

Corporate governance

Executive guide to King III in national, provincial and local government

# King's Counsel\*

Understanding and unlocking the benefits of sound corporate governance in government and the public sector

\*connectedthinking

PRICEWATERHOUSECOOPERS 



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

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

We trust that it will assist in providing practical advice and guidance to national, provincial and local government in South Africa.

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

Suresh Kana  
Chief Executive Officer  
PricewaterhouseCoopers Southern Africa



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## A note on terminology

For the purposes of this guide:

- The third King Report on Governance for South Africa 2009 is referred to as ‘the Report’.
- The provisions of the Report are based on principles enshrined in the Code of Governance Principles for South Africa 2009, referred to as ‘the Code’.
- The Report and the Code are collectively referred to as ‘King III’.
- The Companies Bill, 2008, (which constitutes a revision of the Companies Act, 1973) had not been enacted at the time of the release of King III. Nevertheless, it is referred to as ‘the Act’ both here and in King III.
- The terminology used to address the requirements for national, provincial and local government legislation, regulations, practice notes and the Framework for Managing Programme Performance Information introduced by National Treasury is collectively referred to as the Public Finance Management Act (PFMA) for national and provincial institutions; the Municipal Finance Management Act (MFMA) and both the Municipal Structures Act and the Municipal Systems Act (MSA) for local government.
- King III applies to all entities regardless of the manner and form of their incorporation or establishment. The use of the terms ‘organisation’, ‘company’ and ‘business’ should be interpreted accordingly. For this purpose the principles will remain as stated in King III.
- Although the terms ‘company’, ‘boards’ and ‘directors’ are used, King III refers to the functional responsibility of those charged with governance in any entity. This document is aligned to the functional responsibility within public sector structures, and we have used the term ‘leadership’ where appropriate to describe the functional responsibility. Leadership includes the accounting officer or equivalent and the executive committees that may be established to support this position. The terms institution/s is utilised to address all spheres of government, in this publication.
- DPSA refers to the Department of Public Service and Administration.

# Introduction

The release of King III on 1 September 2009 represents a significant milestone in the evolution of corporate governance in South Africa and brings with it significant opportunities for institutions that embrace its principles. Moreover, the South African Government has publicly committed itself to improving service delivery, which is reflected in the statement made by President Jacob Zuma during his 2010 State of the Nation address:

*The public service has to respond to the call to make this term one of faster action and improved State performance. We require excellence and hard work.*

At PricewaterhouseCoopers (PwC), we believe that free enterprise prospers in an environment of good and balanced corporate governance. While we understand that achieving good governance is a complex task, we believe that sound governance practices offer numerous practical benefits and that institutions should integrate such practices into their operational processes. In this publication, we have aligned the national, provincial and local government legislation, regulations and codes to the principles of King III. We are committed to helping you meet these standards by delivering a comprehensive service offering that translates principles into practical actions and takes the pressure off you.

## The need for King III

King III became necessary because of the anticipated new Companies Act and changing trends in international governance. As with King I (1994) and King II (2002), the King Committee endeavoured to be at the forefront of governance internationally and this has again been achieved by focusing on the importance of reporting annually on how an institution has both positively and negatively affected the economic life of the community in which it operated during the year under review. In addition, emphasis has been placed on the requirement to report on how the organisation intends to enhance those positive aspects and eradicate or ameliorate any possible negative impacts on the economic life of the community in which it will operate in the year ahead. This approach is in keeping with the Government's commitment to furthering accountability, integrity and service delivery, which is supported through the establishment of the National Planning Commission and the Ministry of Performance Management, Monitoring and Evaluation.

The King Code of Corporate Practices and Conduct 2002 (King II) saw only limited adoption in government and the public services. This was largely due to the preemptive legal requirement of compliance with the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA) and the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), as minimum requirements in the

public sector. In contrast, the provisions of King III are specifically intended to be 'applied or explained' within all economic sectors, including the public sector.

## The benefits of self-regulation

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

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

In the case of the public sector, Parliament, on behalf of the public at large, acts as a key stakeholder and it will determine the level of compliance that each public institution should strive to achieve in addition to its statutory compliance required in terms of the PFMA, MFMA and other applicable acts. National and provincial institutions will have similar compliance obligations and these will reside with the executive authority, who delegates these responsibilities to the accounting officer or equivalent.

South Africa's public sector is governed by a vast number of acts and regulations and the extent of self-regulation, in which an institution voluntarily monitors its own adherence to legal and ethical standards, needs to be balanced against these

statutory and regulatory requirements. The extent of the success of self-regulation can militate against the need for further statutory and regulatory requirements.

## Key principles of King III

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

These key principles are given prominence:

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

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

## Governance framework

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

The framework recommended by King III is principles-based and there is no ‘one size fits all’ solution. Entities are encouraged to tailor the principles of the Code as appropriate to the size, nature and complexity of their institution. Public sector institutions should similarly tailor the principles in accordance with public sector legislation and regulations.

## Application of the Code

In contrast to King I and King II, King III applies to all entities regardless of the manner and form of their incorporation or establishment. Principles are drafted on the basis that, if they are adhered to, any entity would have practiced good governance. The compliance with the PFMA and MFMA has established many of the governance practices within the public sector and the challenge is now to assess what changes, if any, are needed to achieve King III compliance.

All institutions should disclose which principles and/or practices they have decided not to apply or explain. This level of disclosure will allow stakeholders to comment on and challenge the leadership to improve the level of governance within an institution. For public sector institutions, this may be incorporated in the framework of reports made during the year and in annual reports to the executive authority and Parliament.

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

## New requirements

Some of the requirements introduced by King III include:

- The need for an annual integrated report that focuses on the impact of the institution in the economic, environmental and social spheres;
- A statement by the audit committee to the board and shareholders on the effectiveness of internal financial controls to be included in the integrated report;

- The consideration of the strategic role of IT and its importance from a governance perspective;
- The positioning of internal audit as a strategic function that conducts a risk-based internal audit and provides a written assessment of the institution's system of internal control, including internal financial controls; and
- The governance of risk through formal risk management processes.

#### Our involvement in the King Committee

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

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

# 1. Ethical leadership and corporate citizenship

## Overview

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

The notion of corporate citizenship is not new, but King III gives it more credence and concrete expression than ever before, while continually highlighting the unbroken chain that links ethical leadership, institutional strategy and sustainability. The Constitution of the Republic of South Africa together with the Public Service Act (PSA), the Public Finance Management Act (PFMA), the Municipal Systems Act and the Municipal Structures Act (MSA) sets out regulations and codes directly related to this.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 1. Ethical leadership and corporate citizenship</b>					
Leadership	1.1 Responsible leadership, the board's responsibilities and ethical foundation	<p>1.1 The board should provide effective leadership based on an ethical foundation</p> <p>The board/ethical leaders should:</p> <p>1.1.3 do business ethically;</p> <p>1.1.5 take account of the company's impact on internal and external stakeholders; and</p> <p>1.1.8 ensure that all deliberations, decisions and actions are based on the four values underpinning good governance:</p> <ul style="list-style-type: none"> <li>• Responsibility</li> <li>• Accountability</li> <li>• Fairness</li> <li>• Transparency</li> </ul>	<p>The responsibility for leadership is assigned to the executive authority in terms of section 3 of the Public Service Act and delegated to the accounting officer or equivalent.</p> <p>The principles need to be considered and applied as appropriate by the accounting officer or equivalent.</p>	<p>Part VII of the Public Service Regulations articulates these principles and it is the responsibility of the accounting officer and should be incorporated in the strategic plan of each institution.</p>	<p>Section 151 of the Constitution of South Africa vests the executive and legislative authority of a municipality in its municipal council. Section 30 of the MSA makes the executive committee (exco), the executive mayor or a committee appointed by council responsible for the implementation, evaluation and monitoring of the Integrated Development Plan (IDP), which incorporates these principles. (This can be read together with section 21 and 53 of the MFMA).</p> <p>Schedule 5 of the Municipal Structures Act and Schedules 1 and 2 the MSA provides a code of conduct for municipal councillors and staff.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 1. Ethical leadership and corporate citizenship</b>					
	<p>1.2. The board should ensure that the company is and is seen to be a responsible corporate citizen</p>	<p>The board should:</p> <p>1.2.1. consider not only financial performance but also the impact of the company’s operations on society and the environment;</p> <p>1.2.2. protect, enhance and invest in the wellbeing of the economy, society and the environment;</p> <p>1.2.3. ensure that the company’s performance and interaction with its stakeholders is guided by the Constitution and the Bill of Rights;</p> <p>1.2.4. ensure that collaborative efforts with stakeholders are embarked upon to promote ethical conduct and good corporate citizenship;</p> <p>1.2.5. ensure that measurable corporate citizenship programmes are implemented; [and]</p> <p>1.2.6. ensure that management develops corporate citizenship policies.</p>	<p>The responsibility for effective service delivery is assigned to the accounting officer or equivalent and management, through the executive authority.</p> <p>The principles need to be considered and applied as appropriate by the accounting officer or equivalent.</p>	<p>Treasury Regulation 5.2.3 establishes this to be the responsibility of the accounting officer.</p> <p>Measureable objectives must be established in the strategic plan. Outcomes are to be reported on a quarterly basis to the executive authority as per Treasury Regulation 5.3.</p> <p>The principles of Batho Pele, together with the Public Sector Code of Conduct contained in chapter 2 of the Public Service Regulations, 2001 (as amended in 2004), drives the commitment to service delivery, ethics and a code of conduct in the public sector respectively.</p> <p>In terms of section 76 (4) (c) of the PFMA, National Treasury has issued a code of conduct for supply chain management practitioners.</p>	<p>Chapter 4 of the MSA provides for community participation, while chapter 5 stresses the need for community involvement in approving amendments to the IDP (section 23 and 34).</p> <p>Section 95 of the MSA provides for the provision of sound customer care and management systems.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 1. Ethical leadership and corporate citizenship</b>					
	Ethics, risk and opportunity profile	<p>1.3 The board should ensure that the company's ethics are managed effectively.</p> <p>The board should ensure that:</p> <p>1.3.3 adherence to ethical standards is measured;</p> <p>1.3.4 internal and external ethics performance is aligned around the same ethical standards;</p> <p>1.3.5 ethical risk and opportunities are incorporated in the risk management process;</p> <p>1.3.6 A code of conduct and ethics-related policies are implemented; and</p> <p>1.3.8 the company's ethics performance should be assessed, monitored, reported and disclosed.</p>	<p>The management of ethics is delegated to the accounting officer or equivalent. The measurement and the development of ethics policies are not mandated in the PFMA or the MFMA.</p> <p>Ethical risk is considered but is not elevated to this extent with regard to reporting and disclosure.</p>	The ethics and code of conduct standards to be applied in the public sector are laid out by the Public Service regulations.	Schedule 5 of the Municipal Structures Act and Schedules 1 and 2 of the MSA provide a code of conduct for municipal councillors and staff.

