

**HOMEWORK 1 - MEMORANDUM**

**CORPORATE GOVERNANCE**  
**(+ 15 – 20 marks in Exam)**  
**(JACKSON Chapter 4)**

**QUESTION 1: Corporate Governance**

1

The directors of ABC limited request your input on the implementation of good corporate governance, according to the second report of the King Committee, into their company.

**Required:**

1.1 List and describe Seven (7) principles of good Corporate governance. (10)

**ANSWERS:**

**1.1 Corporate Governance**

- Discipline
- Transparency
- Independence
- Accountability
- Responsibility
- Fairness
- Social Responsibility

Give a brief description for each one (10)

**QUESTION 2 - General questions on Corporate Governance - Assignment 3 – 2011**

Top Hair Limited, a company that manufactures hair products, recently decided to adopt the King Code on Corporate Governance for South Africa 2009 (King 111).

Your audit firm received numerous enquiries regarding King III from the owners of the company. Consequently, you were assigned by the audit partner to give a presentation to these owners on the contents of King 111.

To identify the focus areas for your presentation, you decided to distribute a questionnaire on the various elements of King III to identify the problematic areas. The results of these questionnaires revealed that there is uncertainty regarding:

the party responsible for:

- the risk management of the company
- the appointment of the head of the internal audit function
- the introduction of new directors regarding the manner in which the company operates
- the appointment of new directors
- the confirmation of the effective operation of the internal audit system.

the key risks facing the company.

the function of a board committee.

**REQUIRED**

	<b>Marks</b>
2.1 Who holds the ultimate responsibility for the management of risk?	(1)
2.2 Who is responsible for the appointment of the head of the internal audit function?	(1)
2.3 Who is responsible for the induction of new directors regarding the manner in which the company operates?	(1)
2.4 Who is responsible for the appointment of new directors?	(1)
2.5 Who is responsible for the confirmation of the effective operation of the company's system of internal controls?	(1)
2.6 Identify four (4) key risks facing a company as per King III.	(2)
2.7 What is the function of a board committee? Provide two (2) examples of board committees.	(3)

**QUESTION 2 : ANSWER**

- 2.1 The board of directors, (1)
- 2.2 The audit committee, (1)
- 2.3 The company secretary. (1)
- 2.4 The shareholders of the company. (1)
- 2.5 The internal audit function. (1)
- 2.6 Key risks:
- Stakeholder risk
  - Reputational risk
  - Compliance risk
  - Ethics risk
  - Sustainability risk
  - Corporate social investment, employee equity, black economic empowerment, skills development and retention
  - Human and financial capital
  - Strategic risk
  - Operating risk
  - Information technology risk
- 2.7 A board committee is an aid to assist the board and its directors. (1)
- Examples include: audit committee, nomination committee, remuneration committee, risk committee. (2)

### QUESTION 3 (JUNE 2013)

Minetech (Pty) Limited is a large company in the mining industry in South Africa. The company intends to list on the Johannesburg Stock Exchange (JSE) in the near future. In order to do so, Minetech has to meet the recommendations of good governance of the King III Report, as compliance is compulsory for companies listed on the JSE.

#### **Fraud in the company**

Six months ago Minetech appeared in the business news headlines when the financial director was found guilty of defrauding the company of R 2,8 million. This was done by transferring money from the company's bank account via internet banking. The financial director was immediately dismissed.

No physical controls exist to prevent access to the computer onto which the company's internet banking software is loaded. All personnel in the finance department share a single password to gain unlimited access to the bank account.

#### **Corporate governance in the company**

As a result of the fraud scandal and Minetech's intentions to list on the JSE, the shareholders requested a review of the company's current corporate governance practices with reference to the King III Report recommendations.

