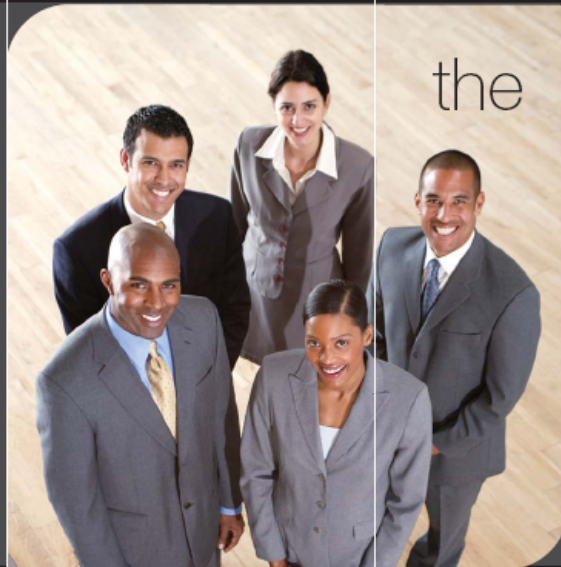




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**DRAFT CODE OF GOVERNANCE
PRINCIPLES FOR SOUTH AFRICA - 2009
KING COMMITTEE ON GOVERNANCE**

THE BUSINESS LEADERS

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The Practice Notes supporting the Report and then Code will be released on the 1st of September 2009.

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Preface

1. The need for King III

The third Report on Governance in South Africa (King III) became necessary because of the anticipated new Companies Act (hereafter the Act)¹ and changes in international governance trends. This report was compiled by the King committee with the assistance of the King subcommittees.

On the advice of Sir Adrian Cadbury, the King Committee has been retained even though only three members of the committee formed in 1992 remain on the present King Committee. In giving his advice, Sir Cadbury pointed out the evolutionary nature of corporate governance - various commissions were held in England under people other than Sir Cadbury after the Cadbury Report was issued. Following the Cadbury report were the Greenbury, Hampel, Turnbull, Smith and Higgs Reports. These were combined and the UK governance code is now known as the Combined Code. Following Sir Cadbury's advice, the committee continues to be known as the King Committee and the King code has become an internationally recognised brand.

There are nine subcommittees for King III, namely boards and directors; audit committees; risk management; internal audit; integrated sustainability reporting; compliance with laws, regulations, rules and standards; managing stakeholder relationships; fundamental and affected transactions and business rescue. Six researchers worked on King III, together with the subcommittees of 79 people. Lindie Engelbrecht, Chief Executive of the Institute of Directors of Southern Africa, acted as the convener of the chairmen of the subcommittees. Michael Katz checked all the legal aspects contained in the report.

The remits of the subcommittees as well as the names of the chairmen and the members of the subcommittees are given in an attachment to this report.

We have endeavoured, as with King I and King II, to be at the forefront of governance internationally. We believe this has been achieved because of the focus on the importance of reporting annually on:

- how a company has both positively and negatively affected the economic life of the community in which it operated during the year under review; and
- how the company intends to enhance those positive aspects and eradicate or ameliorate the negative aspects on the economic life of the community in which it will operate in the year ahead.

As with King I and II, none of the members received remuneration. The only value driver for members was service in the best interest of South Africa Inc.

2. The governance framework

The governance of corporations can be on a statutory basis, as a code of principles and practices, or a combination of the two. The United States of America has chosen to codify a significant part of its governance in an act of Congress known as the Sarbanes-Oxley Act (SOX). This statutory regime is 'comply or else'. In other words, there are legal sanctions for non-compliance.

There is an important argument against the 'comply or else' framework: a 'one size fits all' approach cannot logically be suitable because the scales of business carried out by companies vary to such a large degree. The cost of compliance is burdensome, both in time and money. Further, the board and the management become focused on compliance rather than the business of the enterprise. It is the duty of the board of a trading enterprise to undertake risk for reward and to try to improve the economic value of a company. If the board follows a narrow focus on compliance, the board's responsibility towards enterprise and its ultimate responsibility, namely performance, may be diluted.

The cost of compliance by American companies with section 404 of SOX, which deals with the verification of internal controls, is estimated at \$264bn since the inception of SOX in 2002. The total cost to the American economy of complying with SOX is more than the total write-off of Enron, World Com and Tyco combined. Some argue that companies compliant with SOX are more highly valued and that perhaps another Enron debacle has been avoided. It is appropriate to quote two American professors from Yale Law School and the University of Illinois Law School. Prof Romano of Yale Law School has said: *"SOX's corporate governance provisions were ill-conceived. Other nations, such as the members of the European Union who have been revising their corporation codes, would be well advised to avoid Congress' policy blunder."* Prof Ribstein of Illinois Law School has said: *"It is unlikely that hasty, crash-induced regulation like SOX can be far sighted enough to protect against future problems, particularly in light of the debatable efficiency of SOX's response to current market problems. Even the best regulators might err and enact regulation that is so strong that it stifles innovation and entrepreneurial activity. And once set in motion, regulation is almost impossible to eliminate. In short, the first three years of SOX was, at best, an overreaction to Enron and related problems and, at worst, ineffective and unnecessary."*

The 56 countries in the Commonwealth, including South Africa and the 27 states in the EU including the United Kingdom, have opted for a code of principles and practices on a 'comply or explain' basis, in addition to certain governance issues that are legislated.

In the case of this code, there is flexibility, because this type of code is a recommendation for a course of conduct. Thus, if a board believes it to be in the best interests of the company, it can

adopt a practice different from that recommended in the code, but must explain it. Explaining the different practice adopted and the acceptable reasons for it, results in compliance. In the real world, the ultimate compliance officer is not the company's compliance officer or a bureaucrat ensuring compliance with statutory provisions, but the marketplace.

At the United Nations, the question whether the United Nations Governance Code should be on a 'comply or explain' or 'comply or else' basis, was hotly debated. The representatives of several of the world bodies were opposed to the word 'comply', because it connoted that there had to be adherence and there was no room for flexibility. Ultimately it was agreed that the UN code should be on an 'adopt or explain' basis.

The King III code, as with King I and II, is also based on the 'explain' principle. In the Netherlands, directors are required to 'apply' their code or 'explain' the reasons for not doing so. We concluded that this language more appropriately conveys the intent of the King code from inception.

King III, therefore, is on an 'apply or explain' basis.

One of the legal duties of a board of directors is to act in good faith. This connotes several requirements, including the duty to act honestly and in the best interests of the company, to not appropriate the company's opportunities or receive secret profits, and to endeavor to fulfill the purpose for which the company was established. One of the principles of good governance is acting in the best interests of the company. In an 'apply or explain' regime, the board of directors, in its collective decision making, can conclude that to follow a practice recommended in a code would not, in the particular circumstances pertaining at the time in regard to an issue, be in the best interests of the company and apply another practice. It must explain the practice it applies other than the recommended one and the reasons for applying it. Hindsight is a perfect judge on whether the board's determination in applying another practice was justified as in the best interests of the company.

The JSE Limited (JSE) requires listed companies to comply with King II. However, there are examples in South Africa of companies listed on the JSE that have not followed practices recommended but have explained the practice adopted and have prospered. In these examples, the board ensured that acting in the best interests of the company was the overriding factor, subject always to proper consideration for the legitimate interests of all stakeholders, including actual and potential investors and creditors.

For all these reasons, the King Committee continues to believe that there should be a code of principles and practices on an 'apply or explain' basis. Boards have to comply with their duties such as acting in good faith and in doing so, have to apply their minds in the best interests of the company in regard to any recommended practice, subject to the above qualification.

South African listed companies are regarded by foreign institutional investors as being among the best governed in the world's emerging economies and we must strive to maintain that high ranking. South Africa has benefited enormously as a result of its listed companies following

good governance principles and practices, as was evidenced by the significant capital inflows into South Africa prior to the global financial crisis of 2008.

3. Corporate governance and the financial crisis

The credit crunch, and the resulting crisis among leading financial institutions, is increasingly often presented as a crisis of corporate governance. However, although current problems are to an extent indicative of shortcomings in the global financial architecture, they should not be interpreted as reflecting dysfunction in the broader South African and UK corporate governance models where values based principles are followed and governance is applied in substance and not only in form.

Consequently, it is essential that South African policy makers focus their response to the crisis on the underlying sources of the problem, including any defects in the financial regulatory framework (both in SA and globally). Populist calls for more general legislative corporate governance reform must be treated with the appropriate caution.

The main corporate governance alternative to the SA model is the US model. The latter places emphasis on enforced regulation. Critics of SA's light regulatory touch often suggest that emulation of the more "robust" US approach would improve corporate governance standards, and thereby reduce the risk of systemic economic crisis in the future. However, it is worth remembering that the US is the primary source of the current financial crisis. The Sarbanes-Oxley Act – with all of its statutory requirements for rigorous internal controls has not prevented the collapse of many of the leading names in US banking and finance.

4. The new constitution of commerce

An analysis of the register of shareholders of the major companies listed on the JSE will show that they are mostly comprised of financial institutions, both foreign and local. These institutions are 'trustees' for the ultimate beneficiaries, who are individuals. The ultimate beneficiaries of pension funds, who are currently among the largest holders of equities in South Africa, are individuals who have become the new owners of capital, as opposed to wealthy families, which was the norm until the end of the first half of the 20th Century. This is a worldwide trend.

The company is integral to society, particularly as a creator of wealth and employment. The company is the preferred vehicle in which to pool human and monetary capital. These are applied enterprisingly in the expectation of a return greater than a risk free investment such as a deposit in a bank.

A survey by KPMG and the United Nations Environmental Programme has shown that while the first priority of stakeholders of a company is the quality of the company's product or service, the second priority is the trust and confidence that the stakeholders have in the company.

Although the board is accountable to the company itself, the board should not ignore the expectations of its stakeholders. In the board's decision-making process, the inclusive approach to governance dictates that the board should take account of the legitimate expectations of the company's stakeholders in making decisions in the best interests of the company.

5. The link between governance principles and law

There is always a link between good governance and law. Good governance is not something that exists separately from the law. It is entirely inappropriate to unhinge governance from the law.

The starting point of any analysis on this topic is that directors and management must discharge their legal duties. These are grouped into two categories, namely duty of care, skill and diligence, and fiduciary duties.

Corporate governance mainly involves the establishment of structures and processes, with appropriate checks and balances that enable directors to discharge their legal responsibilities.

In assessing the standard of appropriate conduct, a court will take into account all relevant circumstances, including what is regarded as the normal or usual practice in the particular situation.

Criteria of good governance, governance codes and guidelines will be relevant in the determination of what is regarded as an appropriate standard of conduct. The more established certain governance practices become, the more likely a court would regard conduct that conforms with these practices as meeting the required standard of care.

Corporate governance practices, codes and guidelines lift the bar of what are regarded as appropriate standards of conduct.

Consequently, any failure to meet a recognised standard of governance, albeit not legislated, may render a board or individual director liable at law.

Around the world hybrid systems are developing. In other words, some of the principles of good governance are being legislated. In an 'apply or explain' regime, principles override practices. Now some principles and practices are law and there has to be compliance with the law. Also, what was the common law is being restated in statutes. In this regard, perhaps the most

important change is that in part the common law duties of directors, which will be codified in the Act.

In consequence, in King III we point to those matters that were recommendations in King II, but will soon be matters of law.

6. Legislation

Besides the Act, there are other statutory provisions which create duties on directors and we draw some of these statutes to the attention of directors.

The Act legislates in respect of state-owned companies as defined in the Public Finance Management Act (PFMA) (which include both national government business enterprises and national public entities) and the Municipal Finance Management Act (MFMA). These state-owned companies are described as 'SOC Limited'. Private companies (Pty Ltd) are companies that have memoranda of incorporation that prohibit their offering of shares to the public and restrict the transferability of their shares. There are personal liability companies (Inc) that provide that directors and past directors are jointly and severally liable for the contractual debts of the company. Public company (Ltd) means a profit company that is not a state-owned company, private company or personal liability company. A non-profit company carries the naming convention (NPC).

Persons who hold a beneficial interest in the shares issued by a company have certain rights to company information in terms of the Act and in terms of the Promotion of Access to Information Act.

All companies have to prepare annual financial statements, but there are limited exceptions from the statutory requirement for an external audit of these annual financial statements.

A company is generally permitted to provide financial assistance for the purchase or subscription of its shares and to make loans to directors, subject to certain conditions such as solvency and liquidity. The Act describes the standards of directors' duties essentially by reference to the common law principles. A new statutory defence has been introduced for the benefit of directors who have allegedly breached their duties. This defence will be availed by a director who establishes that he had no conflict, was reasonably informed, and acted rationally.

The duties of directors can be grouped into:

- (1) the duty of care, skill and diligence, in terms of which directors must manage the business of the company as a reasonably prudent person would manage his own affairs. The standard of care is a mixed objective and subjective test, in the sense that the minimum standard is that of a reasonably prudent person but a director who has greater skills, knowledge or experience than the reasonable person must give to the company

the benefit of those greater skills, knowledge and experience; and

- (2) fiduciary duties, being the duty to act in the best interests of the company, to avoid conflicts, to not take corporate opportunities or secret profits, to not fetter their votes and to use their powers for the purpose conferred and not for a collateral purpose.

There is personal liability for breach of certain statutory duties.

Provision exists for relieving directors of liability in certain circumstances either by the courts or if permitted by the company's constitution, but not in the case of gross negligence, willful misconduct or breach of trust.

Every public company and state-owned company must have a company secretary, who has specific duties set out in the Act. The company secretary is dealt with in Chapter 1.

The designated auditor may not be such for more than five consecutive years and in general terms he cannot perform any services that would be implicated in the conduct of the audit or determined by the audit committee.

Every public company and state-owned company must appoint an audit committee whose duties are described in the Act and repeated in Chapter 3.

We have distinguished between statutory provisions as opposed to practices and made clear that it is the board's duty, if it believes it to be in the best interests of the company, to override a recommended practice, but then to explain why the chosen practice was applied and give the reasons for not applying the recommended practice.

A company will become aware from its stakeholders whether a departure from a recommended practice is or is not seen to be in the best interests of the company.

7. Key principles of this report

The philosophy of the Report revolves around leadership, sustainability and corporate citizenship. To facilitate an understanding of the thought process, debate and changes in the Report, the following key principles should be highlighted:

1. Good governance is essentially about effective **leadership**. Leaders need to rise to these challenges if there is to be any chance of effective responses. Leaders need to define strategy, provide direction and establish the ethics and values that will influence and guide practices and behaviour with regard to sustainability performance.
2. **Sustainability** is the primary moral and economic imperative for the 21st Century, and it is one of the most important sources of both opportunities and risks for businesses. Nature, society, and business are interconnected in complex ways that need to be understood by decision makers. Most importantly, current, incremental changes towards

sustainability are not sufficient – we need a fundamental shift in the way companies and directors act and organise themselves.

3. **Innovation, fairness, and collaboration** are key aspects of any transition to sustainability – innovation provides new ways of doing things, including profitable responses to sustainability; fairness is vital because social injustice is unsustainable; and collaboration is often a prerequisite for large scale change.
4. The legacy of apartheid is fundamentally unsustainable – social transformation and redress is therefore an important aspect and needs to be integrated within the broader transition to sustainability. **Integrating sustainability and social transformation** in a strategic and coherent manner will give rise to greater opportunities, efficiencies, and benefits, for both the company and society, than the fragmented and at times contradictory approach currently adopted by many companies.
5. King II explicitly required companies to implement the practice of sustainability reporting as a core aspect of corporate governance. Since 2002, sustainability reporting has become a widely accepted practice and South Africa is an emerging market leader in the field (partially due to King II). However, **sustainability reporting is in need of renewal** in order to respond to a) the lingering distrust among civil society of the intentions and practices of big business and b) concerns among business decision makers that sustainability reporting is not fulfilling their expectations in a cost effective manner.

Sustainability

A key challenge for leadership to make sustainability issues mainstream: the leadership must integrate strategy, sustainability and control (integrated governance), and establish the values and ethics that underpin sustainable practices. Governance, strategy and sustainability have become inseparable; hence the phrase integrated performance and reporting which is used throughout this report.

The achievement of best practices in sustainability performance and reporting is only possible if the leadership of a company embraces the notion of integrated sustainability performance and reporting. There are some examples of visionary leadership in this area. Tomorrow's Global Company: Challenges and Choices, for example, recognises that tomorrow's global company needs to "expand its view of success and redefine it in terms of lasting positive impacts for business, society and the environment"².

Sustainability is about more than just reporting on sustainability. It is vital that companies focus on integrated performance. The board's role is to set the tone at the top in order for the company to achieve this integrated performance.

This report seeks to emphasise the inclusive approach.

Sustainability issues have gained in importance internationally since the publication of King II. The United Nations has published the Global Compact and the Principles for Responsible Investment. There have also been the European Union Green Paper for Corporate Social Responsibility (CSR) and the Organization for Economic Cooperation and Development (OECD) Guidelines for Multinational Companies.

The Swedish government has laid down that its state-owned enterprises must have sustainability reports following the Global Reporting Initiative's (GRI) G3 guidelines. In the United Kingdom, the CSR relevant part of the Companies Act came into operation in October 2007. It requires that directors must take into account in their decision making, the impacts of the company's operations on the community and the environment. In Germany, in terms of the German Commercial Code, management reports must include non-financial performance indicators and companies should demonstrate that their decisions have taken CSR into account in an effective way.

In January 2009, the Norwegian government launched a national White Paper on CSR. It deals with the responsibility companies have in Norway of reporting on sustainability performance. The White Paper explains how the GRI G3 guidelines can be used to fulfil the company's responsibilities to make transparent disclosure about sustainability issues.

In December 2008, the Danish parliament passed a law on CSR reporting for its companies, mandating that companies have to disclose their CSR activities or reason for not having any, following the principle of 'report or explain'. Denmark encourages the use of accepted tools such as the GRI G3 guidelines and the UN Global Compact Communication on Progress.

A KPMG international survey for 2008 shows that over 80% of the global Fortune companies now have sustainability performance reports.

Recently, President Obama stated that sustainability issues would be something which would be central to the policies of his administration.

By issuing integrated sustainability reports, a company increases the trust and confidence of its stakeholders and the legitimacy of its operations. It can increase the company's business opportunities and improve its risk management. By issuing an integrated sustainability report, internally a company evaluates its ethics, fundamental values, and governance and externally, improves the trust and confidence which stakeholders have in it.

The Department of Environmental Affairs and Tourism of South Africa carried out a long-term mitigation scenario about climate change. Plans were put in place in the third quarter of 2008 to fast-track the process of translating strategic options into policy directions. Minister, Martinus van Schalkwyk, said that he would eventually inform a legislative, a regulatory and a fiscal package to give effect to South Africa's long-term

climate policy. He has added that if South Africa continued with business as usual, greenhouse gas emissions would quadruple by 2050 and in the process, South Africa would become an international pariah. He pointed out that South Africa's actions in reducing electricity demand were in line with the Department of Environmental Affairs and Tourism's long-term mitigation scenario and have already had a positive impact on the country's footprint. South Africa will have a full climate change plan in place early in 2009³.

An incentive for investments by companies in energy efficient equipment will be introduced in South Africa, in the form of a supplementary depreciation allowance. Existing excise duties on motor vehicles will be adjusted to take into account carbon emissions.

Global and local attention on sustainability issues is clearly growing. Because the company is so integral to society, it is considered much of a citizen of a country as is a natural person who has citizenship. It is expected that the company will be directed to be and be seen to be a decent citizen. This involves social, environmental and economic issues – the triple bottom line. Boards should no longer make decisions based only on the needs of the present because this may compromise the ability of future generations to meet their own needs.

“The success of companies in the 21st Century is bound up with three interdependent sub-systems – the natural environment, the social and political system and the global economy. Global companies play a role in all three and they need all three to flourish.” – Tomorrow's Company, UK. In short, planet, people and profit are inextricably intertwined.

The market capitalisation of any company listed on the JSE equals its economic value and not its book value. The financial report of a company as seen in its balance sheet and profit and loss statement is a photograph of a moment in time of its financial position. In buying a share on any stock exchange, the purchaser makes an assessment of the economic value of a company, which takes into account the value of matters not accounted for, such as future earnings, brand, goodwill, the quality of its board and management, reputation, strategy and other sustainability aspects. The informed investor assesses the quality of the company's risk management and whether it has taken account of the sustainability issues pertinent to its business.

In King III, we have integrated sustainability as a major aspect of performance and reporting to enable stakeholders to better assess the value of a company.

The integrated report, which is used throughout the Report and explained in Chapter 3, should have sufficient information to record how the company has both positively and negatively affected the economic life of the community in which it operated during the year under review. Further, it should report how the board believes that in the coming year it can enhance the positive aspects and eradicate or ameliorate the negative

aspects that affected the economic life of the community in which it operates. Stakeholders today want forward looking information that will enable them to better assess the economic value of a company.

Individuals today are the indirect providers of capital. They are consumers and, as citizens, are concerned about the sustainability of our planet. Those who prepare integrated reports have to give the readers the forward looking information they want. It is one of the most important mechanisms a company can use to earn and maintain the trust and confidence of its stakeholders. Today's stakeholders also want assurance on the quality of this forward looking information.

As has been pointed out in 'The Reform of United Kingdom Company Law', the intention of corporate law reform in this area is to encourage companies to take an appropriate long-term perspective, to develop productive relationships with employees and in the supply chain and to take seriously their ethical, social and environmental responsibilities.

Sustainability also means that management pay schemes must not create incentives to maximise relatively short-term results at the expense of longer-term performance.

8. Emerging governance trends incorporated in the report

Alternative dispute resolution (ADR)

Electronic communication has expedited the process of concluding contracts and doing business generally. The world is borderless as far as capital flows are concerned. Capital can easily flow with the click of a mouse to where there is good governance. International bodies such as the International Finance Corporation have started to recognise that alternative dispute resolution (ADR) clauses are needed in contracts. Mediation is being used not only as a dispute resolution mechanism, but as a management tool.

For example, in the building of a bridge, a mediation expert is called in when the contracts are being finalised because he will know that the formulation of a clause in a certain way could lead to disputes or, conversely, avoid disputes. Further, as disputes arise, with immediacy of knowledge, the mediator is called in to assist the parties to resolve them. The disputants can arrive at novel solutions quickly, efficiently and effectively. There is an identity of interest to complete the bridge timeously, for example, to earn bonuses. If it is not, there may well be penalties.

It is accepted around the world that ADR is not a reflection on a judicial system of any country, but that it has become an important element of good governance. Directors

should preserve business relationships. Consequently, when a dispute arises, in exercising their duty of care, they should endeavour to resolve it expeditiously, efficiently and effectively. Also, mediation enables novel solutions, which a court may not achieve, being constrained to enforce legal rights and obligations. In mediation, the parties' needs are considered, rather than their rights and obligations. It is in this context that the Institute of Directors in Southern Africa (IoD) advocates administered mediation and, if it fails, expedited arbitration. Together with the Arbitration Foundation of Southern Africa, the IoD has developed an enforceable ADR clause for inclusion in contracts.

Risk-based internal audit

Risk involve operational, strategic, financial and sustainability issues. Strategy in itself involves risk because one is dealing with future events. King II and other codes require directors to enquire and then, if satisfied, confirm in the annual report the adequacy of internal controls in a company.

A compliance-based approach to internal audit adds little value to the governance of a company. A risk-based approach is more effective as it allows internal audit to find out whether controls are adequate for the risks which arise from the strategic direction that a company, through its board, has decided to adopt.

For internal audit to add value, at least the head of internal audit, or the chief audit executive as he has become known, needs to understand the strategic direction of the company to ensure that its internal controls are adequate. Strategies involve short- and long-term planning.

Internal audit should be risk-based and internal auditors should furnish an annual assessment to the audit committee on the adequacy of internal controls. The audit committee needs to report fully to the board in regard to its conclusion arising from the internal audit assessment. This will give substance to the endorsement by directors of the adequacy of internal controls in a company. Internal audit forms part of the combined assurance model introduced in Chapter 3 of this report.

IT governance

Information systems were used as an enabler to business, but have now become pervasive in the sense that they are built into the strategy of the business. The risks involved in information technology (IT) governance have become significant.

We therefore deal with IT governance in detail in King III for the first time. There is no doubt that there are operational risks when one has a service provider because confidential information leaves the company. In IT governance, one seeks confidentiality; integrity and availability of the functioning of the system; possession of

the system, authenticity of system information; and assurance that the system is usable and useful. Concerns are unauthorised use, access, disclosure, disruption or changes to the information system.

In exercising their duty of care, directors should ensure that prudent and reasonable steps have been taken in regard to IT governance. Legislation is not the answer. International guidelines such as COBIT or ITIL may be used as a check or audit for the adequacy of the company's information security, but it is not possible to have 'one size fits all'.

Shareholders and remuneration

We have dealt with the trend for the board to put a policy of remuneration to the shareholders for their approval in Chapter 1. Within the remuneration policy the board and management fix individual remuneration.

