disclosures. These risks should then be mitigated by controls that are adequately designed and are operating effectively to ensure fair presentation of the financial statement results and disclosures
- Have internal audit evidence an annual assessment of the design adequacy and operating effectiveness of internal financial controls and maintain relevance over time by taking into consideration any changes to both internal and external factors impacting the entity
- Apply a cost-efficient approach that ensures a sensible balance between the cost of implementing and monitoring the framework and the benefits of such a framework.

## Key questions the audit committee should be asking

- Is there a control framework (e.g. COSO) governing financial reporting in the organisation?
- Have all probable risks to fair presentation in the financial statement results and disclosures been identified and documented? (Fair presentation implies that the numbers and disclosures are not materially misstated).
- Are there controls in place to address these risks and are they adequately designed to prevent or detect material misstatements in the financial statement results and disclosures?
- Do the controls identified operate as they are supposed to and are they appropriately evidenced?
- Has internal audit tested the controls identified above and reported their results to the audit committee completely and accurately?
- Is the audit committee's assertion appropriately evidenced (including internal audit's assessment)?
- Is a process in place to ensure that the framework remains relevant over time?

## How we can help you

Organisations should make an informed decision as to how to adopt the principles of King III in regard to internal financial controls. We can help you to achieve this by advising and assisting you on the implementation of a framework tailored to your business that will support internal audit's assessment of internal financial controls. This approach takes into account the design of a framework that is flexible to the needs of your business and the cost and associated benefits envisaged to achieve the desired result.

The methodology we apply in helping our clients is principles based and which we approach from management's perspective. Almost all frameworks that enable management to assess internal financial controls draw on experiences gained in complying with Section 404 of the Sarbanes-Oxley Act (SOX). Unlike King III, SOX requires the external auditor to assess internal financial controls. As a result, much of the guidance in applying SOX came from the external auditors and did not always take management's requirements into consideration. Management best understands the risks that impact financial reporting. Our methodology is based on management's experience and takes into consideration the relative size and complexity of the business. The result of this is that our clients are able to maximise the benefits and minimise the effort of applying the principles of King III.

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# 13. Solvency and liquidity tests

## Overview

In section four of the introduction to the Code, entitled “The link between governance principles and law”, it is stated that certain recommendations made in King II have now become matters of law because they are contained in the new Companies Act.

These new provisions of the Act create duties on directors which, if not discharged in the appropriate manner, can result in personal liability exposure.

One of the sections of the Act that has been revised substantially and is specifically referred to in King III revolves around the requirements for solvency and liquidity tests to be applied by directors for certain transactions.

## Implications

The main categories of transactions that now require formal solvency and liquidity tests include:

- Financial assistance to third parties for the acquisition of or subscription for the company's own shares
- Loans or financial assistance to related parties (including subsidiaries, fellow subsidiaries, holding companies and directors)
- Any dividends or distributions to shareholders
- Capitalisation shares (where there is an option to receive capitalisation shares or cash)
- Share buybacks.

Directors are required, amongst other things, to ensure that following any of these transactions, the company would satisfy the solvency and liquidity test. The requirement for the solvency and liquidity test is much wider under the new Act and includes common transactions such as dividend payments and inter-group lending, which previously did not require directors to perform this test. Directors therefore have to be particularly vigilant that any transaction proposed, falling into the above new categories, does not breach the application of the test.

In performing a solvency and liquidity test, a director needs to satisfy himself/herself, considering all reasonably foreseeable financial circumstances of the company at the time, that after the transaction:

- The assets (fairly valued) of the company must exceed liabilities (this would include all reasonably foreseeable contingent assets and liabilities)
- The company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months.

A director is personally liable for loss, damage or costs sustained by the company as a direct or indirect consequence of his or her actions if he or she:

- Was present at the meeting where the resolution was considered or participated in the decision
- Failed to vote against the resolution despite knowing that it was inconsistent with the requirements of the Act or the company's memorandum of incorporation or the director did not responsibly consider its impact (this would include the instance where the company undertook any of the above transactions when it was not in a position of solvency and/or liquidity).

## Expert opinion

The solvency test requires that assets and liabilities are to be fairly valued and that reasonably foreseeable contingent assets and liabilities are taken into account. This necessitates that a more detailed exercise than a simple review of the balance sheet be undertaken.

