

**EXECUTIVE SUMMARY
of the
KING REPORT 2002**

KING COMMITTEE ON CORPORATE GOVERNANCE



INSTITUTE OF DIRECTORS

LOGO : PROUDLY SOUTH AFRICAN

MARCH 2002

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RICHARD S. WILKINSON
Executive Director
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PREFACE

The guidelines for the review of the King Report 1994 on corporate governance and the remits of the task teams are set out in Appendix II.

The task teams considered boards and directors, accounting and auditing, internal audit and risk management, non-financial matters, and compliance and enforcement.

The work of the task teams was studied and debated by the King Committee, who distilled their recommendations into the Code of Corporate Practices and Conduct. For the full background to and an understanding of the Code the sections, aligned with each task team's work, should be read. On this reading, it will be seen that the Code is in line with best international practices. This is necessary in our borderless world of the information age.

I want to record my thanks and appreciation for the work done by the task teams and my Committee. Hundreds of hours went into the compilation of this Report, which we decided to issue as a work of reference with aspirational recommendations from which the Code evolved. In particular I want to thank the convenors of the task teams and more particularly the convenor of convenors and principal editor, Philip Armstrong, who not only had to deal with the various task teams but with my interventions, amendments and suggestions.

Thanks are due to the Institute of Directors, under whose auspices the King Committee was initiated and especially Richard Wilkinson who has provided the Secretariat and been a member of the Committee from inception.

I was inspired in my work on this Report by the fact that so many prominent South Africans gave of their time on an honorary basis. None of us even attempted to recover our disbursements in preparing this Report.

The King Committee is proud that some major investors and institutions have said that South Africa has the best governance of listed companies in emerging economies. It will be adequate reward for our work if in the future, South African directors of our listed companies continue to be recognised as practitioners of good corporate governance. It will be better than adequate if all affected companies implement the Code.

The Code of Corporate Practices and Conduct contained in this Report will replace the present Code contained in the first King Report 1994 with effect from 1 March 2002.

MERVYN E. KING S.C
Chairperson

MARCH 2002

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INTRODUCTION AND BACKGROUND

“Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals...the aim is to align as nearly as possible the interests of individuals, corporations and society.”

*Sir Adrian Cadbury
Corporate Governance Overview, 1999
World Bank Report*

1. Corporate governance in South Africa was institutionalised by the publication of the *King Report on Corporate Governance* (“King Report 1994”) in November 1994.
2. The King Committee on Corporate Governance was formed in 1992, under the auspices of the Institute of Directors, to consider corporate governance, of increasing interest around the world, in the context of South Africa. This coincided with profound social and political transformation at the time with the dawning of democracy and the re-admission of South Africa into the community of nations and the world economy.
3. The purpose of the King Report 1994 was, and remains, to promote the highest standards of corporate governance in South Africa.
4. Unlike its counterparts in other countries at the time, the King Report 1994 went beyond the financial and regulatory aspects of corporate governance in advocating an integrated approach to good governance in the interests of a wide range of stakeholders having regard to the fundamental principles of good financial, social, ethical and environmental practice. In adopting a participative corporate governance system of enterprise with integrity, the King Committee in 1994 successfully formalised the need for companies to recognise that they no longer act independently from the societies and the environment in which they operate.
5. But a distinction needs to be made between accountability and responsibility:
 - 5.1. One is liable to render an account when one is accountable and one is liable to be called to account when one is responsible. In governance terms, one is accountable at common law and by statute to the company if a director, and one is responsible to the stakeholders identified as relevant to the business of the company. The stakeholder concept of being accountable to all legitimate stakeholders must be rejected for the simple reason that to ask boards to be accountable to everyone would result in their being accountable to no one. The modern approach is for a board to identify the company’s stakeholders, including its shareowners, and to agree policies as to how the relationship with those stakeholders should be advanced and managed in the interests of the company. Wherever the term “stakeholder” is applied in this Report, it is used in the sense enunciated in this paragraph.

- 5.2. In decades past, if people had gathered in order to establish a company to produce goods, they would have applied to a regulator for a licence, hired premises, bought plant, and proceeded to manufacture without much regard to the impact on the environment, or the interests of other stakeholders. The permission from the regulator to manufacture the goods would have been the “licence to operate”. Today, the licence to operate a company is much more complex. Boards have to consider not only the regulatory aspect, but also industry and market standards, industry reputation, the investigative media, and the attitudes of customers, suppliers, consumers, employees, investors, and communities (local, national and international), ethical pressure groups, public opinion, public confidence, political opinion, etc.
- 5.3. The inclusive approach recognises that stakeholders such as the community in which the company operates, its customers, its employees and its suppliers need to be considered when developing the strategy of a company. The relationship between a company and these stakeholders is either contractual or non-contractual.
6. The inclusive approach requires that the purpose of the company be *defined*, and the values by which the company will carry on its daily life should be *identified* and *communicated* to all stakeholders. The stakeholders relevant to the company’s business should also be identified. These three factors must be combined in developing the strategies to achieve the company’s goals. The relationship between the company and its stakeholders should be mutually beneficial. A wealth of evidence has established that this inclusive approach is the way to create sustained business success and steady, long-term growth in shareowner value.
7. However, it must constantly be borne in mind that entrepreneurship and enterprise are still among the important factors that drive business:
 - 7.1. Emerging economies have been driven by entrepreneurs, who take business risks and initiatives. With successful companies, come successful economies. Without satisfactory levels of profitability in a company, not only will investors who cannot earn an acceptable return on their investment look to alternative opportunities, but it is unlikely that the other stakeholders will have an enduring interest in the company.
 - 7.2. The key challenge for good corporate citizenship is to seek an appropriate balance between enterprise (performance) and constraints (conformance), so taking into account the expectations of shareowners for reasonable capital growth and the responsibility concerning the interests of other stakeholders of the company. This is probably best encapsulated in the statement attributed to the President of the World Bank, Jim Wolfensohn, that “[t]he proper governance of companies will become as crucial to the world economy as the proper governing of countries”. Proper governance embraces both performance and conformance.
8. Conforming to corporate governance standards results in constraints on management. Boards have to balance this with performance for financial success and the sustainability of the company’s business. Tomorrow’s Company in the United Kingdom developed the concept of three corporate sins, namely *sloth*, being a loss of flair when enterprise gives way to administration; *greed*, when executives might make a short-term decision because it has greater impact

on their share options and bonuses, than a decision that might create longer term prosperity for the company; and *fear*, where executives become subservient to investors and ignore the drive for sustainability and enterprise.

9. Corporate governance principles were developed, *inter alia*, because investors, with the era of the professional manager, were worried about the excessive concentration of power in the hands of management. This protection against greed could encourage the sins of sloth and fear, with an erosion of enterprise and an encouragement of subservience. A balance is needed.
10. While the King Committee remains firmly committed to the above governance concepts, a number of the far-reaching recommendations contained in the King Report 1994 have been superseded by legislation in the social and political transformation that coincided with its release. Some of the more significant have been the Labour Relations Act (No. 66 of 1995), Basic Conditions of Employment Act (No. 75 of 1997), Employment Equity Act (No. 55 of 1998) and the National Environmental Management Act (No. 107 of 1998) amongst a number of others. The intervening period has also seen the listings requirements of the JSE Securities Exchange South Africa (formerly Johannesburg Stock Exchange) ("JSE") comprehensively revised in 1995 and again in 2000 to ensure that they remain current with international best practice. During this time some of the recommendations for statutory amendments to the Companies Act (No. 61 of 1973) ("Companies Act") contained in the King Report 1994 were promulgated thereby permitting companies to obtain liability insurance cover indemnifying their directors and officers¹, compelling disclosure of the identity of beneficial owners of shares held by nominees², and making the appointment of the company secretary mandatory for public companies with a share capital³.
11. Other legislative developments since the publication of the King Report 1994 include the introduction of the Insider Trading Act (No. 135 of 1998) providing for more rigorous supervision and monitoring of insider trading, the Public Finance Management Act (No. 1 of 1999) bringing into force more stringent provisions for reporting and accountability by adopting an approach to financial management in government that focuses on outputs and responsibilities rather than the rule driven approach under previous legislation, and a comprehensive update of the provisions and regulations governing the Banks Act (No. 94 of 1990) enforcing substantially higher levels of corporate governance compliance and risk reporting in banking institutions. Also notable in this period has been the priority accorded to corporate governance practices in state enterprises culminating in the release of the *Policy Framework for State Owned Enterprises* by the Department of Public Enterprises in August 2000, which is in the process of being comprehensively updated.
12. A dominant feature of business since 1994 has been the emergence of information technology in all its facets, as a key driver of business strategy and decisions. The proliferation of cheap, accessible communication via the internet has facilitated a potent form of information exchange across all spectrums of society. Information technology has now become an integral part of internal controls and reporting information. At the same time, there are fiduciary

¹ Paragraph 24.7 of the King Report 1994 by way of an amendment to section 247 of the Companies Act

² Paragraph 24.4 of the King Report 1994 by the introduction of section 140A of the Companies Act

³ Paragraph 24.8 of the King Report 1994 by the introduction of sections 268A to 268J of the Companies Act

implications because of the electronic formation of contracts, the integrity of electronic communications, the retention of records etc.