Evaluation

The evaluation of boards and individual directors, including the chairman, is now entrenched internationally.

9. New issues in the report

Business rescue

South Africa has been an unusual case in not having adequate business rescue legislation. Clearly, the ability to rescue appropriate companies is in the best interests of shareholders, creditors, employees and other stakeholders as well as in the interests of the country as a whole because of the high costs to the economy if businesses fail.

Business rescue legislation needs to balance the rights of stakeholders without facilitating abuse. The business community has long suggested that there should be business rescue provisions, but for all types of entities and not only companies. Further, directors need to be aware of the possible abuses that may arise.

Fundamental and affected transactions

We did not concern ourselves with fundamental and affected transactions in King I or King II. However, by reason of the changes in the Act, we have included a section on fundamental and affected transactions to ensure that directors are aware of their responsibilities and duties in regard to mergers, acquisitions and amalgamations.

Also, it must be borne in mind that the existence of an active take over industry promotes good governance and is more likely to ensure good managerial performance and discipline.

10. Language, gender and terminology

Although the terms 'company', 'boards' and 'directors' are used, King III refers to the functional responsibility of those charged with governance in any entity and should be applied as appropriate. When we refer to 'he' or 'his' in this report we include 'she' or 'her'. Likewise, when we refer to 'chairman', we include 'chairwoman', 'chairperson' and 'chair'.

As certain aspects of governance are legislated in the Act and the PFMA, the use of instructive language is important in reading and understanding the report and the code. The word 'must' indicates a legal requirement. In aspects where we believe the application of the code will result in good governance, the word 'should' is used. The word 'may' indicates areas where the committee proposes certain practices for consideration.

11. Application of the code

In contrast to the King I and II codes, King III applies to all entities regardless of the manner and form of incorporation or establishment. We have drafted the principles on the basis that, if they are adhered to, any entity would have practised good governance. For that reason, we have not focused on or discussed the implementation of the code and each entity should consider the approach that best suits its size and complexity.

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

The practice notes to King III, issued by the IoD, provide the necessary guidance to all entities on the implementation of the code.

12. Effective date

It is expected that the new Act will become operative on 1 July 2010. The King III report will be effective from 1 March 2010 and until then, King II will apply.

13. Appreciation

I record my thanks and appreciation to my committee, the subcommittee members and researchers who devoted so much time and effort in the interests of SA Inc without remuneration or reimbursement of expenses. In particular, I thank Lindie Engelbrecht, who tirelessly convened the chairmen of the subcommittees, collected subcommittee reports and edited them before passing them to me for my scrutiny. I also record my thanks to Michael Katz for checking the legal aspects contained in the report.

Mervyn E King, SC, Chairman

25 February 2009

Chapter 1

Boards and directors

Role and function of the board

Principle 1.1: The board should act as the focal point for corporate governance

1. Companies should be headed by a board that should direct, govern and be in effective control of the company. Every board should have a charter setting out its responsibilities.
2. The board should collectively provide effective corporate governance that involves managing the relationships between the management of the company, its board, its shareholders and other relevant stakeholders.
3. The board is the focal point of the corporate governance structure in the company and is the link between the stakeholders and the company. The board's paramount responsibility is the positive performance of the company in creating value for its shareholders. In doing so, it should appropriately take into account the interests of other stakeholders.
4. The board should exercise leadership, enterprise, integrity and judgment in directing the company so as to achieve continuing survival and prosperity for the company.
5. An important role of the board is to identify the stakeholders relevant to the business of the company. Although the board is accountable to the company it should take account of the legitimate expectations of all the company's stakeholders in its decision-making.
6. The board should ensure that stakeholders are engaged in such a manner as to create and maintain trust and confidence in the company.

Principle 1.2: The board should ensure that the company acts as and is seen to be a responsible corporate citizen

7. The board should ensure that the company, as a responsible corporate citizen, does not undermine the sustainability of its social and natural environments, but rather protects and enhances them.

8. Responsible corporate citizenship is necessary to protect the sustainability of the company and to ensure the ability of future generations to meet their needs. The interests of shareholders and stakeholders coincide over the long term.

Please refer to Chapter 2 Principle 2.1 for more detail.

Principle 1.3: The board should cultivate and promote an ethical corporate culture

9. The board should actively cultivate a culture within the company in which ethical conduct is promoted and embraced, and set the values to which the company will adhere.
10. The board should ensure that integrity permeates all aspects of the company and that its vision, mission and objectives are ethically sound. The manner in which it conducts its internal and external affairs should be beyond reproach.
11. The board's commitment to ethical conduct should also manifest in the company's responsibility towards the societies and natural environment in which it operates. An ethical culture is thus about more than social philanthropy or charitable donations.
12. Sustaining an ethical corporate culture requires that the board and executive leadership are clear about the company's ethical values and standards and that they are seen to support these. It also requires that the company should take active measures to ensure that its ethical standards are adhered to in all aspects of its business.

Please refer to Chapter 2 Principle 2.4 for more detail.

Principle 1.4: The board should appreciate that strategy, risk, performance and sustainability are inseparable

13. The board should play a prominent role in the strategy development process and should not be the mere recipient of a strategy proposed by the management. The board needs to balance its role of maintaining prudent control with the performance of the company.
14. The board should approve the long-term and short-term strategy for the business of the company and monitor its implementation by the management.
15. The board should identify key performance and risk areas and the associated performance and risk indicators and measures – this would include areas such as

financial, ethics, compliance as well as sustainability. The objectives that are set as part of the strategy should be clear, measurable, profitable and sustainable.

16. Before approving the strategy, the board should ensure that the strategy is aligned with the purpose of the company, the value drivers of its business and the legitimate expectations of its stakeholders.
17. The board should ensure that its long-term planning will result in sustainable outcomes. Strategy involves an assessment of risks and opportunities, and the strategy should establish a framework for action by the board and the management. The strategy development process should take account of the dynamics of the changing external environment so as to respond to changing market conditions.

Principle 1.5: The board should consider sustainability as a business opportunity

18. The primary reason for the existence of business enterprise is to create value. Traditionally the notion of value was viewed narrowly as financial value for shareholders. This has evolved into the notion of value in terms of the triple bottom line: social, economic and environmental performance.
19. Sustainable business practices require that the needs of the present are met without compromising the ability of future generations to meet their needs. This approach recognises that a business cannot operate in an economically viable manner over a prolonged period without due regard for long-term sustainability issues.
20. The board should consider sustainability as a business opportunity, where long term sustainability is linked to the strategy to create business opportunities. In making these decisions the board should be aware of the effect the company has on the economic life of the community in which it operates, both positive and negative. Efforts should be made to enhance these positive effects and eradicate or ameliorate the negative effects.

Principle 1.6: The board should appoint the chief executive officer and establish a framework for the delegation of authority

21. The board should appoint the chief executive officer (CEO) and should provide input on senior management appointments such as the chief financial officer and chief operating officer. As from June 2009, listed companies are required by the JSE listing requirements to appoint a financial director.
22. The board should also ensure that a succession plan is in place for the CEO, other appropriate senior executives and board members.

23. The board may delegate authority to the management but doing so must not in any way result in the board and its directors abdicating their duties and responsibilities.
24. The board should define its own levels of materiality, reserving specific powers to it and delegating other matters to the management. Such delegation by the board should have regard to directors' statutory and fiduciary responsibilities to the company, while taking into account strategic and operational effectiveness and efficiencies.
25. The board should exercise objective judgment on the affairs of the company independently from the management, but with sufficient management information to enable a proper and objective assessment to be made.
26. Through a process established by the board, directors should have unrestricted access to all entity information, records, documents, property and staff.

Principle 1.7: The board should be responsible for the process of risk management

27. The board's role is to set a risk appetite or risk tolerance level for the company. This should be determined according to the strategy adopted by the company and should take into account sustainability, ethics and compliance risks.
28. The board should oversee the identification of the key risk areas of the company and ensure that the management directs its mind to pertinent risks. These identified risks should be assessed for likelihood and magnitude of potential effect.
29. The board should be actively involved in identifying and monitoring the key risks emanating from this process. Where appropriate, a risk committee should be established.

Please refer to Chapter 4 Principle 4.4 for more detail.

Principle 1.8: The board and its directors should act in the best interests of the company

30. The board should always act in the best interests of the company and the foundation of each decision should be intellectual honesty, based on all the relevant facts. Every decision should be a rational business one taking into account relevant information at the time.
31. The board has a reflective role with collective authority and decision-making as a board, but directors have individual responsibility.

32. Directors of companies are appointed in terms of the constitution of the company and in terms of the Act. Each director of a company has:
- 32.1 a duty to exercise a degree of care, skill and diligence that would be exercised by a reasonably diligent individual who has both:
 - 32.1.1 the general knowledge, skill and experience that may reasonably be expected of an individual carrying out the same functions as are carried out by a director in relation to the company; and
 - 32.1.2 the general knowledge, skill and experience of that director; and
 - 32.2 a fiduciary duty to act in good faith and in a manner that the director reasonably believes to be in the best interests of the company.
33. These minimum fundamental principles described in paragraph 32 above, should be applied to all other entities, regardless of the framework under which these entities have been established, subject to any specific standards required.
34. Failure to properly perform these duties may render a director personally liable to pay monetary damages, whereas the failure to perform certain statutory duties may result in a director facing criminal liability. Currently, such statutory duties are regulated by the Act.
35. Individual directors or the board as a whole should be entitled, at the expense of the company, to take independent professional advice in connection with their duties, if they deem it necessary, but only after following a process agreed by the board.

Principle 1.9: The board and its directors should manage conflicts of interests

36. The personal interests of a director, or persons closely associated with that director, should not take precedence over those of the company.
37. Any director who is appointed to the board as the representative of a party with a substantial interest in the company, such as a major shareholder or a substantial creditor, should recognise the potential for a conflict of interest and accept that his primary duty is always to act in the best interests of the company.
38. Certain conflicts of interest are so fundamental that these should be avoided. Other conflicts (whether real or perceived) should be disclosed timeously and in full detail to the board.
39. Every listed company should have a practice of 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 should have regard to the listing requirements of the JSE in respect of dealings of directors.

Principle 1.10: The board should ensure that there is an effective risk-based internal audit

40. Internal audit plays an important role in providing assurance to the management and the board regarding the effectiveness of internal controls.
41. The board should ensure that assurance of internal control procedures provides reliable, valid and timely information for purposes of monitoring and evaluating the management and company performance. Internal controls should be established not only over financial matters but also operational, compliance and sustainability matters to manage the risks facing the company.
42. The board should ensure that the internal audit plan is risk-centric, and that the internal audit function has given the audit committee a written assessment of the adequacy of the internal controls. This assessment should be discussed by the audit committee, which should report the outcomes of that discussion to the board.

Please refer to Chapter 5 Principle 5.1 for more detail.

Principle 1.11: The board should ensure the integrity of financial reporting

43. Companies should have structures independently to verify and safeguard the integrity of their financial reporting.
44. The board should ensure that the company has implemented a structure of review and authorisation designed to ensure the truthful and factual presentation of the company's financial position. The structure should include:
 - 44.1 review and consideration of the financial statements by the audit committee; and
 - 44.2 a process to ensure the independence and competence of the company's external auditors.
45. A structure as described above does not diminish the ultimate responsibility of the board to ensure the integrity of the company's financial reporting.

Please refer to Chapter 3 Principle 3.4 for more detail on the audit committee's role in financial reporting.

Principle 1.12: The board should report on the effectiveness of internal financial controls

46. The integrated report (as defined in Chapter 3) should include a statement from the board, outside the annual financial statements, that they have established formal policies and frameworks for the design and implementation of the system of internal financial controls, and that a review of internal financial controls has taken place. The board should make a statement on the effectiveness of the company's internal financial controls.
47. The internal audit should make a written assessment of the internal financial controls as described in Chapter 5 Principle 5.2. The audit committee should assist the board with this review and statement as described in Chapter 3 Principle 3.8.

Principle 1.13: The board should ensure that the company makes full and timely disclosure of material matters concerning the company

48. The board should ensure that there is transparent and relevant communication with stakeholders.
49. The integrated report is an important mechanism for formal contact with stakeholders. Accordingly, companies should not only report on the positive aspects of their businesses but also on challenges and what steps are being taken to meet these challenges. It follows therefore that the integrated report should not be confined to past issues. It should provide forward-looking information to place the results and performance in context and to show transparency. This approach will foster the trust that is necessary for maintaining good stakeholder relationships.
50. The board should include commentary on the company's financial results to enhance the clarity and balance of reporting. This commentary should include information needed by an investor to make an informed assessment of the company's economic value and not merely its book value.
51. The board should disclose that the company is a going concern and whether it will continue to be a going concern. If it will not continue to be a going concern, the board should give the reasons and the steps it is taking to remedy the situation.
52. The following aspects regarding directors should be disclosed in the integrated report:
 - 52.1 the reasons for the cessation of appointment of directors. The purpose of this is to enable shareholders to fulfill their role as the ultimate arbiters of who should sit on the board or in case it signals cause for concern. Full, timely and appropriate disclosure will reduce speculation and uncertainty;

- 52.2 the composition of the board and board committees and the number of meetings held, attendance and activities;
 - 52.3 in considering the effectiveness and independence of the directors, the board should consider the length of service and age of its directors, and disclose these in the integrated report; and
 - 52.4 significant directorships of each board member.
53. With specific reference to shareholders, the board should ensure that each item of special business included in the notice of the AGM of a company, or any other shareholders' meeting, is accompanied by a full explanation of the effects of any proposed resolutions.
54. The board should encourage shareholders to attend AGMs and other company meetings, at which all the directors should be present. The chairmen of each of the board committees should be present at the AGM.

Principle 1.14: The board should ensure that internal and external disputes are resolved effectively, expeditiously and efficiently

55. A director's duty of care should involve an endeavour to ensure that there is a mechanism to manage disputes and, if disputes arise, to resolve them as effectively, expeditiously and efficiently as possible.

See Chapter 8 Principle 8.9 for more detail.

Principle 1.15: The board should ensure that the company implements an effective compliance framework and effective processes

56. The board should seek to drive business performance without contravention of any laws and regulations.
57. The board has the responsibility to ensure that the company complies with all relevant laws and regulations and the risk of noncompliance should be considered as part of the company's risk profile.
58. This duty of compliance with laws and regulations is not limited to a director's exercise and discharge of his common law and codified duties in terms of the Act. Rather, directors have a wider responsibility to familiarise themselves with the

relevant laws, regulations and codes applicable to the company and to ensure that appropriate processes are in place to address compliance.

Please refer to Chapter 7 Principle 7.5 for a detailed discussion.

Principle 1.16: The board should commence business rescue proceedings as soon as the company is financially distressed

59. The company's board, and not the company itself through its members, should commence the business rescue procedure. The board may resolve to commence voluntary business rescue proceedings and place the company under supervision, if the board has reasonable grounds to believe that:
 - 59.1 the company is financially distressed, and
 - 59.2 there appears to be a reasonable prospect of rescuing the company.
60. The board should consider the consequences involved where it becomes evident that the company will be unable to pay its debts as they fall due in the immediately ensuing six months, or if it is evident that the company will become insolvent in the immediately ensuing six months. In such a case the board will have to do one of two things:
 - 60.1 adopt a resolution commencing the voluntary business rescue procedure in Chapter 6 of the Act whereby the company will be placed under the supervision of a practitioner, or
 - 60.2 send a written notice to each affected person of the company setting out the financial position of the company and explaining why a decision has been made by the board not to voluntarily commence business rescue proceedings.
61. However, the board should consider the risk of reckless trading and if there is no prospect of business rescue proceedings succeeding, and it would be reckless to incur further credit, the board should lodge an application for the liquidation of the company.
62. If liquidation proceedings have already been commenced by or against the company at the time an application is made to court for the commencement of business rescue proceedings, the application for business rescue proceedings will suspend the liquidation proceedings.
63. The board should appoint a suitably qualified and independent business rescue practitioner. It is recommended that directors do not appoint a business rescue practitioner that is seen to be 'friendly' to their cause, as this will inevitably lead to the challenge of the practitioner's appointment.
64. The board should request the practitioner to furnish security for the value of the assets of the company.

65. The board and individual directors should be aware of their duties during business rescue proceedings as well as the duties and powers of the practitioner.

Composition of the board

Principle 1.17: The board should comprise a balance of executive and non-executive directors, with a majority of non-executive directors

66. Given the positive interaction and diversity of views that occur between individuals of different skills, experience and backgrounds, the unitary board structure with executive directors (refer Annex 1.1) and non-executive directors (refer Annex 1.2) interacting in a working group remains appropriate for South African companies.
67. The board should ensure that there is an appropriate balance of power and authority on the board. No one individual or block of individuals should be able to dominate the board's decision-making and the board should comprise a balance of executive and non-executive directors, with a majority of non-executive directors. The majority of non-executive directors should preferably be independent (refer Annex 1.3) as this reduces the possibility of conflicts of interest.
68. A lack of available and sufficiently experienced directors should not be a reason for boards not to seek to constitute the majority of the non-executive directors as independent.
69. A balance should be sought between continuity in board membership, subject to performance and eligibility for re-election as well as considerations of independence and the sourcing of new ideas through the introduction of new board members.
70. When determining the number of directors to serve on the board, the knowledge, skills and resources required to fulfil all the duties of the board should be considered. Factors determining the number of directors to be appointed are:
- 70.1 evolving circumstances and needs of the company;
 - 70.2 the need to achieve an appropriate mix of executive and independent non-executive directors;
 - 70.3 the need to have sufficient directors to structure board committees appropriately;

- 70.4 the fact that the absence of directors can make it difficult for a small board to raise a quorum;
- 70.5 regulatory requirements; or
- 70.6 the skills and knowledge needed in making business judgment calls for the company.
71. Every board should consider whether its size, diversity and demographics make it effective. Diversity applies to academic qualifications, technical expertise, relevant industry knowledge, experience, nationality, age, race and sex.
72. All directors should be individuals of integrity and courage, and have the relevant skill and experience to bring judgment to bear on the business of that company.
73. As a minimum, two executive directors should be appointed to the board, being the chief executive officer (CEO) and the director responsible for the finance function. This will ensure that there is more than one point of contact between the board and the management. For listed companies, a financial director must be appointed to the board from June 2009.
74. A programme ensuring a staggered rotation of non-executive directors should be put in place by the board to the extent that this is not already regulated by the company's memorandum of incorporation or relevant legislation.
75. Rotation of board members should be structured so as to retain valuable skills, to have continuity of knowledge and experience and to introduce people with new ideas and expertise.
76. At least one third of non-executive directors should retire by rotation at the company's AGM or other general meetings. These retiring board members may be re-elected, provided they are eligible. The board, through the nomination committee, should recommend eligibility, taking into account past performance and contribution.
77. The memorandum of incorporation of the company should allow the board to remove the CEO as an executive director on the board. Shareholder approval is not deemed necessary for these decisions.

Principle 1.18: The board should be led by an independent non-executive chairman who should not be the CEO of the company

78. The board should elect a chairman who can provide the direction necessary for an effective board. The chairman should be appointed by the board on an annual basis.

79. The chairman of the board should be independent and free of conflicts of interest on appointment, failing which, the board should consider appointing a lead independent non-executive director (refer to Annex 1.4).
80. If the board appoint a chairman who is a non-executive director but is not independent, this should be disclosed in the integrated report, together with the reasons and justifications for it.
81. The independence of the chairman should be carefully monitored.
82. The chairman's capacity and capability to add value to the company should form part of his annual evaluation.
83. The company should determine the duration of tenure of chairmen and this should be published in the integrated report.
84. The chairman should preside over board meetings and should ensure that the time of the meeting is used productively. The chairman should encourage collegiality among board members but without inhibiting candid debate and creative tension among board members.
85. The chairman should manage conflicts of interest. It is not sufficient merely to table a register of interests. All internal and external legal requirements must be met. The chairman should ask affected directors to recuse themselves from discussions and decisions in which they have a conflict, unless they are requested to provide specific input, in which event they should not be party to the decision. Attention is drawn to section 75 of the Act, which deals with personal financial interests and requires the director to recuse himself from all further participation in the board meeting if he has personal financial interests that may lead to a conflict of interest.
86. The chairman's role and function will be influenced by matters such as the lifecycle or circumstances of the company, the complexity of its operations, the qualities of the CEO and the management team, as well as the skills and experience of each board member. Core functions performed by the chairman should include the following:
 - 86.1 setting the ethical tone for the board and the company;
 - 86.2 providing overall leadership to the board without limiting the principle of collective responsibility for board decisions, but at the same time being aware of individual responsibility of board members, unless specifically provided otherwise by legislation;
 - 86.3 actively participating in the selection of board members (via a nomination committee), and overseeing a formal succession plan for the board, CEO and certain senior management appointments such as the chief financial officer (CFO);

- 86.4 determining and formulating (in conjunction with the CEO and company secretary) the annual work plan for the board against agreed objectives and goals and playing an active part in setting the agenda for board meetings;
 - 86.5 acting as the link between the board and the management and particularly between the board and the CEO;
 - 86.6 being collegiate with board members and senior management while at the same time maintaining an arm's length relationship;
 - 86.7 ensuring that directors play a full and constructive role in the affairs of the company and taking a lead role in the process for removing non-performing or unsuitable directors from the board;
 - 86.8 ensuring that relevant objective information is placed before the board to enable directors to reach an informed decision;
 - 86.9 monitoring how the board functions collectively, how individual directors perform and how they interact at meetings. The chairman should meet with individual directors once a year regarding evaluation of their performance. The chairman should know board members' strengths and weaknesses;
 - 86.10 mentoring to enhance directors' confidence (especially those new to the role) and encouraging them to speak up and make an active contribution at meetings. The mentoring role is encouraged to maximise the potential of the board;
 - 86.11 striking the right balance between informed and intellectually naive questions in eliciting decisions;
 - 86.12 ensuring that all directors on the board are appropriately educated in their duties and responsibilities and that a formal programme of continuing professional education is adopted at board level;
 - 86.13 ensuring that good relations are maintained with the company's major shareholders and its strategic stakeholders, and presiding over shareholders' meetings; and
 - 86.14 building and maintaining stakeholders' trust and confidence in the company.
87. The chairman should focus on social, sustainability and transformation issues, including employment equity, diversity management and social investment.
88. The CEO should not become the chairman of the company.

89. The chairman should carefully consider the number of additional chairmanships that he holds in companies. The relative size and complexity of the companies in question should be taken into account. In this regard, chairmen of boards and board committees should apply their minds, in an intellectually honest manner, to their workloads and abilities to discharge their duties.
90. The chairman should meet with the CEO and/or the CFO and/or the company secretary prior to a board meeting to discuss important issues on the agenda.
91. With regard to additional roles of the chairman on committees:
 - 91.1 the chairman should not be a member of the audit committee;
 - 91.2 the chairman should not chair the remuneration committee, but may be a member of it;
 - 91.3 the chairman should be a member of the nomination committee and may also be its chairman; and
 - 91.4 the chairman should not chair the risk committee but may be a member of it.

Principle 1.19: The board should appoint an effective and ethical chief executive officer

92. The CEO plays a critical and strategic role in the operations and success of the company's business. The CEO should consistently strive to achieve the company's financial and operating goals and objectives, and ensure that the day-to-day business affairs of the company are appropriately managed.
93. The CEO should ensure that the long-term strategy and vision of the company and its management are developed and recommended to the board to generate satisfactory levels of shareholder value and positive relations with stakeholders.
94. The CEO should ensure that a positive and ethical work climate is maintained which is conducive to attracting, retaining and motivating employees at all levels in the company.
95. The CEO should foster a corporate culture that promotes sustainable ethical practices, encourages individual integrity and fulfils social responsibility objectives and imperatives.

96. The CEO should serve as the chief spokesperson of the company.
97. The CEO should not be a member of the remuneration, audit or nomination committees, but should attend by invitation. CEOs should, however, recuse themselves when conflicts of interest arise, particularly when their performance and remuneration are discussed.
98. CEOs should carefully apply their minds, in consultation with the chairman, to whether it would be appropriate to take on non-executive directorships outside of the primary company or group so served, but should not become chairman of a major company outside of the group.
99. Given the strategic operational role of the CEO, this function should be separate from that of the chairman of the board.
100. The role of the CEO includes:
 - 100.1 recommending or appointing the executive team and ensuring proper succession planning and performance appraisals;
 - 100.2 developing the company's strategy for board consideration and approval;
 - 100.3 developing and recommending to the board annual business plans and budgets that support the company's long-term strategy;
 - 100.4 monitoring and reporting to the board performance and conformance with strategic imperatives;
 - 100.5 organising the structure of the company necessary to achieve the strategic plans;
 - 100.6 setting the tone from the top in providing ethical leadership and creating an ethical environment; and
 - 100.7 ensuring that the company complies with all relevant laws and regulations.