Items such as the fair valuation of subsidiaries, intellectual property, investment holdings, vendor facilitation on BEE transactions and contracts (to name a few) need to be taken into account. Liabilities too have to be fairly valued, which, for example, may affect the valuation of fixed rate instruments. Contingent liabilities in particular have to be identified and a value placed on these.

The liquidity test requires the development of a 12-month cash flow forecast that takes into account issues such as the details around the debt repayment profile of the company, mandatory capex expenditures and seasonal working capital movements.

### Key questions directors should be asking

1. Does the transaction being proposed fall into the category of transactions that require a formal liquidity and solvency test?
2. Do we have the necessary information to allow us to determine whether the company will be solvent and liquid after the transaction?
3. Have the assets and liabilities been fairly valued in the application of the test, or does the calculation merely reflect the book value of the assets?
4. Does the calculation take into account all contingent assets and liabilities?

### How we can help you

The specialists in PwC's Transactions division have extensive experience in the valuation of companies and assets and can provide valuable input and assistance in the preparation of cash flow forecasts. The team has vast experience and a proven track record in valuing companies for M&A transactions, providing fairness opinions and working capital statements for regulated transactions, developing purchase price allocation models and preparing cash flow forecasts for clients.

The Transactions team is well placed to give directors external independent third-party confirmation or input concerning the solvency and liquidity test, thereby equipping them with the necessary information upon which to base their decisions in a responsible manner.

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# 14. Remuneration of directors and senior executives

## Overview

Scrutiny of executive pay is now greater than ever as a result of the economic downturn combined with public anger over the role played by excessive levels of remuneration in the collapse of the financial markets. Globally, there is a focus on the need for robust governance processes around executive remuneration coupled with the requirement for transparency.

These themes are echoed in King III and three general principles in respect of the remuneration of directors and senior executives are set out:

- Companies should remunerate directors and executives fairly and responsibly
- Companies should disclose the remuneration of each individual director and certain senior executives
- Shareholders should approve the company's remuneration policy.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
Remuneration of directors and senior executives	2.25. Companies should remunerate directors and executives fairly and responsibly	<p>Companies must adopt remuneration policies that create value for the company over the long term. Short-term and long-term performance-related awards must be fair and achievable.</p> <p>The remuneration committee should assist the board in setting and administering remuneration policies.</p> <p>Annual bonuses:</p> <ul style="list-style-type: none"> <li>• Should clearly relate to performance against annual objectives consistent with long-term value for shareholders</li> <li>• Should be reviewed regularly to ensure that they remain appropriate.</li> </ul>	<p>The provisions in King III are more prescriptive than the general wording included in King II.</p> <p>For example, King II stated that performance-related elements of remuneration should constitute a substantial portion of the total remuneration of executives.</p>

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
		<p>Share-based and other long-term incentive schemes:</p> <ul style="list-style-type: none"> <li>• Participation should be restricted to employees and executive directors. The chairman and other non-executive directors should not receive share options or other incentive awards geared to share price or corporate performance</li> <li>• Vesting of rights, whether settled in cash or shares, should be based on performance conditions measured over a period appropriate to the strategic objectives of the company. This should be not less than three years</li> <li>• Where performance conditions are not met, they should not be re-tested in subsequent periods</li> <li>• Regular annual grants of awards is desirable</li> <li>• There should be no re-pricing or surrender and re-grant of share options which are ‘underwater’</li> </ul>	<p>As regards the granting of share options to non-executive directors, King II stated that it should be left to the shareholders’ discretion and approval.</p> <p>Detailed provisions relating to share-based and long-term incentive schemes were not included in King II.</p> <p>King II stated that the re-pricing of share options should be subject to shareholder approval.</p>

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
		<ul style="list-style-type: none"> <li>• There should be no automatic waiving of performance conditions on a change of control, a capital reconstruction or termination of employment. It may be appropriate to pro-rate the benefit both for time and performance</li> <li>• On termination of employment, where early vesting is deemed to be appropriate, vesting should be dependant upon the extent to which performance conditions have been met over the period, as well as the time served.</li> </ul>	