The company secretary provided the following schedule of directors and committees:

#### **1. Board of directors**

M Lebate	– Chairman and executive director
S Gouws	– Chief executive officer (CEO)
D Govender	– Marketing director (an executive director)
B Langa	– Human resources director (an executive director)
A Peters	– Information technology (IT) director (an executive director)
H Ally	– Risk director (an executive director)
L Pretorius CA(SA)	– Independent non-executive director

- 1.1 The position of financial director has been vacant for 6 months after the previous director's dismissal. The CEO, S Gouws is in the process of interviewing candidates and will in due course appoint the new financial director.
- 1.2 The board of directors meets twice a year to accommodate L Pretorius who lives abroad and does not have the time to travel more regularly to South Africa for meetings.

## 2. Board committees

The company has two board committees; an audit committee and a risk committee.

### 2.1 Audit committee

M Lebete (chairman of the audit committee)

L Pretorius CA(SA)

A Peters

The audit committee meets twice a year. The internal auditors always attend and take part in these meetings, whilst the external auditors do not attend any of the meetings. A Peters has extensive IT experience and knows Minetech's systems well.

### 2.2 Risk committee

M Lebete (chairman of the risk committee)

H Ally

The risk committee knows the risks that the business face and has not identified any new threats that would necessitate a review of the risk management plan and process of the company.

## REQUIRED

Marks

### 1.1 Comment on the information provided in relation to the requirements of sound corporate governance in terms of the King III Report.

Present your answer under the following headings:

1. Board of directors: composition and appointments (4)
2. Board of directors: meetings (2)
3. Audit committee: composition and appointments (3)
4. Audit committee: meetings (3)
5. Risk committee: composition and appointments (2)
6. General remarks (2)

Both **compliance** and **non-compliance** should be addressed in your answer. Two marks will be awarded for the correct presentation of your answer.

(25)

### QUESTION 3: ANSWERS:

#### 1.1 The requirements of sound corporate governance pertaining to the board of directors and board committees 25 marks

Reference: The King III Report (2009:29-75)

##### 1. Board of directors: composition and appointments

1. M Lebetse, the chairman of the board, is not an independent non-executive director (Principle 2.16). (1½)
2. S Gouws, the chief executive officer (CEO), is not the chairman of the board which is in **accordance** with the Principle 2.16. (1½)
3. The board should comprise a balance of power with a majority of non-executive directors who should be independent. The board has only one independent non-executive director and does **not** comply with principle 2.18. (1½)
4. At least a chief executive director and finance director should be appointed to the board (Principle 2.18, point 73). Minetech does not currently have a financial director acting on the board (for the past six months). (1½)
5. Appointments to the board should be a matter for the board as a whole, assisted by the nominations committee (principle 2.19, point 80), and **not** the CEO, S Gouws, alone (financial director appointment). (1½)

**Limited to 4 valid answers**

##### 2. Board of directors: meetings

1. Non-executive directors should ensure that they have the time required to attend properly to their duties (principle 2.19, point 83). L Pretorius, the independent non-executive director, does **not** meet this requirement. (1½)
2. Minetech's board meets only twice a year, and **not** 4 times a year as required by principle 2.1 point 1. (1½)

**Limited to 2 valid answers**

### **3. Audit committee: composition and appointments**

1. All members should be independent non-executive directors (Principle 3.2 point

- 9). Minetech does **not** comply as only L Pretorius is an independent non-executive director. (1½)
2. The audit committee is not independent if two thirds of membership, which includes the chairman (influential), are **not** independent non-executive directors (Principle 3.2). (1½)
3. Minetech **complies** with principle 3.2 point 10 with its minimum of three members. (1½)
4. Audit committee members should be suitably skilled and experienced (Principle 3.2 and point 12). Minetech does **comply** with this requirement as L Pretorius is a CA(SA) and A Peters an IT specialist who knows computerised accounting systems well. (1½)