Board appointment processes

Principle 1.20: Directors should be appointed through a formal process

101. Shareholders are ultimately responsible for the composition of the board and it is in their own interests to ensure that the board is properly constituted.
102. Procedures for appointments to the board should be formal and transparent and a matter for the board as a whole, assisted by the nomination committee, subject to shareholder approval when necessary.
103. Boards should ascertain whether potential directors are competent to be appointed and can contribute to the business decisions to be made by the board. Prior to their appointment, their backgrounds should be investigated along the lines of the approach required for listed companies by the JSE. It is also important to ensure that new directors have not been declared delinquent nor are serving probation in terms of section 162 of the Act. The nomination committee should play a role in this process.
104. As part of a due diligence exercise in relation to sourcing appropriately skilled and experienced directors and ensuring that they are appropriately independent of the company, the onus is on the individual director to determine whether he has the requisite capability to make a meaningful contribution and that he is free from apparent or actual conflicts.

Director development

Principle 1.21: Training and development of directors should be conducted through formal processes

105. 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 introduce them to their fiduciary duties and responsibilities.
106. An appropriate introduction programme should meet the specific needs of both the company and the individual and should enable any new director to make the maximum contribution as quickly as possible.
107. New directors with no or limited board experience should receive development and education on their duties, responsibilities, powers and potential liabilities. Mentorship by an experienced director is encouraged. The development of the skills of inexperienced directors is vital in alleviating the shortage in the pool of directors available for appointment.

108. Ongoing director development should be encouraged, in the same manner as continuing professional development is for certain professions, to enhance governance practices within the board itself and in the best interests of the company.
109. Directors should receive regular briefings on matters relevant to the business of the company, changes in laws and regulations applicable to the business of the company, including accounting standards and policies, and the environment in which it operates.
110. Incompetent or unsuitable directors should be removed, taking relevant legal and other requirements into consideration. The chairman should lead the process.
111. In looking at the skills and suitability of a proposed candidate director, there are three dimensions that require consideration, namely:
 - 111.1 knowledge and information required to fill a gap on the board;
 - 111.2 the competence of the individual to contribute to the board; and
 - 111.3 the availability of the individual to discharge his responsibilities to the board.

Company secretary

Principle 1.22: The board should be assisted by a competent company secretary

112. The appointment of a company secretary in public companies with share capital is mandatory under the Act. Furthermore, the Act contains various provisions regarding the appointment, removal and duties of the company secretary. The company secretary has a pivotal role to play in the corporate governance of a company, and it is advisable that entities other than companies delegate this responsibility to an appropriate individual(s) or organisation.
113. The chairman and board will look to the company secretary for guidance on their responsibilities and their duties and how such responsibilities and duties should be properly discharged in the best interests of the company.
114. The company secretary should ensure that the board and board committee charters are kept up to date.

115. The company secretary should have a direct channel of communication to the chairman and should be available to provide comprehensive practical support and guidance to directors, with particular emphasis on supporting the non-executive directors and the chairman.
116. 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, as well as providing administrative support to the board and board committees.
117. The company secretary is responsible to ensure the proper compilation of board papers.
118. The company secretary should be tasked with the obligation of eliciting appropriate responses, feedback and input to specific agenda items in board and board committee deliberations. The company secretary's role should also be to raise matters that may warrant the attention of the board.
119. The company secretary must ensure that the minutes of board and board committee meetings are circulated to the directors in a timely manner, after the approval of the chairman of the relevant board committee.
120. The appointment and removal of a company secretary is a matter for the board.
121. The board should be cognisant of the duties imposed upon the company secretary and should empower the individual accordingly to enable him to properly fulfil those duties.
122. The company secretary should ensure that the procedure for the appointment of directors is properly carried out and he should assist in the proper induction, orientation and development of directors, including assessing the specific training needs of directors and executive management in their fiduciary and other responsibilities.

Performance assessment

Principle 1.23: The performance of the board, its committees and the individual directors should be evaluated annually

Board and committee evaluation

123. Improved board performance and effectiveness can be achieved through regular and timely appraisals of the board.
124. Effective and meaningful evaluation is only possible once the board has determined its own functions and has identified the key roles, performance and attendance standards for directors on the board and on board committees.
125. The board should carefully consider whether the evaluations of performance and independence should be done in house or conducted professionally by independent service providers, subject to legislative requirements. Evaluation results should be reviewed by the nomination committee or such similar committee of the board.
126. Annual performance appraisals of individual directors, the board as a whole, board committees and the chairman, can provide the basis for identifying future training needs and, where necessary, explain why a re-appointment may not be appropriate.
127. The chairman may lead the overall performance evaluation of the board, its individual members and the company secretary, although independent performance appraisals should be considered. The board should discuss the board evaluation results at least once a year.
128. The board should state in the integrated report that the appraisals of the board and its committees have been conducted.
129. The same principles adopted in the evaluation of the board should be applied to the board committees' chairmen and members.

Individual director evaluation

130. Directors' contribution and reporting to the board should be measured against their duties. The nomination of a director at the AGM should not be an automatic process and should only occur after the proper evaluation of the performance and attendance of the director in question.

131. Formal evaluations should be led by the chairman or an independent service provider. The chairman should ensure that directors know that they will be subject to review, know the criteria used for evaluation, and know the procedures that will be followed. A series of evaluation questions should be distributed in time for directors to complete prior to any meeting with the chairman.
132. 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 develop appropriate behavioural patterns. It is important that the director evaluation be approached in an open, constructive and non-confrontational manner.
133. The action plan arising out of the evaluation should be reported and discussed and a consolidated summary of the whole process should be reported to the full board.
134. Evaluation questions should include the questions to evaluate the performance of the chairman.
135. The board should appoint an independent non-executive director from within its ranks to lead the process of the evaluation of the chairman's performance. Where a lead independent director (LID) has been appointed, that person should lead the process.
136. The chairman should not be present when his performance is discussed by the board.

CEO and executive director evaluation

137. The chairman, or a committee appointed by the board, should evaluate the performance of the CEO at least once a year.
138. The evaluation should assess the performance of the CEO, both as a director and as the chief executive officer. The results of such an evaluation should also be considered by the remuneration committee to guide it in its evaluation of the performance and remuneration of the CEO, and a summary of the remuneration committee's evaluation should be provided to the board.
139. Executive directors, despite being evaluated as to how they performed as executives, should be separately assessed as directors on the board.

Board committees

Principle 1.24: The board should delegate certain functions to well-structured committees without abdicating its own responsibility

140. Board committees with formally established terms of reference, criteria for appointment, life span, role and function constitute an important element of the governance process and should be established with clearly agreed reporting procedures and a written scope of authority. The Act recognises the right of a board to establish board committees with the qualification that by so doing, the board will not necessarily be exonerated from compliance with its legal responsibilities.
141. Committees should be appropriately constituted, taking into account any relevant legislation and the objectives of the company. The composition of board committees should be disclosed in the integrated report.
142. Board committees should only comprise members of the board. External parties, such as paid advisers, may be present at committee meetings by invitation.
143. The terms of reference for each committee should, as a minimum, cover:
- 143.1 composition;
 - 143.2 objectives, purpose and activities;
 - 143.3 delegated authorities, including the extent of power to make decisions and/or recommendations;
 - 143.4 tenure; and
 - 143.5 reporting mechanism to the board.
144. Where subsidiary companies within a group establish their own board committees, the relevant board committees of the holding company should review the terms of reference and the activities of such subsidiary's committees to assess the degree to which reliance can be placed on their work.
145. Unless legislated otherwise, the board should appoint the audit, risk, remuneration and nomination committees as standing committees. Smaller companies need not establish formal committees to perform these functions, but should ensure that these functions are appropriately addressed by the board.

146. The respective committees' chairmen should give at least an oral summary of their committees' deliberations at the board meeting following the committee meeting.
147. Board committees should be free to take independent outside professional advice when necessary, at the cost of the company, subject to a proper process being followed.
148. The audit and remuneration committees should be chaired by an independent non-executive director.
149. The nomination committee should comprise the board chairman and non-executive directors only, of whom the majority should be independent.
150. All members of the remuneration committee should be non-executive directors, of which the majority should be independent.
151. Every director will normally be entitled to attend committee meetings for the purpose of gaining information relating to the company and its business. However, unless the director is a member of the committee, the director will not be entitled to participate in the proceedings without the consent of the chairman and will not have a vote. Directors who wish to attend the meetings in these circumstances should follow the process established by the board.

Group boards

Principle 1.25: A governance framework should be agreed between the group and its subsidiary boards

This section is applicable to companies only

152. In cases where the subsidiary company is listed, special attention should be paid to the rules of the relevant stock exchange and the requirement that all shareholders should be treated equally. This is of specific relevance to the subsidiary company in establishing the flow of information between the subsidiary company and the holding company in so far as the Securities Services Act is concerned. Particular attention should be given to the need to comply with relevant rules in respect of inside information.
153. Depending on the jurisdiction in which the subsidiary company operates, different legal and regulatory requirements from those applicable to the holding company may apply and need to be recognised by the holding company.

154. The holding company needs to recognise the fiduciary duties of the subsidiary company's directors and particularly their duty to act in the best interests of the subsidiary company at all times whether or not the director is nominated to the board of the subsidiary company by the holding company. In the case of a conflict between the duties of a nominee director to a company on whose board he sits and the interests of his principal, the duties of the board must prevail.
155. The holding company should consult the chairman of the board of the subsidiary company before nominating a director or directors to the subsidiary company board. This is to ensure that any candidates to be nominated meet the minimum requirements of the board of the subsidiary company as to skills, experience, background and other relevant attributes.
156. The implementation or application of the policies, processes or procedures of the holding company in the operations of the subsidiary company should be a matter for the board of the subsidiary company to consider and approve, if deemed appropriate. Full disclosure of such practices should be made in the annual report of the subsidiary company.
157. In many situations, the chairman or CEO of a subsidiary company is appointed as director of the holding company board. These situations are acceptable. It is, however, important to note that the fiduciary duties of the director apply to the company to which he has been appointed.

Remuneration of directors

Principle 1.26: Companies should remunerate fairly and responsibly

158. Companies should adopt remuneration policies and practices that create value for the company over the long term. The policies and practices should be aligned with the company's strategy, reviewed regularly and be linked to the executive's contribution to performance. Factors outside the influence of the executives, which affect performance, should not be taken into account in assessing the executive's remuneration.
159. The board should use every endeavour to promote a culture that supports enterprise and innovation with appropriate short- and long-term performance-related rewards that are fair and achievable.
160. The remuneration committee should assist the board in its responsibility for setting and administering remuneration policies in the company's long-term interests. The committee considers and recommends remuneration policies for all levels in the

company, but should be especially concerned with the remuneration of senior executives, including executive directors, and should also advise on the remuneration of non-executive directors.

161. In proposing the remuneration policy, the remuneration committee should ensure that the mix of fixed and variable pay, in cash, shares and other elements, meets the company's needs and that incentives are based on targets that are stretching, verifiable and relevant. It should satisfy itself as to the accuracy of recorded performance measures that govern vesting of incentives.
162. Non-executive director fees, including committee fees, should comprise a retainer, where considered desirable, which may vary according to factors including the level of expertise of each director, as well as an attendance fee per meeting. Non-executive directors should not receive incentive awards geared to share price or corporate performance. Non-executive fees should be approved by shareholders in advance.
163. The proceedings of the remuneration committee should be governed by a charter approved by the board.

Base pay and bonuses

164. In setting remuneration policies, the remuneration committee should ensure that remuneration levels reflect the contribution of executives and should be rigorous in selecting an appropriate comparative group. The committee should guard against unjustified windfalls and inappropriate gains arising from the operation of share-based and other incentives.
165. Annual bonuses should clearly relate to performance against annual objectives consistent with long-term value for shareholders. Individual and corporate performance targets, both financial and nonfinancial, should be tailored to the needs of the business and reviewed regularly to ensure they remain appropriate.
166. Depending on the nature of the business it may be appropriate to have overriding conditions for the award of bonuses (often termed 'gatekeepers'), such as the achievement of safety goals or minimum levels of financial performance. Targets for threshold, expected and stretch levels of performance, should be robustly set and monitored and the main performance parameters should be disclosed.
167. Incentives may be given for both long-term and short-term goals. However, the performance drivers should not be duplicated, and a balance needs to be struck with the need to reward success over the long term. Multiple performance measures

should be used to avoid manipulation of results or poor business decisions. Targets may be linked to bonuses.

168. The remuneration committee should scrutinise all other benefits including pensions, benefits in kind and other financial arrangements to ensure they are justified, appropriately valued and suitably disclosed.

Contracts and severance

169. Contracts should not commit companies to pay on termination arising from failure.
170. Balloon payments on termination do not generally meet the requirements of a balanced and fair remuneration policy.
171. For bonuses, there should be a contractual link between variable pay and performance. In the event of early termination there should be no automatic entitlement to bonuses or share-based payments.
172. Contracts should make clear that if a director is dismissed as a result of a disciplinary procedure, a shorter notice period than that given in the contract would apply. Contracts should not compensate executives for severance as a result of change of control; however this does preclude payments for the retention of key executives during a period of uncertainty.

Share-based and other long-term incentive schemes

173. The remuneration committee should regularly review incentive schemes to ensure their continued contribution to shareholder value.
174. Because of the significant cost to the company of incentive schemes, shareholders should approve in advance all long-term share-based and other incentive schemes or any substantive changes to existing schemes.
175. Participation in share incentive schemes should be restricted to genuine employees and executive directors, and be subject to appropriate limits for individual participation, which should be disclosed.
176. The chairman and non-executive directors should not receive incentive awards geared to the share price or corporate performance that may be seen to impair their ability to provide impartial oversight and advice. Non-executive directors should limit their shareholdings to a level which will not impair their independence.

177. Non-executive directors should not receive share options.
178. All share-based incentives, including options and restricted/conditional shares, whether settled in cash or in shares, should align the interests of executives with those of shareholders and should link reward to performance over the longer term. Vesting of rights should therefore be based on performance conditions measured over a period appropriate to the strategic objectives of the company.
179. Highly leveraged incentive schemes should be used with care as they may result in excessive cost or risk for the company.
180. The regular and consistent granting of share incentive awards and options, generally on an annual basis, is desirable as it reduces the risk of unanticipated outcomes that arise out of share price volatility and cyclical factors, allows the adoption of a single performance measurement period and lessens the possibility and impact of 'underwater' options or excessive windfall gains.
181. The price at which shares are issued under a scheme should not be less than the midmarket price or volume-weighted average price (or similar formula) immediately preceding the grant of the shares under the scheme. There should be no re-pricing or surrender and re-grant of awards on 'underwater' share options.
182. The rules of a scheme should provide that share or option awards should not be granted within a closed period. No backdating of awards should be allowed.
183. Options or other conditional share awards are normally granted in respect of the year in question and in expectation of service over a performance measurement period of not less than three years. Accordingly, shares and options should not vest or be exercisable within three years from the date of grant. In addition, options should not be exercisable more than 10 years from the date of grant. For new schemes it is best practice to restrict the exercise period to less than seven years.
184. To align shareholders' and executives' interests, vesting of share incentive awards should be conditional on the achievement of performance conditions. Such performance measures and the reasons for selecting them should be fully disclosed. They should be linked to factors enhancing shareholder value, and require strong levels of overall corporate performance, measured against an appropriately defined peer group or other relevant benchmark where annual awards are made. If performance conditions for share-based incentive schemes are not met, they should not be re-tested in subsequent periods. Where performance measures are based on a comparative group of companies, there should be disclosure of the names of the companies chosen.

185. Awards should be made on a sliding scale to avoid an 'all or nothing' vesting profile and should start at a level that is not significant in comparison with base pay. Awards with high potential value should be linked to commensurately high levels of performance. Full vesting should require significant value creation.
186. In periods of severe skills shortages, remuneration policies should focus on retention of key employees as well as performance. Incentive schemes to encourage retention should be established separately, or should be clearly distinguished, from those relating to reward performance.
187. In the event of a change of control or where options and awards are 'rolled over' for a capital reconstruction, or in the event of the early termination of the participant's employment, there should be no automatic waiving of performance conditions. Depending on the circumstances, it may be appropriate to prorate the benefit both on time and performance, or to create new instrument(s) to preserve the value of the outstanding awards. In the case of change of control, it may be appropriate to allow prorata early vesting, to the extent that performance conditions have been satisfied, and the time served of vesting periods.
188. Where individuals leave voluntarily before the end of the service period, or are dismissed for good cause, any unvested share-based awards should lapse.
189. In other cases of cessation of employment, where the remuneration committee decides that early vesting is appropriate, the extent of vesting should depend on performance criteria over the period to date as well as the time served of vesting periods.

Principle 1.27: Companies should disclose the remuneration of each individual director

190. Companies should provide full disclosure of directors' remuneration on an individual basis, giving details of pay, bonus, share-based payments, restraint payments and all other benefits.

Principle 1.28: The remuneration committee should issue a remuneration report to explain the company's remuneration philosophy and how it has been implemented

191. In its annual remuneration report the company should explain the remuneration policies followed and the strategic objectives that it seeks to achieve and should provide clear disclosure of their implementation. The report should enable stakeholders to form a view of those policies and how they are implemented.
192. The remuneration report should explain the policy on base pay, including the use of appropriate benchmarks. A policy to pay salaries on average at above median requires special justification.
193. Any material payments that may be viewed as being ex-gratia in nature should be fully explained and justified.

Contracts and severance

194. Policies regarding executive service contracts should be set out in the annual remuneration report.
195. These policies normally include at least the following:
- 195.1 the period of the contract as well as the notice of termination (after the initial period, contracts will normally be renewable on an annual basis); and
 - 195.2 the nature and period of any restraint.
196. The remuneration report should disclose the maximum and the expected potential dilution that may result from the incentive awards granted in the current year.
197. Details of the remuneration of non-executive directors and the committee fees should be disclosed in the annual remuneration report.

Principle 1.27: Shareholders should approve the company's remuneration policy

198. The company's policy of remuneration should be approved by shareholders in a general meeting.
199. The board is responsible for determining the remuneration of executive directors. These decisions need not be approved by shareholders.

Annex 1.1: Executive director

Involvement in the management of the company and/or being in the full-time salaried employment of the company and/or its subsidiary define the director as executive.

An executive director may take on other non-executive directorships, provided these are not detrimental to his immediate responsibilities as an executive director of the company and are in accordance with a board-approved policy. An executive director should therefore timeously apply his mind, in consultation with the chairman and chief executive officer, as to whether such directorships would be appropriate.

Executive directors should carefully manage the conflict between their management responsibilities and their fiduciary duties as directors in the best interests of the company.

Annex 1.2: Non-executive director

The non-executive director plays an important role in providing judgment independent of management on issues facing the company.

Not being involved in the management of the company defines the director as non-executive.

Non-executive directors are independent of management on all issues including strategy, performance, sustainability, resources, transformation, diversity, employment equity, standards of conduct and evaluation of performance.

Non-executive directors should ensure that they have (and take) the time required to attend properly to their obligations. It is expected of them to:

- i. attend board and board committee meetings; and
- ii. acquire and maintain a broad knowledge of the economic environment, industry and business of the company.

In view of the time and dedication required to fulfil the above obligations properly, it is important that non-executive directors do not hold any more directorships than is reasonably considered appropriate in order for them to provide the care, skill and diligence that is required from a board member. They should therefore honestly apply their minds to their workloads and abilities to discharge their duties.

The non-executive directors should meet from time to time in the absence of the executive directors to consider the performance and actions of executive management.

An individual in the full-time employment of the holding company is also considered a non-executive director of a subsidiary company unless the individual, by his conduct or executive authority, is involved in the day-to-day management of the entity.

Annex 1.3: Independent non-executive director

Independent non-executive directors should be independent in fact and in the perception of a reasonably informed outsider.

Independence is, however, more a state of mind than an objective fact and perception.

The independence of an independent non-executive director should be assessed annually by the board.

An independent non-executive director is a non-executive director who:

- i. is not a representative of a shareholder who has the ability to control or significantly influence management.
- ii. does not have a direct or indirect interest in the company (including any parent or subsidiary in a consolidated group with the company) which is either material to the director or to the company. A holding of five percent or more is considered material.
- iii. has not been employed by the company or the group of which he currently forms part in any executive capacity for the preceding three financial years.
- iv. 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.
- v. is not a professional adviser to the company or the group, other than as a director.
- vi. is free from any business or other relationship which could be seen to interfere materially with the individual's capacity to act in an independent manner.
- vii. does not receive remuneration contingent upon the performance of the company.

Annex 1.4: Lead independent non-executive director (LID)

A company may have sound reasons for appointing a chairman who does not meet all the criteria for independence or being non-executive and should be prepared to justify its decision in terms of this code. The appointment of a LID can assist the board in dealing with any actual or perceived conflicts of interest that arise in these or future circumstances.

The main function of a LID is to provide leadership and advice to the board, without detracting from the authority of the chairman, when the chairman has a conflict of interest. Such assistance may be provided:

- i. at any board meeting (including meetings of committees of the board) or at any other meeting of the company;
- ii. at any meeting the chairman may initiate with the LID;
- iii. in any consultations that any other director or executive of the company may initiate with the LID;
- iv. in any consultation that the LID may initiate.

The LID should at all times be aware that the role is that of support to the chairman and board and not in any way to undermine the authority of the chairman.

The LID should also chair the board meetings which deal with the succession of the chairman and the chairman's performance appraisal.

The term of the LID's appointment will depend on the circumstances of the company and could either be an ongoing appointment or of limited duration for so long as the actual or perceived lack of independence or conflict of interest of the chairman endures.

Chapter 2

Corporate citizenship: leadership, integrity and responsibility

Principle 2.1: The board should ensure that the company acts as and is seen to be a responsible corporate citizen

1. The board is not only responsible for the company's financial bottom line, but for the company's performance in respect of its *triple bottom line*. This means that the board should report to its shareholders and other stakeholders on the company's economic, social and environmental performance.
2. Although a company is an economic institution, it remains a corporate citizen and therefore has to *balance* economic, social and environmental value. The triple bottom line approach enhances the potential of a company to create economic value. It ensures that the economic, social and environmental resources the company requires to remain in business are treated responsibly. By looking beyond immediate financial gain, the company ensures that its *reputation*, its most significant asset, is protected. There is growing understanding in business that social and environmental issues have financial consequences.
3. The triple bottom line performance approach recognises the effect of the modern company on society and the natural environment. It acknowledges that companies need to act with economic, social and environmental responsibility. It is unethical for companies to expect society and future generations to carry the economic, social and environmental costs and burdens of its operations. Business itself needs to ensure that its impact on society and the natural environment is socially and environmentally sustainable.
4. Good corporate citizenship is the establishment of an ethical relationship of responsibility between the company and the society in which it operates. As good corporate citizens of the societies in which they do business, companies have, apart from rights, also legal and moral obligations in respect of their social and natural environments. The company as a good corporate citizen should protect, enhance and invest in the wellbeing of society and the natural ecology.
5. Corporate citizenship and sustainability require business decision makers to adopt a holistic approach to economic, social, and environmental issues in their core business strategy. Only a holistic approach will allow for the effective management of business opportunities and risks⁴.

6. The expectation that business has an important role to play in responding to social and environmental challenges has become widely accepted. The debate on the need for voluntary business action or government regulation is being superseded by an understanding that an appropriate mix of both approaches is important. Governments are learning to encourage voluntary action beyond legal compliance, while at the same time ensuring compliance with minimum standards.
7. There are increasing concerns surrounding the role of South African companies in the rest of Africa⁵. In this regard, it is important to note that good corporate governance and citizenship requires special attention particularly in other African countries that are characterised by the Organization of Economic Cooperation and Development (OECD) as 'weak governance' zones, in which companies can become unwitting accomplices to human rights abuses.⁶ Indeed, next to climate change, the issue of human rights in weak governance areas is arguably a key corporate citizenship frontier for the next decade. Companies need to be encouraged and supported in applying the precautionary principle in such governance contexts, and they need to learn to adopt international best practice while adapting to local contexts.
8. There is a shift away from the emphasis – common in 2002 – on individual companies' sustainability-related efforts. Though these are important, it is increasingly realised that there are inherent limits to what individual companies acting by themselves can achieve, particularly considering the systemic character of many socio-environmental challenges, such as climate change, water depletion, informal settlements, and corruption. There is a need to encourage mechanisms for business decision makers to engage in collaborative responses to sustainability⁷.
9. Increasingly, companies view corporate social responsibility, corporate social investment and other social initiatives as central to doing business – companies no longer treat them as merely nice to have and done on an ad hoc basis, but as part of their business strategy and, in turn, supporting business growth. Companies have drifted away from naive types of activities that are thinly-veiled marketing ploys undertaken to improve their corporate citizenship profiles.
10. Good corporate citizenship should be infused as an integral part of the culture of the company.
11. Corporate citizenship is about the contribution a company makes to society, the economic dimension and the environment through its core business activities, its social investment and philanthropy programmes, and its engagement in public policy.
12. In the context of sustainable development, corporate citizenship goes further. It considers the rights and responsibilities of companies within a broader societal context, and is therefore concerned with the contribution a company makes through its social and environmental impacts as well as its economic contribution. These impacts and contributions relate to⁸:

- 12.1. managing the enterprise - how effectively and ethically the company governs, controls and manages its operations;
 - 12.2. workplace practices - how it manages its employees, workplace conditions and employment practices;
 - 12.3. stakeholder interactions - how it engages external stakeholders in the company supply chain, marketplace, government and community;
 - 12.4. environment - how it controls its impact on the environment; and
 - 12.5. transformation - how SA companies meet their obligations to help all citizens become meaningful economic partners.
13. A good corporate citizen is therefore one that has comprehensive policies and practices in place throughout the business that enable it to make decisions and conduct its operations ethically, meet legal requirements and show consideration for society, communities and the environment.
 14. The aspiration of every company should be to be a good corporate citizen. This means the adoption of practices that go beyond corporate philanthropy.
 15. Integrity (the adherence to formal requirements and the voluntary commitment to ethical standards and values) yields many positive benefits. It assists in attracting and retaining top talent. It empowers employees to speak up on both performance and integrity concerns. It also assists in creating a culture where personal values and company values are aligned, thereby improving morale and pride in the company and, ultimately, enhancing productivity.