## Implications

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

In developing institutional strategy, leaders will also have to give due consideration to the full range of material economic, social and environmental dimensions and impacts that the institution and its processes have on the community in which it operates.

The ethical foundation of governance is required to be specifically considered in all aspects of governance incorporating the four values of responsibility, accountability, fairness and transparency. Ethics programmes that are specifically measurable should be implemented. The Code of Conduct, as prescribed in chapter 2 of the Public Services Regulations and chapters 1 and 2 of the Municipal Systems Act, is well established and forms the ethical basis to be followed in the public sector. Overall, the inextricable link between leadership and ethics is an expectation of good corporate governance.

## Expert opinion

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

Corporate citizenship is an ethical concept, which finds expression in sustainable development across the economic, social and environmental aspects of the business. In the public sector, this is a substantial driver of political accountability. A properly constructed ethics programme can have a substantial impact on improving an institution's control environment in that it pervades the various lines of defence that well-governed institutions feature. Moreover, the 'tone at the top' is a powerful preventative control mechanism and also an effective detective and corrective control mechanism.

## Key questions leadership should be asking

- Corporate citizenship, sustainability and stakeholder inclusivity requires judgement, balance and compromise. How does leadership in the public sector environment make these types of judgements?
- Is legislative change needed to enforce ethical behaviour?
- Have we assessed the moral and economic imperatives of our mandate? Have we taken this into account when reviewing our institutional strategy and application of our mandate?
- Ethical and sustainability risks may be obscure or indirect. Have we identified these risks? How do we identify and manage these?
- Do we have policies in place that will guide every level of the institution in terms of expected behaviours and practices and with reference to our interaction with all material stakeholders?
- Do we measure the impact or lack thereof, of our ethical initiatives?
- Have our values been appropriately defined in view of the ethos that we wish to establish?
- Does our code of conduct align to our values?
- Has our ethics programme been subjected to a robust assessment?
- Is ethics sufficiently embedded in our risk management processes?
- Do we monitor, report and disclose ethics matters sufficiently?

## How we can help you

High-performing institutions achieve sustainable service delivery. As a cornerstone of sustainability, sound ethics and leadership are increasingly proving their worth as drivers of effective performance. We offer a range of services to assist institutions to achieve their objectives:

- Review of institutional values;
- Development of values, governance principles and key performance indicators;
- Sustainable development strategy formulation;
- Development of codes and policies in support of ethics, corporate citizenship and sustainability;
- Leadership evaluation to assess composition, skills and other key criteria;
- Socio-economic impact assessments;
- Assessment of ethics programmes;
- Determination of whether ethics is appropriately embedded in your risk management processes; and
- Assessment of the effectiveness of your complaints and allegations reporting mechanism.



# 2. Boards and directors

## Overview

Boards and directors, acting in the best interest of the institution, form the focal point of corporate governance with responsibilities extending to stakeholders: “Companies should be headed by a board that should direct, govern and be in effective control of the company”. As public sector institutions do not have boards of directors, their functions are performed by the executive authority as delegated to the accounting officer. Municipal councils perform many of the board’s functions.

This chapter discusses key governance responsibilities that leadership are expected to consider, including:

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

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
Role and function of the board	2.1. The board should act as the focal point for and custodian of corporate governance	The board is responsible for ensuring the continued success of the company and is guided by its charter. It is the link between management and stakeholders and should meet at least four times per year.	Public sector institutions do not have boards of directors. Board functions are performed by the accounting officer and their executive management team in the form of an executive committee (exco). Meetings are held every fortnight with the executive authority relating to performance and key issues at hand.  Municipal councils perform many of the board functions.	This is the responsibility of the accounting officer.	Section 30 of the MSA delegates responsibility to the exco, the executive mayor or a committee appointed by council for the implementation, evaluation and monitoring of the Integrated Development Plan (IDP), which incorporates these requirements. The frequency of such meetings is normally on a weekly basis.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.2. The board should appreciate that strategy, risk, performance and sustainability are inseparable	The board should inform and approve the company's strategy and satisfy itself that business plans are not encumbered by unexamined risks. In doing so it identifies key performance and risk areas. The board also ensures that the strategy will result in sustainable outcomes and considers sustainability to be a business opportunity.	This responsibility is vested in the executive authority, and is tabled in Parliament.	Treasury Regulation 5.1.1 establishes that the strategy is approved by the executive authority.  The areas articulated in Treasury Regulation 5.2.3 are detailed; however, the risk management framework, as updated by National Treasury, clearly articulates enterprise risk management (ERM) and should be applied to the strategy of the institution.	See comment above
	2.3. The board should provide effective leadership based on an ethical foundation	Explained in chapter 1	Refer to chapter 1	Refer to chapter 1	Refer to chapter 1