**Limited to 3 valid answers**

#### **4. Audit committee: meetings**

1. Minetech **complies** with principle 3.1 point 7's requirements to meet at least twice a year. (1½)
2. Minetech **complies** with principle 3.1 point 8's requirements to meet with internal audit at least once a year. (1½)
3. Minetech does **not** comply with principle 3.1 point 8's requirements to meet with internal and external audit at least once a year. (1½)
4. Minetech does **not** comply with principle 3.1 point 8's requirements to meet with internal and external audit without management being present (with reference to M Lebete and A Peters who are also part of management). (1½)

**Limited to 3 valid answers**

#### **5. Risk committee: composition and appointments**

1. The chairman, M Lebete, should not chair the risk committee but may be a member of it (Principle 2.16, point 45.4). Minetech does **not** comply with this requirement as M Lebete is also the chairman of the risk committee. (1½)
2. The risk committee has only two members and does **not** comply with the requirements of principle 4.3 point 21 of three members. (1½)
3. The risk committee has executive and non-executive directors as members, which **complies** with principle 4.3 point 20. (1½)
4. Principle 4.3 point 20 requires members of the risk committee to have, as a

whole, adequate risks management skills and experience. H Ally, the risk director, should have the necessary skills and experience and **complies** with the principle. (1½)

**Limited to 2 valid answers**

## **6. General remarks**

1. The board has a company secretary in **accordance** with principle 2.21 point 95. (1½)
2. The board should appoint audit-, risk-, remuneration- and nomination committees (Principle 2.23, point 129-130). Minetech does not have remuneration and nomination committees. (1½)
3. Risk is an ever present factor in any large company, and risks change. It is unrealistic for Minetech Ltd to think otherwise and the theft committed by the financial director is an example of a current financial threat faced by the company. Mineco did **not** comply with principles of good governance of risk (principle 4.1) (1½)
4. Overall, the board of directors and board committees do **not** meet the King III Report's requirements for good corporate governance. (1½)

**Limited to 2 valid answers**

## **7. Presentation**

Presentation of answer under sub-headings provided in paper. (2)

**(1½ for each valid point compliance or non-compliance to the max. of 25 marks, available 36 marks)**

**Comments to markers:**

- **Students are required to comment on both compliance and non-compliance.**
- **Students only have to identify compliance / non-compliance with brief explanations; and not also the King III principle or requirement. The memorandum includes these for reference purposes.**



## QUESTION 4 (October 2013)

Speedsew Ltd is a Cape Town-based clothing manufacturing company in the South African textile industry. Speedsew is listed on the Johannesburg Stock Exchange (JSE). The board of directors is well aware of the fact that good governance in terms of the King III Report is compulsory for companies listed on the JSE, and as such has requested your response to the information provided below.

### The board of directors and board committees

The CEO (chief executive officer) and chairman of the board, M Swart, provided you with the following list detailing the other directors on the board:

- B Black - Marketing director (an executive director)
- H Makina - IT director (an executive director)
- W Peters - Human-resources director (an executive director)
- P Gomba - Health and safety director (an executive director)

The board meets every two months to ensure it is able to make decisions rapidly in response to volatility in the textile industry. Decisions include the approval of capital projects at the plant, and the appointment of new directors. The board has a nominations and remuneration committee to assist with the appointment of new directors, as well as an audit committee. No other committees, nor a company secretary have been appointed by the board, and M Swart, CEO, performs secretarial duties, when required.

### REQUIRED

### Marks

- 1.1** Based on the information presented in the scenario under the sub-heading “**The board of directors and board committees**”, comment in relation to the **requirements of sound corporate governance** in terms of the King III Report.

Both **compliance** and **non-compliance** should be addressed in your answer.

(14)

- 1.2** **Indicate** whether internal audit should, in accordance with King III, perform the functions listed in the scenario under the sub-heading “**Internal audit**”, and provide **brief reasons** for your answers.