Principle 2.2: Companies should develop strategies and policies to guide their activities in becoming and remaining good corporate citizens

23. Corporate citizenship issues should be relevant to the national needs and priorities of those countries in which companies have business operations.
24. Corporate citizenship should be manifested in tangible programmes and results which can be reported on based on standard performance measures. In South Africa, corporate citizenship includes, among many others, issues related to transformation, human rights, human capital, social capital, safety and health.
25. There is no universal approach to good citizenship programmes. The key success factor is that such programmes should have the commitment of the leadership and should focus on corporate citizenship, rather than on public relations. In

implementing programmes as a good corporate citizen, each company should develop its own policies to define and guide its activities.

26. The strategies and policies designed to achieve good corporate citizenship should be planned and coordinated across all sections of the company. The negative consequences of fragmentation include duplication of effort and missed opportunities for synergies. For instance, companies seek to respond to the pressing requirements of the industry's BEE charter and the government's BEE scorecard, but rarely integrate these efforts effectively into a broader sustainability framework. The result is often a short-term emphasis on compliance and 'box-ticking', and this leads to less beneficial social returns as a corporate investment. There are also potential inefficiencies within the company, as corporate policies, targets, and lines of reporting are duplicated or even contradict each other.
27. A further implication of the current fragmentation between sustainability and BEE relates to investors' perceptions. There is also a growing movement of international investors, including many of the largest institutional investors, that highlights the role of sustainability considerations in investment⁹. There is thus an important opportunity to emphasise and institutionalise the crucial linkages between BEE and sustainability and thereby to support greater confidence among investors in companies' social transformation efforts in South Africa.

Principle 2.3: Corporate governance requires effective and responsible leadership to ensure that the company is run ethically, in a transparent and accountable manner

28. Good corporate governance is essentially about effective and responsible leadership, which calls for integrity, transparency and accountability. Leaders need to define strategy, provide direction and establish the ethics and values that will influence and guide practices and behaviour to achieve sustainable performance.
29. Ethics (integrity and responsibility) is the foundation of and reason for corporate governance. The *ethics of governance* requires the board to ensure that the company is run with *integrity* and *ethically*. As this is achieved, the company earns the necessary approval, its *licence to operate*, from those who are affected by and who affect its operations.
30. It follows that all the typical aspects of corporate governance (the role and responsibilities of the board and directors, internal audit, risk management, managing stakeholder relations, and the like) rest on a foundation of *ethical values or standards*. As such, corporate governance is the expression of ethical values and standards.
31. The responsibility for corporate governance lies with the board and consists of two main functions. First, the board is responsible for determining the company's *strategic direction*, and hence its ultimate performance. Second, the board is responsible for the *control* of the company, which entails supervising management to

ensure that they execute strategic decisions effectively and in accordance with laws, regulations and societal expectations.

32. Corporate governance models around the world differ on *who* the board is responsible to. This Report deliberately stands in the tradition created by its two predecessor reports, namely, the *First King Report* (1994) and the *Second King Report* (2002). This tradition opts for a *stakeholder model of governance*, which emphasises that the board is accountable not only to the company, but should take account of the legitimate expectations and interests of its stakeholders in its decisions. A *stakeholder approach* to corporate governance looks after the interests of all the company's stakeholders, thus ensuring the cooperation and support of all stakeholders on which the company depends for its sustainable success. In this way, the company creates trust between itself and its internal and external stakeholders, without whom no company can operate sustainably. In short, *stakeholders entrust the company with its licence to operate*.
33. The *ethics of governance* requires that all decisions and actions of the board and executive management be based on the following four basic ethical values that underpin good corporate governance:
 - 33.1. *Responsibility*: The board should assume responsibility for the assets and actions of the company and be willing to take corrective actions to keep the company on its strategic path.
 - 33.2. *Accountability*: The board should be able to justify its decisions and actions to shareholders and other stakeholders who require it to do so.
 - 33.3. *Fairness*: In its decisions and actions, the board should ensure it gives fair consideration to the interests of all stakeholders of the company.
 - 33.4. *Transparency*: The board should disclose information in a manner that enables stakeholders to make an informed analysis of the company's performance.
34. A director is a steward of the company. The *ethics of governance* requires that in this stewardship role, each director be faithful to the four basic ethical values of good corporate governance (responsibility, accountability, fairness and transparency). In performing their stewardship role directors need to exercise the following five moral duties:
 - 34.1. *Conscience*: A director should act with intellectual honesty in the best interest of the company and all its stakeholders in accordance with the enlightened shareholder value approach. Conflicts of interest should be avoided. Independence of mind should prevail to ensure the best interest of the company and its stakeholders is served.

- 34.2. *Care*: A director should devote serious attention to the affairs of the company. Relevant information required for exercising effective control and providing innovative direction to the company needs to be acquired.
- 34.3. *Competence*: A director should have the knowledge and skills required for governing a company effectively. This competence should be developed continuously. Willingness to be regularly reviewed is a prerequisite for ensuring competence.
- 34.4. *Commitment*: A director should be diligent in performing directors' duties. Sufficient time should be devoted to company affairs. Effort needs to be put into ensuring company performance and conformance.
- 34.5. *Courage*: A director should have the courage to take the risks associated with directing and controlling a successful sustainable enterprise, but also the courage to act with integrity in all board decisions and activities.

Principle 2.4: The board should actively manage the company's ethics performance

35. Good corporate governance requires that the board takes responsibility for creating and sustaining an *ethical corporate culture* in the company.
36. The establishment and maintenance of an ethical corporate culture requires the *governance of ethics*, that is, that the board should ensure that the company has a well designed and properly implemented ethics management process consisting of the following four aspects:
 - 36.1. *Ethics risk and opportunity profile*: The board should ensure that an ethics risk profile is compiled, reflecting the company's negative ethics risks (threats) as well as its positive ethics risks (opportunities). See Chapter 4 on risk management.
 - 36.2. *Code of ethics*: The board should ensure that a company code of ethics is developed, stipulating the ethical values or standards as well as more specific guidelines guiding the company in its interaction with its internal and external stakeholders.
 - 36.3. *Integrating ethics*: The board should ensure that the company's ethical standards (code of ethics and related ethics policies) are integrated into the company's strategies and operations. This requires, among others, ethical leadership, management practices, structures and offices, education and training, communication and advice, and prevention and detection of misconduct for example, through whistle-blowing.

36.4 *Ethics performance reporting and disclosure:* The board should assess the company's ethics performance, and report and disclose findings to internal and external stakeholders. Refer to chapter 5 for internal audit and chapter 6 for integrated sustainability reporting.

37. An ethical corporate culture will require that:

37.1. ethical practice for directors is a non-negotiable requirement;

37.2. the stewardship of a director is firstly towards the company and its shareholders. However, the director should appropriately take into account the interests of other stakeholders.

37.3. sound moral values and ethics are propagated by the conduct of individuals;

37.4. the effectiveness of free enterprise and the market economy demands responsibility and it is important that business activity is directed by people with integrity, fairness and vision;

37.5. because fair competition is fundamental to the free enterprise system directors support laws regulating restraints of trade, unfair practices, abuse or the unscrupulous use of economic power and avoidance of collusion; and

37.6. ethics can never become an excuse for poor performance.

Chapter 3

Audit committees

Principle 3.1: A company should have an effective audit committee

1. An independent audit committee fulfils a vital role in corporate governance. The audit committee is a critical component in ensuring the integrity of integrated reporting and financial controls, the proper identification and management of financial risks and the integrity of the reporting practices. Integrated reporting refers to a company's integrated sustainability report, as described in Chapter 6, incorporating the applicable statutory financial reporting.
2. The board and the management of any company, regardless of size, should be fully committed to the goal of supporting and maintaining an effective audit committee.
3. At each AGM, the shareholders of a public company, state-owned company or any other company that has an audit committee must elect an audit committee. The nomination committee (where there is one) should present shareholders with suitable candidates for election as audit committee members.
4. Best practice indicates that shareholders should take the following into account when selecting audit committee members:
 - 4.1. members should be independent non-executive directors;
 - 4.2. members should have the necessary level of financial literacy; and
 - 4.3. the chairman should be an independent non-executive director and not the chairman of the board.

Membership and resources of the audit committee

Principle 3.2: Audit committee members should be suitably skilled and experienced independent non-executive directors

5. Subject to specific legislation, the audit committee should consist of at least three members. All members of the audit committee, at holding company level for companies incorporated in South Africa, should be independent non-executive directors (please refer to Chapter 1 for the definition of independent non-executive

director). Where an audit committee is appointed at subsidiary level that will act as a subcommittee of the holding company's audit committee, executive directors within the group may be appointed as audit committee members provided the group audit committee accepts overall responsibility.

6. There should be a basic level of qualification and experience for audit committee membership, even though the members may have been appointed by the shareholders. The board should evaluate whether collectively (but not necessarily individually) the audit committee has a good understanding of financial risks, financial and sustainability reporting and internal controls. The collective skills of the audit committee should be appropriate to the company's size and circumstances, as well as its industry.
7. The audit committee as a whole should possess sufficient and relevant knowledge of corporate law.
8. Because of the audit committee's responsibility for overseeing integrated reporting, there is a clear need for this committee, as a whole, to have a thorough understanding of the complexities of International Financial Reporting Standards, South African Statements of Generally Accepted Accounting Practice, Global Reporting Initiative standards or any other financial reporting framework and set of standards applicable to the company.
9. In cases where the board evaluates the skills and experience of the committee as a whole, and finds specific gaps, the board should either take this matter up with the shareholders or give the committee the necessary skills through independent contractors. These contractors should not be considered as members of the committee and should not be entitled to vote on any matters. The responsibility of these contractors should be set out contractually.
10. Audit committee members should keep themselves current with key developments in financial reporting and relevant legal and regulatory developments.

Public sector perspective

11. Audit committee members of public companies and state-owned companies must comply with the financial qualification criteria established by the minister as defined in Section 94(5) of the Act.
12. In addition to the above, the relevant executive authority in the public sector must concur with any premature termination of the services of a person serving on an audit committee.

Principle 3.3: The audit committee should be led by an independent non-executive director

13. The chairman of the audit committee should be a director of the company and a proactive leader and should understand the function of the audit committee and be able to lead constructive dialogue with the management, the internal and external auditors, other external assurance providers and the board. The chairman should have time available to develop and closely monitor the audit committee agenda.
14. The chairman of the board has a strategic and comprehensive role to play in guiding the board and cannot simultaneously lead and participate objectively in the audit committee. The chairman of the board should therefore not be eligible for appointment as an audit committee member but may be invited to join the audit committee by invitation, subject to any specific legislation prohibiting attendance, such as the Banks Act.
15. The audit committee chairman should, in consultation with the company secretary, decide the frequency and timing of its meetings. The audit committee should meet as frequently as necessary to perform its role, but should meet at least twice a year. Reasonable time should be allocated for all audit committee meetings.
16. There should be at least one meeting a year, or part of a year, where the external and internal auditors attend without the management being present.

Responsibilities of the audit committee

Principle 3.4: The audit committee should oversee stakeholder reporting

17. All companies should prepare an integrated report annually that conveys adequate information about the operations of the company and its integrated sustainability and financial reporting.
18. Although the board should be responsible for reporting and internal control in a company, these responsibilities may be delegated to the audit committee, which then makes recommendations to the board in this regard.
19. The audit committee generally oversees the company's reporting and assurance functions on behalf of the board, and serves as a link between the board and these functions. It may also review aspects of risk and sustainability issues where it is mandated to do so by the board. The board should critically evaluate the recommendations and reports of the audit committee before approving them.

Financial reporting

20. The board should be responsible for the integrity of financial reporting (please refer to Chapter 1). This responsibility should be delegated to an appropriately structured and experienced audit committee.
21. The audit committee should be responsible for monitoring the integrity and completeness of the company's financial reporting.
22. The audit committee should be responsible for evaluating the judgments and reporting decisions made by the management, including changes in accounting policies, decisions requiring a major element of judgment and the clarity and completeness of the proposed disclosures. It should require explanations from the management on the accounting of significant or unusual transactions and should consider the views of the external auditor's in these instances.
23. The audit committee should take into account any factors that might predispose the management to present an incomplete or misleading picture of the company's financial position and performance. Such factors might include, for example, a perceived need to counter adverse market sentiment or to report the achievement of performance targets on which bonus payments depend.
24. The audit committee's review of financial reports should encompass the integrated report and annual financial statements, interim reports, preliminary or provisional result announcements, summarised financial information, any other intended release of price-sensitive financial information and prospectuses. The audit committee should review prospectuses for approval to the board. Scrutiny by the audit committee should not be confined to the financial statements and should extend to all relevant narrative information which should present a balanced view of the company's performance.
25. The audit committee should oversee the controls for the publication of financial information by the company. This is to ensure that the financial information complies with applicable financial reporting requirements, including whether the management has adopted appropriate accounting policies and made defensible assumptions, supported by reasonable estimates and judgements.
26. The audit committee should consider any evidence that comes to its attention that brings into question any previously published financial information, including complaints about previously published financial information. Where necessary, the audit committee should take steps to recommend that the board publicly correct the previously published financial information if it were materially incorrect.

27. The audit committee should discourage opinion shopping by the company regarding audit and accounting matters. The audit committee should act as arbiter between the management and the external auditors when there is a disagreement on auditing and accounting matters. Where opinion shopping has occurred, the reasoning for the opinion adopted should be obtained and should be approved by the audit committee before the committee's recommendation is made to the board.
28. The audit committee should be fully informed of regulatory and other monitoring and enforcement requirements designed to ensure that company financial information complies with financial reporting and other regulatory requirements.
29. The audit committee should be informed of any monitoring or enforcement activities regarding the company on a timely basis so as to allow audit committees to be involved in the company's response to such activities.
30. In order for the audit committee to assist the board in making a statement on the going concern status of the company, the audit committee should review a documented assessment by the management of the going concern premise of the company. To enable the audit committee to conduct a thorough discussion, the management should document the key assumptions in reaching their conclusions.
31. The chairman of the audit committee should be present at the AGM to answer questions, through the chairman of the board, on the report on the audit committee's activities and matters within the scope of the audit committee's responsibilities.
32. Shareholders should be encouraged to submit questions relating to the financial statements, the audit process and accounting policies prior to the AGM to enable the audit committee chairman to prepare suitable responses after discussion with the external auditor.
33. Companies should subject forward looking statements of financial information, when prepared, to careful review to ensure that these statements provide a proper appreciation of the key drivers that will enable the company to achieve these forward looking statements.

Interim results

34. To ensure that shareholders are informed of a company's financial position and financial performance on a continuous basis, reliable financial information should be published periodically.
35. The board should periodically review the needs of users of financial information of the company and, based on that review, determine whether interim information should be provided every six months basis or more frequently (for example quarterly).

36. The audit committee should consider whether there is any reason for internal audit or external audit to perform assurance procedures on quarterly (if prepared) or six monthly interim results and should make a recommendation to the board in this regard. Such reasons could include a modification to the audit report on the latest set of annual financial statements or issues identified regarding the previously issued interim results.
37. Where internal or external auditors are engaged to perform a review of the interim results, the audit committee should review the results of such engagement.
38. Where external auditors are appointed to perform a publicly reported review of the interim results, the report of the external auditor should be made available to users of the interim results and should be summarised in the interim results.

Summarised financial information

39. Users benefit from comprehensive financial information as published in the integrated report and also from summarised financial information.
40. The objective of summarised annual financial statements is to give a concise but balanced view of the company's financial information. In preparing summarised financial information, companies should give due consideration to:
 - 40.1. providing key financial information. The International Financial Reporting Standard on Interim Reporting (IAS 34) is a good benchmark as to which financial information and notes should be included; and
 - 40.2. providing sufficient commentary by the directors to provide an unbiased, succinct overview of the company's financial information.
41. The board should publish summarised annual financial statements in addition to the integrated report. Summarised annual financial statements should be sent to all shareholders to complement the full set of financial statements, and both the full and summarised sets should be placed on the company's website. Where shareholders receive summarised financial information instead of the full integrated report, the full integrated report must be distributed on request.
42. The audit committee should engage the external auditors to provide an assurance report on summarised financial information, confirming that the summarised financial information is appropriately derived from the annual financial statements.
43. Summarised financial information should be derived from the underlying annual financial statements and should include a statement to this effect.

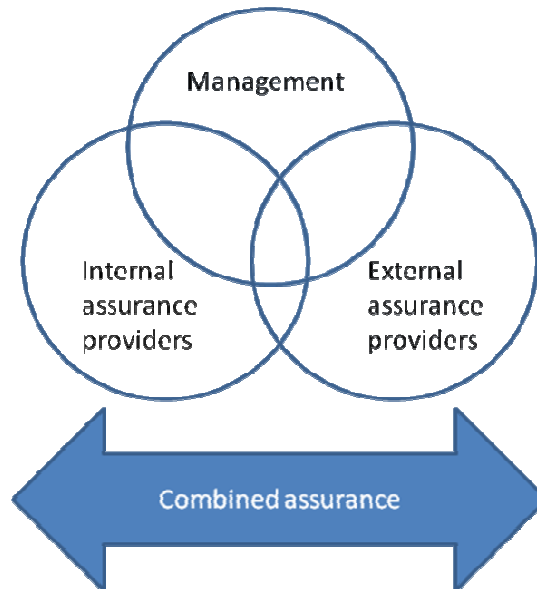
Integrated sustainability reporting

44. The board should ensure that the company makes full and timely disclosure of material matters beyond just financial information concerning the company and establishes an effective communication with stakeholders through its sustainability report. Refer to Chapter 6 for more detail on integrated sustainability reporting.
45. The board may delegate the responsibility for, and review of, the integrated sustainability section of the integrated report to the risk committee, sustainability committee or audit committee.
46. The audit committee should consider and recommend to the board the need to engage an external assurance provider to provide assurance over the accuracy and completeness of the sustainability reporting to stakeholders. The audit committee should evaluate the independence and quality of these external assurance providers.
47. The audit committee should assist the board in reviewing the sustainability reporting to ensure that the information is reliable and that no conflicts or differences arise when compared with the financial results.

Principle 3.5: The audit committee should satisfy itself of the expertise, resources and experience of the finance function

48. The audit committee should on an annual basis consider and satisfy itself of the appropriateness of the expertise, resources and experience of the management, with particular focus on the senior members of management responsible for the financial function.
49. For listed companies, the audit committee must evaluate the suitability of the finance director and recommend to the board if any changes are necessary.

Principle 3.6: The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities



50. The audit committee is responsible for monitoring the appropriateness of the company's combined assurance model and ensuring that significant risks facing the company are adequately addressed.
51. The combined assurance provided by internal and external assurance providers and the management should be sufficient to satisfy the audit committee that significant risk areas within the company have been adequately addressed and suitable controls exist to mitigate and reduce these risks.
52. Depending on the governance structure applied by the company, the internal assurance providers may report directly to the board or to the audit committee or another board subcommittee. As discussed in Chapter 5, the chief audit executive should report directly to the audit committee.
53. External assurance providers may include the external auditor, regulators (inspectorate) or any other external assurance providers such as sustainability assurance providers. The relationship between the external assurance providers and the company should be monitored by the audit committee.
54. By providing an effective counterbalance to the executive management, audit committees uphold the independence of internal and external assurance providers, thus helping to ensure that these functions are carried out effectively.

Internal assurance providers

Principle 3.7: The audit committee should be responsible for the oversight of internal audit

55. The audit committee should play a key role in ensuring that the company's internal audit function is independent and has the necessary resources, standing and authority within the company to enable it to discharge its functions.
56. The audit committee should oversee cooperation between external and internal audit to avoid overlapping of audit functions.
57. The audit committee should formally consider the effectiveness of internal audit at least annually and report to the board on the assessment from internal audit on the adequacy of the internal controls.

Principle 3.8: The audit committee should be an integral component of the risk management process

Financial reporting and risks

58. The board is responsible for overseeing the design, implementation and maintenance of a sound system of internal control. This responsibility may be delegated to the audit committee in full, or to a risk committee. Regardless of method and framework of delegation by the board, the audit committee should remain responsible for the overseeing financial risk management and controls and ensuring that the controls:
 - 58.1. provide guidance that embeds internal financial control in the business processes and evolves to remain relevant over time;
 - 58.2. follow a risk-based approach; and
 - 58.3. weigh up not only the likelihood of financial risks materialising but also the costs of operating certain controls relative to the benefit in managing these related financial risks i.e. the cost benefit analysis.
59. The audit committee's role, when given responsibility for a company's risk management programme, is to ensure there is a balance between a company's approach to risk management and the nature of the company's legal, operational and financial environment. By understanding the environment, both external and internal, and the related challenges a company and its management are facing, the audit committee can assure itself that the risk programme is appropriate to the company.

The audit committee's responsibility for risk management should be identical to that of a risk committee if there is no separate risk committee.

Review of internal financial controls

60. The management should at least annually conduct a formal documented review of the design, implementation and effectiveness of the company's system of internal financial controls by conducting suitable testing and report back to the audit committee. This enables the audit committee to perform its responsibilities to oversee the integrity of the company's financial information.
61. The audit committee should determine the nature and extent of a formal documented review of internal financial controls to be performed by the management, including internal audit, on behalf of the board on an annual basis. The review should cover all significant areas of financial reporting to enable the audit committee to perform its responsibilities to oversee the integrity of the financial information published by the company. The audit committee should ensure that the management has adequate capacity to perform the formal documented review.
62. The audit committee may task internal audit to perform the review. The audit committee should determine the nature and extent of the review of internal financial controls to be performed by the management. It is not required that the report of internal audit, or another party to the management, be for public disclosure. External auditor attestation on internal financial controls is not a requirement.
63. The audit committee should conclude and report annually to the board on the effectiveness of the company's internal financial controls. Before the audit committee concludes and reports to the board on the effectiveness of internal financial controls, it should holistically consider all information brought to its attention from all sources, including communications with, and reports from, internal audit, other assurance providers and the management, as well as the external auditors.
64. Financial control inadequacies, whether from design, implementation or execution, that are considered material individually or in combination with other inadequacies that resulted in actual material financial loss, including fraud and/or material errors, should be reported to the board and disclosed in the statement from the board. It is not intended that this disclosure be in the form of an exhaustive list, but rather an acknowledgement of the nature and extent of material inadequacies and the corrective action, if any, that has been taken to the date of the report.

Fraud risks

65. The audit committee should review arrangements made by the company to enable employees and outside whistleblowers (including customers and suppliers) to report in confidence concerns about possible improprieties in matters of financial reporting, or compliance with laws and regulations, that may have a direct or indirect effect on financial reporting.

66. The audit committee should ensure that the company has appropriate arrangements in place for the balanced and independent investigation of whistleblowing reports and for taking any action necessary as a result of such reports. Improprieties and malpractice or any related matter can have a significant effect on the business and are not limited to financial and accounting matters. Failures in other areas, such as those relating to compliance with laws and regulations, unethical behaviour, the safety of employees and the general public and the protection of the environment, may also inflict serious and long-lasting damage to the company's reputation.
67. The audit committee should be aware of any amendments to the company's code of conduct as it applies to financial reporting and should satisfy itself that the management monitors compliance with the code of conduct.
68. The audit committee should consider matters that may result in material misstatements in the financial statements due to fraud.
69. The audit committee should receive and deal appropriately with any complaints (whether from within or outside the company) relating either to the accounting practices and internal audit of the company or to the content or auditing of its financial statements, or to any related matter.