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.4. The board should ensure that the company is and is seen to be a responsible corporate citizen	Explained in chapter 1	Refer to chapter 1	Refer to chapter 1	Refer to chapter 1
	2.5. The board should ensure that the company's ethics are managed effectively	Explained in chapter 1	Refer to chapter 1	Refer to chapter 1	Refer to chapter 1
	2.6. The board should ensure that the company has an effective and independent audit committee	Explained in chapter 3	Refer to chapter 3	Refer to chapter 3	Section 166 of the MFMA states that a municipality must have an independent advisory body – the audit committee – to advise the council.
	2.7. The board should be responsible for the governance of risk	Explained in chapter 4	Refer to chapter 4	Refer to chapter 4	Section 166.(2)(a)(ii) of the MFMA tasks the audit committee to advise the council on risk management.  Section 62.(1)(c)(i) of the MFMA makes the municipal manager responsible for risk management.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.8. The board should be responsible for information technology (IT) governance	Explained in chapter 5	Refer to chapter 5	Refer to chapter 5	Section 62.(1)(a) of the MFMA makes it the municipal manager's responsibility to ensure that resources are used effectively, efficiently and economically.
	2.9. The board should ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes and standards	Explained in chapter 6	Refer to chapter 6	Refer to chapter 6	Section 55.(1)(b) of the MSA makes the municipal manager responsible for management in accordance with legislation. Sections 65.(2)(f); 73.(b); 74.(2) and 171 of the MFMA also assign responsibilities to comply with legislation to the municipal manager.
	2.10. The board should ensure that there is an effective risk-based internal audit	Explained in chapter 7	Refer to chapter 7	Refer to chapter 7	In terms of section 165.(2)(a) of the MFMA, internal audit must prepare a risk-based plan.
	2.11. The board should appreciate that stakeholders' perceptions affect the company's reputation	Explained in chapter 8	Refer to chapter 8	Refer to chapter 8	Section 130 of the MFMA stipulates that meetings of council are to be made open to the public.
	2.12. The board should ensure the integrity of the company's integrated report	Explained in chapter 9	Refer to chapter 9	Refer to chapter 9	Sections 121 and 129 of the MFMA provide for an annual report and an oversight report.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.13. The board should report on the effectiveness of the company's system of internal controls	Explained in chapter 11	Refer to chapter 11	Refer to chapter 11	Section 166.(2)(a)(i) of the MFMA tasks the audit committee with reporting to council on internal controls.
	2.14. The board and its directors should act in the best interests of the company	Directors act in the best interests of the company by, amongst other actions, disclosing conflicts where they exist, dealing in securities only as allowed by internal policies and by adhering to legal standards of conduct. Where required, they should be permitted to take independent advice.	Those in leadership positions are expected to perform their duties in the best interests of the institution. Regulations provide for specific compliance such as annual conflict of interest declarations.	Chapter 9 of the Senior Management Services handbook requires a declaration of interest be made annually.	Schedule 1 (Paragraph 7) to the MSA states that a declaration of interest is required annually, or where changes occur.  Council rules provide for the declaration of interest at meetings.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.15. The board should consider business rescue proceedings or other turnaround mechanisms as soon as the company is financially distressed as defined in the Companies Act.	<p>The board should ensure that:</p> <p>2.15.1. the solvency and liquidity of the company is continuously monitored;</p> <p>2.15.2. its consideration is fair to save a financially distressed company either by way of workouts, sale, merger, amalgamation, compromise with creditors or business rescue;</p> <p>2.15.3. a suitable practitioner is appointed if business rescue is adopted; and</p> <p>2.15.4. a practitioner furnishes security for the value of the assets of the company.</p>	There is no need for consideration of financial distress requirements in public institutions. However, financial discipline is fundamental to good governance in the public sector.	Section 30 (2) of the PFMA allows for funds to be requested through the adjustment estimates process, with subsection (a) and (b) specifically referring to “unavoidable” and “unforeseeable” expenditure.	Section 135 of the MFMA specifies that the municipality is responsible for the resolution of financial problems and must notify the MEC for local government.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.16. The board should elect a chairman of the board who is an independent non-executive director. The CEO of the company should not also fulfil the role of chairman of the board	Where the guidelines in the principle are not applied, a lead independent director should be appointed and disclosure provided in the integrated report. The role of the chairman should be formalised and assessed annually and a succession plan put in place. The chairman should consider the number of chairmanships held.	The role of the chairman is achieved through the delegated responsibilities.	The executive authority provides the role of the chairman or as delegated to the accounting officer	Section 36.(1) of the Municipal Structures Act rules that the speaker chairs council meetings. This is substantially different to the principles of King III and the challenge is for the speaker to perform the role of the chairman in providing governance oversight and leadership.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.17. The board should appoint the chief executive officer and establish a framework for the delegation of authority	The board ensures that the role of the CEO is formalised and his performance evaluated against specified criteria. It also makes recommendations regarding senior management appointments and its own assessment of materiality for the company.	Executive appointments are regulated through the Public Service Act and Municipal Structures Act.	<p>The accounting officer's role is formalised by the PFMA and other legislative measures. The performance of the accounting officer and the senior management services body is measured against specific outcomes detailed in their respective contracts and assessed against the DPSA performance management protocol through the DPSA performance management system.</p> <p>The delegation frameworks are set by the DPSA. The accounting officer and the executive management team provide the thresholds for delegation within the DPSA and supply chain management frameworks.</p>	The municipal council appoints the municipal manager in terms of sections 30.(5)(c) and 82 of the Municipal Structures Act.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.18. The board should comprise a balance of power, with a majority of non-executive directors. The majority of non-executive directors should be independent	The majority of non-executive directors should be independent, with independence assessed annually. As a minimum, the CEO and director responsible for finance should be appointed to the board. The section also deals with the re-appointment, rotation and removal of directors.	The executive authority is ultimately responsible for institutions, while political structures provide the governance oversight and direction.	Not applicable to these institutions.	The municipal council consists of a number of councillors elected by the local community through a system of proportional representation, as prescribed by section 20 of the Municipal Structures Act. The positions (mayor, speaker, exco, etc) are elected by the elected councillors. In the case of district municipalities, some councillors are elected and others are appointed by the local municipality in terms of section 23 of the Municipal Structures Act.
	2.19. Directors should be appointed through a formal process	The director appointment process should be transparent and include background and reference checks. It is the responsibility of the nomination committee to identify suitable members.	Political performance is determined through party political structures.	Not applicable to these institutions.	As prescribed by section 20 of the Municipal Structures Act, a municipal council consists of a number of elected councillors, each of whom must meet defined qualification requirements.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.20. The induction of and ongoing training and development is conducted through formal processes	New and inexperienced directors should be suitably trained through formal induction and mentorship programmes. Directors should be kept up to date through regular briefings and continuing professional development programmes.	Training of the executive authority and councillors should be completed to ensure that their responsibilities and requirements are understood.	Not applicable to these institutions.	Section 53 of the MSA states that the council must define the roles and responsibilities of councillors and structures.
	2.21. The board should be assisted by a competent, suitably qualified and experienced company secretary	The board appoints and removes the company secretary. The requirements of the Companies Act in relation to the company secretary apply to listed and state-owned companies. King III further elaborates on the duties of the company secretary.	Secretarial responsibilities are completed through delegated officials.	Not applicable to these institutions.	According to section 55.(1) (i) of the MSA, the municipal manager is appointed to advise the political structures.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.22. The evaluation of the board, its committees and the individual directors should be performed every year	Annual evaluations of the board, its committees and directors (including evaluations of the chairman, CEO and other executive directors) should be performed by the chairman or an independent service provider. The overview of the process should be disclosed in the integrated report. The performance evaluation of directors assists in identifying their training needs and should be a prerequisite for reappointment.	Political performance is determined through party political structures.  Performance assessment could be tailored for municipal councillors.	Not applicable to these institutions.	Not applicable in the municipal environment. However, paragraph 4.(2) of the Councillor's Code of Conduct in both the Municipal Structures Act and the MSA, stipulates that a councillor may not be absent from three consecutive meetings.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.23. The board should delegate certain functions to well-structured committees but without abdicating its own responsibilities	Committees should be appropriately constituted and should formulate terms of reference that are reviewed annually. The need for audit, risk, nomination and remuneration committees is also discussed. Committees (with the exception of the risk committee) should comprise a majority of non-executive directors of which the majority should be independent.	The audit committee is a statutory committee of the institution. Other committees are established as deemed appropriate.	The committees are established and appointed by the accounting officer according to Treasury Regulation 3.1.2 and in consultation with the executive authority.	Section 32 of the Municipal Structures Act provides that municipal councils must develop a system of delegation and may delegate to exco, an executive mayor, the speaker, sub-councils, ward/other committees, the municipal manager or other officials.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.24. A governance framework should be agreed between the group and its subsidiary boards	Governance matters related to listed subsidiaries, the nomination of directors to the boards of subsidiaries and the disclosures coupled thereto required in the integrated report, are discussed.	Institutions do establish subsidiary entities and corporations to undertake some of their required activities. These entities are often governed through boards of directors who report to the executive authority or council of the relevant institutions.	The governance responsibilities remain with the institution. Treasury Regulation 26.1.2 clearly establishes the reporting and compliance requirements for the designated accounting officer and the accounting authority (of the public entity under the control of the institution). The governance requirements stipulated in the PFMA and further articulated in the Treasury Regulations are binding on such entities.	The responsibility for governance remains with the municipalities. However, this may also apply to district and local municipality shared services.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.25. Companies should remunerate directors and executives fairly and responsibly	Refer to chapter 14	Public sector remuneration is managed through the DPSA.	Institutional remuneration structures are managed through the DPSA.	<p>Councillors' salaries and allowances are determined in terms of the Remuneration of Public Office Bearers Act in consultation with the MEC for local government.</p> <p>The salaries and allowances of the municipal manager and heads of departments are approved by council.</p> <p>The salaries and allowances of other staff are approved by the SA Local Government Bargaining Council.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	2.26. Companies should disclose the remuneration of each individual director and certain senior executives	Refer to chapter 14	Public sector remuneration is managed by standards issued by the DPSA and set out in the Municipal Structures Act.	Institutional remuneration is managed through the DPSA.	The remuneration of Councillors, the municipal manager and heads of departments is disclosed in the notes to the annual financial statements as mandated in section 124.(1)(a) and (c) of the MFMA.
	2.27. Shareholders should approve the company's remuneration policy	Refer to chapter 14	Public sector remuneration is managed through the DPSA.	Institutional remuneration is managed through the DPSA.	See 2.25 above.

## Implications

King III places substantial emphasis on the role and responsibilities of the board. In the public sector, the functions to be performed by the board under King III are shared between the executive authority and the accounting officer through the delegation of authority in public institutions and by the councils in the case of local government. The various committees stipulated by King III are appointed by the accounting officer and councils. Where applicable, terms of reference establish committee roles and responsibilities.

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

The evaluation of leadership performance is essential, not only to assess efficiency and competence, but also to appraise reappointment and training needs. Performance evaluations in the public sector are carried out through DPSA approved procedures. Performance evaluation in municipalities is governed through the councils.

## Expert opinion

The role of the board as the focal point of governance is vital to the success of any institution. In the public sector this role is performed through other mechanisms. The local government has councils that can be equated with boards of directors except for the political accountability associated with the elected positions. National and provincial institutions are governed through the executive authority with political oversight providing the accountability elements.

In order to maximise the benefit that a public institution obtains from its leadership, regular performance evaluations need to be conducted and areas of improvement identified. This is essential to improve the efficiency and effectiveness of the leadership.

The principle that governance, strategy and sustainability are inseparable is one of the fundamental tenets of King III. The interplay between these elements and the manner in which the institution incorporates them into its processes will be keenly watched. These principles should be achieved in the public sector through performance assessments of executive management and self assessments for committees and municipal councils.

## Key questions leadership should be asking

- Do we have the right people in place to lead and manage all aspects of our institution?
- Do we need to get external expert advice?
- Will we get greater value from leadership and committee evaluations if we employ an independent service provider?
- Are we comfortable that we have satisfied our overarching responsibilities adequately in situations where we have delegated functions to subcommittees or other officials?
- Are we spending our time efficiently in meetings and dealing only with material issues?
- Is there a need to revise our committee charters or delegations of authority?
- Which committee or official should deal with sustainability issues?
- Are the current roles and structures of our institution's leadership adding value?
- How do we incorporate strategy, risk, performance and sustainability into our decision making philosophy?

## How we can help you

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

- Independent, comprehensive leadership and committee evaluations;
- Thorough independent individual evaluations of office bearers including CEOs, CFOs, and other leadership positions;
- Review and development of leadership meeting and committee documentation;
- Review and development of leadership and committee systems and processes; and
- Governance training.