Present your answer in the following tabular format:

Function nr	Yes/No (1mark)	Brief reason (1.5 marks)
1. Assisting nominations committee		
2. Performing monthly reconciliations		
3. Designing production costing system		
4. Reviewing compliance		
5. Investigating suspected fraud		

(12.5)

Communication skills.

(1.5)

#### Question 4: ANSWERS

**1.1 The requirements of sound corporate governance pertaining to the board of directors and board committees** **14 marks**

**Reference:** The King III Report (2009:29-53)

1. They do **not** comply as M Swart, the chairman of the board, is **not an independent non-executive director** (principle 2.16). (1½)
2. M Swart is the CEO and chairman of the board, which is **not** in accordance with principle 2.16. (1½)

*(Students to make clear the differentiation between (1.) chairman/CEO is not independent vs (2.) CEO may not be chairman)*

3. The board should comprise a balance of power with a majority of non-executive directors who should be independent. The board itself, excluding board committees, has no independent non-executive directors and does **not** comply with principle 2.18. (1½)
4. A chief executive director and a finance director should at least be appointed to the board (principle 2.18, point 73). They do **not** comply as Minetech does not have a financial director. (1½)
5. The company secretary should ideally not be a director of the company (principle 2.21.98). Although the company has no appointed secretary, the chairman (a director) is performing these duties, which is **not in accordance** with King III. (*secretary should not be a director*)
6. Appointments to the board should be a matter for the board as a whole, which is in fact the case at Speedsew, and as such **is in terms** of King III (principle 2.19, point 80). (1½)
7. The board should be assisted by the nominations committee when appointing new directors (principle 2.19, point 80). Speedsew does **apply** this principle. (1½)
8. Speedsew's board meet six times a year, which is in **accordance** with the "at least 4 times a year" as required by principle 2.1, point 1. (1½)
9. The board should appoint audit-, risk-, remuneration- and nomination committees (principle 2.23, point 129-130). Speedsew does not have a risk and remuneration committee. (1½)
10. Speedsew does not have a company secretary which is **not** in accordance with principle 2.21, point 95. (1½) (*no company secretary*)
11. Overall, the board of directors and board committees do **not** meet the King III Report's requirements for good corporate governance and any recommendations that are not applied should be explained by them. (1½)

**(1½ for each valid point, to the max of 14 marks; available 18 marks)**

**Comments to markers:**

- **Students are required to comment on both compliance and non-compliance. They must be very specific on compliance vs non-compliance.**
- **Students are only required to identify compliance / non-compliance with brief explanations. References to the King III principles for teaching purposes only.**

**1.2 The functions of internal audit**

**14 marks**

**Reference:** The King III Report (2009:95-98)

<b>Function nr.</b>	<b>Yes/No</b>	<b>Brief reason</b>
1. Assisting the nominations committee: company secretary	Yes (1)	The company secretary is an <u>important appointment in respect of corporate governance</u> . In a sense, the company secretary is similar to internal audit in that both are " <u>control mechanisms</u> ". (1½)
2. Monthly production reconciliations	No (1)	Production reconciliations are <u>routine accounting and production (operational) procedures</u> which should be performed by the production manager and accounting section. (1½)
3. Designing a production costing system	No (1)	The design of systems is an <u>operational responsibility</u> from which the internal audit department should be <u>independent</u> . Internal audit may review the proposed system. (1½)
4. Reviewing compliance with health and safety	Yes (1)	<u>Compliance audits</u> (evaluating whether the company is complying with relevant laws and regulations) are part of internal audit's <u>risk management</u> . (1½)
5. Investigating wage pay-out fraud	Yes (1)	One of internal audit's roles is to provide information regarding <u>instances of fraud</u> or alleged fraud to the board so that appropriate action can be taken. (1½)

Award 1.5 marks for the correct presentation in tabular format.

**(1 for each valid "yes/no"; 1.5 for each valid explanation, and 1.5 for presentation to the max of 14 marks (5x1 + 5x1.5 + 1.5))**