Information technology (IT) risks

70. Audit committees should consider IT risk as a crucial element of the effective oversight of risk management of the company. In many cases the audit committee may need to rely on expert advice from within or outside the company.
71. The audit committee should play an oversight role regarding:
 - 71.1. IT risks and controls;
 - 71.2. business continuity and data recovery related to IT; and
 - 71.3. information security and privacy.
72. In understanding and measuring IT risks, the members of the audit committee should understand the company's overall exposure to IT risks from a business perspective including the areas of the business that are most dependent on IT for their effective and continual operation.
73. Areas that are highly dependent on IT are more exposed if IT risks are not appropriately governed and the audit committee should obtain appropriate assurance that controls are adequate to address these risks.

External assurance providers

Principle 3.9: The audit committee is responsible for recommending the appointment of the external auditor and overseeing the external audit process

74. The audit committee should recommend to shareholders the appointment, reappointment and removal of external auditors, taking into account that this is a legal requirement for public and state-owned companies. Where the audit committee recommends to shareholders that the incumbent firm and designated auditor (a statutory responsibility for public companies and state-owned companies in terms of the Act) should be appointed as external auditor, its recommendation should be based on an assessment of the firm and individuals' qualifications, expertise and resources, effectiveness and independence. The audit committee should ensure that the external auditor that is recommended for appointment is approved by the JSE (applicable only to listed companies).
75. The audit committee should oversee the report of the activities of the external auditors, among others, the planning and execution of the annual external audit.
76. The audit committee should approve the external auditors' terms of engagement and remuneration. In doing so, it should engage with the auditor to satisfy itself that the level of fee payable is appropriate to enable an effective audit to be conducted.
77. The audit committee should review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process on an annual basis. Auditor rotation at an individual engagement partner level enhances actual and perceived independence.
78. The audit committee should define a policy for board approval as to the nature, extent and terms under which the external auditor may perform non-audit services.
79. The annual financial statements should include a description of non-audit services rendered by the external auditor, including their nature and quantity. The audit committee can preauthorise services proposed for a future date within the policy framework set by the audit committee.
80. The audit committee should review any accounting and auditing concerns identified as a result of the internal or external audit.
81. The audit committee should develop a protocol to receive, consider and resolve reportable irregularities (as defined in the Auditing Profession Act, 2005) reported by the external auditor to the Independent Regulatory Board for Auditors. Where the auditor's report is modified as a result of a reportable irregularity, the audit committee

should review the completeness and accuracy of the disclosure of such matters in the financial statements.

82. At the end of each annual audit, the audit committee should review the quality and effectiveness of the audit process. It should assess whether the external auditors have performed the audit as planned and establish the reasons for any changes, obtaining feedback as necessary about the conduct of the audit from key members of the company's management, including the finance director and the head of internal audit.

Reporting

Principle 3.10: The audit committee should report to the board and stakeholders on how its duties have been carried out

83. The audit committee should report to both the board and stakeholders on how it has fulfilled its duties during the financial year. To report to stakeholders, the audit committee should include a report on the discharge of its responsibilities in the integrated report. As a minimum, it should provide:
 - 83.1. a summary of the role of the audit committee;
 - 83.2. whether the audit committee has adopted formal terms of reference and if so, whether the committee satisfied its responsibilities for the year in compliance with its terms of reference;
 - 83.3. the names and qualifications of all members of the audit committee during the period under review, and the period for which they served on the committee;
 - 83.4. the number of audit committee meetings held during the period and the attendance at these meetings;
 - 83.5. a description of how the audit committee carried out its functions in the period under review;
 - 83.6. a statement whether the audit committee is satisfied that the auditor was independent of the company;
 - 83.7. commentary in any way the committee considers appropriate on the financial statements, the accounting practices and the internal financial control of the company; and

- 83.8. information regarding any other roles assigned to the audit committee by the board, for example, interaction with other assurance providers.

Public sector perspective

84. For departments and constitutional institutions in the public sector, the report of the audit committee must also include comments on the quality of the management and monthly/quarterly reports submitted in terms of the PFMA, the MFMA and the Division of Revenue Act.
85. Should a report to an audit committee, whether from the internal audit function or any other source, implicate the accounting officer in fraud, corruption or gross negligence, the chairman of the audit committee must promptly report this to the relevant executive authority and the Auditor-General. The Prevention of Corrupt Practices Act requires reports from the directors as well.
86. An audit committee may communicate any concerns it deems necessary to the executive authority (as defined in the relevant Acts), the relevant treasury (if applicable), the Auditor-General and, if appropriate, to the external auditor.

Chapter 4

Risk management

Principle 4.1: Risk management is inseparable from the company's strategic and business processes

1. Business involves the undertaking of risk for reward. Risks are uncertain future events that could influence the achievement of a company's objectives. Some risks must be taken in pursuing opportunity, but a company should mitigate its exposure to losses by responsible risk taking and well defined risk strategies.
2. A considered and systematic approach to risk underpins the success of the company. (A schematic of the risk management process is depicted in Annex 4.1). The board is expected to exercise duties of care, skill and diligence in identifying, assessing and monitoring risks as presented by the management.
3. Risk management is the practice of identifying and analysing the risks associated with the business and, where appropriate, taking adequate steps to manage these risks. 'Risk management' may imply the elimination or mitigation of particular risks. It may also imply increasing the risks accepted as a deliberate and calculated move to benefit from a forecast outcome, for example investing in additional plant and machinery in anticipation of increased market demand. The costs arising from risks flow not just from the harm from unforeseen events, but also from the failure to capitalise on foreseeable opportunities or circumstances.
4. Risk management should be intrusive and should not be viewed only as a reporting process to satisfy governance expectations. The rigours of risk management should seek to provide interventions that optimise the balance between risk and reward within the company.
5. Risk management is important to companies of all sizes and complexity. Indeed, for smaller companies with their traditionally higher rate of business failure or missed opportunities, risk management is essential. Because such companies are frequently young and flexible enough to adapt their culture, these companies may find it easier than their larger counterparts to adopt more aggressive risk management policies. However, time constraints and scarce resources (including capital) may have a negative effect on these companies' ability to implement appropriate and effective risk management processes.

Responsibility for risk management

Principle 4.2: The management should be responsible for the implementation of the risk management process

6. The 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. The management is also accountable to the board for providing assurance that it has done so.
7. The CEO should be at the forefront of the adoption or upgrading of the risk management plan, but involving the management at all levels within the operations will enhance risk management.
8. Risk management remains the primary responsibility of line management, which should be regarded as the first line of defence. This should be reflected in individual letters of appointment, key performance areas and reward systems.
9. To the extent that risk experts are appointed to assist line management, such individuals are not primarily responsible for risk management, and should be regarded as a second line of defence. Line management cannot abdicate their responsibility for risk management to such risk experts.
10. Assurance functions, such as internal audit, constitute the third line of defence, and provide assurance on the effectiveness of the system of risk management and related mitigating actions including internal controls. (Refer to Chapter 5 in this report).
11. Although the management may appoint a corporate risk officer or chief risk officer (CRO) to assist in the execution of the risk management process, the accountability to the board remains with the management, and specifically with the CEO.
12. Roles and responsibilities will be determined by considering the company's current risk related decision-making structures and framework of authorities. The reporting lines for risk management should be considered taking such structure into account.
13. To the extent that the CEO makes use of an executive committee or similar structure, risk management should be a regular item on its agenda.
14. A CRO may be appointed in larger companies or companies with a complex risk profile. The role of the CRO is to facilitate and coordinate the development and implementation of risk management in the company. Because of the strategic and multi-faceted nature of risk management, the function should be positioned at an executive level within the company. The CRO should have ready and regular access to the CEO and the chairman of the risk committee. The board and the management should establish an appropriate level of support for and commitment to risk management.

15. The risk management process does not reside in any one individual or function but requires an inclusive, team-based approach for effective application across the company. It is therefore critical that risk management functions should be established with appropriate reporting lines. Roles beyond that of the CRO should be established and defined. These roles may include risk management coordinators, risk officers and risk owners. The roles and responsibilities of other functions with a close association with risk management, such as compliance, internal audit and insurance, should be clearly delineated.
16. Companies may wish to establish risk management committees at different levels in the company to address the risks at those levels in accordance with the chosen risk management plan.
17. It is critical that the performance of the company against its risk management plan is reviewed by management at least annually. The intention of this review is to determine whether risk management objectives have been achieved, to assess deviations from intended results and to refine the plan, taking into account changes in the business environment.

Principle 4.3: Risk management should be practised by all staff in their day-to-day activities

18. Management should design and implement measures to inculcate a culture of risk management in the company which should be embedded within its operations, decision-making processes and the execution of strategy. Change management initiatives should be applied to encourage desired risk management behaviour. Designated ownership of risks and risk mitigation should be allocated to responsible persons or bodies within the company.
19. A key issue for most companies, especially smaller ones, is the resources available for establishing and maintaining risk management procedures. It is accordingly sensible to avoid unnecessary complexity so that risk management procedures can be understood and implemented with minimum cost and disruption. An approach that places the primary focus on, and concentrates training around, risks that are significant, ensures objectives are prioritised and clearly allocates responsibility within the company for the procedures.

Principle 4.4: The board should be responsible for the process of risk management

20. The crystallisation of a risk may mean that a company's realised outcomes are very different from its goals. As risk can have a significant influence on how a company performs, or even on its very existence, it must be a prime concern of the board. The development of the processes of risk management and monitoring should be the responsibility of the board.
21. The board should decide the company's appetite for risk – those risks it will take and those it will not take in the pursuit of its goals and objectives. The board should calculate the company's risk-bearing capacity and the tolerance limits for key risks, to

ensure that these two metrics do not exceed the company's risk appetite. The board should have the responsibility to ensure that the company has implemented an effective ongoing process to identify risk, measure its potential outcome, and then activate what is necessary to proactively manage these risks.

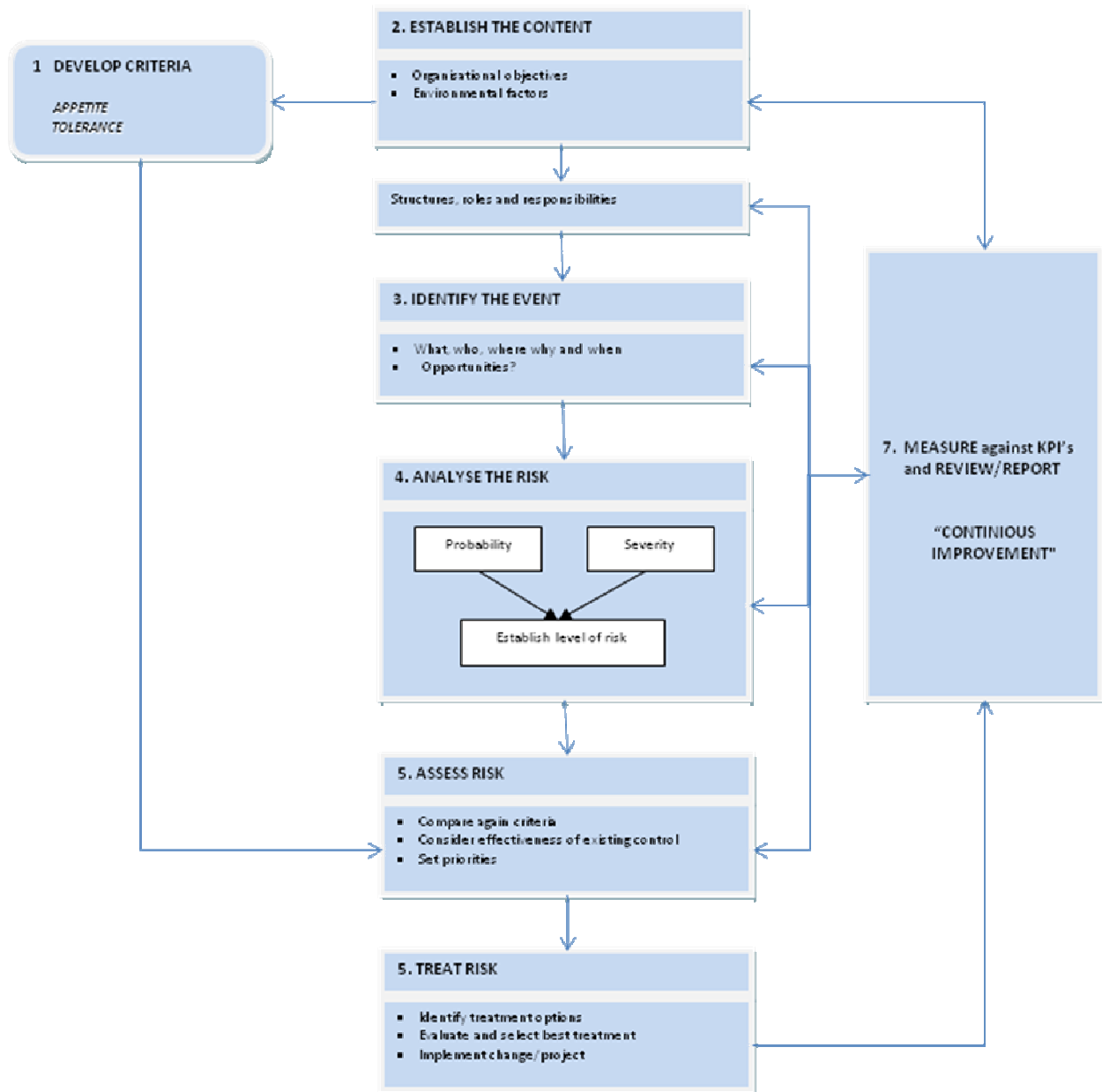
22. Risks that are regarded as low probability but high severity (so-called "black swans") should receive specific attention, including the recognition that the probability of occurrence of an unpredictable but severe event is much greater than is generally recognised. The most effective way to mitigate such risks may ultimately be by way of business continuity plans, including consideration of capital adequacy as the ultimate mitigating factor. Such exposures and mitigating actions should be considered by the board as part of its annual assessment of the going concern assumption.
23. Risks should not only be considered in isolation, as the effect of negative events occurring simultaneously can be multiplicative as opposed to additive.
24. The board should not rely solely on the embedded monitoring processes within the company to discharge its responsibilities. It should, at appropriately considered intervals, receive and review risk management reports. In this regard, the board should ensure that a comprehensive risk assessment, as well as a systematic, documented review of the processes and outcomes surrounding key risks, is undertaken:
 - 24.1. on a regular basis; and
 - 24.2. following significant changes to, or shocks within, the company's operating environment.

The purpose of this comprehensive risk assessment is for the board to make a public statement on risk management, including the effectiveness of the system of internal control.

In its statement, the board should acknowledge its responsibility for the risk management process and for reviewing its effectiveness.

25. The board's ultimate responsibility for the process of risk management should be expressed in its board charter and supported by training and induction processes.
26. The board has an obligation to demonstrate that it has dealt comprehensively with the issues of risk management. This requires appropriate disclosure on matters such as risk tolerance and the risk management process in the integrated report. Companies are not expected to disclose risk management information that is strategically sensitive or that could compromise their competitive advantage.

Annex 4.1: The risk management process



Principle 4.5: The board should approve the company’s chosen risk philosophy

27. The risk philosophy is the board’s position or stance on the risks in its business environment. The company’s broad stance on risk will be somewhere along the spectrum ranging from risk taking to risk averse. The company’s risk philosophy should be self evident from its existing business activities but the board may choose to define this in a way that sets the tone for risk management.

28. The board should draft a risk management philosophy statement. Its contents may include the board's appetite for risk, downside risk tolerance limits, regulatory

compliance expectations, safety and health demands, sustainability management and corporate governance requirements. The philosophy statement should affirm the board's accountability for risk and the management's responsibility for designing and implementing risk management.

29. The board's desired level of appetite for risk (not the company's risk-bearing capacity) should influence the design of risk management processes. The approach to determining risk appetite will differ between business types. A starting point is to consider the degree of risk that the board is willing to expose to the balance sheet (statement of financial position), income statement (statement of recognised income and expense) and cash flow. The upper limit beyond which the board would not be willing to put further capital at risk in pursuit of reward must be determined. The company's financial capacity to absorb losses, variances and unplanned consequences should be determined.
30. In determining the company's level of risk appetite the board should consider materiality limits, insurance risk retention limits and treasury policies. Companies may select a level of risk appetite based on a single monetary value and a percentage level of variance from a financial parameter.

Principle 4.6: The board should adopt a risk management plan

31. The board should arrange for a risk management plan to be documented. The responsibility to design the plan rests with the management but other stakeholders may provide input in crafting it. The risk management plan should not be prepared in isolation from the company's strategy. The board should approve the risk management plan.
32. The management should design the processes of risk management based on the board's appetite for risk, the company's defined risk philosophy and the company's short- and long-term strategies. The risk management plan should include an implementation plan which should be monitored as a medium-term project and have scheduled reviews. The plan should outline the resources, tasks and responsibilities for introducing and developing the risk management processes and activities into the company. When designing the implementation plan, management should determine the sequence of implementation, document roles and responsibilities determine the target dates for implementation and decide on the frequency and format of reporting against milestones.
33. The risk management plan should state the company's objectives on risk optimisation, how risk management should support its business strategy and how regulatory requirements should be managed. Risk management processes should be incorporated into budgeting and business planning activities.
34. An essential part of the risk management plan is the determination of whether the board wishes to accept the risks identified in light of the defined risk appetite. Each risk should be considered in the context of the company's objectives. The board should decide whether the identified risks exceed the benefits that will accrue by

achieving the objective, that is, whether the risks will likely outweigh the reward associated with the particular objective. If the decision is to carry on, then the board should decide how to respond to the risk by adopting specific control strategies.

35. The board should review its risk management plan annually, evaluate progress with implementation and document any revisions to the risk management plan accordingly.
36. The risk management plan should be widely disseminated in decentralised companies. The risk management plan should be communicated through relevant change management methods.

Principle 4.7: The board may delegate the responsibility of risk management to a risk committee

37. The board may appoint a dedicated risk committee to assist it in carrying out its responsibilities in relation to risk management, or it may delegate this role to another board committee. Where the material risks are predominantly of a financial nature it may mandate the audit committee to take responsibility for risk management, though cognisance should be taken of that committee's existing significant workload. In addition, where the composition of the audit committee is prescribed by statute and prohibits executives from being members of the committee, this situation may not provide sufficient detailed knowledge represented on the committee to enable effective oversight of risk management.
38. If a risk committee is established, membership of this committee should include executive and non-executive directors, members of senior management and independent risk management experts, if necessary. The relationship of these experts should be defined contractually and, in order to avoid them being deemed to be directors, they should not have a vote.
39. The board should specifically consider the risks that may affect the sustainability of the company. It may thus be appropriate for the mandate of the risk committee or audit committee to include oversight of sustainability, including considering and recommending the sustainability report or similar statements to the board for approval. It may be appropriate to name the committee as the 'risk and sustainability committee', in which case its terms of reference should include the recommendations in Chapter 6, including the provision of assurance where appropriate.
40. The board may also wish to delegate responsibility for the oversight of insurance arrangements, including the acceptance of risks that will not be insured, to the risk committee.
41. Given the pervasive nature of information technology in most companies, the board may wish to task the risk committee to oversee IT strategy, governance and risk management on its behalf.

42. The risk committee should be chaired by a non-executive director.
43. The risk committee should have a minimum of three members but with no limit to the total number of members. The risk committee should convene at least twice a year. Reports to the committee should provide the members with sufficient information to effectively discharge their responsibility.
44. The committee should review the risk management maturity of the company, the status of risk management activities and the significant risks facing the company. The company's risk management arrangements should incorporate risk reporting processes, including risk trends, risk materialisation, forecasting and emerging risks.
45. Where the company is not large or complex enough to justify a separate risk committee, the board should delegate this function to the audit committee. If there is no audit committee, the board should assume this function directly.
46. The risk committee should consider the risk management strategy and policy and should monitor the risk management process. Effective and continuous monitoring is an essential part of the risk management process.
47. The risk committee should consider and evaluate, among others, the following: a register of key risks; estimated costs of significant losses; whether risk management costs are consistent with the risk profile of the business; material losses; reduction in earnings or cash flows caused by unforeseen incidents; material changes to the risk profile; details of risk finance arrangements that could expose the company; the risk-bearing capacity of the business; due diligence activities; and information technology risks.
48. The risk committee should ensure that risk assessments, risk reports and assurance on risks overseen by other board committees are referred to those committees for their consideration.

Risk assessment

Principle 4.8: Risk assessments should be performed on an ongoing basis

49. The outputs of risk assessments should provide the board and management with a realistic perspective of material risks facing the company.
50. The board should ensure that a thorough risk assessment, using a generally recognised methodology, is performed at least annually and used continually. Emerging risks should be incorporated and assessed as soon as they are identified.
51. In assessing the risks of a company, the board should take into account inter alia:
 - 51.1. stakeholder risk;
 - 51.2. reputational risk;

- 51.3. compliance risk in relation to legislation with a significant effect on the company, specifically including the Companies Act, tax legislation, labour law, health & safety legislation, environmental legislation, competition law and anti-corruption legislation (refer to Chapter 7 Principle 7.6 for more detail);
 - 51.4. ethics risk;
 - 51.5. sustainability issues pertinent to or affecting the business of the company;
 - 51.6. the company's activities with regard to corporate social investment, employment equity, BEE, skills development and retention; and
 - 51.7. whether it has the human and financial capital to sustain its activities into the future.
52. In addressing transformation issues, an assessment should be made of whether initiatives are implemented effectively so that they contribute to mitigating the risks faced by the company on skills, retention and development of human capital and empowerment.
53. These sustainability risks should also be taken into account when the board is considering whether the company will continue as a going concern.

Principle 4.9: The board should approve key risk indicators and tolerance levels

54. Operating risk tolerance limits should be aligned to the company's risk appetite and its risk philosophy. Risk tolerances are the thresholds of variation around relevant objectives. They are best measured in the same units as the related objectives, and indicators are used to check whether actual results achieved are within the acceptable risk tolerances. In setting risk tolerances, the management should consider the relative importance of the related objectives and align risk tolerances with risk appetite. Operating within risk tolerances provides the management with greater assurance that the company remains within its risk appetite.
55. Risk tolerance limits should be established for each key risk. The tolerance limits should be established for risk exposure levels, risk response performance, levels of loss or measured levels of performance. Tolerance limits should be considered against the backdrop of the company's strategy and business objectives. It is also important to assess the company's resilience (for example, cash resources) when determining tolerance limits.
56. Tolerance limits should be tested and evaluated by studying their potential effect on company objectives. The management should compare tolerance calculations with risk retention capacity limits and the level of materiality. The selected tolerance thresholds should be reviewed regularly when circumstances change, for example in business downturns, when there are changes in risk exposures, or business objectives are revised.

Risk identification

Principle 4.10: Risk identification should be directed in the context of the company's purpose

57. Risk identification should not adopt a conceptual view or limit itself to a fixed list of risk categories. Risk identification is most effective when it is directed towards company objectives.
58. Risk identification should adopt an all-embracing approach. It should not be limited to strategic risks. Operational risk management must form part of the risk management plan.
59. Risk identification produces the required information for the ensuing risk management processes, so it is therefore critical that the process is accurate, thorough and complete. Risk identification should not rely solely on the perceptions of a select group of managers. A thorough approach to risk identification should include the use of data analysis, business indicators, market information, loss data, scenario planning and portfolio analysis.

Risk quantification and response

Principle 4.11: The board should ensure that key risks are quantified and are responded to appropriately

60. Having considered the risks identified by the management, the board should decide which risks are significant. This should entail consideration of the nature, extent and timing of events and the amount of room to manoeuvre available to the company if major issues arise.
61. The board should ensure that key risks are quantified where practicable. A detailed quantification of risk should be helpful and for smaller companies it may be sufficient to classify risk as high, moderate or low. It is important that the board and the management develop a clear, shared understanding of the risks that are acceptable or likely to become unacceptable and then decide how they will manage the risks and control strategies.
62. An assessment of the company's resilience to risk and loss should be calculated. This will include consideration of the following:
 - 62.1. risk probability or likelihood;
 - 62.2. potential effect of risk;
 - 62.3. effectiveness of risk responses;

- 62.4. capital adequacy;
 - 62.5. solvency, liquidity;
 - 62.6. sustainability of strategy;
 - 62.7. going concern;
 - 62.8. financial performance;
 - 62.9. values at risk;
 - 62.10. risk bearing capacity;
 - 62.11. mitigation of risk; and
 - 62.12. transference of risk.
63. The outcome should be interpreted in those risks that require immediate action, those risks where action should be considered and a contingency plan implemented and those risks that need to be periodically reviewed.
64. The board should ensure that risks are validated with relevant stakeholders to confirm the:
- 64.1. accuracy and validity of risk information recorded;
 - 64.2. assumptions made in assessment of the risk information provided; and
 - 64.3. the need for any additional data or information on the effectiveness of the control environment.
65. Risks evaluated should be prioritised and ranked to focus risk response measures on those risks outside the board's risk tolerance limits.
66. The management must identify and consider the possible risk response options. The options that should be considered include:
- 66.1. *avoiding* the risk by ceasing the activity creating the exposure;
 - 66.2. *treating, reducing or mitigating* the risk through improvements to the control environment such as the development of contingencies and business continuity plans. Risk treatment may include methods, procedures, applications, management systems and the use of appropriate resources that reduce the probability or possible severity of an uncertain event;
 - 66.3. *transferring* the risk exposure, usually to a third party better able to manage the risk, for example insurance, outsourcing;
 - 66.4. *accepting* the risk, where the level of exposure is as low as reasonably practicable, or where exceptional circumstances prevail;

- 66.5. *exploiting* the risk, where the exposure represents a potential missed or poorly realised opportunity;
 - 66.6. *terminating* the activity that gives rise to an intolerable risk; and
 - 66.7. *integrating* a series of the risk responses outlined above.
- 67. The documentation of response plans and actions should include the allocation of responsibilities for implementation.
 - 68. The board should receive and review a register of the company's key risks. It is important that the risk information presented to the board includes a profile of aggregated risks, correlated risks and risk concentrations.
 - 69. The risk register should include at least a risk description, risk category, risk ratings, a description of the current risk responses, possible root causes and a description of management's planned risk responses.
 - 70. The reports from the management to the board should provide a balanced assessment of the significant risks and the effectiveness of the system of internal control in managing those risks. Any significant control failings or weaknesses identified should be discussed in the reports, including the effect that they have had, or may have had, on the company, and the actions being taken to rectify them. It is essential that management communicates openly with the board on matters relating to risks and controls.