13. Consequently, directors need to ensure that the necessary skills are in place for them to discharge their responsibility for internal controls. While technology can be used to improve reporting and transparency, directors must be aware of the blurring of organisational barriers as a consequence of e-business.
14. The “company” remains a key component of modern society. In fact, in many respects, companies have become a more immediate presence to many citizens and modern democracies than either governments or other organs of civil society. As a direct consequence, companies remain the legitimate and necessary focal point for profit-making activities in market economies. They are also increasingly a target for those discontented with business liberalisation and globalisation, an agenda that companies are perceived as driving. In the global economy, there are many jurisdictions to which a company can run to avoid regulation and taxes or to reduce labour costs. But, there are few places where a company can hide its activities from sceptical consumers, shareowners or protestors.⁴ In short, in the age of electronic information and activism, no company can escape the adverse consequences of poor governance.
15. It is becoming difficult for companies to account for profitability alone. In a report by an international institutional investor,⁵ while South Africa ranked among the top five of 25 emerging markets in terms of corporate governance, it rated poorly in terms of disclosure and transparency. The minimalist approach to corporate governance adopted by many local companies needs to change. While South Africa may arguably offer investment returns comparable with some of the best in the world, even after accounting for political, currency and other risks, it must visibly demonstrate impeccable governance standards in all sectors of commercial activity not only in principle, but also in practice, if it is to remain a destination of choice for emerging market global investors.
16. If there is a lack of good corporate governance in a market, capital will leave that market with the click of a mouse. As Arthur Levitt, the former Chairperson of the US Securities and Exchange Commission has said, *“If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country – regardless of how steadfast a particular company’s practices may be – suffer the consequences. Markets must now honour what they perhaps, too often, have failed to recognise. Markets exist by the grace of investors. And it is today’s more empowered investors that will determine which companies and which markets will stand the test of time and endure the weight of greater competition. It serves us well to remember that no market has a divine right to investors’ capital”*
17. There is a move from the single to the triple bottom line, which embraces the economic, environmental and social aspects of a company’s activities:

⁴ Canadian Democracy & Corporate Accountability – An Overview of Issues, The Democracy & Corporate Accountability Commission, Canada
website: www.corporate-accountability.ca

⁵ *The Tide’s Gone Out: Who’s Swimming Naked?* – CLSA Emerging Markets, October 2000

- 17.1. The economic aspect involves the well-known financial aspects as well as the non-financial ones relevant to that company's business. The environmental aspects include the effect on the environment of the product or services produced by the company. The social aspects embrace values, ethics and the reciprocal relationships with stakeholders other than just the shareowners. There is an endeavour now through the Global Reporting Initiative to lay down guidelines on how a company should report on the triple bottom line.
- 17.2. It is now generally accepted by multinationals operating in various jurisdictions that *“demonstrating concern creates an atmosphere of trust and a better understanding of corporate aims, so that when the next crisis comes (and these are inevitable for big companies) there will be a greater goodwill to help the company survive”*⁶.
- 17.3. This triple bottom line reporting also stems from the in-depth study now being done on the importance of ownership in business. Ownership is not unique to companies. It is a societal phenomenon. With ownership comes responsibilities. The logic has been that shareowners are entitled to expect directors to run the company in their sole interests – the so-called shareowner dominant theory. This approach has been rejected by Courts in various jurisdictions, because on incorporation the company becomes a separate persona in law and no person whether natural or juristic can be owned. Courts have also held that shareowners have no direct interest in the property, business or assets owned by a company, their only rights being a right to vote and a right to dividends. Shareowners also change from time to time while as the owner, the company remains constant. Consequently, directors, in exercising their fiduciary duties, must act in the interest of the company as a separate person.
- 17.4. Shareowners obtain their power from the democratic process of voting by which means they can elect or dismiss directors, who carry out the objectives of the company.
- 17.5. The relationship between the company and the shareowners arises out of the articles of association, which are nothing more than a contract between them. This is the only means of shareowner protection, which is quite ineffective in practice. Because the shareowners have little or no protection, the quality of governance is of absolute importance to them.
18. It would be useful, at this point, to illustrate what can be regarded as constituting the seven characteristics of good corporate governance⁷:

18.1. ***Discipline***

Corporate discipline is a commitment by a company's senior management to adhere to behaviour that is universally recognised and accepted to be correct and proper. This encompasses a company's awareness of, and commitment to, the underlying principles of good governance, particularly at senior management level.

⁶ Reputation Assurance
⁷ Source: CLSA Emerging Markets

18.2. ***Transparency***

Transparency is the ease with which an outsider is able to make meaningful analysis of a company's actions, its economic fundamentals and the non-financial aspects pertinent to that business. This is a measure of how good management is at making necessary information available in a candid, accurate and timely manner – not only the audit data but also general reports and press releases. It reflects whether or not investors obtain a true picture of what is happening inside the company.

18.3. ***Independence***

Independence is the extent to which mechanisms have been put in place to minimise or avoid potential conflicts of interest that may exist, such as dominance by a strong chief executive or large shareowner. These mechanisms range from the composition of the board, to appointments to committees of the board, and external parties such as the auditors. The decisions made, and internal processes established, should be objective and not allow for undue influences.

18.4. ***Accountability***

Individuals or groups in a company, who make decisions and take actions on specific issues, need to be accountable for their decisions and actions. Mechanisms must exist and be effective to allow for accountability. These provide investors with the means to query and assess the actions of the board and its committees.

18.5. ***Responsibility***

With regard to management, responsibility pertains to behaviour that allows for corrective action and for penalising mismanagement. Responsible management would, when necessary, put in place what it would take to set the company on the right path. While the board is accountable to the company, it must act responsively to and with responsibility towards all stakeholders of the company.

18.6. ***Fairness***

The systems that exist within the company must be balanced in taking into account all those that have an interest in the company and its future. The rights of various groups have to be acknowledged and respected. For example, minority shareowner interests must receive equal consideration to those of the dominant shareowner(s).

18.7. ***Social responsibility***

A well-managed company will be aware of, and respond to, social issues, placing a high priority on ethical standards. A good corporate citizen is increasingly seen as one that is non-discriminatory, non-exploitative, and responsible with regard to environmental and human rights issues. A company is likely to experience indirect economic benefits such as improved productivity and corporate reputation by taking those factors into consideration.

19. One of the difficulties, and challenges, has been to provide sufficient empirical evidence that good corporate governance pays:

19.1. In recent years, research has been developed that increasingly supports this proposition. In its *Investor Opinion Survey* published in June 2000, McKinsey & Co., working with Institutional Investors Inc., found that good governance could be quantified and was significant. For the survey, well-governed companies were defined as:

- having a clear majority of outsiders on the board, with no management ties;
- holding formal evaluations of directors;
- having directors with significant stakes in the company and receiving a large proportion of their pay in the form of stock options; and
- being responsive to investor requests for information on governance issues.

19.2. The survey found that:

- more than 84% of the more than 200 global institutional investors, together representing more than US\$3 trillion in assets, indicated a willingness to pay a premium for the shares of a well-governed company over one considered poorly governed but with a comparable financial record;
- three-quarters of these investors indicated that board practices were at least as important as financial performance, when evaluating companies for potential investment; and
- the actual premium these investors would be willing to pay varied from country to country. In the United Kingdom, they would pay 18% more for the shares of a well-governed company than for the shares of a company with similar financial performance but poorer governance practices. In emerging markets or markets perceived to have poor governance practices, this premium escalated to 22% for a well-governed Italian company and to as much as 27% for one in Venezuela or Indonesia.

19.3. The implications for companies are profound. Simply by developing good governance practices, managers can potentially add significant shareowner value. The results of this survey should also be apparent to policy makers and regulators in recognising that the creation of a good governance climate can make countries, especially in the emerging markets, a magnet for global capital. This survey emphasised that companies not only need to be well-governed, but also need to be perceived in the market as being well governed.

20. Other similar surveys support the contentions put forward by McKinsey⁸. In March 2001, Stanford University issued a report on corporate governance in emerging markets, re-enforcing the McKinsey findings. Add to this the immense influence of US pension funds, where the proportion of overall foreign holdings of some US\$410 billion in 1999 held by the top 25 pension funds leapt from 42% in 1998 to 66%. Amongst these are many of the funds that have been at the forefront of the governance movement in the United States, such as CalPERS, TIAA-CREF, CalSTRS, and the States of Wisconsin and Florida. It is notable that these funds are developing activist strategies abroad, and that a number of such funds are invested in South African companies. Moreover, over the past year or so, the South African market has experienced a rise in shareowner activism that is gathering momentum. Corporate governance is at the heart of most of the issues that have arisen thus far.
21. In the information age everyone, willingly or not, is a member of the global market place:
- 21.1. As members of this global club, everyone lives in a borderless world, not one as envisaged by the World Trade Organisation with no geographic trading borders but one where information crosses borders with the “click of a mouse”. Relying on this information, capital flows across geographic borders as if they were non existent.
- 21.2. It follows that the information must be trustworthy before an investor will decide to invest. The measurement for this trust and confidence is the quality of the governance of the company imparting the information.
- 21.3. In their own self-interest global investors are promoting good governance in companies. Thus, the Association of Unit Trusts and Investment Funds in the United Kingdom requires member funds routinely to inform their investors in annual reports about how they have promoted good corporate governance in the companies in which they invest. Under the Employment, Retirement and Income Security Act in the United States, the vote of an investor is seen as a trust “asset” and must be treated with the same level of care as the cash and other assets under the management of a company. The trend now is that fiduciaries should be required to vote and disclose how they have voted. The International Trade Union movement, amongst many others, is driving to mobilise labour-orientated funds as shareowner activists. The goal is the pooling of financial power across borders to press shared interests in corporate governance and social issues.
- 21.4. The era of deference of shareowners and society to the company generally, has gone. Shareowner activism has taken root globally, notwithstanding that share ownership is now dispersed through institutions throughout the world. Institutional investors, both national and global, are drafting criteria for investment and for how investors can improve the corporate governance in companies in which they invest.