# 3. Audit committees

## Overview

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

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

Audit committees have been mandated in the public sector through the PFMA since 1999, and the MFMA since 2003. Treasury regulations issued in terms of the PFMA also give effect to provisions of the Act dealing with audit committees.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 3. Audit committees</b>					
	<p>3.1. The board should ensure that the company has an effective and independent audit committee</p>	<p>While listed and state-owned companies are required by law to establish audit committees, all other companies should also establish this committee and define its composition, purpose and duties in the memorandum of incorporation. The terms of reference of the committee should be approved by the board.</p> <p>The audit committee should meet as often as is necessary, but at least twice a year, and meet with internal and external auditors at least once a year without management being present.</p>	<p>Public sector institutions are required to establish independent audit committees. Such audit committees need to operate in terms of written terms of reference that set out its membership, authority and responsibilities.</p> <p>Though audit committees are only empowered through legislation to meet separately with the Auditor-General, the current practice in the public sector is that this right is extended to internal auditors through the audit committee charters.</p> <p>This is in line with the principles of King III.</p>	<p>Section 76(4)(d) and 77 of the PFMA, read together with Treasury Regulation 3.1.8, require the accounting officer to set up an independent audit committee, which must operate in terms of written terms of reference. The audit committee is also required to meet at least twice a year, and to meet at least annually with the Auditor-General. The audit committee also meets annually without the presence of management.</p>	<p>Section 166 of the MFMA proclaims that every municipality must have an audit committee.</p> <p>According to section 166.(4)(b) of the MFMA, the audit committee must meet as often as is required, but at least four times a year.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 3. Audit committees</b>					
	<p>3.2. Audit committee members should be suitably skilled and experienced independent non-executive directors</p>	<p>The audit committee should consist of at least three members, all of whom should be independent non-executive directors. It should not be chaired by, nor have as a member, the chairman of the board. The committee as a whole should have sufficient qualifications and experience to fulfil its duties, with members keeping up to date with developments. An agreed process should be in place to allow the committee to consult with specialists. Should vacancies arise, these should be filled by the board.</p>	<p>Public institutions do not have boards of directors. Members of audit committees are therefore mainly drawn from outside the institution.</p> <p>In line with this principle, members of the audit committee are required to be knowledgeable and independent.</p> <p>The accounting officer is also required to afford the audit committee with the necessary resources to perform its duties.</p>	<p>Section 76(4)(d) and 77 of the PFMA, read together with Treasury Regulations 3.1.4, require the chairperson to be independent, knowledgeable of the status and position, and have the requisite business, financial and leadership skills. The chairperson may not be in the employ of the institution.</p> <p>Treasury Regulation 3.1.11 further requires that the audit committee be provided with the resources it needs.</p>	<p>Section 166.(4)(a) of the MFMA states that the audit committee consist of at least three persons with appropriate experience of whom the majority may not be in the employ of the municipality. In addition, no councillor may be a member of the audit committee.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 3. Audit committees</b>					
	3.3. The audit committee should be chaired by an independent non-executive director	The board should elect the chairman of the audit committee. The chairman of the audit committee should participate in and agree the agenda of the committee and should be present at the AGM.	Appointments to the audit committee, including that of the chairperson, are made by the accounting officer, in consultation with the executive authority. Aligned to this principle and recommendation is the requirement that the audit committee must present its annual report to the institution, commenting on amongst other things, the effectiveness of internal control. As such, the report is included in the annual report of the institution.	In terms of Treasury Regulation 3.1.2, the accounting officer of an institution appoints audit committee members in consultation with the relevant executive authority.	Section 166.(5) of the MFMA states that the chairperson is to be appointed by the council.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 3. Audit committees</b>					
	<p>3.4. The audit committee should oversee integrated reporting</p>	<p>The audit committee should review the financial statements included in the integrated report and should have regard to all factors and risks that may impact on the integrity of the integrated report. It should also review the disclosure of sustainability issues in the integrated report to ensure that it does not conflict with the financial information. Where there are material sustainability issues, it should recommend to the board whether to engage an external assurance provider.</p> <p>The audit committee should consider the need for summarised information and engage external auditors to provide assurance on the summarised results.</p>	<p>Public sector institutions publish annual reports, which include operational, management, performance and financial information. There is no specific requirement to include sustainability issues in the annual reports of public sector institutions. Complying with this requirement will require public sector institutions to either publish a separate sustainability report, which addresses environmental and social issues (economic matters are already addressed in the annual financial statements), or alternatively to enhance their annual reports to include these issues.</p>	<p>Treasury Regulations 3.1.10 and 3.1.13 set out most activities of the audit committee relating to reporting within the institution. These activities are quite broad and include management reports and compliance issues.</p> <p>Apart from sustainability issues, all other requirements of this principle are addressed through these regulations.</p>	<p>Section 38.(a)(ii) of the MFMA states that annual financial statements are to be reviewed by the audit committee and included in the annual report.</p> <p>Sustainability disclosure as presented is reviewed by the Auditor-General.</p> <p>Section 166.(2)(iv) of the Act requires the audit committee to advise on the adequacy, reliability and accuracy of financial reporting and information.</p> <p>The MFMA does not address summarised sustainability information.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 3. Audit committees</b>					
	<p>3.5. The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities</p>	<p>The audit committee should monitor the relationship between the external assurance providers and the company and should ensure that combined assurance is given to address all the significant risks facing the company.</p>	<p>Audit committees in the public sector are required to review coordination between internal and external audit, reports of significant investigations, as well as management responses to specific recommendations. This gives effect to the combined assurance principle as proposed in the Code. A more formal coordination process of all assurance providers might be required to be implemented in public sector institutions in order to fully comply with this principle.</p>	<p>Treasury Regulation 3.1.10(g) requires the audit committee to coordinate the assurance activities of internal audit, external audit, other assurance providers and management.</p>	<p>Section 166.(2)(a)(ii) of the MFMA makes risk management the responsibility of the audit committee.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 3. Audit committees</b>					
	<p>3.6. The audit committee should satisfy itself of the expertise, resources and experience of the company's finance function</p>	<p>The review of the finance function should be performed annually and the results thereof disclosed in the integrated report.</p>	<p>Public sector audit committees are required to review the effectiveness of internal control systems, including the adequacy, reliability and accuracy of financial information. The audit committee must also report, in the institution's annual report, on the quality of in-year management and monthly/quarterly reports. Although there is not a direct requirement to review the finance function, the review of the function is implied through the review of the effectiveness of internal controls and the quality of reports.</p>	<p>Treasury Regulations 3.1.10(a) and 3.1.13 set out the requirements relating to the audit committee's review and reporting on financial controls and the quality of management in the institution.</p>	<p>While not addressed specifically in the MFMA, section 166.(2)(a)(i) and (b) states that the audit committee has the responsibility/power to advise the council on, amongst other things, internal financial control and internal audits as well as to review the annual financial statements to provide the council with a credible view of the financial position of the municipality, its efficiency and effectiveness. The MFMA further states that the audit committee must have access to financial records and other relevant information and may conduct investigations into the financial affairs of the municipality as well as performing other functions as may be prescribed.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 3. Audit committees</b>					
	3.7. The audit committee should be responsible for overseeing of internal audit	The audit committee should be responsible for the performance management of the chief audit officer, approve the internal audit plan and ensure the internal audit function is subject to an independent quality review as and when the committee deems appropriate.	Internal audit activities in the public sector are required to be under the control and direction of the audit committee. Furthermore, audit committees are required to review the effectiveness of the internal audit function, as well as to approve the scope of internal audit.	Section 38(a)(ii) of the PFMA, read together with Treasury Regulation 3.1.10(b) and (g), mandate the audit committee to review the effectiveness of internal audit as well as its annual work programme.	In terms of section 165.(2) (b) of the MFMA, internal audit must report to the audit committee.
	3.8. The audit committee should be an integral component of the risk management process	Guided by its charter, which should set out its responsibilities regarding risk management, the audit committee should specifically have oversight of financial reporting risks and internal financial controls as well as fraud and IT risks as they relate to financial reporting.	Audit committees in the public sector are responsible for the risk management process through their review of the internal and external audit plans, and must ensure that these plans will address the risk areas of the institution. The audit committee must ensure that the strategic internal audit plan is based on key areas of risk, including having regard to the institution's risk management strategy.	Treasury Regulation 3.1.10(c) requires the audit committee to review the key areas of risk to be covered by internal and external audit. Treasury Regulation 3.2.7(a) requires that the strategic internal audit plan be based on key areas of risk facing the institution, and take into account its risk management strategy.	Section 166.(2)(a)(ii) of the MFMA makes the audit committee responsible for advising the council on risk management.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 3. Audit committees</b>					
	<p>3.9. The audit committee is responsible for recommending the appointment of the external auditor and overseeing the external audit process</p>	<p>The audit committee:</p> <p>3.9.1. must nominate the external auditor for appointment;</p> <p>3.9.2. must approve the terms of engagement and remuneration for the external audit engagement;</p> <p>3.9.3. must monitor and report on the independence of the external auditor;</p> <p>3.9.4. must define a policy for non-audit services provided by the external auditor and must approve the contracts for non-audit services;</p>	<p>This principle is only partially applicable in the public sector in that the external auditor is by law, the Auditor-General. The audit committee would therefore not have any input in the appointment of the external auditor.</p> <p>The other parts of the principle are still applicable, as the audit committee is required to review the scope of external audits, as well as the independence and objectivity of the external auditors. In reviewing the objectivity and independence of the external auditor, the audit committee would approve non-audit services conducted by the external auditor.</p>	<p>Treasury Regulation 3.1.10 requires the audit committee to review the scope of external audit. Treasury Regulation 3.1.16 requires the audit committee to meet at least annually with the Auditor-General to ensure that there are no unresolved issues of concern.</p> <p>In terms of Treasury Regulation 27.1.8(h), the audit committee must review the independence and objectivity of the external auditors.</p> <p>Treasury Regulation 9.1.5 requires the amount of unauthorised, irregular, fruitless and wasteful expenditure to be disclosed as a note to the annual financial statements of the institution.</p>	<p>The external audits are conducted by the Auditor-General, in line with section 188.(1)(b) of the Constitution of the Republic of South Africa and the Public Audit Act.</p> <p>The audit committee does not approve the terms of engagement or remuneration of the Auditor-General.</p> <p>The audit committee does not monitor or report on the independence of the Auditor-General.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 3. Audit committees</b>					
		<p>3.9.5. should be informed of any reportable irregularities identified and reported by the external auditor; and</p> <p>3.9.6. should review the quality and effectiveness of the external audit process.</p>	<p>Irregularities are reported to the audit committee as part of the annual financial statements, since these are required to be included as notes to the financial statements.</p> <p>There is no specific requirement for the audit committee to review the effectiveness of the external audit, however the audit committee reviews the scope of the external audit, as well as meeting with the Auditor-General on an annual basis to discuss any issues of concern.</p>		<p>The scope of the external audit is constitutionally defined in terms of the audit and report on accounts, financial statements and financial management (this may include performance audits, special reviews, etc). Non-audit services are not provided for.</p> <p>While there is no specific mention of “reportable irregularities”, the Auditor-General reports to the council and the council may refer the matter to the audit committee.</p> <p>There is no specific mention in the MFMA allowing the audit committee to review the quality and effectiveness of the external audit process.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 3. Audit committees</b>					
	3.10. The audit committee should report to the board and shareholders on how it has discharged its duties	<p>The audit committee should report internally to the board on its statutory duties and duties assigned to it by the board.</p> <p>The audit committee must report to the shareholders on its compliance with its statutory duties; the independence of the external auditor; its view on the financial statements and the accounting practices; and whether the internal financial controls are effective.</p> <p>It should also recommend the integrated report for approval by the board and provide details of its role, composition, number of meetings and activities.</p>	<p>Since there are no boards in national, provincial and local government, the audit committee reports on its duties in the annual report of the institution, and to the executive authority and accounting officer.</p> <p>The annual report is published for the benefit of the institution's stakeholders, which include Parliament and the general public.</p>	Treasury Regulation 3.1.9 requires an institution's annual report to include a disclosure of whether the audit committee has satisfied its responsibilities for the year, in compliance with its terms of reference.	<p>The audit committee must report to the municipal council in terms of section 166.(2)(a) of the MFMA.</p> <p>Section 121.(3)(j) of the MFMA requires the annual report to include any recommendations of the audit committee.</p> <p>There are no shareholders in municipalities. The reference in the public sector is to stakeholders, being Parliament and the general public.</p> <p>The audit committee only recommends/ accepts the annual financial statements and not the entire annual report. However, this responsibility may be assigned to the audit committee in terms of sections 166.(2)(a)(ix) and 166.(2)(e) of the MFMA and if prescribed by the Minister of Finance.</p>