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	<p>2.26. Companies should disclose the remuneration of each individual director and certain senior executives</p>	<p>Full disclosure of remuneration paid to each executive director and non-executive director must be made. Details should be provided of base pay, bonuses, share-based payments, granting of options or rights, restraint payments and all other benefits.</p> <p>Disclosure of the maximum and expected potential dilution that may result from incentive awards granted in the current year is also required.</p> <p>In addition, this information must also be disclosed for the three most highly-paid employees who are not directors in the company.</p> <p>The company’s annual remuneration report must explain the remuneration policies followed throughout the company and explain the strategic objectives that the policies seek to achieve.</p> <p>The remuneration report must also explain the company’s policy on base pay and the use of appropriate benchmarks.</p>	<p>King II required full disclosure of remuneration paid to directors on an individual basis. This requirement has been extended under King III to certain senior employees.</p> <p>King II required a company to establish a formal and transparent procedure for developing a policy on director and executive remuneration, which should be supported by a statement of remuneration philosophy in the annual report.</p>

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	2.27. Shareholders should approve the company's remuneration policy	<p>On an annual basis, the company's remuneration policy should be tabled to shareholders for a non-binding advisory vote at the annual general meeting.</p> <p>This vote enables shareholders to express their views on the remuneration policies adopted and on their implementation.</p>	Was not part of King II

### Implications

King II laid the foundations for governance of executive remuneration. King III builds on this and takes into account the direction in which the global market is moving and the demands of institutional shareholders.

The inclusion of specific, detailed provisions around remuneration will provide South African companies with a clear framework with which to comply and enable them to achieve best practice standards.

It will, however, increase the burden on companies in so far as disclosure is concerned. Companies would also be well-advised to review their policies in light of King III to assess the extent of their compliance.

As far as companies in the financial services sector are concerned, King III does not go far enough in terms of representing best practice. In response to shortcomings identified as a result of the financial crisis, regulators across the world have been issuing codes of practice and best practice principles in this area. On 12 August 2009, for example, the Financial Services Authority in the UK became the first regulator to publish a final form code of practice on remuneration for financial services companies. We believe that it is only a matter of time before a similar code is published in South Africa.

### Expert opinion

The remuneration principles laid out in King III are to be welcomed. It is imperative that executive remuneration be aligned with the company's strategy and that executives create long-term value for shareholders. Both themes are evident in the Code.

Globally, share-based long-term incentives have become an important part of total remuneration packages paid to executives. In the past, this has been a grey area in terms of governance in South African and it is illuminating that King III has laid down some explicit rules regarding the operation of such plans.

Given the focus placed on executive remuneration recently and the part it played in the reversal in the global economy and turmoil in the financial services sector, the King III principles around the governance and disclosure of executive remuneration will ensure that South African companies are at the forefront of international best practice. It is worth noting that, in a comparison of the King III principles on remuneration with the UK Combined Code, the similarities are striking. King III has ensured consistency between local and international governance, thus clearing the way for South African companies to attract global investment and compete effectively.

### Key questions directors should be asking

1. Does our remuneration policy comply with the principles of King III and reflect current international best practice?
2. Are our long-term incentive plan rules consistent with the principles of King III in terms of the use and application of performance conditions?
3. Do our non-executive directors receive share options and/or other share incentive awards?
4. Does our annual bonus plan link performance to clearly set objectives that create long-term value for shareholders?
5. Do we fully disclose remuneration paid to executive directors, non-executive directors and certain senior employees in our annual remuneration report?

6. Can we explain how our remuneration policy links into our strategic objectives?

### How we can help you

Intense scrutiny of corporate governance, increased shareholder activism and the recent financial crisis have led to the restructuring and re-evaluation of traditional remuneration structures.

In addition, the role of the remuneration committee has widened. There is a need for committees to be more challenging and to exercise more discretion in managing the board to avoid divisiveness over pay. Being a member of a remuneration committee is, and should be, a tough job.

Our executive reward specialists at PwC offer a wealth of experience in this area and work closely with clients to offer practical, multi-disciplined approaches to the complex challenges faced by businesses today.

Some of the ways we can assist companies to deal with King III:

- Assess the remuneration policy against the King III principles and assist with the development of a policy that is fully compliant
- Assist with the preparation of an annual remuneration report
- Advise on executive remuneration – base pay, benefits, annual bonuses and long-term incentives

- Advise on non-executive fees
- Devise performance targets and measures for annual bonuses
- Design and implement short-term and long-term incentive arrangements (including drafting the relevant documentation, providing tax and accounting opinions and assistance with investor relations)
- Advise on benchmarking and best practices
- Provide training to remuneration committee members and advise them on trends and risks in the remuneration field.

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Disclaimer: This document is not intended to constitute legal or professional advice. The purpose of the document is to provide readers with a guideline of certain provisions of King III but is not a substitute for reading the detailed provisions of King III.

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