8

Some examples of other surveys include the research undertaken by Russell Reynolds in its *Corporate Governance in the New Economy – 2000 International Survey of Institutional Investors* and that conducted by R LaPorta, F Lopez-de-Silanes, A Schleifer and R Vishny *Investor Protection and Corporate Value – NBER Working Paper 7403*. Findings in both instances indicated a close correlation between investors' perceptions of good governance practices and companies, and the influence this had on their investment decision process

22. Apart from the value added to a company by good corporate governance, interest in such practices has been fuelled by the international financial crises of the 1990s. In East Asia, in 1997 and 1998, it was demonstrated that macro-economic difficulties could be worsened by systemic failure of corporate governance, stemming from:
- 22.1. weak legal and regulatory systems;
 - 22.2. poor banking regulation and practices;
 - 22.3. inconsistent accounting and auditing standards;
 - 22.4. improperly regulated capital markets; and
 - 22.5. ineffective oversight by corporate boards, and scant recognition of the rights of minority shareowners.
23. The significance of corporate governance is now widely recognised, both for national development and as part of international financial architecture, as a lever to address the converging interests of competitiveness, corporate citizenship, and social and environmental responsibility. It is also an effective mechanism for encouraging efficiency and combating corruption. Companies are governed within the framework of the laws and regulations of the country in which they operate. Communities and countries differ in their culture, regulation, law and generally the way business is done. In consequence, as the World Bank has pointed out, there can be no single generally applicable corporate governance model. Yet there are international standards that no country can escape in the era of the global investor. Thus, international guidelines have been developed by the Organisation for Economic Co-operation and Development (OECD), the International Corporate Governance Network, and the Commonwealth Association for Corporate Governance. The four primary pillars of fairness, accountability, responsibility and transparency are fundamental to all these international guidelines of corporate governance.
24. The 19th century saw the foundations being laid for modern corporations: this was the century of the entrepreneur. The 20th century became the century of management: the phenomenal growth of management theories, management consultants and management teaching (and management gurus) all reflected this pre-occupation. As the focus swings to the legitimacy and the effectiveness of the wielding of power over corporate entities worldwide, the 21st century promises to be the century of governance.
25. Historically, whilst the focus on governing corporations has been financial, a balance sheet is only a record of one moment in time of the financial affairs of a company. Investors now want a forward-looking approach to reporting. Thus the balanced scorecard approach, which results in information at a glance so that companies can be measured against defined goals, has been developed. What stakeholders want is a form of reporting from which they can see whether or not a company is likely to have sustained success.⁹ For example, if working capital

⁹ Clearly the notion of providing a balanced scorecard does not entail the disclosure of competitive or sensitive information that could be detrimental to a company's legitimate interests. However, the extent to which companies withhold disclosure of information must be carefully weighed against the expectation by investors and others with a legitimate interest in the affairs of the company for full and frank disclosure without prejudicing corporate interests for which directors carry fiduciary responsibility. On the other hand, excessive secrecy on the part of boards and

needs to be reduced, the company would aim to reduce its debt/equity ratio and its working capital to sales ratio by a stated percentage at a fixed time in the future, such as at the next annual general meeting date.

26. Some companies have appointed corporate reputation officers (CRO) to monitor how third parties view the company and to report to the chief executive on their findings. Further, the CRO reports on matters such as customer satisfaction and customer perception of key service areas. Of even greater importance in the information age, particularly in IT companies, is the report on human resources aspects such as morale, skills, training, incentivisation, attraction of talent and succession. Other examples of so-called non-financial aspects of company performance include innovation, training, reciprocal relationships with defined stakeholders, management credibility as seen by third parties, technology (as compared with the technology of competitors), internal audit, management information systems, risk management, service standards, productivity levels, benchmarking, etc.
27. What stakeholders are looking for are reports that evidence good stewardship by the directors. While communicating in financial terms is retrospective, this is in a common language that is understandable to all stakeholders. The difficulty with communicating the less defined sustainability, or non-financial aspects is that no universal reporting standard or language has yet been developed.

What shareowners, especially institutional investors want are understandable measurements, to enable them to judge stewardship, performance, conformance and sustainability on a common basis.

28. In the context of all the above, the King Committee considered it appropriate to review corporate governance standards and practices for South Africa against developments that have taken place since the advent of the King Report 1994 in November 1994.
29. Four primary Guiding Principles were established for the purposes of this review:
- 29.1. to review the King Report 1994 and to assess its currency against developments, locally and internationally, since its publication on 29 November 1994;
 - 29.2. to review and clarify the earlier proposal in the King Report 1994 for an “inclusive approach” for the sustainable success of companies;
 - 29.3. to recognise the increasing importance placed on non-financial issues worldwide, and to consider and to recommend reporting on issues associated with social and ethical accounting, auditing and reporting (“SEAAR”) and safety, health and environment (“SHE”); and
 - 29.4. to recommend how compliance with a new Code of Corporate Governance for South Africa can be measured and based on outcomes, that is, how the success of companies can be measured through the “balanced scorecard” approach for reporting.

companies may lose the trust of those they are attempting to convince, particularly should events subsequently arise where in hindsight it may have been better to have informed investors and other legitimate stakeholders

30. A number of task teams was established to undertake a detailed review of specified areas of corporate governance, namely:
- 30.1. The *Boards and Directors* task team looked into issues regarding board practice, the status and responsibilities associated with executive, non-executive and independent directors, executive and non-executive director remuneration. It also re-visited the “Business Judgment Rule”. This task team was chaired by Roy Andersen.
 - 30.2. The *Accounting and Auditing* task team considered developments surrounding auditing and non-audit services, accounting standards in relation to international developments, auditor skills required for reporting on non-financial aspects and the King Committee’s previous recommendations regarding legal backing for accounting standards in South Africa. This task team was chaired by Malcolm Dunn.
 - 30.3. The *Internal Audit, Control and Risk Management* task team reviewed the role and function of internal audit and the scope and status of the internal auditor in relation to developments since 1994 against international best practice. It also investigated recommendations introducing risk management as a criterion for boards and companies in corporate governance. This task team was chaired by Nigel Payne.
 - 30.4. The *Integrated Sustainability Reporting* task team perhaps had the most compelling brief in that it had to analyse a wide range of complex, and in some cases undefined, areas of reporting of a non-financial nature. Topics ranged from stakeholder engagement to ethics and ethical reporting, as well as societal and transformation issues including black economic empowerment for example. This task team was chaired by Reuel Khoza.
 - 30.5. The *Compliance and Enforcement* task team was required to consider the supervision and enforcement of existing statutory and regulatory provisions governing companies in South Africa and to make recommendations to improve compliance with governance guidelines. This task team was chaired by Michael Katz.¹⁰
31. The task teams, comprising some 50 or so individuals in total, represented a cross-section of South African business and society in both the private and public sectors.
32. Extensive consultation was sought by the task teams themselves, and the draft Report was subject to exhaustive public consultation, both in South Africa and internationally.
33. Many of the observations and recommendations contained in the King Report 1994 remain current and, for completeness and where appropriate, have been repeated in this Report.
34. While it has been noted that some of the recommendations contained in the King Report 1994 have subsequently been superseded by legislation, this should only be seen as addressing the minimum acceptable standards. As society in South Africa has evolved since 1994 through local developments and international

¹⁰ Read with paragraph 40 below

circumstances, it is clear that business in this country continues to be faced with many challenges in a complex environment of political imperatives, globalisation and increasing relevance of stakeholder interests. While this Report attempts to discuss many of these issues, it cannot presume to prescribe the detailed course of conduct for each company and its board. It can only recommend some priorities that directors and boards need to blend into the particular circumstances of the companies for which they are responsible and accountable, so as to derive a balanced scorecard approach to corporate governance standards according to international best practice.

35. The responsibilities of a board under the inclusive approach in the 21st century will be to define the purpose of the company and the values by which the company will perform its daily existence and to identify the stakeholders relevant to the business of the company. The board must then develop a strategy combining all three factors and ensure that management implements this strategy. The board's duty then is to monitor that implementation. The board must also deal with the well-known financial aspects. The key risk areas and the key performance indicators must be identified, as well how those risks are to be managed. In regard to the obligation to report as a going concern, the directors need to ensure that the facts and assumptions they rely on in coming to that conclusion are recorded. The board needs regularly to monitor the human capital aspects of the company in regard to succession, morale, training, remuneration, etc. In addition, the board must ensure that there is effective communication of its strategic plans and ethical code, both internally and externally. The board must see to it that there are adequate internal controls and that the management information systems can cope with the strategic direction in which the company is headed. There must be a "licence to operate" check in language understandable to all those to whom it is communicated.
36. Against this, companies in South Africa must recognise that they co-exist in an environment where many of the country's citizens disturbingly remain on the fringes of society's economic benefits.
37. Hence, it is the King Committee's unanimous view that the inclusive approach is fundamental to doing business in South Africa in order to ensure that companies succeed at balancing economic efficiency and society's broader objectives.
38. Governance in any context reflects the value system of the society in which it operates. Accordingly, it would be pertinent to observe and to take account of the African worldview and culture in the context of governance of companies in South Africa, some aspects of which are set out as follows:¹¹
 - 38.1. Spiritual Collectiveness, is prized over individualism. This determines the communal nature of life, where households live as an interdependent neighbourhood.