## Implications

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

- Responsibility of the audit committee has been extended beyond financial reporting to include sustainability reporting;
- The appointment of the audit committee is made in accordance with the relevant statute. The appointment of the chairman of the committee can take into account the principles contained within King III;
- The appointment of external audit is mandated to the Auditor-General in accordance with the Constitution and not by the audit committee; and
- The composition, size and sufficiency as well as the appropriateness of the skills set of the audit committee should be reviewed annually by the accounting officer or equivalent.

Audit committees should coordinate the use of appropriate assurance providers to assure the identified risks.

Increased time and resource commitments may be needed for audit committees, management and internal audit to adequately review internal financial controls.

Audit committees will be reporting on the effectiveness of internal financial controls.

### Expert opinion

The audit committee will need to consider how to

respond to the assessment of the effectiveness of internal controls and the extent that non financial information is included in reporting to the executive authority or council. Consideration will need to be given to the ultimate recipients such as Parliament, portfolio committees, SCOPA, councils and the Council of Provinces. The recommendations of King III will need to be implemented in addition to existing audit committee responsibilities.

The appointment of the chairman of the audit committee by the accounting officer or equivalent should consider the principles in King III and how best to apply them in the appointment. The chairman's independence may result in potential conflicts with the accounting officer and we recommend that accounting officers agree on a process to resolve such conflicts within the institution, even if this means agreeing to external arbitration.

The audit committee's role in overseeing the combined assurance process is to be carried out over and above the requirements of the PFMA/MFMA and provides for greater levels of assurance for institutions.

A primary function of the audit committee is to oversee the integrity of the institution's integrated report and to assess its continuing ability to meet its mandate/service delivery requirements. Assumptions and conclusions relating to this should be formally

recorded. It should also ensure that there is sufficient cooperation between the institution's various assurance providers, including the external auditor, the internal audit function, the risk officer and the compliance officer. The internal audit function should review the institution's internal control system annually and should specifically report its findings on internal financial controls to the audit committee. It should place particular emphasis on internal financial control and the effect that information technology has on processes and internal controls. The audit committee should ensure that all pertinent risks are covered by audit activities and, specifically, should monitor the effectiveness of the internal audit function.

### Key questions leadership should be asking

- How does the accounting officer/council ensure the competence and independence of the audit committee chairman and what processes are there to resolve potential conflicts?
- Does the audit committee have the appropriate blend of skills to discharge its responsibilities, specifically the skills required to oversee integrated reporting and to provide input on sustainability?
- Has a process been approved by leadership to allow the audit committee to consult with specialists or consultants to assist the audit committee with the performance of its functions?

- Do members of the audit committee have the necessary skill and know-how to report on performance management, risk management and compliance with all applicable legislation?
- Is there effective communication and coordination of the leadership's oversight activities to ensure that the audit committee is informed of all significant actual or potential financial and non-financial risks?
- Does the internal audit function have appropriate skills and resources to deliver on expectations regarding the review of internal financial controls as well as risk management and governance processes?
- Does a mechanism exist for resolving differences of opinion between the audit committee and the leadership regarding the audit committee's statutory responsibilities, should such differences arise?
- What approach is the audit committee applying to provide oversight of the assessment of the effectiveness of internal financial control?
- What approach is the audit committee applying to provide oversight of the assessment of the effectiveness of combined assurance?

### How we can help you

PwC has specialists to assist audit committees complete their responsibilities:

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



# 4. The governance of risk

## Overview

The essential focus of the Code is that the board should “exercise leadership to prevent risk management from becoming a series of activities that are detached from the realities of the company’s business.” This challenge is particularly relevant in the public sector where risk management has been required by statute for some time. King III positions risk as a cornerstone of governance and risk governance is substantially different to the requirement to implement risk management. Greater emphasis is placed on the accountable leadership structure to ensure that it is satisfied with the management of risk. Both the PFMA and MFMA clearly establish the responsibility for risk management to the accounting officer.

The concept of risk is not new to the public sector and the Risk Management Framework issued by National Treasury embraces the principles enshrined in King II. The basis for the framework emanates from the PFMA and sound risk management principles are also dictated by the principles of Batho Pele, which aim to drive Government’s service delivery objectives.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 4. The governance of risk</b>					
The board's responsibility for risk governance	4.1. The board should be responsible for the governance of risk	This responsibility must be demonstrated.	<p>The responsibility for risk management has been established by the applicable legislation. The issues are how this responsibility is disclosed and accountability is enforced.</p> <p>The risk management framework as established by National Treasury is applicable to all public sector institutions.</p>	Section 38 (a) i of the PFMA makes the accounting officer responsible for risk management, while section 76 empowers the National Treasury to issue instructions that will assist in the application of the Act. Thus, the Risk Management Framework issued by National Treasury must be applied and the concept of governance of risk is further articulated in the framework.	<p>The municipal manager may be delegated the responsibility by council, whereas the MFMA also assigns responsibility to:</p> <ul style="list-style-type: none"> <li>• The audit committee to advise council [section 166.(2)(a)(ii)];</li> <li>• Internal audit to advise the municipal manager and report to the audit committee [section 165.(2)(b)(iv)];</li> <li>• The municipal manager [section 62.(1)(a)(i)]; and</li> <li>• All senior managers [section 78].</li> </ul>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 4. The governance of risk</b>					
	4.2. The board should determine the levels of risk tolerance	The board should understand the risk levels that it has the ability to tolerate versus the risk that it is willing to take (risk appetite).	The principles of Batho Pele require prudent risk management to form the basis for Government's services delivery programmes. The Risk Management Framework establishes the need to set objectives that are aligned to the institution's mission, and is the reference point for compliance with this principle.	This function is performed by the accounting officer together with his/her executive management team.	In terms of the responsibilities mentioned above, the council should determine the risk appetite in the approved risk management policy. The municipal manager with his/her management team would implement the policy.
	4.3. The risk committee or audit committee should assist the board in carrying out its risk responsibilities	The board can delegate the responsibility to a committee of the board.	The Risk Management Framework establishes the role of the risk management committee, with a mandate to make recommendations to the accounting officer on how to improve management of the institution's risks.	The Risk Management Framework requires both the audit and the risk management committee to have clear definitions of their purpose, related roles and responsibilities. The delegation or appointment of the risk management committee lies with the accounting officer.	The municipal manager may delegate this responsibility. According to Treasury, there is no legal mandate to establish a risk management committee, although it can be established in terms of section 32 of the Municipal Structures Act.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 4. The governance of risk</b>					
Management's responsibility for risk management	4.4. The board should delegate to management the responsibility to design, implement and monitor the risk management plan	The risk management plan requires specific activities to be completed.	Management is responsible and accountable to the accounting officer for managing and owning the risks facing the institution.	The Risk Management Framework establishes the responsibilities of management in terms of risk ownership and management.	Responsibility of the municipal manager. See 4.1 above.
Risk assessment	4.5. The board should ensure that risk assessments are performed on a continual basis	The board should ensure that risk assessments are performed on a continuous basis (minimum annually) using a top-down approach.	The complexity and dynamics of the challenges facing the public sector requires risks to be monitored and impacts to be assessed on a regular basis.	Treasury Regulation 3.2.1 requires the accounting officer to ensure that risks are assessed on a regular basis. The Risk Management Framework sets out guidance on performing this function.	Responsibility of the municipal manager. See 4.1 above.
	4.6. The board should ensure that frameworks and methodologies are implemented to increase the probability of anticipating unpredictable risks	Risks should be prioritised and ranked to focus the responses and interventions on those risks outside the board's risk tolerance limits.	The chief risk officer is responsible as the custodian of the ERM framework and risk identification and ranking are an integral part of the enterprise risk management.	According to the Risk Management Framework, this requirement is vested in the chief risk officer, who is required to provide specialist expertise in effective enterprise risk management.	Responsibility of the municipal manager. See 4.1 above.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 4. The governance of risk</b>					
Risk response	4.7. The board should ensure that management considers and implements appropriate risk responses	Annual risk management plan approval, implementation and monitoring.	National Treasury's Risk Management Framework and Guidelines provide extensive recommendations on the frameworks and methodologies that should be applied within the public sector. Risk management plans are required to be assessed and approved on a regular basis.	As the responsibility of the accounting officer, implementation, monitoring and evaluation of performance is to be reported to the executive authority through the quarterly reporting requirement established in Treasury Regulation 5.3.1.	Responsibility of the municipal manager. See 4.1 above.
Risk monitoring	4.8. The board should ensure continuous risk monitoring by management	Annual risk management plan approval, implementation and monitoring.	See 4.7 above.	See 4.7 above.	Responsibility of the municipal manager. See 4.1 above.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 4. The governance of risk</b>					
Risk assurance	4.9. The board should receive assurance regarding the effectiveness of the risk management process	Combined assurance requires active consideration of the assurance the board receives on the risks to which the institution is exposed.	Although there is no requirement for combined assurance, this is a progression from the current risk-based internal audit approach. Audit committees have been responsible and they should continue to take ownership of the combined assurance approach.	Treasury Regulation 3.2.7 requires internal audit to assess the key risks facing the institution. The Risk Management Framework further articulates the responsibility of the audit committee, internal audit and Auditor-General in providing independent assurance on the effectiveness of the institution's risk management processes.	Assurance is provided by the Auditor-General and internal audit to the municipal manager, the mayor and the stakeholders.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 4. The governance of risk</b>					
Risk disclosure	4.10. The board should ensure that there are processes in place enabling complete, timely, relevant, accurate and accessible risk disclosure to stakeholders	The board should disclose how it has satisfied itself that risk assessments, responses and interventions are effective as well as any undue, unexpected or unusual risks and any material losses.	<p>The disclosure is detailed in the quarterly report, which is accessible to direct stakeholders and not the broader public sector stakeholders.</p> <p>There is no requirement to disclose how risk management has been applied. The annual report is to include a disclosure on risk management.</p>	Quarterly disclosure is required, but is limited to Treasury Regulation 5.3.1. The disclosure is further limited in the annual report.	<p>Section 166.(4)(b) and 166.(2)(a)(ii) of the MFMA requires the accounting officer to meet and report to council quarterly, and council meetings are to be open to the public.</p> <p>Formal disclosure is included in the annual report (which encompasses the annual financial statements).</p>