Assurance over the risk management process

Principle 4.12: Internal audit should provide independent assurance on the risk management process

- 71. The internal audit function or an independent, proficient third party should be used to provide independent assurance in relation to the management's assertions surrounding the robustness and effectiveness of risk management (including compliance) and may comment on the level of risk management maturity. Internal audit does not assume the functions, systems and processes of risk management but should assist the board and the management in the monitoring of risk management in the company. Internal audit should also monitor, through its own assurance processes, the progress of the different units in the company in managing their risk, in coordination with the chief risk officer (CRO).
- 72. Internal audit should not share reporting lines with risk management and these functions should not report to one another. Risk management should remain independent from the internal audit function. The board should consider whether it is appropriate for internal audit and the risk management function to report administratively to the same executive, unless the executive is the CEO.

73. Other assurance providers may assist in the monitoring and validation of risk controls or risk response plans that may be beyond the scope of the company's internal audit function. External audit should consult with the risk management function to understand the robustness of the company's risk management activities. This should assist in the development of the combined assurance model as described in Chapter 3.
74. The board should receive assurance regarding the changes to the internal and external environment, significant risks and the way they are managed since the last assessment, as well as:
 - 74.1. the fulfilment of the company's objectives and any specific objectives set for the risk management process;
 - 74.2. the reasons relating to the non-achievement of objectives;
 - 74.3. the company's ability to respond to significant changes in its internal and external business environment;
 - 74.4. the coverage and quality of the management's monitoring process in relation to the assessment, identification, evaluation, control and management of risk;
 - 74.5. the structure in place to ensure effective communication of the results of the risk management process – both bottom up and top down;
 - 74.6. the structure in place to rectify identified areas of exposure;
 - 74.7. the effectiveness of the company's reporting process; and
 - 74.8. the management's ongoing processes for development, implementation and monitoring of the risk control systems, especially when the board becomes aware at any time of significant failings or weaknesses in such systems.
75. There should be an indication of how a risk management culture is being inculcated and the appropriate infrastructure built within the company. This may require: a change in management processes that will include senior management commitment; a common language and process; a change in management process owner, risk coordinators and risk owners; establishing the process or methodology for ongoing risk management; effective communication, learning and education; measurement of the risk profile; reinforcement of the risk management process through human resource mechanisms; and monitoring the risk management process.
76. The level of unacceptable risk, both financially and from a reputation perspective, should be disclosed as well as the manner and frequency in which significant risks are reported to the board.
77. Where material joint ventures and associates have not been dealt with as part of the company for the purposes of applying these recommendations, this should be disclosed by the board. Alternative sources of assurance regarding the risk management process and internal control should be sought for material joint ventures and associates.

78. If the company has a compliance officer, ethics officer or related functions, and without detracting from their independence, they should interact regularly with role players in the risk management process. Consideration should be given to combining the ethics and compliance functions.

Disclosure

Principle 4.13: The board should report on the effectiveness of risk management

79. It is assumed that companies have different degrees of risk management maturity. This should be reflected in the company's risk profile, commitment of the board to risk management and the extent to which risk management has been embedded in business processes. The board should assess the company's degree of risk management maturity and disclose their findings in their integrated report to stakeholders.
80. In its statement in the integrated report on how the company has dealt with risk management, the board should:
- 80.1. provide a statement that the board is responsible for the total process of risk management as well as forming its opinion on the effectiveness of the process. The board should disclose the system that it has put in place to support its opinion on the effectiveness of the company's risk management, including independent and objective reviews of the risk management processes within the company;
 - 80.2. make a disclosure confirming that, for the period under review, the board maintained a reporting system that enabled it to monitor changes in the company's risk profile and gain an assurance that risk management was effective;
 - 80.3. disclose that the company has and maintains an efficient and effective process of risk management to manage key risks and, accordingly, the board is not aware of any key risk current, imminent or forecast that may threaten the sustainability of the company.
 - 80.4. having given due regard to the company's commercially privileged information, disclose any material losses and their causes that the company has suffered for the period under review. The materiality of losses should be in relation to the predetermined and communicated materiality levels in line with the company's risk appetite. In disclosing the material losses, the board should endeavour to quantify and disclose the effect that these losses have had on the company and the steps taken by the board and the management to prevent a recurrence.

81. The board should disclose where it cannot make any of the disclosures set out above, and should provide a suitable explanation for the benefit of shareholders and relevant stakeholders.

Key risks facing the modern company

G3 guidelines

82. Consideration of the G3 guidelines of the Global Reporting Initiative should assist management in ensuring that they have taken all possible risks into account.

Principle 4.14: The board should ensure that the company's reputational risk is protected

83. External perceptions of a company are affected by the level of risk it faces and by the way its risks are managed. Reputational risk can be the biggest risk faced by a company as it undermines the confidence of shareholders, financiers and other stakeholders. Reputational risk is greatest in those areas where the company claims to have distinctive competencies, and is thus closely aligned to its capacity to implement its strategy. Conversely, the effective management of risks can improve the company's credit rating, its ability to raise funds and the price of funding, and to favourably affect the value of its shares over the long term.
84. There is an increased interest, both globally and in South Africa, in the 'value of values' and the benefit of considering sustainability issues as business issues. In the current business climate, intangible assets such as brand value and reputation; goodwill; stakeholders and shareholder value; and customer loyalty/retention value often exceed the value of tangible assets.
85. Business scandals have recently again demonstrated how important it is to build, maintain and defend the company's reputation.
86. Reputation can be regarded as the sum of images which can be equated to the performance and behaviour of the company over time as well as how this is communicated to the various stakeholders. This definition makes it clear that performance and behaviour, as well as communication, are critical components of reputation.
87. The value of a company's reputation is not merely measured in monetary terms, and includes value in the broader concept including value to the community and trust, which is ultimately incorporated into the share price.
88. A good reputation has both intangible and tangible benefits. Companies with better reputations attract more and better candidates for employment, pay less for supplies,

gain essentially free press coverage that is worth as much if not more than advertising, and accrue other benefits that actually contribute to profits. Reputation adds value to the actual worth of a company – that is, market capitalisation includes more than just the book value or liquidation value of assets. The reputation component of market capitalisation, reputational capital, is a concept closely related to ‘goodwill’. However, few companies take a rigorous, quantifiable approach to reputation management – measuring, monitoring, and managing reputation assets and liabilities – yet such an approach is intrinsic to the concept of asset management. Without a system for regular, periodic accountability on variations in reputation, system opportunities may be missed and problems may become magnified. Measurement, acknowledgement and planning make possible proactive behaviours and communication to take advantage of reputational opportunities and minimise problems – thereby building reputational capital.

89. The reputational value of a company can be influenced by the performance and behaviour of the business components and employees, but tends to be subject to damage as a result of external events. Companies are the most vulnerable to reputational damage if the problem relates directly to what the stakeholders perceive to be the company’s core responsibility.
90. Reputational damage is consequently one of the key risks facing the modern company and is one of the few threats that can destroy a company’s ability to continue as a going concern.
91. Stakeholder expectations are increasingly focused on how the company performs and the effect the company has on its community. A company’s reputation can therefore be significantly damaged if these expectations are not met.

Principle 4.15: The board should determine the extent to which risks relating to sustainability are addressed and reported on

92. The essence of sustainability risk management is to protect the value of the company’s intangible assets by combining various elements of risk management into a sustainable and economic enterprise risk management system.
93. Sustainability issues have significant effects on the economic value of a company. The failure to address these issues effectively could threaten the viability and sustainability of the business and should be taken into account in considering whether a business will continue as a going concern. Sustainability management is linked to having a more predictive ability to stay ahead of the competitive environment, since many of today’s risks are newly emerged and their frequency and severity are still unknown.
94. Consequently, an assessment of risks without a proper consideration of the sustainability risks pertinent to the business of the company will not result in a complete assessment of the risks facing the business.

Stakeholders

95. A stakeholder risk assessment requires a number of key steps:
 - 95.1. establishing an appropriate process and accountable person;
 - 95.2. determining stakeholder perceptions;
 - 95.3. determining the company's risk profile in relation to the relevant stakeholders; and
 - 95.4. assessing the perception of the company's reputation and risks relating to its reputation.

Ethics

96. An ethics risk assessment should consider the following:
 - 96.1. whether there is clarity on the accountability for managing ethics;
 - 96.2. identifying ethics risks through engagement with stakeholders;
 - 96.3. establishing a process to identify perceptions on ethics issues; and
 - 96.4. determining the company's ethics risk profile and identifying vulnerable areas for attention.

Please refer to Chapter 2 for more detail on the ethics management process.

Environment

97. The company should conduct a baseline assessment of its direct and indirect environmental impacts to aid in the identification of the risks and opportunities inherent in these impacts. The impact assessment should be followed by a risk assessment appropriate to the impact level of the relevant company.
98. An environmental impact assessment:
 - 98.1. considers all company activities and their potential effect on the environment;
 - 98.2. determines whether the company falls into high or low impact sectors; and
 - 98.3. should also consider effects arising indirectly through upstream (supply chain) or downstream (product life cycle, project finance, etc.).
99. The risk assessment following the impact assessment includes examining in particular energy use, sources, and alternatives, as well as greenhouse gas emissions, sequestration, and compensation. The risk assessment should also

include issues such as vulnerability status of the location of the operation, regulatory risks (national and international), and a determination of the company's carbon exposure.

Human capital

100. The human capital of a company is one of its most important assets and the effective management of this valuable asset should not be neglected. It is therefore critical that a company establishes policies and processes to develop, retain and manage human capital in an effective manner. An integral part of this process is to identify the human capital needs and shortcomings on an ongoing basis so that this risk can be mitigated.
101. A company should consider whether it has the skills and expertise necessary for the sustainability of the business. This means not only an evaluation of the existing skills and resources needed for the business, but also the changing needs for the future.
102. A deeper analysis is required to consider whether, and how, the business operations and strategy could change, and whether the available human capital is sufficient to achieve the strategic objectives of the business. The company should determine how it will obtain the necessary human capital.

Principle 4.16: The board should ensure that IT is aligned with business objectives and sustainability

103. Information technology is essential to manage the transactions, information and knowledge necessary to initiate and sustain economic and social activities. In most companies, IT has become pervasive because it is an integral part of the business and is fundamental to support, sustain and grow the business. Successful companies understand and manage the risks and constraints of IT. As a consequence, boards understand the strategic importance of IT and have put IT governance on the board agenda.
104. IT governance is a “framework that supports the effective and efficient management of information resources (for example people, funding and information) to facilitate the achievement of corporate objectives. The focus is on the measurement and management of IT performance to ensure that the risks and costs associated with IT are appropriately controlled⁹.” IT governance should be an integral part of the overall governance structures within a company that ensure that the company's IT sustains and extends the strategy and objectives.
105. IT governance should focus on four key areas¹⁰:

- 105.1. strategic alignment with the business and collaborative solutions, including the focus on sustainability and the implementation of 'green IT' principles;
 - 105.2. value delivery: concentrating on optimising expenditure and proving the value of IT;
 - 105.3. risk management: addressing the safeguarding of IT assets, disaster recovery and continuity of operations; and
 - 105.4. resource management: optimising knowledge and IT infrastructure.
106. IT governance is the responsibility of the board and the management. The board should specify the decision rights and accountability framework to encourage the desirable culture in the use of IT. Therefore:
- 106.1. board members should take an active role in IT strategy and governance, probably through the risk committee;
 - 106.2. CEOs should provide organisational structures to support the implementation of IT strategy;
 - 106.3. chief information officers must be business oriented and provide a bridge between IT and the business; and
 - 106.4. all executives should become involved in IT steering or similar committees.
107. The strategic alignment "involves making certain that business and IT plans are linked together; defining, maintaining and validating the IT value proposition; and aligning IT operations with overall business operations¹¹".
108. The board should ultimately be responsible to ensure the proper value delivery of IT and should ensure that the expected return on investment from IT projects is delivered and that the information and intellectual property contained in the information systems are protected. This can be achieved by:
- 108.1. clarifying business strategies and the role of IT in achieving them;
 - 108.2. measuring and managing the amount spent on and the value received from IT;
 - 108.3. assigning accountability for organisational changes required to benefit IT capabilities; and

- 108.4. learning from each implementation, becoming more adept at sharing and reusing IT assets.
109. The overall objective of IT governance is to understand the issues and the strategic importance of IT so that the company can sustain its operations and implement the strategies required extending its activities into the future. IT governance aims at ensuring that expectations for IT are met and IT risks are mitigated².
110. Every company's approach to IT governance should be based on the business needs and reliance on IT to drive and support the company's objectives. For example, IT governance could be a regular task addressed by the audit committee or the board.
111. It is important for the board to take ownership of IT governance and set the direction management should follow. This is best done by making sure that the board operates with IT governance in mind:
- 111.1. ensuring IT is on the board agenda;
 - 111.2. challenging the management's activities with regard to IT, to make sure IT issues are uncovered;
 - 111.3. guiding the management by helping it to align IT initiatives with real business needs, and ensuring that it appreciates the potential effect on the business of IT-related risks;
 - 111.4. insisting that IT performance be measured and reported to the board;
 - 111.5. establishing an IT strategy committee with responsibility for communicating IT issues between the board and the management; and
 - 111.6. insisting that there be a management framework for IT governance based on a common approach, for example, COBIT.
112. Larger companies may consider appointing a chief information officer to take responsibility for the implementation and monitoring of IT governance within the company. Smaller companies may not appoint an individual responsible for this role, but should assign the responsibility to executive management reporting directly to the board.

IT security

113. An important aspect of IT governance relates to the issue of IT security. The term "information security" is defined by one of the long-standing information security standards, BS7799-1:1991¹², as having three components as follows:

- 113.1. *confidentiality*: ensuring that information is accessible only to those authorised to have access;
 - 113.2. *integrity*: safeguarding the accuracy and completeness of information and processing methods; and
 - 113.3. *availability*: ensuring that authorised users have access to information and associated assets when required.
114. Information security deals with the protection of information, in its electronic and paper-based forms, as it progresses through the information lifecycle for capture, processing, use, storage, and destruction. For this reason, information security has to address people-, process- and technology-related dimensions in order to be truly effective.
115. In considering the importance of and need for IT security, the board should consider that IT security contributes to:
- 115.1. *enabling the business strategy*: increasingly, information security is vital in creating and sustaining trust between companies and their business partners, customers and employees. This means that a strong alignment between business, technology and information security strategies is required;
 - 115.2. *sustaining normal business operations*: as information becomes increasingly valuable, it becomes a greater target for theft, fraud and attack. Even inadvertent and accidental events that damage information systems may render key business processes unavailable, and important business information lost or corrupt;
 - 115.3. *managing risk*: improved risk management not only contributes to improved governance and executive decision-making ability, it also allows companies to leverage risk, and thus be more competitive in exploring new business opportunities. The management of information security risk is a key aspect to achieving this;
 - 115.4. *avoiding unnecessary costs*: poor information security typically results in business and IT process inefficiencies, lost productivity and poor customer service. Publicised information security incidents often result in poor publicity and the need for significant marketing and brand protection expenditure;
 - 115.5. *reduced chance of litigation due to legal liability*: security breaches create a variety of litigation risks and companies may face legal liability in the event of security breaches;

- 115.6. *meeting compliance requirements*: the need for sound risk processes within business means that focusing on developing, implementing and sustaining sound information security risk processes is essential. Directors have a fiduciary responsibility for implementing sustainable risk management processes and meeting corporate governance requirements; and
- 115.7. *investing for success*: information security is a strategic business issue. However, it is unlikely to realise any meaningful business value if boards and senior management do not direct its development and deployment strategies.
116. An effective information security strategy is such that the business strategic direction drives the information security strategy, activities and initiatives, that is, the business value of information security is clearly understood. Information security related decisions can be made using formally evaluated risks, costs and benefits.
117. An information security measurement system is effective if it:
- 117.1. manages information security using a holistic approach, addressing the people-, process- and technology-related dimensions of information security;
 - 117.2. is able to measure the effectiveness of the security strategy, including the extent of return and value to the business that is realised, as well as the information security risk reduced and managed; and
 - 117.3. benchmarks the extent to which information security has improved versus target levels, compliance requirements and industry standards.

Principle 4.17: The board should consider the risk of the unknown as part of the qualitative and quantitative risk assessment process

118. The modern company is faced with more than just risk. Uncertainty is a key factor that impact every company's strategic decisions and related risks.
119. Knight differentiated risk as "...where probabilities of different outcomes are known, but not the outcome itself" as opposed to uncertainty as "...where the probabilities themselves are unknown."
120. Directors today find themselves dealing with the realm of uncertainty and having to define and monitor trends carefully in a business environment where political, physical, environmental, economic, social, technology and trade changes on a constant and unpredictable basis.

121. These constant changes require learning from directors rather than planning thereby reducing the uncertainty which must then be complemented by strategies for absorbing such uncertainty.

Chapter 5

Internal audit

The need for and role of internal audit

Principle 5.1: The board should ensure that there is an effective risk-based internal audit

1. Continual and rapid changes as well as the complexity of business, organisational dynamics and the regulatory environment require companies to establish and maintain an effective internal audit function. Where the board, in its discretion, decides not to establish an internal audit function, full reason should be disclosed in the company's integrated report, with an explanation as to how adequate assurance of an effective governance, risk management and internal control environment have been maintained.
2. The key responsibility of internal audit is to the board and/or its committees in discharging its governance responsibilities by:
 - 2.1 performing reviews of the company's governance process including ethics, especially the "tone at the top";
 - 2.2 performing an objective assessment of the adequacy and effectiveness of risk management and all other elements of the internal control framework;
 - 2.3 systematically analysing and evaluating business processes and associated controls; and
 - 2.4 providing a source of information, as appropriate, regarding instances of fraud, corruption, unethical behaviour and irregularities.
3. In cases where total outsourcing is selected as the method for obtaining internal audit services, a senior executive or director should be the custodian of internal audit, with the responsibility to oversee, manage, inform and take responsibility and accountability for the effective functioning of the outsourced internal audit activity.
4. Internal audit's processes need to be flexible and dynamic in addressing emerging business, organisational, operational and assurance needs.

5. An internal audit charter should be formally defined and approved by the board (generally through its audit committee).
6. The internal audit function should adhere to the Institute of Internal Auditors Standards for the Professional Practice of Internal Auditing and Code of Ethics at a minimum.

Principle 5.2: Internal audit should provide a written assessment of the effectiveness of the company's system of internal control, performance and risk management to the board

7. The internal audit function should possess the appropriate competencies to allow it to focus its attention across the governance, risk and internal control spectrum.
8. Internal audit should play a pivotal role in the combined assurance framework by providing independent assurance over governance, risk management and systems of internal control, as well as over the combined assurance framework. Contributors predominantly include internal audit, risk management, quality assurance, environmental and occupational health and safety auditors (if separate from internal audit), external auditor and management. The combined assurance framework is described in Chapter 3.
9. The internal audit function, generally through the audit committee, should assure the board that the combined assurance provided for the company is coordinated to best optimise costs, avoid duplication, and prevent assurance overload and assessment fatigue.
10. A company should maintain an adequate and effective governance, risk management and internal control framework that should include:
 - 10.1 clear accountability and responsibility between the roles of the board, the management and internal audit as well as other assurance providers;
 - 10.2 a clear understanding of the risk management framework among all role players;
 - 10.3 a clear understanding of how risk management and internal controls contribute to and improve business performance; and
 - 10.4 consideration of the value added by the respective role players in business performance.

11. The management of a company should specify the elements of a control framework according to which its control environment can be measured. Such a control framework should enable a clear link between the company's risk management and independent assurance processes.

Principle 5.3: Internal audit should assist the audit committee in fulfilling its duties

12. The audit committee needs to consider and review the company's changing risk profile. Executive and senior management, business unit leaders and other key assurance providers all have the responsibility in this regard to ensure that risks are identified and remediated. A risk-based internal audit plan should be developed and discussed with the audit committee. The plan should:
 - 12.1 address the full spectrum of risks facing the company, with a link to the broader enterprise risk management framework;
 - 12.2 show areas of high priority, greatest threat to the company, risk frequency and potential change;
 - 12.3 indicate how assurance will be provided on the effectiveness of the management's risk management process. Reliance should only be placed on a mature risk management process;
 - 12.4 reflect the linkage between the developed plan and the assessment of risk maturity;
 - 12.5 have any changes presented in a timely manner to an audit committee meeting for either approval or ratification as the change(s) necessitate.
13. The internal audit function should provide independent and objective assurance to the audit committee that the risk management, governance, and internal control considerations of the company are adequately contemplated by all relevant personnel and that the level of management oversight and risk management is appropriate, relevant and reliable.
14. The audit committee should evaluate the performance of the internal audit function annually to ensure that internal audit is fulfilling its responsibility to assist and advise the audit committee.

Internal audit's approach and plan

Principle 5.4: Internal audit should follow a risk-based approach to its plan

15. An effective internal audit function's planning and approach should be informed by the strategy of the company and should direct its efforts to align with business performance. Internal audit, as a significant role player in governance, should contribute in the endeavour to achieve strategic objectives and should provide effective challenge to all aspects of the governance, risk management and the internal control environment.
16. An effective internal audit function should be an independent, objective provider of assurance that considers:
 - 16.1. the risks that may impair the realisation of strategic goals; and
 - 16.2. the opportunities that will promote the realisation of strategic goals that are identified timeously, assessed adequately and managed effectively by the company's management team.
17. Internal audit should pursue a risk-based approach to planning, assess the needs and expectations of its key stakeholders and assure audit reporting meet the management and audit committee requirements.
18. The chief audit executive (CAE)'s internal audit planning should take the form of an assessment of the company's strategic, financial, IT, operational, human and environmental risks and opportunities and should:
 - 18.1. align with the company's risk assessment process (considering the risk maturity of the company);
 - 18.2. focus on rendering an assessment of the company's control environment;
 - 18.3. consider the company's risks and opportunities identified by the management and other key stakeholders;
 - 18.4. take cognisance of industry relevant emerging issues; and
 - 18.5. discuss the adequacy of resources and skills available to the CAE with the audit committee.

Internal audit's status in the company

Principle 5.5: Internal audit should be strategically positioned to achieve its objectives

19. Companies should have an effective internal audit function that has the respect and cooperation of both the board and the management and should report at a level within the company that allows it to remain independent and objective to ensure it fully accomplishes its responsibilities.