¹¹ These principles and philosophies were taken from an article that appeared in *Directorship* (March 2001) titled *African Imperatives and Transformation Leadership* by Shepherd Shonhiwa – a Fellow and a Vice-Chairperson of the Institute of Directors in Southern Africa. In the public comment received by the King Committee, various interpretations were attached to this piece. It is important to recognise the diversity that exists in South Africa in relation to culture, religion, ethnicity, etc. What this attempts to highlight, is the need for companies and boards operating in South Africa to take account of this wide range of value systems and rich diversity in defining its corporate ethos and conduct – both internally and externally

- 38.2. An inclination towards consensus rather than dissension, helps to explain the loyalty of Africans to their leadership.
 - 38.3. Humility and helpfulness to others is more important than criticism of them.
 - 38.4. In the main, African culture is non-discriminatory and does not promote prejudice. This explains the readiness with which Africans embrace reconciliation at political and business levels.
 - 38.5. Co-existence with other people is highly valued. The essence of *ubuntu* (humanity) that cuts across Africa is based on the premise that you can be respected only because of your cordial co-existence with others.
 - 38.6. There is also an inherent trust and belief in fairness of all human beings. This manifests itself in the predisposition towards universal brotherhood, even shared by African-Americans.
 - 38.7. High standards of morality are based on historical precedent. These are bolstered by the close kinship observed through totem or clan names and the extended family system.
 - 38.8. An hierarchical political ideology is based on an inclusive system of consultation at various levels. The tradition of consultation as practised by the chiefs since time immemorial should form the basis of modern labour relations and people management practices.
 - 38.9. Perpetual optimism is due to strong belief in the existence of an omniscient, omnipotent and omnipresent superior being in the form of the creator of mankind.
39. Corporate governance, is essentially about leadership:
- 39.1. leadership for efficiency in order for companies to compete effectively in the global economy, and thereby create jobs;
 - 39.2. leadership for probity because investors require confidence and assurance that the management of a company will behave honestly and with integrity in regard to their shareowners and others;
 - 39.3. leadership with responsibility as companies are increasingly called upon to address legitimate social concerns relating to their activities; and
 - 39.4. leadership that is both transparent and accountable because otherwise business leaders cannot be trusted and this will lead to the decline of companies and the ultimate demise of a country's economy.
40. Monitoring and supervision across the entire spectrum of economic and commercial enterprise is impossible by any measure, and thus the recommendations contained in this Report remain self-regulatory – although conformance can be encouraged in various ways. It is the submission of the King Committee, however, that it would be in the enlightened self-interest of every enterprise to take careful cognisance of the recommendations outlined in this Report and to adhere to these to the extent practicable and applicable.

41. In summary, successful governance in the world of the 21st century requires companies to adopt an inclusive and not an exclusive approach. The company must be open to institutional activism and there must be greater emphasis on the sustainable or non-financial aspects of its performance. Boards must apply the tests of fairness, accountability, responsibility and transparency to all acts or omissions and be accountable to the company also but responsive and responsible towards the company's identified stakeholders. The correct balance between conformance with governance principles and performance in an entrepreneurial market economy must be found, but this will be specific to each company.

CODE OF CORPORATE PRACTICES AND CONDUCT

1. Application of Code

- 1.1. The Code applies to the following business enterprises (hereinafter referred to as “affected companies”):
 - 1.1.1. All companies with securities listed on the JSE Securities Exchange South Africa.
 - 1.1.2. Banks, financial and insurance entities as defined in the various legislation regulating the South African financial services sector.
 - 1.1.3. Public sector enterprises and agencies that fall under the Public Finance Management Act and the Local Government: Municipal Finance Management Bill (still to be promulgated) including any department of State or administration in the national, provincial or local sphere of government or any other functionary or institution:
 - exercising a power or performing a function in terms of the Constitution or a provincial constitution; or
 - exercising a public power or performing a public function in terms of any legislation, but not including a Court or a judicial officer,unless otherwise prescribed by legislation.
- 1.2. All companies, in addition to those falling within the categories listed above, should give due consideration to the application of this Code insofar as the principles are applicable. Stakeholders interacting with such companies are encouraged to monitor the application by these companies of the principles set out in this Code (to the extent applicable).
- 1.3. While it is acknowledged that certain forms of State enterprises may not lend themselves to some of the principles set out in this Code, it is recommended that the principles should be adapted appropriately by such enterprises. To assist entities falling within this category, National Treasury will be issuing “Good Practice Guides” as official directives in line with the overall framework for financial management for the public sector.
- 1.4. All references to “company” or “companies” in this Code and the accompanying Report should be taken to refer to “affected companies” as defined in 1.1 above.
- 1.5. The Code is a set of principles and does not purport to determine the detailed course of conduct of directors on any particular matter. Clearly, companies and their boards will be required to measure the principles set out in this Code against all other statutes, regulations and other authoritative directives regulating their conduct and operation with a view to applying not only the most applicable requirements but also to seek to

adhere to the best available practice that may be relevant to the company in its particular circumstances.

- 1.6. The Code will be effective in respect of affected companies whose financial years commence on or after 1 March 2002. The Code should be seen as a “living document” that may require to be updated from time to time by the King Committee to ensure the currency of its recommended principles of corporate practices and conduct.

2. **Boards and Directors**

2.1. ***The Board***

- 2.1.1. The board is the focal point of the corporate governance system. It is ultimately accountable and responsible for the performance and affairs of the company. Delegating authority to board committees or management does not in any way mitigate or dissipate the discharge by the board and its directors of their duties and responsibilities.
- 2.1.2. Given the positive interaction and diversity of views that take place between individuals of different skills, experience and background, the unitary board structure with executive and non-executive directors interacting in a working group remains appropriate for South African companies.
- 2.1.3. The board must give strategic direction to the company, appoint the chief executive officer and ensure that succession is planned.
- 2.1.4. The board must retain full and effective control over the company, and monitor management in implementing board plans and strategies.
- 2.1.5. The board should ensure that the company complies with all relevant laws, regulations and codes of business practice, and that it communicates with its shareowners and relevant stakeholders (internal and external) openly and promptly and with substance prevailing over form.
- 2.1.6. The board should define levels of materiality, reserving specific power to itself and delegating other matters with the necessary written authority to management. These matters should be monitored and evaluated on a regular basis.
- 2.1.7. The board should have unrestricted access to all company information, records, documents and property. The information needs of the board should be well defined and regularly monitored.
- 2.1.8. The board should consider developing a corporate code of conduct that addresses conflicts of interest, particularly relating to directors and management, which should be regularly reviewed and updated as necessary.

- 2.1.9. The board should have an agreed procedure whereby directors may, if necessary, take independent professional advice at the company's expense.
- 2.1.10. Every board should consider whether or not its size, diversity and demographics makes it effective.
- 2.1.11. The board must identify key risk areas and key performance indicators of the business enterprise. These should be regularly monitored, with particular attention given to technology and systems.
- 2.1.12. The board should identify and monitor the non-financial aspects relevant to the business of the company.
- 2.1.13. The board should record the facts and assumptions on which it relies to conclude that the business will continue as a going concern in the financial year ahead or why it will not, and in that case, what steps the board is taking to remedy the situation.
- 2.1.14. The board should ensure that each item of special business included in the notice of the annual general meeting, or any other shareowners' meeting, is accompanied by a full explanation of the effects of any proposed resolutions.
- 2.1.15. The board should encourage shareowners to attend annual general meetings and other company meetings, at which the directors should be present. More particularly, the chairpersons of each of the board's committees, especially the audit and remuneration committees, should be present at the annual general meeting.
- 2.1.16. A brief CV of each director standing for election or re-election at the annual general meeting should accompany the notice contained in the annual report.
- 2.1.17. Every board should have a charter setting out its responsibilities, which should be disclosed in its annual report. At a minimum, the charter should confirm the board's responsibility for the adoption of strategic plans, monitoring of operational performance and management, determination of policy and processes to ensure the integrity of the company's risk management and internal controls, communications policy, and director selection, orientation and evaluation.
- 2.1.18. The board must find the correct balance between conforming with governance constraints and performing in an entrepreneurial way.

2.2. **Board Composition**

- 2.2.1. Companies should be headed by an effective board that can both lead and control the company. The board should comprise a balance of executive and non-executive directors, preferably with a majority of non-executive directors, of whom sufficient should be independent of management so that shareowner interests

(including minority interests) can be protected. An obvious consideration for South African companies would be to consider the demographics in relation to the composition of the board.

- 2.2.2. Procedures for appointments to the board should be formal and transparent, and a matter for the board as a whole, assisted where appropriate by a nomination committee. This committee should constitute only non-executive directors, of whom the majority should be independent, and be chaired by the board chairperson.
- 2.2.3. Board continuity, subject to performance and eligibility for re-election, is imperative, and a programme ensuring a staggered rotation of directors should be put in place by the board to the extent that this is not already regulated.