## Implications

The requirement to disclose how the accounting officer, or equivalent, has satisfied him/herself that risk assessments, responses and interventions are effective will need to be decided in consultation with the audit committee. The accounting officer, or equivalent, will need to ensure that due care and diligence is applied in ensuring what is disclosed is an accurate reflection of the status of risk management in the institution. The current reporting templates in the annual report do not provide much guidance on the recommended disclosures.

This due care and diligence is achieved through:

- The structures of governance – risk/audit committee;
- Adoption and implementation of an annual risk management plan;
- Effective risk management practices through the application of the Risk Management Framework issued by National Treasury, methodologies, continuous assessments and monitoring;
- Applying risk considerations into the decision-making frameworks (appetite and tolerance) and on specific decisions;
- Ensuring that the leadership receives adequate assurance on the effectiveness of the risk

management process and on the management of specific risks; and

- Disclosing how the leadership is satisfied with the effectiveness of risk management.

## Expert opinion

The dynamics of challenges facing the public sector requires a prudent approach to risk management. The concept of managing risk in the public sector is not new and has been driven by the principles of Batho Pele. The uniqueness of challenges such as limited resources and competing objectives, together with stakeholders'/public's high expectation of service delivery, escalates the need for risk-averse decisions to be taken by public sector institutions.

Governance requires active consideration of risk management. The future is uncertain and risk management deals explicitly with uncertainty. Effective risk management is a fundamental requirement for institutions to succeed and provide effective public services.

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

Framework and supporting documents provide relevant public sector guidance on how effective risk management can be applied.

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

- Coordinated and relevant assurance efforts focusing on key risk exposures;
- Minimised operational disruptions;
- Comprehensive and prioritised tracking of remedial action on identified improvement opportunities/weaknesses;
- Improved reporting to the leadership and committees, including reducing the repetition of reports being reviewed by the different committees; and
- Possible reduced assurance costs.

The current reporting templates prescribed by National Treasury are limited and due consideration needs to be given to decide which sections of the templates the risk disclosures will need to be inserted into.

### Key questions leadership should be asking

- Is the annual report geared for this disclosure requirement? Where should the annual report be adapted? Will it form part of the normal performance per programme or part of the annual financial statements section?
- Do we understand how risk appetite and tolerance is applied?
- How do we know that the biggest risk exposures are being adequately managed?
- When last did we participate in a risk assessment activity?
- How often have we considered the same risk-related issue in the various management and governance meetings?
- Is ICT risk actively considered in our risk management process?
- Do we specifically consider compliance risk and, if so, how satisfied are we that it is effectively covered?
- Are risks prioritised and ranked to focus the responses and interventions on those risks outside the board's risk tolerance limits?
- Do we have an approved annual risk management plan?
- Who assures non financial risks, such as plant

availability, staff capacity and competency, the impact of legislative changes on the institution, etc? And to which management or governance committee is the assurance provided? Are we satisfied that this assurance is reliable?

- Do we have a fraud risk plan to consider our fraud exposure and prevention?
- Does our disclosure on the effectiveness of risk management reflect the actual position?

### How we can help you

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

- Advising on risk governance and risk management plans;
- Articulating risk appetite and tolerance;
- Linking performance and risk management;
- Developing effective risk management frameworks and methodologies;
- Facilitating risk assessments;
- Benchmarking risk and risk mitigation activities;

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



# 5. The governance of information technology

The vision of Government is to be driven by service excellence by providing quality and sustainable services in an effective and economical manner through the equitable distribution of resources and by promoting sustainable growth in which all communities live in harmony and prosperity.

Public sector institutions at all levels of Government are facing rapid, inevitable change and economic pressure to improve service delivery through the maximisation of administrative and operational efficiencies. In this environment, the effective use of information technology (IT) is a key success factor enabling government agility and the ability to respond promptly to the demand for services.

The South African Government understands the need to develop an information society and harness the power of information and communication technologies (ICTs) for economic and social development for the benefit of the country and its citizens. This understanding includes the need for reform and the transformation of its core activities to make processes more effective and efficient, and more citizen-oriented. The need to manage information and internal functions while serving business and citizens is core to the Government's e-government strategy. E-government is part of a public service transformation programme, which is guided by the principle of 'public service for all' and Batho Pele.

The e-government vision is informed by the growth and development priorities expressed in Vision 2014 as well as the Millennium Development Goals, whereby ICTs are regarded as an enabler for the achievement of these goals within a broad and integrated developmental approach, rather than just as an element of infrastructure. E-government is seen as being integral to developing an information society in South Africa, encompassing e-education, e-health, and the development of small and medium enterprises within the ICT sector.

King III recognises that information technology (IT) has become an integral part of doing business today, as it is fundamental to the support, sustainability

and growth of institutions. IT cuts across all aspects, components and processes in business and is therefore not only an operational enabler for an institution, but an important strategic asset which can be leveraged to create opportunities and to facilitate service delivery.

Chapter 5 of the Public Service Regulations acknowledges the important role that IT has to play in achieving Government's vision, through the establishment of a requirement for all Government and public sector institutions to manage IT effectively and efficiently. The Regulations stipulate that the acquisition, management and use of information technology shall be informed by the Batho Pele principle of offering equal access to services, while increasing productivity and lowering costs.

The National Treasury Risk Management Framework encourages institutions to adhere to the principles espoused in King II for the promotion of an advanced level of institutional conduct. Since King II has been superseded by King III, it can be reasonably assumed that the principles embodied in King III will be endorsed in future revisions of the Framework. King III recognises that as well as being a strategic asset to the institution, IT also presents institutions with significant risks. The code recommends that the strategic assets of IT and its related risks and constraints should be well governed and controlled to ensure that IT supports the strategic objectives