Principle 5.6: Internal audit through the chief audit executive should have a direct relationship with the audit committee, corporate governance committee and risk committee

20. Internal audit should establish and maintain a strong working relationship with the audit committee, with the CAE reporting functionally to the audit committee chairman.
21. With increased focus on corporate governance, greater scrutiny of risk management and more direct audit committee oversight of internal audit, the degree of interaction between the audit committee and risk committee with internal audit should ensure that an optimum level of control oversight is maintained.
22. The audit committee should be ultimately responsible for the appointment, performance assessment and/or dismissal of a CAE or outsourced internal audit service provider.
23. The audit committee should ensure that the internal audit function is sufficiently resourced and has the appropriate budget to meet the company's expectations.
24. The CAE should develop a solid working relationship with the audit committee:
 - 24.1. providing an objective set of eyes and ears across the company;
 - 24.2. providing assurance and awareness on risks (including ethics risks as described in chapter 2) and controls specific to the company and its industry and geographic sector;
 - 24.3. focusing on strategic, financial, IT, operational human and environmental risks;
 - 24.4. positioning internal audit as a trusted strategic adviser to the audit committee;
 - 24.5. confirming to the audit committee, at least annually, the independence of the internal audit function; and

- 24.6. communicating regularly with the audit committee chairman.
25. Internal audit should report at all audit committee meetings and consider meeting with the audit committee chairman prior to and immediately after each audit committee meeting.
26. The CAE should attend each of the audit committee meetings and provide the meeting with an assessment of the adequacy and effectiveness of the management's governance, risk and control environment, and report on how any deficiencies have been/will be repaired/mitigated by management.
27. The CAE's assessment should not necessarily relate to a particular financial year and should be based on audits completed by the internal audit function. The notion of rolling assessments is thus advised. The audit committee should provide comment on the state of the internal control environment in the company's integrated report.
28. The CAE's assessment needs to consider the scope, nature and extent of audit work performed, and evaluate what the evidence from the audit means concerning the adequacy and effectiveness of the governance, risk and control environment (refer to Chapter 4). Such an assessment should express:
- 28.1. the evaluation criteria and approach used;
- 28.2. the scope and period over which the assessment applies;
- 28.3. who has responsibility for the establishment and maintenance of internal controls; and
- 28.4. the measure of degree of assurance provided.
29. In order to ensure that the CAE's assessment adds value to the company, the CAE's plan of internal audits and any significant deviations from this plan should be subjected to a process of endorsement by the audit committee and appropriate members of executive management, without diluting the internal audit function's independence and objectivity.
30. The audit committee should ensure that the internal audit function is subjected to an independent quality review at least once every three years, as a measure to ensure the function remains effective.

Principle 5.7: The internal audit function should be staffed with a competent, independent team

31. The quality of internal audit resources should bear directly on its ability to service complex areas of the business and provide greater value to the company and audit committee.
32. The internal audit function should be skilled and resourced to the extent that their tools and audit techniques keep pace with the complexity and volume of risk and assurance needs.
33. Internal auditors should have the appropriate technical and business skills to ensure that they are connected to the realities of the business and organisational dynamics of the company. Internal audit should effectively challenge all facets of a company.
34. The CAE needs to have at least the following key attributes:
 - 34.1. possess strong leadership skills;
 - 34.2. command respect;
 - 34.3. be a strong communicator and facilitator;
 - 34.4. display a strategic and pragmatic mindset;
 - 34.5. be a networker;
 - 34.6. be an influencer;
 - 34.7. be an innovator; and
 - 34.8. command strong business analysis skills.
35. The CAE should develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit function.
36. Consideration should be given to the CAE becoming a member of a company's executive committee where one exists.

Chapter 6

Integrated sustainability reporting and disclosure

Transparency and accountability

Principle 6.1: Effective communication with stakeholders is essential

1. Effective reporting means proactive and transparent communication and engagement with stakeholders on all material matters affecting the company.
2. Reporting should be integrated across all areas of performance, reflecting the choices made in the strategic decisions adopted by the board, and should include reporting on economic, social and environmental issues. The board should be able to report forward-looking information that will enable stakeholders to make a more informed assessment of the economic value of the company as opposed to its book value.
3. The communication should be relevant and material. The question is not only about what is communicated to stakeholders but also how well that information is presented to maximise the reader's understanding.
4. Focusing on the result of the communication from the perspective of stakeholders should assist in avoiding jargon, in using simple and understandable language, and in ensuring the relevance and materiality of the issues communicated.

Principle 6.2: Sustainability reporting should be focused on substance over form and should transparently disclose information that is material, relevant, accessible, understandable and comparable with past performance of the company

5. Successful companies recognise that the principle of transparency in reporting sustainability (commonly but incorrectly referred to as 'non-financial') information is a critical element of effective reporting. The key consideration is whether the information provided has allowed stakeholders to understand the key issues affecting the company as well as the effect the company's operation has had on the economic, social and environmental wellbeing of the community, both positive and negative.
6. In order to effectively communicate and engage with stakeholders, information should be shared openly and transparently. This will engender a relationship based on trust and will serve to enhance the standing of the company in society. Obviously, this does not include a company's confidential information. This is important because the board should ensure that the trust and confidence of the stakeholders in the company are maintained.

7. The need for transparency includes the imperative for honest and open engagement and this requires communicating the positive and negative effect the company has had on the stakeholders. It is important for sustainability reporting and disclosure to highlight the company's plans to enhance the positive impact and eradicate or ameliorate its negative effects in the financial year ahead.
8. Communicating effectively about the goals and strategies of the company, as well as its performance with regard to economic, social and environmental issues, also serves to align the company with the legitimate expectations of stakeholders, and at the same time, obtain stakeholder buy in and support for the objectives that the company is pursuing. This support can prove to be invaluable during difficult times, for instance when the company needs certain approvals or authority, or when it needs and relies on the confidence and loyalty of customers.
9. As with financial reporting, there is a need for credible sustainability reporting to both internal as well as external stakeholders. Sustainability reporting parameters are not standardised as is the case with financial reporting, and the performance indicators reported on should be explained in terms of their implications and also having regard to available benchmarks. Excellent guidance is to be found in the G3 guidelines.

Principle 6.3: Sustainability reporting and disclosure should be formalised as part of the company's reporting processes

10. Sustainability reporting is becoming increasingly formalised and sophisticated, which is evident in the third generation Global Reporting Initiative (GRI) guidelines of 2007. These guidelines provide a number of important innovations building upon the 2002 guidelines referred to in King II. These include a much greater emphasis on the principle of materiality, which links sustainability issues more closely to strategy, as well as the principle of considering a company's broader sustainability context. The formalisation of sustainability reporting is also evident in the current development of an ISO standard (26000) on social responsibility.
11. The GRI guidelines have become the accepted international standard for sustainability reporting. Although having a global standard in place assists in providing common parameters and facilitating benchmarking and comparability across companies, these should be incorporated into the company's systems based on its specific practical and strategic needs, relevant areas of operation and stakeholder concerns.

Methods and timing of reporting

Principle 6.4: Effective reporting should take place at least once a year

12. Effective engagement and communication needs to take place on a more frequent basis than just once a year in an annual report. It should also take into account the

specific needs of the different stakeholders in content as well as frequency and the mechanism used.

13. Each company should determine the most effective mechanisms through which it will engage with stakeholders. These may include meetings with stakeholders, as well as the distribution of written reports when necessary or the use of electronic media such as the company's website.
14. Given the above, sustainability reporting cannot be a matter of collating information and reporting at year end, but should rather be integrated with other aspects of the business process and managed throughout the year. It should be built into the 'DNA' of the company.
15. Companies can draw on a number of international and local guidance materials, including industry codes of practice, standards, and practical method and management tools in developing and improving their stakeholder identification and engagement, and sustainability accounting, control and disclosure processes. Some examples are the:
 - 21.1 GRI guidelines;
 - 21.2 AA1000 framework and stakeholder engagement standard;
 - 21.3 OHSAS 18000 occupational health and safety standards;
 - 21.4 ISO 9000 quality management assurance standards; and
 - 21.5 ISO 14000 environmental standards.

Principle 6.5: Sustainability reporting and disclosure should have independent assurance

16. A formal process of assurance with regard to sustainability reporting should be established as referred to in Chapters 3 and 5.
17. Globally, two complementary standards have emerged in sustainability assurance: AccountAbility's AA 1000 Assurance Standard (AA1000AS) and the International Accounting and Auditing Standard Board's International Standard on Assurance Engagements (ISAE 3000), to which all auditing professionals in South Africa must comply.
18. While AA1000AS aligns the assurance process to the material concerns of stakeholders in terms of the report as a whole, ISAE 3000 concentrates on the errors and omissions within the company's defined scope. It is therefore recommended that:
 - 18.1. "sustainability" assurance is an ongoing, integral part of the integrated reporting cycle, and

- 18.2. ISAE3000 and AA100AS methodologies are used in combination to ensure the needs of the stakeholders as well as those of the company are met in one process.

19. To the extent that reports are subject to assurance, the name of the assurer should be clearly stated, together with the period under review, the focus of the assurance exercise and the methodology adopted.

20. The audit committee should assist the board in reviewing the integrated reporting and disclosure. Refer to Chapter 3 for more detail.

21. The board should be responsible for the accuracy and completeness of the sustainability reporting and disclosure and may place reliance on the opinion of a credible, independent assurance provider.

22. Sustainability reporting should also be subject to a process of assurance regarding the information reported on.

23. Sustainability reporting, and its subsequent assurance, should be designed to add value by providing a credible account of the company's economic, social and environmental impact.

Chapter 7

Compliance with laws, regulations, rules and standards

Principle 7.1: Companies must comply with applicable laws and regulations

1. Companies must comply with the law and regulations (Acts promulgated by Parliament, subordinate legislation and applicable binding industry requirements such as JSE listings requirements.) Exceptions permitted in law and shortcomings in the law should be handled in a responsible manner.

Principle 7.2: Companies should consider adherence to applicable rules and standards

2. Companies should consider if adherence to applicable non-binding rules and standards achieves good governance, and should adhere to them if that would result in best practice. Companies should disclose the applicable non-binding rules and standards to which they adhere on a voluntary basis.

Principle 7.3: The board and each individual director should be aware of the laws, regulations, rules and standards applicable to the company

3. The board has a duty to identify the laws, regulations and non-binding rules and standards applicable to the company.
4. The board should ensure processes are in place to ensure that it is timeously informed of relevant laws, rules and standards, including changes, as part of their induction, risk management processes and continuing education referred to under Chapter 1.
5. Directors should sufficiently familiarise themselves with the content of applicable laws and regulations, as well as those non-binding rules and standards which the company has voluntarily elected to abide by, to ensure that they have a sufficient understanding of the applicable content and effect of such laws, regulations, rules and standards on the company and its business.

Principle 7.4: The board is responsible for the company's compliance with laws and regulations and should ensure that the company implements an effective compliance framework and processes

6. One of the important responsibilities of the board is to assess the company's compliance with all laws and regulations, and applicable non-binding rules and standards which the company has decided to abide by. Refer to Chapter 1.
7. Compliance with laws and regulations should be proactively managed by companies and compliance should be a standing item on the agenda of the board even if this responsibility is delegated to a separate committee or function within the organisational structure.
8. The extent of reliance placed by the board on these delegated committees or functions depends on the board's assessment of the competence of the committee or function.
9. A company's policy of compliance should be developed by management and approved by the board. Management should be responsible for implementing this policy and reporting to the board regarding compliance.
10. A company's procedures and control framework should incorporate procedures and controls to ensure compliance with laws and regulations and applicable non-binding rules and standards.
11. Specific codes of practice should be drafted and adopted by the company to entrench a culture of compliance and employees should be encouraged to understand and implement these codes.
12. The development of a compliance culture should be encouraged using relevant tools and techniques, including key performance indicators relevant to compliance.

Principle 7.5: Compliance should form part of the risk management process

13. Compliance risk can be described as the risk of damage, arising from non-adherence to the law and regulations, to the company's business model, objectives, reputation, financial soundness, stakeholder relationships or sustainability.
14. The risks of non-compliance should be identified and addressed through the company's risk management processes as described in Chapter 4.
15. As part of the broader risk management framework, a compliance function, which should be sufficiently independent, provides assistance to the board and the management in complying with laws and regulations, and applicable non-binding rules and standards.

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16. The head of the compliance function should be an experienced person who should interact regularly on strategic matters with the board and executive management. The board should support the independence of the compliance officer and should give proper attention to the reports from the compliance function.

17. The compliance function should have adequate resources to discharge its responsibilities.

Chapter 8

Managing stakeholder relationships

Introduction

Principle 8.1: The board should take account of the legitimate interests of stakeholders in its decisions

1. A stakeholder-inclusive corporate governance approach recognises that a company has many stakeholders that can affect the company in the achievement of its strategy and long-term sustained growth. Stakeholders can be considered to be any group who can affect, or be affected by, the company or its reputation. Some of the important stakeholders include shareholders, creditors, lenders, suppliers, customers, regulators, employees, the media, analysts, consumers, auditors and potential investors. This list is not exhaustive.
2. The board should from time to time identify important stakeholders (by groupings not by individuals) relevant to the company's long-term sustainability. Individual stakeholders which could materially affect the operations of the company should be considered and identified as part of the risk management process (refer to Chapter 4). These stakeholders could include not only stakeholders who could cause detriment to the company in a material manner, but also stakeholders who could enhance the wellbeing and sustainability of the company and also stakeholders who could affect the reputation of the company. For instance a local community may not of itself affect the operations of the company, but the way in which the company impacts on the community may well affect its reputation.
3. Companies should take account of the fact that stakeholders' interests in the company could change and so re-examine the interests of such stakeholders at appropriate intervals.

Principle 8.2: The company should proactively manage the relationships with its stakeholders

4. Having identified its key stakeholders and the related interests, the company should develop a strategy and suitable policies of how it will manage its relations with each of those stakeholder groups.

5. Companies need to realise that stakeholder expectations, even if not warranted, need to be managed and cannot be ignored unless the board, after due consideration, decides that it is appropriate to ignore such expectations.
6. The company should consider from time to time whether it is appropriate to publish its stakeholder policies. If the company decides that it is in its best interests not to publish its stakeholder policies, it should consider whether, apart from any legal requirements, it would be willing to disclose all or any of them to any stakeholders on request.
7. The company should consider whether it is appropriate to publish a list of its stakeholder groupings (not the names of individual members of any stakeholder grouping) which it intends to deal with on a proactive basis and the method of engagement.
8. The company should consider not only formal processes, such as annual general meetings and liaison with union representatives, for interaction with its stakeholders. It should also consider informal processes such as direct contact, websites, advertising, or press releases. Regardless of the means of engagement, communication with the various groups is important.
9. The company should consider reporting on an annual basis on its dealings with its stakeholders and the outcomes of these dealings.
10. The development of a close stakeholder network may provide companies with valuable information about stakeholders' views, external events, market conditions, technological advances, or trends or issues. This can help companies anticipate, understand, and respond to external changes more efficiently, enabling the company to deal with problems more effectively.
11. The stakeholder-inclusive corporate governance approach also aims to stimulate appropriate dialogue between the company and its stakeholders. Such dialogue can enhance or restore stakeholder confidence, remove tensions, relieve pressure on company reputation and offer opportunities to align expectations, ideas and opinions on issues.
12. The company should create and maintain the trust and confidence of its various stakeholder groups.

Principle 8.3: The company should identify mechanisms and processes that promote enhanced levels of constructive stakeholder engagement

13. Stakeholder activism should be achieved by constructive engagement with the company. It should be seen as a method of encouraging the company to consider and implement enhanced corporate governance.

14. Constructive engagement should not second guess the board or the management of the company or permit interference or undue influence in the running of the company.
15. The board should identify mechanisms and processes that can support stakeholders in constructive engagement to ultimately promote enhanced levels of corporate governance.
16. The board should guard against using legal or other processes to frustrate or block constructive engagement by stakeholders, for instance by compelling stakeholders continuously to resort to courts. This should not prevent the board from resorting to litigation or other dispute resolution mechanisms and in appropriate circumstances to pursue the company's legitimate interests.
17. If the board, acting in the best interests of the company, considers that it is not possible to make the information public, the stakeholders may have to consider becoming insiders if they consider any intervention and disclosure of price-sensitive information to be vital in promoting corporate governance. Even taking this into account, stakeholders should encourage the directors to share information with all stakeholders as soon as possible. Use of SENS, the JSE news service may ensure that instances of uneven disclosure are minimised.

Principle 8.4: The board should strive to achieve the correct balance between its various stakeholder groupings, in order to advance the interests of the company

18. Notwithstanding that the law directs the board only to act in the best interests of the company as a whole, the board should strive, within these confines and while recognising the primacy of the economic objectives of the company, to achieve, where possible, an appropriate balance between the interests of its various stakeholders, in order to achieve the long-term objectives of the company. The board, while accountable to the company, should take account of the legitimate expectations of its stakeholders in its decision-making.
19. Board decisions as to how to balance interests of stakeholders should be guided by the aim of ultimately advancing the best interests of the company. This applies equally to the achievement of the "triple bottom line" and the whole notion of good corporate citizenship as described in Chapter 2.
20. Although the company has the primary duty as a matter of good corporate governance to manage the relationships with its stakeholders, the stakeholders also should, where possible, accommodate the process. The board cannot achieve successful interaction with the company's stakeholders alone. It needs the cooperation of the stakeholders.
21. Stakeholders therefore need to consider, before acting solely in their own interests, the implications of their actions for the other stakeholders in the company. Ultimately,

not taking account of the interests of the other stakeholders may result in damage to the company and its long term sustainability.

22. The stakeholders should consider whether, and if so how, to give active support to a company's corporate governance initiatives.

Principle 8.5: Companies should ensure the equitable treatment of shareholders

This section applies only to companies and state-owned companies

23. Although the principle of constructive engagement is one that should be applied to all stakeholders, it should specifically be considered in engaging with shareholders who provide the necessary risk capital.
24. There must be equitable treatment of all holders of the same class of shares issued by a company as regards those shares, including minorities, and between holders of different classes of shares in the company, save to the extent necessary to protect the interests of the shareholders of those classes which have a priority in ranking.
25. Minority shareholders should be protected from abusive actions by or in the interests of the controlling shareholder.
26. The formation of stakeholder associations should be encouraged where appropriate. Stakeholders likewise should communicate a clear approach to the board as to the steps they would consider taking if they consider that dialogue is failing. Stakeholders, and especially shareholders, should be very circumspect about making public statements as these could be very damaging to the company. Litigation should be a last resort.
27. A structured process of engagement between company and stakeholders, including structured timeframes for questions and responses, could reduce the risk of confrontation, could prevent tying up the board in constant interventions with stakeholders and could mitigate against mischievous action by competitors.
28. Companies could consider creating a stakeholder liaison forum that can, with relative ease, be accessed by all stakeholders. This should be structured to avoid the problem of only certain stakeholders being in possession of inside information.

Principle 8.6: Transparent and effective communication is important for building and maintaining relationships

29. Stakeholders can only enrich the governance processes if they have sufficient, relevant, accurate and honest information.

30. The need for transparency should be considered in the light of legal requirements, the maintenance of the company's competitive advantage and access to information.
31. The decision on the level of disclosure of information and its timing is a strategic one.
32. The company should put in place processes to prevent the limitation of appropriate disclosure.
33. Subject to the maintenance of the company's competitive advantage, reports for shareholders should present a fair and objective assessment of the activities of the company. The board should consider which of the other stakeholders are entitled by law to be furnished with copies of any or all such reports (or an abridged version) and which other stakeholders the board considers should be furnished with such reports or abridged versions in order to build relationships or facilitate constructive engagement.
34. Companies should be mindful that their communications should be timeous and the methods of communication should be easily understandable for the target market with all the facts both positive and negative.
35. The board should not use complex and obfuscatory language in an endeavour to prevent stakeholders from understanding potentially detrimental situations that the company faces. Both positive and negative effects on the company arising out of an issue should be published.
36. However, the board should recognise its duty to protect the long term sustainability of the company when considering making communications to stakeholders about potentially adverse situations facing the company which may well be corrected in the short term.
37. Shareholders should not be requested to waive their right to receive an integrated report unless the full integrated report is easily accessible to those who might want to read it in the future and the shareholders are furnished with a high-quality, easily understood summary of the key issues.
38. A company should consider disclosing in its integrated report the following additional information, subject to such disclosure detrimentally affecting the company or breach any agreement to which it is a party:
 - 38.1. the reasons for refusals of requests for information that were lodged with the company in terms of the Promotion of Access to Information Act, 2000; or

- 38.2. any material or immaterial but often repeated regulatory penalties, sanctions and fines for contraventions or noncompliance with statutory obligations that were imposed on the company or any of its directors or officers.

Principle 8.7: The board should promote mutual respect between the company and its stakeholders

39. If a company and its stakeholders in general adhere to the same quality of corporate governance, mutual respect will be a natural consequence.
40. It is important from the company's perspective to monitor the quality of corporate governance practised by its strategic stakeholders.
41. An inclusive corporate governance approach enables the company and its stakeholders to adopt a collaborative approach – one that will promote reciprocal trust and respect between the company and its key stakeholders.
42. A symbiotic relationship of mutual respect and mutual reliance should arise from the realisation that each party needs the other and that it is in its best interests that the other continues to operate in a sustainable manner. Bearing that in mind, the board should take a long-term vision rather than relying on short-term expedience.

Suppliers

43. The company needs to monitor the risks associated with a failure to be able to source strategic products and services associated with a failing supplier.

Creditors

44. The underlying base giving rise to creditor comprises of money owed and other commitments, which could include those deriving from contingencies, likely to be from the supply of goods, services and finance. As a result, these stakeholders are in a position to cause dire consequences for a company if not properly managed in that they can cause business rescue processes to be imposed on the company, or worse still, cause it to be liquidated.

Employees

45. Companies should be aware that poor employee relations can result in declining morale, productivity, creativity and loyalty as well as problems in recruiting and retaining staff.
46. Employees and their goals should be aligned with the company's strategy, vision, goals and values. They should understand organisational objectives, directions, and goals. This can be achieved through initiatives such as communicating with

employees (prioritising messages and delivering them through appropriate media for specific audiences) and performance management.

47. Companies need to strategically engage their employees in improving the business. Communication is seen as an enabler to business success.
48. Human and intellectual capital are key competitive differentiators. Leadership and employee communication can also play a vital role in building people capability and retaining employees. Continuous, respectful and candid employee communication also ensures leadership credibility.

Government

49. The company's stakeholder policy should recognise the government as a stakeholder and should address in particular the company's duties to comply with the law.
50. The policy should also address the role of the company as a stakeholder in government. The policy should, among others:
 - 50.1. guide directors, officers and employees in their interaction with government, politicians and civil servants;
 - 50.2. set out the principles that apply when the board considers making a financial contribution to any political party or group (there is a school of thought that suggests good governance is to remain apolitical and not make donations to a political party); and
 - 50.3. ensuring that its directors, officers and employees do not participate in any activity that may corrupt any civil servant or corruptly undermine any government function.
51. Companies should ensure that these policies include compliance with the provisions of the various tax legislation applicable to companies in all their respective capacities. Companies have a duty wider than paying company tax as they need among others to comply with withholding tax provisions, thereby respecting the relationship between the company and government.

External auditors

52. External audit is an independent assurance function performed primarily for the benefit of the shareholders. The objective of an audit of financial statements is to enable the auditor to express an opinion as to whether the financial statements fairly present, in all material respects, the financial position of the company at a specific date and the results of operations and cash flow information for the period ended on that date, in accordance with an identified financial reporting framework and/or statutory requirements. The auditor's opinion enhances the credibility of the financial

statements, but does not guarantee the future viability of the company or the effectiveness or efficiency with which the management has conducted the affairs of the company.

53. The board should not consider the appointment of an external auditor as an imposition. Instead it should appreciate that the external auditor can add value in the combined assurance model and can provide an early warning system.
54. Credible and reliable financial statements are essential for the protection of creditors and the effective functioning of the capital markets and economies of countries. In this regard, the external audit function also plays an important role in protecting other stakeholder interests.
55. The position of the external auditor as a stakeholder is unique in that the external auditor is appointed by and accountable to the shareholders. The external auditor, however, interfaces mainly with the management and the audit committee of the company. In this regard an effective functioning audit committee can play a vital role in strengthening the external auditor's independence and improving the quality of the external audit function. (Refer to Chapter 3 for more detail on the role of the audit committee.)
56. In terms of the relationship of mutual respect between the company and the external auditor, the board should ensure, through the audit committee, that all relevant information is shared with the external auditor in advance to assist the external audit process. The external auditor, in turn, should inform the board of matters relating to the audit or the company as soon as he becomes aware of such information.

Consumers/customers

57. Customers comprise individuals, companies, state and other authorities, as well as non-profit organisations that purchase or procure goods services or finance from the company. In addition to those customers dealing directly with the company, 'deferred' customers may result through the sale of the company's debtors or through onward sales via the customers, where for example, guarantees on products are concerned. Indirect customers could include intermediaries such as agents, non-profit organisations which form part of the company's promotional activities and might distribute 'free' or subsidised products. The definition of customer is therefore wide and includes all users of the company's products or services.
58. In getting their products to their markets, companies should be both proactive and reactive in providing customers with information. The channels of communication include those attached to the products, advertising, promotion, and electronic and

hard copy distribution. In this regard there is likely to be an overlap with information supplied to a number of other stakeholders, such as investors, employees and regulators.

59. Existing customers, future customers and others have an interest in the products or services provided by the company and wish to derive value from their dealings with it. Customer action or reaction can be both product specific and general and will occur if expectations are not met.
60. Responses from customers can be expected where the company does not act in a responsible manner or where the product or its use is:
 - 60.1. harmful to the environment;
 - 60.2. derived through employee working conditions outside reasonable norms, for example, use of child labour;
 - 60.3. produced without taking into account diversity and equal opportunity situations; or
 - 60.4. harmful to the health of customers.
61. Customers may respond to a change in status of the company, for example, a change in major shareholding or a sale of the company. Depending on the nature of the transaction, customers could feel threatened if a competitor acquires the company, or ownership moves from local to international investors. This amounts to reputational risk and should be included in the risk management process as described in Chapter 4.