2.3. ***Chairperson and Chief Executive Officer***

- 2.3.1. There should be a clearly accepted division of responsibilities at the head of the company, to ensure a balance of power and authority, such that no one individual has unfettered powers of decision-making.
- 2.3.2. The chairperson should preferably be an independent non-executive director.
- 2.3.3. Given the strategic operational role of the chief executive officer, this function should be separate from that of the chairperson.
- 2.3.4. Where the roles of the chairperson and chief executive officer are combined, there should be either an independent non-executive director serving as deputy chairperson or a strong independent non-executive director element on the board. Any such decision to combine roles should be justified each year in the company's annual report.
- 2.3.5. The board should appraise performance of the chairperson on an annual or such other basis as the board may determine. If the roles of chairperson and chief executive officer are combined, then the independent deputy chairperson should play a leading part in the evaluation process.
- 2.3.6. The chairperson, or a sub-committee appointed by the board, should appraise the performance of the chief executive officer. The board should satisfy itself that an appraisal of the chief executive officer is performed at least annually. The results of such appraisal should also be considered by the Remuneration Committee to guide it in its evaluation of the performance and remuneration of the chief executive officer.

2.4. ***Directors***

- 2.4.1. The board should ensure that there is an appropriate balance of power and authority on the board, such that no one individual or block of individuals can dominate the board's decision taking.

- 2.4.2. Non-executive directors should be individuals of calibre and credibility, and have the necessary skill and experience to bring judgment to bear independent of management, on issues of strategy, performance, resources, transformation, diversity and employment equity, standards of conduct and evaluation of performance.
- 2.4.3. In the annual report, the capacity of the directors should be categorised as follows:
- Executive director – an individual that is involved in the day-to-day management and/or is in full time salaried employment of the company and/or any of its subsidiaries.
 - Non-executive director - an individual not involved in the day to day management and not a full-time salaried employee of the company or of its subsidiaries. An individual in the full-time employment of the holding company or its subsidiaries, other than the company concerned, would also be considered to be a non-executive director unless such individual by his/her conduct or executive authority could be construed to be directing the day to day management of the company and its subsidiaries.
 - Independent director – is a non-executive director who:
 - (i) is not a representative of a shareowner who has the ability to control or significantly influence management;
 - (ii) has not been employed by the company or the group of which it currently forms part, in any executive capacity for the preceding three financial years;
 - (iii) is not a member of the immediate family of an individual who is, or has been in any of the past three financial years, employed by the company or the group in an executive capacity;
 - (iv) is not a professional advisor to the company or the group, other than in a director capacity;
 - (v) is not a significant supplier to, or customer of the company or group;
 - (vi) has no significant contractual relationship with the company or group; and
 - (vii) is free from any business or other relationship which could be seen to materially interfere with the individual's capacity to act in an independent manner.

- 2.4.4. A “shadow director” is considered to be a person in accordance with whose directions or instructions (whether they extend over the whole or part of the activities of the company) the directors of the company are accustomed to act. Shadow directors should be discouraged.
- 2.4.5. Executive directors should be encouraged to hold other non-executive directorships only to the extent that these do not interfere with their immediate management responsibilities. Non-executive directors should carefully consider the number of appointments they take in that capacity so as to ensure that the companies on which they serve enjoy the full benefit of their expertise, experience and knowledge.
- 2.4.6. The board should establish a formal orientation programme to familiarise incoming directors with the company’s operations, senior management and its business environment, and to induct them in their fiduciary duties and responsibilities. Directors should receive further briefings from time to time on relevant new laws and regulations as well as on changing commercial risks.
- 2.4.7. New directors with no or limited board experience should receive development and education to inform them of their duties, responsibilities, powers and potential liabilities.
- 2.4.8. Boards should ascertain whether potential new directors are fit and proper and are not disqualified from being directors. Prior to their appointment, their backgrounds should be investigated along the lines of the approach required for listed companies by the JSE and under the Banks Act. The nomination committee would prove useful for this purpose.

2.5. **Remuneration**

- 2.5.1. Levels of remuneration should be sufficient to attract, retain and motivate executives of the quality required by the board.
- 2.5.2. Companies should appoint a remuneration committee or such other appropriate board committee, consisting entirely or mainly of independent non-executive directors, to make recommendations to the board within agreed terms of reference on the company’s framework of executive remuneration and to determine specific remuneration packages for each of the executive directors. This is, ultimately, the responsibility of the board. This committee must be chaired by an independent non-executive director. In order to obtain his or her input on the remuneration of the other executives the committee should consult the chief executive officer, who may attend meetings by invitation. However, a chief executive should play no part in decisions regarding his/her own remuneration.
- 2.5.3. Membership of the remuneration committee or board committee that considers executive remuneration, must be disclosed in the annual report and the chairperson of such committee should attend annual general meetings to answer any questions from shareowners.

- 2.5.4. Companies should provide full disclosure of director remuneration on an individual basis, giving details of earnings, share options, restraint payments and all other benefits.
- 2.5.5. Performance-related elements of remuneration should constitute a substantial portion of the total remuneration package of executives in order to align their interests with those of the shareowners, and should be designed to provide incentives to perform at the highest operational standards.
- 2.5.6. Share options may be granted to non-executive directors but must be the subject of prior approval of shareowners (usually at the annual general meeting) having regard also to the specific requirements of the Companies Act. Because of the apparent dilution of independence, in some international markets the view is that non-executive directors should preferably receive shares rather than share options.
- 2.5.7. In regard to the allocation of share options, boards should be mindful of the following:
- A vesting period in relation to the allocation of share options to non-executive directors should be applied to dissuade short-term decision taking, but should also have regard to the possibility or consequences of the removal or resignation of such directors prior to the vesting period maturing and any perceived impact on their independence.
 - Where it is proposed to re-price share options, this should be the subject of prior shareowner approval. Details of the share options of each executive and non-executive director who stands to benefit from any such proposal should be provided and should be subject to shareowner approval individually for each director.
 - If share options are to be issued at a discount to the ruling price, shareowners should vote separately on this clause in the trust deed at its inception. Any subsequent amendments proposed to an existing trust deed that would permit allocations of share options at a discount must be subject to the specific approval of shareowners.
- 2.5.8. The overriding principle of full disclosure by directors, on an individual basis, should apply to all share schemes and any other incentive schemes proposed by management.
- 2.5.9. It is not considered appropriate that an executive director's fixed-term service contract, if any, should exceed three years. If so, full disclosure of this fact with reasons should be given and the consent of shareowners should be obtained.
- 2.5.10. Companies should establish a formal and transparent procedure for developing a policy on executive and director remuneration

which should be supported by a Statement of Remuneration Philosophy in the annual report.

- 2.5.11. The remuneration or such other similar board committee should play an integral part in the succession planning, particularly in respect of the chief executive officer and executive management.
- 2.5.12. The remuneration committee should consider, and recommend, to the board the fees to be paid to each non-executive director. The proposed fees, as confirmed by the board, should be submitted to the shareowners in general meeting for approval prior to implementation and payment. The practice of paying non-uniform fees to non-executive directors should also be carefully considered. The level of fees should preferably be determined according to the relative contributions of each non-executive director and their participation in the activities of the board and its committees.

2.6. **Board Meetings**

- 2.6.1. The board should meet regularly, at least once a quarter if not more frequently as circumstances require, and should disclose in the annual report the number of board and committee meetings held in the year and the details of attendance of each director (as applicable).
- 2.6.2. Efficient and timely methods should be determined for informing and briefing board members prior to meetings while each board member is responsible for being satisfied that, objectively, they have been furnished with all the relevant information and facts before making a decision.
- 2.6.3. Non-executive directors should have access to management and may even meet separately with management, without the attendance of executive directors. This should, however, be agreed collectively by the board usually facilitated by the non-executive chairperson or lead independent non-executive director.
- 2.6.4. The board should regularly review processes and procedures to ensure the effectiveness of the company's internal systems of control, so that its decision-making capability and the accuracy of its reporting are maintained at a high level at all times.
- 2.6.5. The board should ensure that it receives relevant non-financial information going beyond assessing the financial and quantitative performance of the company, and should look at other qualitative performance factors that involve broader stakeholder interests.

2.7. **Board Committees**

- 2.7.1. Board committees are an aid to assist the board and its directors in discharging their duties and responsibilities, and boards cannot shield behind these committees (see 2.1.1).

- 2.7.2. There should be a formal procedure for certain functions of the board to be delegated, describing the extent of such delegation, to enable the board to properly discharge its duties and responsibilities and to effectively fulfil its decision taking process.
- 2.7.3. Board committees with formally determined terms of reference, life span, role and function constitute an important element of the process in 2.7.2 and should be established with clearly agreed upon reporting procedures and written scope of authority.
- 2.7.4. As a general principle, there should be transparency and full disclosure from the board committee to the board, except where the committee has been mandated otherwise by the board.
- 2.7.5. At a minimum, each board should have an audit and a remuneration committee. Industry and company specific issues will dictate the requirement for other committees.
- 2.7.6. Non-executive directors must play an important role in board committees.
- 2.7.7. All board committees should preferably be chaired by an independent non-executive director, whether this is the board chairperson or some other appropriate individual. Exceptions should be a board committee fulfilling an executive function.
- 2.7.8. Board committees should be free to take independent outside professional advice as and when necessary.
- 2.7.9. Committee composition, a brief description of its remit, the number of meetings held and other relevant information should be disclosed in the annual report. The chairpersons of the board committees, particularly those in respect of audit, remuneration and nomination, should attend the company's annual general meeting.
- 2.7.10. Board committees should be subject to regular evaluation by the board to ascertain their performance and effectiveness (see 2.8.1).