of the institution and sets out the manner in which institutions can do this. Public sector institutions would be well advised to utilise the requirements laid out in chapter 5 of King III to ensure that IT is governed effectively and harnessed to facilitate the achievement of Government's vision.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 5. The governance of information technology</b>					
	5.1. The board should be responsible for information technology (IT) governance	IT has an important role to play in many organisations and should be directed and controlled effectively by the board through the establishment of an IT governance framework. The IT governance framework supports effective and efficient management and decision making around the utilisation of IT resources to facilitate the achievement of the company's objectives and the management of IT-related risk. It includes a charter, policies, decision-making structures, accountability framework, IT reporting and an IT internal control framework.	Chapter 5 (1) (B) of the Public Service Regulations places an obligation on the head of institution to ensure that the acquisition, management and use of information technology by the institution improves: <ul style="list-style-type: none"> <li>(a) direct or indirect service delivery to the public, including, but not limited to, equal access by the public to services delivered by the institution;</li> <li>(b) the productivity of the institution; and</li> <li>(c) the cost-efficiency of the institution.</li> </ul> The information technology planning guidelines published and adopted by the Government Information and Technology Officers Committee in 2002, applies across government institutions and provides guidance to public sector organisations on how to align IT objectives to the overall organizational strategy.  The guidelines also refer to the internationally recognised Control Objectives for IT (COBIT).	Responsibility of the accounting officer, set out in Treasury Regulation 5.2 and to be reported on in the annual report as well as the quarterly report to the executive authority in terms of Treasury Regulation 5.3.1.	Section 26 (f) of the MSA implies that IT governance may be regarded as a responsibility of the council.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 5. The governance of information technology</b>					
	5.2. IT should be aligned with the performance and sustainability objectives of the company	IT should be exploited in a way that most effectively supports and enables the business strategy, delivers value and improves performance. The board should ensure that the IT strategy is integrated into the company's strategic and business processes and that IT adds value.	<p>The vision of Government is to become an entity driven by service excellence through providing quality and sustainable services in an effective and economic manner through equitable resource distribution and also through the creation of sustainable growth where all communities live in harmony and prosperity.</p> <p>The Public Service Regulations acknowledge the important role that IT has to play in achieving Government's vision, through the establishment of a requirement, for all institutions and governmental institutions to manage IT effectively and efficiently. The regulations stipulate that the acquisition, management and use of information technology shall be informed by the Batho Pele principle of offering equal access to services, increases in productivity and the lowering of costs.</p>	<p>Section 38 1(a) of the PFMA prescribes the duty of the accounting officer to ensure that the institution has and maintains effective, efficient and transparent systems of financial and risk management and internal control. This can be read to include IT systems. This interpretation is supported by Treasury Regulation 5.2.2, which states that the strategic plan of the institution should make reference to its proposed IT acquisitions or expansion with reference to an IT plan.</p> <p>Chapter 5 of the Public Service Regulations further supports the underlying value of electronic government (through acquisition and management) as discussed in the adjacent column including IT security and interoperability.</p>	Section 26 (f) of the MSA implies that IT governance may be regarded as a responsibility of the council.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 5. The governance of information technology</b>					
	5.3. The board should delegate to management the responsibility for the implementation of an IT governance framework	<p>Responsibility for the implementation of IT governance should be assigned to the chief information officer (CIO), as appointed by the CEO.</p> <p>The CIO should act as an intermediary between the board and management on IT-related issues and should be the bridge between IT and business. IT should report to the board on the performance of the IT function.</p>	The Minimum Information Security Standards stipulate that the head of every institution bears overall responsibility for the provision and maintenance of security in his or her institution. This is, however, to be delegated to the head of the security component within the organisation.	The accounting officer assigns the responsibility to the CIO, who in turn reports to the accounting officer.	Section 32 of the Municipal Structures Act allows the council to delegate its responsibility to a sub-committee, the municipal manager or another official (CIO).

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 5. The governance of information technology</b>					
	<p>5.4. The board should monitor and evaluate significant IT investments and expenditure</p>	<p>Value delivery and return on investment of IT should be monitored by the board.</p> <p>The board should ensure that the information and intellectual property contained in the information systems are protected.</p> <p>The board should require independent assurance over IT governance controls supporting outsourced IT services.</p> <p>The board is responsible for ensuring that good governance principles are in place for the acquisition and disposal of IT goods and services.</p> <p>IT management should ensure good project management principles are applied.</p>	<p>See comments above.</p>	<p>The responsibility as set out in the PFMA (as noted above) would be delegated to the CIO whilst Treasury Regulation 3.2.11 requires the internal audit function to evaluate the controls in the information systems (allowing for the assessment of effective utilisation of the investment).</p> <p>The PFMA does not require independent assurance on information systems. However, assurance over other matters that may be prescribed (section 40(3)(b)) might include such assurance.</p>	<p>This would be the responsibility of the municipal manager according to section 63.(1)(a) of the MFMA and would be included in the budget approved by council and reported in accordance with section 71 of MFMA and Supply Chain Management (SCM) Policy.</p> <p>Section 62.(1)(a) of the MFMA makes it the municipal manager’s responsibility to ensure that resources are used effectively, efficiently and economically.</p> <p>Assurance is provided by the Auditor-General (section 92 of the MFMA), the internal audit unit (section 165.(2)(ii) of the MFMA), Council (section 111 of the MFMA) and SCM Policy.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 5. The governance of information technology</b>					
	<p>5.5. IT should form an integral part of the company's risk management</p>	<p>The board should ensure that IT risk is considered as part of the company's risk management activities.</p> <p>IT risk management should include disaster recovery planning, IT legal risks, compliance to laws, rules, codes and standards.</p> <p>The board should evaluate how IT can be used to aid the company in managing its risk and compliance requirements.</p>	<p>The National Treasury Risk Management Framework encourages institutions to adhere to the principles espoused in King II, given its promotion of an advanced level of institutional conduct. Since King II has been superseded by King III, it can be reasonably assumed that the principles embodied in King III will be endorsed in future revisions of the Framework. The Framework is applicable to all public sector institutions and comprehensively articulates IT risk management processes in the public sector.</p>	<p>This is the responsibility of the accounting officer, although IT risk management may be performed by the ICT committee.</p>	<p>Section 62.(1)(c)(i) of the MFMA places this responsibility on the municipal manager. In terms of section 32 of the Municipal Structures Act, this responsibility can be delegated to a subcommittee.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 5. The governance of information technology</b>					
	5.6. The board should ensure that information assets are managed effectively	<p>The board should ensure that processes have been established to ensure a formal information security management system is in place to ensure:</p> <ul style="list-style-type: none"> <li>• the confidentiality, integrity and availability of information;</li> <li>• that company information is adequately protected; and</li> <li>• that personal and sensitive information has been identified and is protected according to relevant laws and regulations.</li> </ul>	<p>The right to privacy is enshrined in the Constitution and gives effect to this right by way of mandatory procedures and mechanisms for the handling and processing of personal information, in line with current international trends and laws on privacy.</p> <p>The Protection of Personal Information (PPI) Bill, applying to both public and private sector institutions, will regulate the processing of 'personal information', including its collection, recording, and storage.</p> <p>The Promotion of Access to Information Act (PAIA) provides public access to records of institutions, including those of national, provincial and local government.</p>	<p>The PFMA does not expressly deal with the management of information, except for the requirement that the accounting officer must ensure that the institution has and maintains effective, efficient and transparent systems of financial and risk management and internal control. However, institutions are required to comply with the requirements of the PAIA, which includes the preparation of a manual of functions and records held by the institution in at least three official languages.</p> <p>Public sector institutions can refer to the Minimum Information Security Standards (MISS), which were written by the National Intelligence Agency and published by the DPSA, in conjunction with standards such as ISO 27001 and 27002 for guidance on how to implement policies, procedures, controls and safeguards that will facilitate compliance with the requirements of the PPI bill.</p>	<p>Section 32 of the Municipal Structures Act allows municipal councils to delegate this responsibility to the municipal manager.</p> <p>See also section 62.(1)(a) and 63.(1)(a) of the MFMA.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 5. The governance of information technology</b>					
	<p>5.7. A risk committee and audit committee should assist the board in carrying out its IT responsibilities</p>	<p>The risk committee should measure and understand the company's overall exposure to IT risks and ensure proper processes are in place to manage these.</p> <p>IT as it relates to financial reporting and the status of the company as a going concern should be the responsibility of the audit committee.</p>	<p>See comments above.</p>	<p>As discussed above, the accounting officer must ensure that the institution has and maintains effective, efficient and transparent systems of financial and risk management and internal control (section 38(1)(a) of the PFMA). In so doing, the Risk Management Framework developed by National Treasury should be followed. This prescribes the enablers of risk management to be:</p> <ul style="list-style-type: none"> <li>• risk management policy;</li> <li>• Risk management strategy;</li> <li>• basic requirements for ERM implementation; and</li> <li>• funding of ERM.</li> </ul> <p>The management of IT risk might include the State Information Technology Agency (SITA) as its mandate provides for the provision of such services (section 7 of the SITA Act).</p>	<p>According to National Treasury, there is no legal mandate to establish a risk management committee, although this may be done in terms of Section 32 of the Municipal Structures Act.</p> <p>Also see sections 166.(2)(a)(ii) and (iv) of the MFMA, where the audit committee is delegated responsibility for risk management and section 62.(1)(c)(i), which assigns responsibility to the municipal manager.</p>

## Implications

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

This due care and diligence can be achieved through:

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

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

## Expert opinion

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

While King III sets out principles, the challenge is to implement them in a practical way. Although the principles have been established in the public sector regulatory environment, the implementation and execution of these principles is lacking due to challenges such as skills and funding. Another challenge lies within the mandate of the State Information Technology Agency (SITA) and National Treasury, where the Transversal systems are within their control and the system limitations pose a huge difficulty to institutions.

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

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

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

- Clarified decision-making and accountability
- Improved understanding of overall IT costs and their input to ROI cases
- Improved risk management, security, efficiency and effectiveness of IT and making this visible (i.e. IT will deliver value)
- Enhancement and protection of reputation and image
- Positioning of IT as a business partner and clarifying IT's role in the business
- Improved and more professional relationships with key IT partners (vendors and suppliers)
- Improved responsiveness to market challenges and opportunities

- Clear identification of whether an IT service or project supports 'business as usual' or is intended to provide future added value
- A focus on performance improvement that will lead to the attainment of best practices
- Avoidance of unnecessary expenditure as spending can be demonstrably matched to business goals
- Enabling an integrated approach to meeting external legal and regulatory requirements.

#### Key questions leadership should be asking

- Should institutions be able to procure their own IT assets outside of the SITA processes? What impact will this have on SITA's mandate?
- Will institutions be held accountable for financial system risks? Will IT be the custodians of the transversal system?
- Will each institution have to report on the transversal systems or will a consolidated report be issued by the Auditor-General?
- Do we understand how IT decisions are taken and who is accountable?
- Do we have an IT governance framework in place which defines and supports decision models, governance structures, accountability and governance processes?