Industry

62. A company's sustainability depends, among others, on the sustainability of the industry or industries in which it operates. A company should therefore acknowledge its responsibility to promote the sustainability of its industry and should have a policy in this regard.
63. A company could consider participating actively in appropriate forums that can promote a sustainable industry and a fair competitive environment. It could consider the establishment of such forums where they do not exist. It should take active steps to ensure that none of its employees or representatives engage in anti-competitive practices.

Local communities

64. Every company operates in a community. The relationship between a company and its local communities is of paramount importance because the members of the local community may be involved in the company as employees, customers and the like. The company's treatment of the local communities affects its reputation.
65. Companies should avoid situations that could create a conflict of interest that could present themselves in a variety of ways, be it political or otherwise. Therefore companies should provide support in enhancing the lives of local communities and promote various local opportunities. A company's involvement in local communities is best described as good corporate citizenship. Refer to Chapter 2 for more discussion.
66. Companies should not only be concerned with their profitability and economic efficiency, but should also broaden their concerns and social involvement. A positive relationship with local communities is essential for the company's functioning as it adds ethical value.

Media

67. Media relations involve managing relationships with the media – media includes the writers, editors and producers who contribute to and control the reporting that appears in the print, broadcast and online media. As with all relationships, a degree of mutual respect is required: the relationship should serve the interests of the media while also serving the interests of the company.
68. Reporters who cover a company or industry speak constantly with industry observers, participants, critics and supporters. They sometimes develop insights that are even deeper than a company's management may have. They can serve as an early warning system of trouble ahead. However, companies often see them as having a biased view. It is important that communicators feel free to pass along to senior management negative comments and questions without fear. It is important for senior leadership to see these negative comments or questions as possible precursors of trouble ahead, not with the individual reporters but with the business performance or practices in question.
69. Given the leading role journalism plays in investment decision-making, investor relations and corporate media relations naturally focus considerable time and energy attempting to inform and generate accurate and positive media coverage for a corporation, its management, and its prospects. The media should ensure that skilled commentators/journalists are used to report in an analytical, objective and unbiased manner. The financial journalists should guard against sensationalism and report pertinent information accurately.

Regulators

70. A regulator may be defined as a body that seeks compliance, either on a voluntary or mandatory basis, with a set of rules, or regulations or a code. These may be directed at a company or the sector within which the company operates.
71. The company should identify any regulator that has or may have jurisdiction over its operations. To do this it should conduct both international and domestic research preferably before it commences operating in order to avoid regulatory sanctions. This research should also assist the company to obtain a clear understanding of what is required by the regulator(s).
72. A regulator should seek to identify any company that falls within its jurisdiction and to inform that company what is expected of it. This ideal does not apply to all regulators, however, and the onus remains on the company to ensure that it complies.
73. Companies may be more inclined to work with regulators if there is a clearly defined communication channel between the two parties. This working relationship should be facilitated by the regulator issuing a document that encompasses its requirements and any guidelines to assist on interpretation. Accessibility can be enhanced by this document being made available electronically or in hard copy together with workshops, seminars and telephonic advice centres. Similarly, in the event of changes to the requirements, these can be communicated and explained by the same methods.
74. The regulator should ensure a company has a clear knowledge of when compliance is mandatory and when it is voluntary. In this regard it is important for the regulator not only to enforce its rules but also to assist in their compliance.
75. Regarding communication, it should be always clear who the company may contact at the regulator and queries should be logged, directed to the appropriate person and promptly answered. Answers need to be clear and consistent since this will encourage companies to comply with the rules and to assist the regulator. In addition, the company may be persuaded to strive for greater disclosure in the relationship.
76. Regulators should be cognisant when drafting legislation of the effect of that legislation on the constructive engagement between the company and its stakeholders and allow for fair opportunities to comment.

Potential investors

77. A potential investor is an individual or entity with the ability to become a future investor in the company, either by subscribing for a fresh issue of shares or by acquiring shares from an existing shareholder.
78. Notwithstanding that cornerstone of good governance which requires all investors to be treated equally, the differences between potential and existing investors should be recognised by the company and its board.
79. The potential institutional investor expects clear and transparent disclosure from companies. This information should be readily available to them in all forms of the media as well as directly from the company. Each corporate entity should make an individual department responsible for dealing with queries from people wishing to invest. These potential investors, whether they are individuals or institutions, will expect high standards of corporate governance, board integrity and confidence as stakeholders in the sustainability of the business of the company.

Dispute resolution

Principle 8.8: Companies should establish a formal process to resolve internal and external disputes

80. Disputes (or conflict) involving companies are an inevitable part of doing business and provide an opportunity not only to resolve the dispute at hand but also to address and solve business problems and to avoid their recurrence.
81. It is incumbent upon directors and executives, in carrying out their duty of care to a company, to ensure that disputes are resolved effectively, expeditiously and efficiently. This means that the needs, interests and rights of the disputants must be taken into account. Further, dispute resolution should be cost effective and not be a drain on the finances and resources of the company.
82. Disputes may arise either within a company (internal disputes) or between the company and outside entities or individuals (external disputes).
83. Internal disputes may be addressed by recourse to the provisions of the Act and by ensuring that internal dispute resolution systems are in place and function effectively.
84. External disputes may be referred to arbitration or a court. However these are not always the appropriate or most effective means of resolving such disputes. Mediation is often more appropriate where interests of the disputing parties need to be addressed and where commercial relationships need to be preserved and even enhanced.

85. A distinction should be drawn between processes of dispute resolution (litigation, arbitration, mediation and others) and the institutions that provide dispute resolution services.
86. In respect of all dispute resolution institutions and regardless of the dispute resolution process or processes adopted by each, an indispensable requirement is its independence and impartiality in relation to the parties in dispute.
87. The courts, independent mediation and arbitration services (not attached to any disputing parties) and formal dispute resolution institutions created by statute (for example, the Companies Tribunal as referred to in Annex 8.1) are empowered to resolve disputes by mediation or conciliation and by adjudication. Their effective use should be ensured by companies.

Principle 8.9: The board should ensure disputes are resolved as effectively, efficiently and expeditiously as possible

88. Successful resolution of disputes entails selecting a dispute resolution method that best serves the interests of the company. This would, in turn, entail giving consideration to such issues as the preservation of business relationships and costs, both in money and time, especially executive time.
89. It is also important to recognise that the use of mediation allows the parties to create options for resolution that are generally not available to the parties in a court process or in arbitration. Further, the Act makes provision for alternative dispute resolution processes to be conducted in private.
90. Mediation is not defined in the Act. The concept has an accepted meaning in practice in South Africa. Mediation may be defined as a process where parties in dispute involve the services of an acceptable, impartial and neutral third party to assist them in negotiating a resolution to their dispute, by way of a settlement agreement. The mediator has no independent authority and does not render a decision. All decision-making powers in regard to the dispute remain with the parties. Mediation is a voluntary process both in its initiation, its continuation and its conclusion.
91. Similarly conciliation is not defined in the Act. Conciliation is, like mediation, a structured negotiation process involving the services of an impartial third party. The conciliator will, in addition to playing the role of a mediator, make a formal recommendation to the parties as to how the dispute can be resolved.
92. Once again, adjudication is not defined in the Act but the process will not differ significantly from arbitration.
93. In selecting a dispute resolution process, there is no universal set of rules that would dictate which is the most appropriate method. Each case should be carefully considered on its merits and, at least, the following factors should be taken into account:

- 93.1. *time available for the resolution of the dispute.* Formal proceedings, and in particular court proceedings, often entail procedures lasting many years. By contrast, alternative dispute resolution (ADR) methods, and particularly mediation, can be concluded within a limited period of time, sometimes within a day.
 - 93.2. *Principle and precedent.* Where the issue in dispute involves a matter of principle and where the company desires a resolution that will be binding in relation to similar disputes in the future, ADR may not be suitable. In such cases court proceedings may be more appropriate.
 - 93.3. *Business relationships.* Litigation and processes involving an outcome imposed on both parties can destroy business relationships. By contrast mediation, where the process is designed to produce a solution most satisfactory to both parties (a win-win resolution), relationships may be preserved. Where relationships and particularly continuing business relationships are concerned, therefore, mediation or conciliation may be preferable.
 - 93.4. *Expert recommendation.* Where the parties wish to negotiate a settlement to their dispute but lack the technical or other expertise necessary to devise a solution, a recommendation from an expert who has assisted the parties in their negotiations may be appropriate. This process would be termed conciliation.
 - 93.5. *Confidentiality.* Private dispute resolution proceedings may be conducted in confidence. Further, the Act makes provision for alternative dispute resolution processes to be conducted in private.
 - 93.6. *Rights and interests.* It is important in selecting a dispute resolution process to understand a fundamental difference they have to adjudicative methods of dispute resolution (court proceedings, arbitration and adjudication). The adjudicative process involves the decision maker imposing a resolution of the dispute on the parties after having considered the past conduct of the parties in relation to the legal principles and rights applicable to the dispute. This inevitably results in a narrow range of possible outcomes based on fundamental considerations of right and wrong. By contrast, mediation and conciliation allow the parties, in fashioning a settlement of their dispute, to consider their respective needs and interests, both current and future. Accordingly, where creative and forward-looking solutions are required in relation to a particular dispute and particularly where the dispute involves a continuing relationship between the parties, mediation and conciliation are to be preferred. For example, a contract can be amended or materially rewritten.
94. Mediation and conciliation require the participation and presence of persons empowered and mandated to resolve the dispute.

Principle 8.10: The board should select the appropriate individual(s) to represent the company in alternative dispute resolution (ADR) processes

95. ADR has been a most effective and efficient methodology to address the costly and time consuming features associated with more formal litigation. Statistics related to success range from a low of 50%, for those situations in which the courts have handed down a case for ADR, to an average of 85% - 90% where both parties are willing participants
96. Mediation is often suggested as an ADR method with the assumption that the parties are willing to engage fully in the process. A process of screening is undertaken by many mediators, which excludes those who fall short of the criteria of will and capacity. This is described in the field in terms of readiness or ripeness for ADRs. Incapacity, as in the case of mental illness and inability to grasp the concepts, should naturally result in exclusion from the process.
97. Those who are resistant to ADRs are problematic in terms of ubiquitous referral.
98. ADR has become the intervention of choice in many instances and so it behoves specialists to improve the overall rate of intake and success. Clearly the optimal outcome would be to increase the overall satisfaction with the process and outcome of successful resolution.
99. The Courts will enforce an ADR clause to resolve a dispute providing all are subject to an agreed set of rules and practices such as the place and language of the process.
100. Contracting parties who are attuned to the fact that a dispute will be administered and resolved by a third party are naturally inclined to resolve it themselves. If, for example, the ADR processes are made subject to the rules of the Arbitration Foundation of Southern Africa (AFSA), it will be administered by AFSA. If the ADR processes are ad hoc, a recalcitrant party in bad faith may be able to frustrate the process.
101. An example ADR clause has been developed by the Institute of Directors and AFSA and settled by senior counsels. That clause is set out in Annex 8.2 and is recommended to be incorporated in all contracts, especially major procurement and cross border contracts.

Annex 8.1 – The Companies Tribunal

1. Section 156 of the Act offers an election to parties in dispute. A person seeking to address an alleged contravention of the Act or to enforce a right in terms of the Act has a choice of four different procedures or remedies. In terms of this section the person:
 - 1.1. May attempt to resolve any dispute with or within a company through alternative dispute resolution;
 - 1.2. May apply to the Companies Tribunal for adjudication where so permitted;
 - 1.3. May apply to the High court; or
 - 1.4. May file a complaint with the Panel or Commission.
2. Section 166 deals with alternative dispute resolution. As an alternative to bringing a matter before a court or filing a complaint with the commission, a person may refer the matter in dispute to the Companies Tribunal or to an “*accredited entity*” for resolution by mediation, conciliation, or arbitration.
3. The resolution of a dispute may be recorded in the form of an order of court. This facility is not available to parties who resolve a dispute by mediation and conciliation outside the terms of the Act. Notwithstanding, a High Court can make a mediation resolution or an arbitrator’s aware an order of court.
4. Section 180 deals with adjudication before the Companies Tribunal. The Companies Tribunal must decide disputes expeditiously and fairly. It may conduct the proceedings informally. It must issue a decision with reasons at the conclusion of proceedings. In appropriate and defined circumstances the proceedings may be held in private.
5. Section 193 deals with the establishment of the Companies Tribunal. The Companies Tribunal is a juristic person. It is described as independent “*subject only to the Constitution and to the law*”. The Companies Tribunal must perform its functions impartially and without fear, favour or prejudice and in as transparent a manner as is appropriate having regard to the nature of the specific function.
6. The Companies Tribunal consists of a chairman and not less than 10 other women or men appointed by the Minister, on a full or part-time basis.
7. The Companies Tribunal may adjudicate any matter brought before it in terms of the Act. It may also assist in the resolution of disputes by the alternative dispute resolution methods referred to in section 166, namely, mediation, conciliation or arbitration.

Annex 8.2 – Private dispute resolution

The Act does not preclude the use of private dispute resolution outside the terms of the Act. In other words, the Act does not preclude the resolution of disputes which arise out of the application of the provisions of the Act by persons or institutions other than the Companies Tribunal and other than accredited agencies. The dispute resolution provisions of the Act would not apply to such (private) dispute resolution processes. Operating within the terms of the Act will however ensure that disputes are dealt with by appropriately accredited bodies (the Companies Tribunal or a duly accredited agency). In addition section 167, which provides for the recordal by consent of the resolution of a dispute in the form of a court order, is a significant addition to our law. This section applies only to disputes resolved in terms of the Act and not to private mediation processes.

Of course those disputes not contemplated by section 156 (that is, disputes not arising out of the application of the provisions of the Act)¹ may be resolved by recourse to court or by private alternative dispute resolution methods. Much of the contents of this chapter apply equally to dispute resolution in terms of the Act and to private dispute resolution.

The recommended ADR clause to be incorporated in contracts reads as follows and is online at www.iodsa.co.za :

DISPUTE RESOLUTION CLAUSE

1 DISPUTE RESOLUTION

If any dispute arises out of or in connection with this Agreement, or related thereto, whether directly or indirectly, the Parties must refer the dispute for resolution firstly by way of negotiation and in the event of that failing, by way of mediation and in the event of that failing, by way of Arbitration. The reference to negotiation and mediation is a precondition to the Parties having the dispute resolved by arbitration.

A dispute within the meaning of this clause exists once one Party notifies the other in writing of the nature of the dispute and requires the resolution of the dispute in terms of this clause.

Within 10 (ten) business days following such notification, the Parties shall seek an amicable resolution to such dispute by referring such dispute to designated representatives of each of the Parties for their negotiation and resolution of the dispute. The representatives shall be authorised to resolve the dispute.

In the event of the negotiation between the designated representatives not resulting in an agreement signed by the Parties resolving the dispute within 15 business days, the parties must refer the dispute for resolution by way of mediation in accordance with the rules of the Arbitration Foundation of Southern Africa (“AFSA”).

In the event of the mediation envisaged in 1.4 failing in terms of the rules of AFSA, the matter must, within 15 business days, be referred to arbitration as envisaged in the clauses below.

The periods for negotiation or mediation may be shortened or lengthened by written agreement between the parties.

Each Party agrees that the Arbitration will be held as an expedited arbitration in Sandton in accordance with the then current rules for expedited arbitration of AFSA by 1 (one) arbitrator appointed by agreement between the Parties, including any appeal against the arbitrator’s decision. If the Parties cannot agree on the arbitrator or appeal arbitrators within a period of 10 (ten) Business Days after the referral of the dispute to arbitration, the arbitrator and appeal arbitrators shall be appointed by the Secretariat of AFSA.

The provisions of this clause 1 shall not preclude any Party from access to an appropriate court of law for interim relief in respect of urgent matters by way of an interdict, or *mandamus* pending finalisation of this dispute resolution process for which purpose the Parties irrevocably submit to the jurisdiction of a division of the High Court of the Republic of South Africa.

The references to AFSA shall include its successor or body nominated in writing by it in its stead.*

This clause is a separate, divisible agreement from the rest of this Agreement and shall remain in effect even if the Agreement terminates, is nullified or cancelled for whatsoever reason or cause.

* AFSA is a non-profit organisation of longstanding and high integrity which provides independent and comprehensive administrative services in support of mediation and arbitration. The IoD recommends the choice of AFSA as a service provider to provide the parties with the maximum benefit from use of the dispute resolution clause. Should the Parties acting on the basis of informed consent wish to dispense with service providers or substitute others, then this clause will need to be redrafted. AFSA has joined with the University of Pretoria in issuing a diploma in Mediation and Arbitration. In doing so, numerous individuals have been trained as mediators and arbitrators. AFSA also has the most experienced panel of experts for effective alternative dispute resolution.

Chapter 9

Fundamental and affected transactions

Present indications are that the Takeover Regulations will be promulgated during 2009 to take effect at a later date. This chapter sets out generally accepted principles of good governance which supplement the Takeover Regulations.

Introduction

1. Chapter 5 of the Act defines affected transactions as a wide range of transactions summarised as follows:
 - 1.1. a transaction or series of transactions amounting to the disposal of all or the greater part of the assets or undertaking of a regulated company;
 - 1.2. an amalgamation or merger, if it involves at least one regulated company;
 - 1.3. a scheme of arrangement between a regulated company and its shareholders;
 - 1.4. the acquisition of, or announced intention to acquire, a beneficial interest in any voting securities of a regulated company;
 - 1.5. the announced intention to acquire a beneficial interest in the remaining voting securities of a regulated company not already held by a person or persons acting in concert;
 - 1.6. a mandatory offer; or
 - 1.7. a compulsory acquisition.

Points 1.1, 1.2 and 1.3 are fundamental transactions. Affected transactions may only be implemented in compliance with Chapter 5 and the Takeover Regulations.

Principle 9.1: Directors must disclose any conflict or potential conflict of interest

2. In an affected transaction, and during the entire course of such affected transaction, a director of an offeree company, whether executive or non-executive, must fully disclose to the offeree company board, any conflict of interest or potential conflict of interest, including its nature, in relation to such transaction. Such disclosure must be made immediately he becomes aware of such conflict. In such a case, where the director considers that such conflict or potential conflict may affect his independence, the director concerned must declare himself non-independent. Where the director does not declare himself non-independent and the board considers such director to be non-independent, the board must declare the director non-independent.
3. The following provides guidance in the determination of conflicts of interest of offeree company directors. Where an offeror is not a company, references to offeror directors apply equally to trustees of trusts, partners of partnerships, members of a consortium and similar personae.
 - 3.1. Directors who are members of the boards of both an offeror and offeree company are presumed to be conflicted and non-independent, but such presumption is rebuttable at the instance of the independent board.
 - 3.2. A director of an offeree company who holds vested shares and/or options ("vested securities") in the offeree Company, which vested securities:
 - 3.2.1. have an intrinsic value (as defined by International Financial Reporting Statements) which represents a material amount of the director's net worth.; and/or
 - 3.2.2. represents a material holding in the offeree company;are presumed to be conflicted and non-independent, but such presumption is rebuttable at the instance of the independent board.
 - 3.3. Directors of an offeree company who hold unvested securities and/or options who are offered any substitute share/option scheme, offer or acceleration of vesting periods giving rise to a benefit in an affected transaction would render them non-independent.
 - 3.4. Directors who are partial to the outcome of an affected transaction because of an increased or decreased future benefit are non-independent. The specific circumstances surrounding the loss of office or employment may result in a director becoming non-independent.
 - 3.5. An offeree company director, who is 'related', as defined in the Act, to any person who is, or would be, non-independent, is rebuttably presumed to be non-independent.

Principle 9.2: Directors involved with affected transactions must not be conflicted

4. Independence is the ability to make impartial decisions without fear or favour, and is a fundamental requirement to be complied with in any affected transaction.
5. In an affected transaction, an offeree company board must consist only of independent directors, whether executive or non-executive (“independent board”). Non-independent directors must recuse themselves from all independent board meetings. However, the independent board may determine the extent of a non-independent director’s attendance at any of its meetings for a defined purpose, such as furnishing information.
6. An independent board should comprise a minimum of three independent directors. Where there are fewer than three independent directors, other independent persons must be appointed to the independent board.

Principle 9.3: Directors duties are expanded to include duties to shareholders

7. Affected transactions require the expansion of a director’s fiduciary duties to include the general body of the company’s relevant shareholders (including all securities as define in the Act).

Principle 9.4: Independent board members should have the requisite knowledge

8. Each member of the independent board should ensure that he has received all necessary information in order to provide a fully informed opinion to relevant shareholders concerning the affected transaction. For that purpose the director:
 - 8.1. must appoint and should meet with all appointed advisers to be briefed on the details of the affected transaction mechanism;
 - 8.2. should, while adhering to regulatory timetables, ensure that he has sufficient time to discharge all duties and responsibilities and resist haste and pressured time deadlines;
 - 8.3. must ensure he is properly informed of the offeree company’s value.

Principle 9.5: The independent board must express an opinion to shareholders

9. An independent board should do all things necessary to satisfy itself that an offeror is able to perform in terms of an affected transaction.
10. An independent board should form a clear basis for the expression of an opinion to shareholders dealing with value and price compared to the consideration offered. Where the consideration offered per share exceeds either the estimated fair value per share or current traded price per share, but not both, a split opinion clearly detailing the independent board's view is required, for example, fair but not reasonable or reasonable but not fair.
11. An independent board must form a view of a range of value, based upon an accepted valuation approach, of the offeree company shares. Any affected transaction with a consideration per share within this range is generally considered to be fair.
12. The independent board should consider factors that are difficult to quantify, or that are unquantifiable, and must disclose them (or state that there are none of which it is aware) and take them into account in forming its opinion in respect of fairness.
13. Any affected transaction may generally be considered reasonable where the consideration per offeree company share is greater than the offeree company's traded share price at the time the consideration per share was announced, or at some other more appropriate identifiable time, taking account of all company specific circumstances.
14. Any affected transaction with a settlement consideration comprising offeror shares requires the independent board to carefully consider the price and value per share of the offeror's shares relative to the offeree company shares.
15. An independent board should be cognisant of the fact that a cash consideration to settle the acquisition of offeree company shares requires the most rigorous value discovery of the offeree company by the directors because acceptance by shareholders constitutes the ultimate capitulation in respect of receipt of future benefits from such holding.
16. An independent board recommending an affected transaction consideration to offeree company shareholders should have exhausted all reasonable endeavours to satisfy itself that the consideration offered could not have been bettered by pursuing an alternate viable deal, that is, they should negotiate with any and all parties they believe to be reasonably interested to secure a more favourable result for shareholders.

17. While an independent board should take account of all advice received from all appointed advisers, it retains the primary responsibility to express an opinion to shareholders and may not abdicate such responsibility.
18. If the independent board is not unanimous in its opinion, all differing opinions of members, including reasons, must be provided to shareholders.

Principle 9.6: Offeree companies must appoint independent competent advisers

19. The number and type of advisers to be appointed should be properly determined at an early stage by the independent board and appointed by the independent board.
20. An independent board must determine that the offeree company appointed advisers are independent and competent.
21. Independent advisers should charge a market related fee, but such fee must not be subject to increase or decrease contingent upon the outcome of the affected transaction.

Principle 9.7: Negotiations should be kept confidential. If confidentiality is breached relevant information should be disclosed

22. An independent board should be cognisant of the fact that confidentiality may only be able to be maintained for a short period, and sometimes not at all.
23. If there is reasonable suspicion of a leak of material price-sensitive confidential information, such information must immediately be disclosed to shareholders of the offeree company, and in the case of a public company, to the general public, in the appropriate manner.
24. An independent board should disclose as much detailed information concerning an affected transaction as early as possible.
25. Information provided to select offeree company shareholders must be disclosed equally and as soon as possible to all other shareholders, and in the case of a public company to the general public, in the appropriate manner.
26. An independent board must ensure that all material changes to previously announced specific information concerning an affected transaction is immediately disclosed to shareholders of the offeree company, and in the case of a public company to the general public, in the appropriate manner.

27. The offeree company should determine and disclose any benefits, other than the consideration offered to offeree company shareholders, offered to any specific offeree company shareholder or offeree company director.

Where an offeror is not a company, references to offeror directors apply equally to trustees of trusts, partners of partnerships, members of a consortium and similar personae.

Principle 9.8: Offerors must treat all offeree company share holders equitably

28. Shareholders of different classes, types and rights to shares should be treated comparably.
29. Where an offeror is a company, its directors are bound by their common law and statutory duties.
30. An offeror should not announce an offer or its intent to make an offer unless it has proper grounds for believing that it can and will continue to be able to implement the offer.
31. The offeror must disclose any benefits offered to any specific offeree company shareholder or Offeree Company director other than in their capacity as shareholders.

Principle 9.9: The non-conflicted directors should drive the process from both the offeror and the offeree company perspective

32. Where a director is declared independent by the independent board of the offeree company, such director is conflicted at the offeror board/management level.

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