2.8. ***Board and Director Evaluation***

- 2.8.1. The board, through its nomination committee or similar board committee, should regularly review its required mix of skills and experience and other qualities such as its demographics and diversity in order to assess the effectiveness of the board. This should be by means of a self-evaluation of the board as a whole, its committees and the contribution of each individual director.
- 2.8.2. The evaluations in 2.8.1 should be conducted at least annually.

2.9. ***Dealings and Securities***

- 2.9.1. Every listed company should have a practice prohibiting dealing in its securities by directors, officers and other selected employees for a designated period preceding the announcement of its

financial results or in any other period considered sensitive, and have regard to the listings requirements of the JSE in respect of dealings of directors.

- 2.9.2. The practice in 2.9.1 should be determined by way of a formal policy established by the board and implemented by the company secretary.

2.10. **Company Secretary**

- 2.10.1. The company secretary, through the board, has a pivotal role to play in the corporate governance of a company.
- 2.10.2. The board should be cognisant of the duties imposed upon the company secretary and should empower the company secretary accordingly to enable him or her to properly fulfil those duties.
- 2.10.3. In addition to extensive statutory duties, the company secretary must provide the board as a whole and directors individually with detailed guidance as to how their responsibilities should be properly discharged in the best interests of the company.
- 2.10.4. The company secretary has an important role in the induction of new or inexperienced directors, and in assisting the chairperson and chief executive officer in determining the annual board plan and the administration of other issues of a strategic nature at the board level.
- 2.10.5. The company secretary should provide a central source of guidance and advice to the board, and within the company, on matters of ethics and good governance.
- 2.10.6. The Company secretary should be subjected to a fit and proper test in the same manner as is recommended for new director appointments under 2.4.8.

3. **Risk Management**

3.1. **Responsibility**

- 3.1.1. The board is responsible for the total process of risk management, as well as for forming its own opinion on the effectiveness of the process. Management is accountable to the board for designing, implementing and monitoring the process of risk management and integrating it into the day-to-day activities of the company.
- 3.1.2. The board should set the risk strategy policies in liaison with the executive directors and senior management. These policies should be clearly communicated to all employees to ensure that the risk strategy is incorporated into the language and culture of the company.
- 3.1.3. The board must decide the company's appetite or tolerance for risk – those risks it will take and those it will not take in the pursuit of its goals and objectives. The board has the responsibility to ensure

that the company has implemented an effective ongoing process to identify risk, to measure its potential impact against a broad set of assumptions, and then to activate what is necessary to proactively manage these risks.

3.1.4. The board should make use of generally recognised risk management and internal control models and frameworks in order to maintain a sound system of risk management and internal control to provide reasonable assurance regarding the achievement of organisational objectives with respect to:

- effectiveness and efficiency of operations;
- safeguarding of the company's assets (including information);
- compliance with applicable laws, regulations and supervisory requirements;
- supporting business sustainability under normal as well as adverse operating conditions;
- reliability of reporting; and
- behaving responsibly towards all stakeholders.

3.1.5. The board is responsible for ensuring that a systematic, documented assessment of the processes and outcomes surrounding key risks is undertaken, at least annually, for the purpose of making its public statement on risk management. It should, at appropriately considered intervals, receive and review reports on the risk management process in the company. This risk assessment should address the company's exposure to at least the following:

- physical and operational risks;
- human resource risks;
- technology risks;
- business continuity and disaster recovery;
- credit and market risks; and
- compliance risks.

3.1.6. A board committee, either a dedicated committee or one with other responsibilities, should be appointed to assist the board in reviewing the risk management process and the significant risks facing the company.

- 3.1.7. Risk management and internal control should be practiced throughout the company by all staff, and should be embedded in day-to-day activities.
- 3.1.8. In addition to the company's other compliance and enforcement activities, the board should consider the need for a confidential reporting process ("whistleblowing") covering fraud and other risks.

3.2. ***Application and Reporting***

- 3.2.1. A comprehensive system of control should be established by the board to ensure that risks are mitigated and that the company's objectives are attained. The control environment should also set the tone of the company and cover ethical values, management's philosophy and the competence of employees.
- 3.2.2. Risks should be assessed on an on-going basis and control activities should be designed to respond to risks throughout the company. Pertinent information arising from the risk assessment, and relating to control activities should be identified, captured and communicated in a form and timeframe that enables employees to carry out their responsibilities properly. These controls should be monitored by both line management and assurance providers.
- 3.2.3. Companies should develop a system of risk management and internal control that builds more robust business operations. The systems should demonstrate that the company's key risks are being managed in a way that enhances shareowners' and relevant stakeholders' interests. The system should incorporate mechanisms to deliver:
 - a demonstrable system of dynamic risk identification;
 - a commitment by management to the process;
 - a demonstrable system of risk mitigation activities;
 - a system of documented risk communications;
 - a system of documenting the costs of non-compliance and losses;
 - a documented system of internal control and risk management;
 - an alignment of assurance of efforts to the risk profile; and
 - a register of key risks that could affect shareowner and relevant stakeholder interests.
- 3.2.4. The board must identify key risk areas and key performance indicators of the company, and monitor these factors as part of a regular review of processes and procedures to ensure the effectiveness of its internal systems of control, so that its decision-

making and the accuracy of its reporting are maintained at a high level at all times.

3.2.5. Reports from management to the board should provide a balanced assessment of significant risks and the effectiveness of the system of internal control in managing those risks. Any significant control failings or weaknesses identified should be covered in the reports, including the impact that they have had, or may have had, on the company and the actions being taken to rectify them.

3.2.6. The board is responsible for disclosures in relation to risk management and should, at a minimum disclose:

- that it is accountable for the process of risk management and the system of internal control, which is regularly reviewed for effectiveness and for establishing appropriate risk and control policies and communicating these throughout the company;
- that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company, that has been in place for the year under review and up to the date of approval of the annual report and financial statements;
- that there is an adequate system of internal control in place to mitigate the significant risks faced by the company to an acceptable level. Such a system is designed to manage, rather than eliminate, the risk of failure or maximise opportunities to achieve business objectives. This can only provide reasonable, but not absolute, assurance;
- that there is a documented and tested process in place that will allow the company to continue its critical business processes in the event of a disastrous incident impacting on its activities;
- where material joint ventures and associates have not been dealt with as part of the group for the purposes of applying these recommendations. Alternative sources of risk management and internal control assurance applied to these activities should be disclosed, where these exist;
- that any additional information in the annual report to assist understanding of the company's risk management processes and system of internal control should be provided as appropriate; and
- where the board cannot make any of the disclosures set out above, it should state this fact and provide a suitable explanation.

3.2.7. Risk should not only be viewed from a negative perspective. The review process may identify areas of opportunity, such as where

effective risk management can be turned to competitive advantage.

4. Internal Audit

4.1. *Status and Role*

- 4.1.1. Companies should have an effective internal audit function that has the respect and co-operation of both the board and management. Where the board, in its discretion, decides not to establish an internal audit function, full reasons must be disclosed in the company's annual report, with an explanation as to how assurance of effective internal controls, processes and systems will be obtained.
- 4.1.2. Consistent with the Institute of Internal Auditors' ("IIA") definition of internal auditing in an internal audit charter approved by the board, the purpose, authority and responsibility of the internal audit activity should be formally defined.
- 4.1.3. The IIA has succinctly set out the role and function of internal audit in its *Standards for the Professional Practice of Internal Auditing*, including the code of ethics and the definition of internal audit, which is fully endorsed by the King Committee.
- 4.1.4. Internal audit should report at a level within the company that allows it to fully accomplish its responsibilities. The head of internal audit should report administratively to the chief executive officer, and should have ready and regular access to the chairperson of the company and the chairperson of the audit committee.
- 4.1.5. Internal audit should report at all audit committee meetings.
- 4.1.6. The appointment or dismissal of the head of the internal audit should be with the concurrence of the audit committee.
- 4.1.7. If the external and internal audit functions are carried out by the same accounting firm, the audit committee and the board should satisfy themselves that there is adequate segregation between the two functions in order to ensure that their independence is not impaired (see also 6.1.5).

4.2. *Scope of Internal Audit*

- 4.2.1. Internal audit is an independent, objective assurance and consulting activity to add value and improve a company's operations. It helps a company accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.
- 4.2.2. An effective internal audit function should provide:

- assurance that the management processes are adequate to identify and monitor significant risks;
 - confirmation of the effective operation of the established internal control systems;
 - credible processes for feedback on risk management and assurance; and
 - objective confirmation that the board receives the right quality of assurance and information from management and that this information is reliable.
- 4.2.3. The internal audit plan should be based on risk assessment as well as on issues highlighted by the audit committee and senior management. The risk assessment process should be of a continuous nature as to identify not only residual or existing but emerging risks and should be conducted formally at least annually, but more often in complex organisations. This risk assessment should be co-ordinated with the board's own assessment of risk.
- 4.2.4. The audit committee should approve the internal audit work plan.
- 4.2.5. The internal audit function should co-ordinate with other internal and external providers of assurance to ensure proper coverage of financial, operational and compliance controls and to minimise duplication of effort.

