King III in South Africa Breaks New Governance Ground

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The *King Report on Governance for South Africa* (King III) and *King Code of Governance Principles* were released in South Africa in September 2009, to become effective March, 2010.

The King III Report, which is a 142 page expansion of the 66 page Code, makes significant progress in key areas. Noteworthy is that, for the first time, King III is to be applied to all South African organizations in the public, private and not-for-profit sectors. It recommends that statutory financial and sustainability information be combined into an "integrated report" and that a holistic "combined assurance"[1] model be overseen by audit committees.

King III adopts a principles and practices-based approach to governance on an "apply or explain" basis. It makes significant progress in the following key governance areas: sustainability, integrated reporting, stakeholder inclusivity, combined assurance, alternative dispute resolution, risk-based internal audit, a non-binding advisory shareholder vote on the company's compensation policy (including each director and certain senior executives), the evaluation of board and director performance and IT governance.

Some of the more salient principles and recommended practices include:

Ethical Leadership and Corporate Citizenship

- The board should issue (and be responsible for ensuring the integrity of) an integrated report on the company's economic, social and environmental performance; and
- The board should ensure that an ethics profile is compiled and the company's ethical performance is assessed, monitored, reported and disclosed. This responsibility may result in independent assurance supported by a formal statement.[2]

Boards and Directors

- The board chair should not be a member of the audit committee, and should not chair the remuneration committee or the risk committee;
- A director is independent if he or she is "free from any business or other relationship … which could be seen by an objective outsider to interfere materially with the individual's capacity to act in an independent manner …";
- Listed companies must appoint a financial director to the board;
- An evaluation of the board, its committees and individual directors should be performed every year, and independent performance appraisals should be considered in the interest of eliciting candid responses;
- Should a deficiency in a director's performance be identified, a plan should be developed and implemented for the director to acquire the necessary skills or to develop appropriate behavioural patterns; and
- Shareholders should approve the company's compensation policy.

Audit Committees

The audit committee should:

- ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities;
- assist the board by reviewing and overseeing the integrity of the integrated report, including ensuring the sustainability information is reliable and no conflicts or differences arise when compared with the financial results;

1 A number of Commonwealth countries speak of "assurance" as opposed to "advisors." There exists a difference between advice and assurance and the latter calls for different governance treatment. An advisor provides an original piece of advice. Assurance refers to the integrity of certain processes and systems. An assurance provider provides assurance over something others have prepared. There are three types of assurance providers: management, internal assurance providers (e.g., internal audit) and external assurance providers (e.g., external audit, an appointed actuary, regulators (inspectorate), an occupational health and safety auditor). Combined assurance satisfies the audit committee that material risks and internal controls are adequately addressed by appropriate assurance providers.

2 The statement would be provided by an internal or external assurance provider who is appropriately independent. Management attesting to accuracy or content (a form of assurance over materials) cannot be considered to be independent assurance.

- recommend to the board whether to engage an external assurance provider on material sustainability issues and oversee the provision of sustainability assurance; and
- ensure that the internal audit function is subjected to an independent quality review.

The Governance of Risk

- The board should set the levels of risk tolerance once a year;
- The board should appoint a committee responsible for risk; and
- The chief risk officer should have access and interact regularly with the board and/or appropriate board committee.

The Governance of Information Technology

- The board should assume the responsibility for the governance of IT and place it on the board agenda;
- The board should ensure that an IT internal control framework is adopted and implemented and that the board receives independent assurance on the effectiveness thereof; and
- A risk and audit committee should assist the board in carrying out its IT responsibilities.

Compliance with Laws, Codes, Rules and Standards

- The board should disclose details in the integrated report on how it discharged its responsibilities to establish an effective compliance framework and processes;
- A legal compliance policy should be approved by the board and the board should ensure it has been implemented by management; and
- The board should receive assurance on the effectiveness of the controls related to compliance with laws, rules, codes and standards.

Internal Audit

- The board should ensure that there is an effective risk-based internal audit;
- The internal auditor should (among other responsibilities) evaluate governance processes, including ethics and "tone at the top";
- Internal controls should be established not only over financial matters, but also operational, compliance and sustainability issues;
- The internal auditor should provide a written assessment to the board on the system of internal controls and risk management; and
- The internal auditor's assessment of internal financial controls should be reported specifically to the audit committee.

Governing Stakeholder Relationships

- The board should identify important stakeholder groupings;
- The board should oversee the establishment of mechanisms and processes that support stakeholders in constructive engagement with the company;
- The board should disclose in its integrated report the nature of the company's dealings with stakeholders and the outcomes of these dealings;
- There must be equitable treatment of all holders of the same class of shares issued; and
- The board should adopt formal dispute resolution processes for internal and external disputes.

Integrated Reporting and Disclosure

- Integrated reporting should be focused on substance over form and should disclose information that is complete, timely, relevant, accurate, honest, accessible and comparable with past practices of the company. It should also contain forward-looking information; and
- Sustainability reporting and disclosure should be integrated with the company's financial reporting and should be independently assured.

King III is noteworthy for Canada in that it is universally applicable and flexibly drafted. The notion that a flexible, principles-based governance code cannot be drafted for diverse companies including small issuers, private and family companies, Crown corporations and not-for-profit organizations, is incorrect.

Two global trends since the financial crisis include first, empowering boards (or committees) to retain external assurance providers, in their discretion, as an assurance check on management and second, empowering boards to ensure the independence, accountability and proper treatment of internal assurance providers. King III skillfully sets out a combined assurance model over risk areas affecting the company with audit committee oversight.

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