5. **Integrated Sustainability Reporting**

5.1. ***Sustainability Reporting***

- 5.1.1. Every company should report at least annually on the nature and extent of its social, transformation, ethical, safety, health and environmental management policies and practices. The board must determine what is relevant for disclosure, having regard to the company's particular circumstances.
- 5.1.2. Stakeholder reporting requires an integrated approach. This would be best achieved gradually as the board and the company develop an understanding of the intricate relationships and issues associated with stakeholder reporting. Companies should categorise issues into the following levels of reporting:
- First level would be disclosures relating to acceptance and adoption of business principles and/or codes of practice that can be verified by reference to documents, board minutes or established policies and standards.
 - Second level should address the implementation of practices in keeping with accepted principles involving a review of steps taken to encourage adherence to these principles evidenced by board directors, designated policies and

communiqués, supported by appropriate non-financial accounting mechanisms.

- Third level should involve investigation and demonstration of changes and benefits that have resulted from the adoption and implementation of stated business principles and/or codes of practice.

5.1.3. When making such disclosures, boards will be required to consider the following:

- Clarity on the nature of the disclosing entity, the scope of issues subject to disclosure, performance expectations as an integral aspect of the “going concern” concept, the period under review and the extent to which items disclosed are directly attributable to the company’s own action or inaction.
- Disclosure of non-financial information should be governed by the principles of reliability, relevance, clarity, comparability, timeliness and verifiability with reference to the Global Reporting Initiative Sustainability Reporting Guidelines on economic, environmental and social performance.
- Criteria and guidelines for materiality should be developed by each company for consistency, having regard to international models and guidelines, as well as national statutory definitions.

5.1.4. Matters requiring specific consideration should include:

- Description of practices reflecting a committed effort to reducing workplace accidents, fatalities, and occupational health and safety incidents against stated measurement targets and objectives and a suitable explanation where appropriate. This would cover the nature and extent of the strategy, plan and policies adopted to address and manage the potential impact of HIV/AIDS on the company’s activities.
- Reporting on environmental corporate governance must reflect current South African law by the application of the “Best Practicable Environmental Option” standard (defined as that option that has most benefit, or causes the least damage to the environment at a cost acceptable to society).
- Policies defining social investment prioritisation and spending and the extent of initiatives to support black economic empowerment, in particular with regard to procurement practices and investment strategies.
- Disclosure of human capital development in areas such as the number of staff, with a particular focus on progress

against equity targets, achievement of corporate training and development initiatives, age, employee development and financial investment committed. This should also address issues that create the conditions and opportunities for previously disadvantaged individuals, in particular women, to have an equal opportunity to reach executive levels in the company and to realise their full potential. It should include progress made in this regard, and mechanisms to positively reinforce the richness of diversity and the added value and contribution from this diversity.

5.2. ***Organisational Integrity / Code of Ethics***

- 5.2.1. Every company should engage its stakeholders in determining the company's standards of ethical behaviour. It should demonstrate its commitment to organisational integrity by codifying its standards in a code of ethics.
- 5.2.2. Each company should demonstrate its commitment to its code of ethics by:
 - creating systems and procedures to introduce, monitor and enforce its ethical code;
 - assigning high level individuals to oversee compliance to the ethical code;
 - assessing the integrity of new appointees in the selection and promotion procedures;
 - exercising due care in delegating discretionary authority;
 - communicating with, and training, all employees regarding enterprise values, standards and compliance procedures;
 - providing, monitoring and auditing safe systems for reporting of unethical or risky behaviour;
 - enforcing appropriate discipline with consistency; and
 - responding to offences and preventing re-occurrence.
- 5.2.3. Disclosure should be made of adherence to the company's code of ethics against the above criteria. The disclosure should include a statement as to the extent the directors believe the ethical standards and the above criteria are being met. If this is considered inadequate there should be further disclosure of how the desired end-state will be achieved.
- 5.2.4. Companies should strongly consider their dealings with individuals or entities not demonstrating its same level of commitment to organisational integrity.

6. Accounting and Auditing

6.1. *Auditing and Non-audit Services*

- 6.1.1. The audit committee should draw up a recommendation to the board for consideration and acceptance by the shareowners for the appointment of the external auditors.
- 6.1.2. The auditors should observe the highest level of business and professional ethics and in particular, their independence must not be impaired in any way.
- 6.1.3. Companies should aim for efficient audit processes using external auditors in combination with the internal audit function.
- 6.1.4. Management should encourage consultation between external and internal auditors. Co-ordination of efforts involves periodic meetings to discuss matters of mutual interest, the exchange of working papers and management letters and reports, and a common understanding of audit techniques, methods and terminology.
- 6.1.5. The audit committee should set the principles for recommending using the accounting firm of the external auditors for non-audit services. In addition to the related Companies Act requirement, there should be separate disclosure of the amount paid for non-audit services with a detailed description in the notes to the annual financial statements of the nature thereof together with the amounts paid for each of the services described.

6.2. *Reporting of Financial and Non-financial Information*

- 6.2.1. The audit committee should consider whether or not an interim report should be subject to an independent review by the external auditor.
- 6.2.2. In the case of an independent review, the audit committee's report commenting on an interim report and the auditors' review report, should be tabled at the board meeting held to adopt the interim report. Where an independent review was not conducted, the audit committee should table the reasons at the board meeting.
- 6.2.3. The board should minute the facts and assumptions used in the assessment of the going concern status of the company at the year end.
- 6.2.4. At the interim reporting stage, the directors should consider their assessment at the previous year end of the company's ability to continue as a going concern and determine whether or not any of the significant factors in the assessment have changed to such an extent that the appropriateness of the going concern assumption at the interim reporting stage has been affected. The board should minute the conclusion reached by the directors at the interim reporting stage.

- 6.2.5. Where non-financial aspects of reporting have been subject to external validation, this fact be stated and details provided in the annual report.
- 6.2.6. Companies should make every effort to ensure that information is distributed via a broad range of communication channels, including the Internet, having regard for its security and integrity while bearing in mind the need that critical financial information reaches all shareowners simultaneously.

6.3. **Audit Committee**

- 6.3.1. The board should appoint an audit committee that has a majority of independent non-executive directors. The majority of the members of the audit committee should be financially literate.
- 6.3.2. The chairperson should be an independent non-executive director and not the chairperson of the board. The better view is that the board chairperson should not be a member of the audit committee at all, but could be invited to attend meetings as necessary by the chairperson of that committee. The board should consider whether or not it is desirable for the chief executive officer to be a member of the audit committee, or to attend only by invitation.
- 6.3.3. The audit committee should have written terms of reference that deal adequately with its membership, authority and duties.
- 6.3.4. Companies should, in their annual report disclose whether or not the audit committee has adopted formal terms of reference and, if so, whether the committee has satisfied its responsibilities for the year, in compliance with its terms of reference.
- 6.3.5. Membership of the audit committee should be disclosed in the annual report. The chairperson of the committee should be available at the annual general meeting to answer questions about its work.

7. **Relations with Shareowners**

- 7.1. Companies should be ready where practicable, to enter into dialogue with institutional investors based on constructive engagement and the mutual understanding of objectives. This should take due regard of statutory, regulatory and other directives regulating the dissemination of information by companies and their directors and officers.
- 7.2. When evaluating a company's corporate governance arrangements, particularly those relating to board structure and composition, institutional investors should give due weight to all relevant factors drawn to their attention and to any specific arrangements to eliminate unnecessary variations in criteria and measurement of performance.
- 7.3. Companies should ensure that each item of special business included in the notice of annual general meeting is accompanied by a full explanation of the effects of a proposed resolution. In the course of the annual general

meeting, as should be the case with other shareowner meetings, the chairperson should provide a reasonable time for discussion.

- 7.4. Companies should consider conducting meetings on the basis of a poll in relation to special business, or where contentious issues are under consideration, in order to ensure that all votes of shareowners (whether in person, by proxy or representation) at company meetings are taken into account. The results of all decisions taken at company meetings should be publicly disseminated, in the most appropriate form, immediately on conclusion of the meeting to ensure that all shareowners (particularly those who were not in attendance or were unable to attend) are promptly informed or at least have ready access to such information.

8. **Communication**

- 8.1. It is the board's duty to present a balanced and understandable assessment of the company's position in reporting to stakeholders. The quality of the information must be based on the principles of openness and substance over form. Reporting should address material matters of significant interest and concern to all stakeholders.
- 8.2. Reports and communications must be made in the context that society now demands greater transparency and accountability from companies regarding their non-financial matters.
- 8.3. Reports should present a comprehensive and objective assessment of the activities of the company so that shareowners and relevant stakeholders with a legitimate interest in the company's affairs can obtain a full, fair and honest account of its performance. In communicating with its stakeholders, the board should take into account the circumstances of the communities in which the company operates.
- 8.4. The directors should report on the following matters in their annual report:
 - 8.4.1. that it is the directors' responsibility to prepare financial statements that fairly present the state of affairs of the company as at the end of the financial year and the profit or loss and cash flows for that period;
 - 8.4.2. that the auditor is responsible for reporting on whether the financial statements are fairly presented;
 - 8.4.3. that adequate accounting records and an effective system of internal controls and risk management have been maintained;
 - 8.4.4. that appropriate accounting policies supported by reasonable and prudent judgments and estimates have been used consistently;
 - 8.4.5. that applicable accounting standards have been adhered to or, if there has been any departure in the interest of fair presentation, this must not only be disclosed and explained but quantified;
 - 8.4.6. that there is no reason to believe the business will not be a going concern in the year ahead or an explanation of any reasons otherwise; and

8.4.7. that the Code of Corporate Practices and Conduct has been adhered to or, if not, where there has not been compliance to give reasons.

9. Implementation of the Code

All boards and individual directors have a duty and responsibility to ensure that the principles set out in this Code are observed.

RECOMMENDATIONS REQUIRING STATUTORY AMENDMENT AND OTHER ACTIONS¹²

1. Urgent liaison should be initiated between the leadership of the business community and the State with a view to determining how the business community can enhance the resources and capacity of the State to handle breaches of criminal law by delinquent directors and officers. In this regard, the role of the State is vital. It is equally essential that the office of the Registrar of Companies be provided with sufficient resources to monitor the implementation of the Companies Act. The resources of the South African Police Services and those of the judicial system also need to be enhanced to ensure that complaints are adequately investigated.
2. An approach should be made to the General Council of the Bar and to the Law Society of South Africa for the use of contingency fees in the context of delinquency in the management of a company in promoting easier access to the law for minority shareowners. The Law Society, South African Law Commission and the Standing Advisory Committee on Company Law should be asked to lobby for the formulation of Rules of Court for the purposes of permitting a more liberal use of class actions.
3. Regulators, including the Financial Services Board, JSE Securities Exchange South Africa, Registrar of Companies, Registrar of Banks and others such as the Auditor-General, should ensure that the rules and regulations of good corporate governance under their control are rigorously enforced with particular reference to enforcing sanctions against delinquent directors.
4. Legislators are encouraged to review the regulations introduced by the Registrar of Banks in regard to directors and corporate governance of banking institutions with a view to some or all of these requirements being extended to the Companies Act as applicable.
5. The office of the Registrar of Companies should be encouraged to establish a register of delinquent directors, being those who have been disqualified from acting as such under the Companies Act. This register should be available on its website, and the list of such directors regularly updated. The Registrar should work in conjunction with other regulators, such as the JSE and FSB with the aim of creating a database of delinquent directors for public information.¹³
6. Section 424 of the Companies Act is a very effective sanction for the punishment of delinquent directors and officers, but proceedings under this provision are both difficult and expensive to implement. Consideration should be given to the means by which section 424 can be more effectively implemented.

¹² It should be noted that these recommendations were identified in the course of the detailed review culminating in the King Report on Corporate Governance for South Africa 2002 and accompanying Code, but which fall outside of the remit of the King Committee. The recommendations, therefore, are offered for consideration. To the extent that any of these recommendations are accepted, the precise construction for their implementation will be a matter for the relevant bodies and/or authorities to determine and is beyond the discretion of the King Committee to prescribe. The King Committee will naturally, as it did with the King Report 1994, monitor and (where requested) participate in the development for implementation of any of these recommendations

¹³ Steps have been initiated by the authorities for the implementation of this proposal following the issue of the draft Report released in July 2001 for public comment

7. While it is important to ensure that the existing quorum threshold for company meetings is sufficient to readily permit access of shareowners to management through this forum, consideration should be given to amending the Companies Act to prescribe a minimum threshold for the passing of ordinary resolutions at a suggested level of at least 25% of the total shares in issue having voting rights (that would align with the existing requirements relating to special resolutions). This would encourage companies to solicit attendance at meetings or receipt of proxies and highlight the need for shareowners to give due consideration to the use of their votes.¹⁴
8. Given the move towards a greater application of information technology to speed up communication and transmission of information, the Companies Act should be reviewed to identify areas where electronic communication would improve governance and communication between companies and their shareowners. A particular area for consideration, in line with developing international practice, is electronic voting by shareowners and the electronic transmission of proxies.¹⁵
9. The Companies Act should be amended to provide for legal backing for accounting standards, approved by the proposed Financial Reporting Accounting Standards Council. In addition, provision should be made for the accounting standard-setting, monitoring and enforcement processes. These should be in line with the recommendations of the Accounting Practices Board and SAICA in terms of the recommendations and structure set out in chapter 3 of Section 5 of the Report. Government is urged to provide the initial funding for these processes of setting and monitoring standards.¹⁶
10. The Companies Act audit requirement should be re-considered for dormant and inactive wholly owned subsidiaries.
11. The Companies Act should be amended to provide for summarised or abbreviated annual financial statements, otherwise termed Concise Financial Reports, to be issued to shareowners, but on the basis that the full set of annual financial statements can be obtained if required.
12. Consideration should be given to amending the Companies Act to require certain categories of private companies to file their annual financial statements with the Registrar of Companies, thus making them available for public inspection.

¹⁴ Considerable public comment was received suggesting that this recommendation was both impractical and unduly onerous. It is the considered view of the King Committee, taking into account these observations, that in an open and transparent governance environment it should be in each company's interest to solicit more active participation by shareowners in company meetings

¹⁵ The Companies Amendment Act (No. 35 of 2001) has introduced provisions permitting electronic communication in certain limited respects, on dates to still be promulgated, including the dissemination of annual reports and financial statements. Specific legislation dealing broadly with electronic communication is being progressed by the authorities arising out of the proposals of the Green Paper released for public comment in 2001

¹⁶ Considerable progress has been achieved by SAICA and the relevant authorities since the release of these recommendations for public comment that will, in due course, lead to the implementation of legislation regulating the legal backing for accounting standards and accompanying review requirements.

13. The question of directors' and officers' liability insurance requires to be revisited, as the current section 247 of the Companies Act is ambiguous and does not fully cover the original King Committee 1994 recommendation.¹⁷
14. Schedule 3 to the Companies Act should be amended to require reference to corporate governance in prospectuses.
15. Current legislation does not require specific disclosures to be made on ethical matters. There is a case for the adoption of measures similar to the US *Federal Sentencing Guidelines* appropriately adapted for the South African situation. In this regard, the Public Finance Management Act should be studied for an example of reporting ethical and disciplinary matters in the public sector.
16. Directors or officers may, by their acts of commission or omission, have contributed to a company's failure. They should be held liable for any conduct leading to a company's failure. Damages against auditors for company failures are becoming a matter of grave concern. Directors and auditors should only be held liable for damages on a basis proportional to their contribution to the failure. Consideration should be given to amending the Apportionment of Damages Act (No. 34 of 1956) accordingly.
17. To encourage best practice and compliance with respect to environmental corporate governance, it is proposed that consideration be given to extending the existing incentives under Section 10(1)(cH)(i) of the Income Tax Act beyond mining operations to all companies, or perhaps at least to those industries considered to be environmentally risky.
18. Institutional shareowners in South Africa have been notable for their apathy towards participating actively in shareowner meetings. Therefore, it is recommended that the bodies representing these institutions look to the steps taken by bodies such as the National Association of Pension Funds and Association of British Insurers in the United Kingdom in setting benchmark standards expected of companies in respect of conformance with good corporate governance.
19. Institutional investors and pension fund managers should make publicly available their voting policies, providing explanations where appropriate, by communicating this information to their own constituencies on a regular basis (probably annually) or by making it accessible to the public at large in line with international standards of practice.
20. The Investment Analysts Society of Southern Africa is encouraged to rate corporate governance performance in their analysis of companies. Shareowner organisations should be encouraged and promoted.
21. Financial markets regulators are urged to provide definitive guidelines, such as those issued by the Financial Services Authority in the United Kingdom, regulating the manner and basis on which communication may occur between investors (specifically institutional) and companies in order to provide a clear guide for market conduct between institutional analysts and investors and companies.

¹⁷ Paragraph 24.7 as read with paragraph 23.3 of the King Report 1994

22. Given the developments internationally around pension fund trustees and their role in the governance process, as well as that of institutions managing such funds, consideration should be given to determining the application of those principles in relation to the South African environment. In particular, it is recommended that trustees of pension funds should always vote the shares in which their funds are invested. Pension funds should, in addition, be obliged to indicate in their Statement of Investment Principles and Policies, or an equivalent document, the extent to which corporate governance issues are taken into consideration in investment decisions relating to funds under their control and/or the extent to which such policies are required to be taken into account by investment managers with whom such funds might have been placed.
23. The business community is encouraged to give every assistance, whether by means of the provision of bursaries or otherwise, to facilitate the development of financial journalism in South Africa as an appropriate monitor of corporate conduct.
24. Institutional investors should be more transparent in their dealings with companies and should be encouraged to demand the highest governance standards.
25. Boards and regulators should be encouraged to censure directors found wanting in their fiduciary obligations.
26. The question of whether the business judgment rule should be statutorily adopted in South Africa should be addressed as part of the overall reform of our corporate legislation.
27. Everyone should view the implementation of qualitative governance standards as a dynamic process. A sub-committee of the King Committee should be established, in conjunction with the Institute of Directors, to monitor the progress of enforcement of the principles embodied in this Report and to address areas where insufficient action has been taken.