- Is IT involved in strategic business decisions and planning?
- Is the investment in IT understood?
- Is our intellectual property, company and client information properly protected?
- How do we ensure compliance of IT with laws, rules, codes, standards and regulations?
- How is the value delivered by IT measured?
- Is the approach towards IT risks facing the institution clear? (Risk avoidance vs. risk taking)
- Is the board regularly briefed on IT risks to which the enterprise is exposed?
- Is IT a regular item on the agenda of the board and is it addressed in a structured manner?
- Does the leadership have a clear view on the major IT investments from a risk and return perspective?
- Does the leadership obtain regular progress reports on major IT projects?
- Is the leadership getting independent assurance on the achievement of IT objectives and the containment of IT risks?

## How we can help you

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

PwC can support you by:

- Providing an assessment of your current IT governance arrangements against King III and other best practices, such as ITIL, CobiT, ISO 38500, ISO 27002 and Val IT;
- Supporting you in determining the King III principles to apply within your institution;
- Developing an IT governance implementation programme aligned to King III requirements and implementing the required IT governance improvements; and
- Supporting the implementation of improvements in IT governance by utilising PwC's proprietary ICT governance framework and methodologies.



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

## Overview

The PFMA and MFMA give effect to sections 213 – 219 of the Constitution of the Republic of South Africa (Act 108 of 1996). Within the public sector environment, the PFMA and MFMA supersede all other Acts as they relate to public sector institutions. Institutions must comply with all applicable laws. Laws should be understood not only in terms of the obligations they create, but also for the rights and protection they afford. The leadership is responsible for the institution's compliance with applicable laws and with those non-binding rules, codes and standards with which the institution has to comply. One of the most important responsibilities of the leadership is to monitor the institution's compliance with all applicable laws, rules, codes and standards.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 6. Compliance with laws, rules, codes and standards</b>					
	6.1. The board should ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes and standards	A strongly linked ethical responsibility that must be demonstrated and disclosed – including the extent of adoption of non-binding rules and standards.	The PFMA/MFMA takes precedence over all other laws relevant within the public sector environment.	This is the responsibility of the accounting officer and is further assigned through sections 76 (4) and 77 of the PFMA and further articulated in Treasury Regulations 3.1.10(f) and 3.2.11(e) to the audit committee and internal audit function respectively.	The mayor's responsibility for compliance is limited to section 131 of the MFMA, although he/she must inform the MEC in situations where he/she is aware of non-compliance in terms of section 27.(1) of the MFMA.  Section 55.(1)(l) of the MSA charges the municipal manager with responsibility and accountability for the implementation of legislation.
	6.2. The board and each individual director should have a working understanding of the effect of the applicable laws, rules, codes and standards on the company and its business	The board must ensure that the applicable laws (and changes thereto) are identified and understood.	Legal services units are established and are the channels to provide such compliance and regulatory requirements to the institution's attention.	Section 38 of the PFMA requires the accounting officer to ensure compliance with any applicable legislation.	Section 60.(b) of the MFMA requires the municipal manager to provide guidance and advice to political structures, political office bearers, officials and municipal entities.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 6. Compliance with laws, rules, codes and standards</b>					
	6.3. Compliance should form an integral part of the company's risk management process	A systematic risk management approach to compliance is recommended, understanding that compliance is compulsory.	Compliance with laws and regulations are articulated within the Risk Management Framework published by National Treasury.	The Risk Management Framework articulates the purpose of and application of ERM principles.	Section 62.(1)(c)(i) of the MFMA makes the municipal manager responsible for risk management.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 6. Compliance with laws, rules, codes and standards</b>					
	6.4. The board should delegate to management the implementation of an effective compliance framework and processes	<p>A legal compliance policy should be established and monitored</p> <p>Compliance should be achieved through integration with business/institutional processes, ethics and culture.</p> <p>Disclosure is required as to how effectively compliance has been achieved and of significant fines and penalties paid.</p> <p>A delegated compliance function/officer is recommended.</p>	<p>No policy requirements exist, however compliance and ethics are embedded within individual functional policies and processes.</p> <p>The accounting officer is ultimately responsible for compliance. This does create disjuncture in monitoring overall compliance.</p> <p>Disclosure in terms of compliance is limited to the audit committee and internal and external audit.</p> <p>Disclosure of penalties and fines is required.</p> <p>A dedicated legal services unit is established in terms of structures prescribed by DPSA.</p>	<p>The review of compliance is delegated to the audit committee (Treasury Regulation 3.1.10(f)) and the internal audit function (3.2.11(e)), but there are no stipulations dealing with the process to manage compliance, with the exception of supply chain management (Treasury Regulation 16A).</p>	<p>Section 11.(3)(a) of the MSA empowers the council to exercise authority by developing and adopting policies, plans, strategies and programmes.</p> <p>Section 61.(1)(a) of the MFMA gives this responsibility to the municipal manager and senior managers as well as other officials (section 78.(1)(a)).</p> <p>Section 125.(2)(d) and (e) of the MFMA states that non-compliance as well as material irregular and fruitless and wasteful expenditure should be disclosed in the financial statements.</p> <p>This function is normally carried out within legal services. However, the SCM regulations specifically call for the establishment of a compliance function, but limited to SCM activities.</p> <p>Section 165.(2)(b)(vii) of the MFMA asserts that internal audit must advise the accounting officer and report to the audit committee on compliance with the MFMA, the annual Division of Revenue Act and any other applicable legislation.</p>

## Implications

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

Compliance can be achieved by:

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

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

## Expert opinion

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

There are many institutions that only consider compliance when there is a breach with specific consequences, such as fines paid for financial misconduct or when reported on in the audit report of the Auditor-General. One of the key aspects of King III is that it recommends proactive consideration of compliance, how the compliance risk is managed and how it is integrated into an institution's operations.

The establishment of compliance functions is set out in the SCM regulations and is limited to the procurement environment. The compliance requirements in all other aspects are driven by the legal services units. A combination of the two would assist in ensuring a complete compliance universe. Skills remain a challenge within the public sector in this regard.

Highly regulated institutions, such as banks, have very mature compliance approaches and have been proactively managing compliance for years. King III has raised the level of awareness of the importance of being able to demonstrate compliance. This can be achieved through:

- Regularly (annually) reviewing the compliance universe and determining which laws, regulations and non-binding rules and standards apply to the institution
- Assessing the basis on which compliance to these laws and regulations is achieved
- Receiving assurance through the risk management and assurance processes that compliance is achieved

- Designing specific compliance activities to evidence the actions taken to ensure compliance – for example annual declarations, records of compliance-related training completed and monitoring of remedial action where compliance breakdowns have or could potentially occur
- Where applicable, embedding compliance activities into the operational processes - for example controls required to apply the law of prescription to debt owed to the institution, in terms of the Law of Prescription.

### Key questions leadership should be asking

- How do we integrate all compliance initiatives in our institution? Where will they fit into our current structures? What will be the cost or opportunity of such change?
- Will we find a compliance officer with skills requisite to address the overall compliance universe of the institution?
- What are the key statutory and regulatory obligations to which our institution needs to comply?
- Are we in compliance with these requirements? If so, how have we received this assurance and are we satisfied that the assurance is credible?
- When last did we consider compliance at the leadership level?

- How are we apprised of changes in the legal and regulatory landscape?
- Do we have sufficient evidence to defend our institution in Parliament and show that we have complied with a specific act?
- Does our disclosure on the effectiveness of compliance reflect the actual position in our institution?

### How we can help you

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

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

Our range of compliance services includes:

- Advising on what laws and regulations are applicable;
- Recommending approaches on how to achieve effective compliance;
- Benchmarking the compliance responses to specific acts/regulations – nationally and globally;
- Developing specific compliance databases to evidence compliance;
- Hosting of compliance databases through our Enterprise Compliance Portal (ECP) – PwC uses this to manage its own global compliance needs;
- Facilitating compliance risk assessments;
- Assisting in embedding specific compliance requirements into the business and operational processes;
- Assuring the effectiveness of compliance achieved; and
- Providing a gap analysis of compliance to specific laws and regulations.

# 7. Internal audit

## Overview

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

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

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 7. Internal audit</b>					
The need for and role of internal audit	7.1. The board should ensure that there is an effective risk-based internal audit	<p>The board should demonstrate how adequate assurance was obtained on an effective governance, risk management and internal control environment, in the event of the absence of an internal audit function.</p> <p>Evaluation of governance processes, including ethics, especially 'tone at the top'.</p> <p>A senior or executive or director to be responsible for internal audit where internal audit is fully outsourced.</p>	<p>All public sector institutions are required to establish an internal audit function.</p> <p>The internal audit function must prepare risk-based strategic and operational internal audit plans, which must be approved by the audit committee.</p> <p>Provision is made in the Treasury Regulations for internal audit to either be in-house or outsourced. In either case, the internal audit function reports to the accounting officer, which satisfies the code's recommendation that a senior executive be responsible for internal audit.</p>	<p>Section 38(a)(ii) of the PFMA sets out the requirement for the establishment of the audit committee.</p> <p>Treasury Regulations 3.1.10(c) and 27.2.7(a) require internal audit to prepare a rolling three-year internal audit plan based on its assessment of key areas of risk.</p> <p>Treasury Regulation 3.2.9 requires that the internal audit function reports directly to the accounting officer.</p>	<p>Each municipality must have an internal audit unit in terms of section 165 of the MFMA.</p> <p>Section 166.(2)(a)(vi) of the MFMA requires the audit committee to advise the council, political office-bearers, the municipal manager and the management staff on effective governance. This should include ethics, although this is not specifically mentioned.</p> <p>Section 165.(1) of the MFMA makes provision for the establishment of an internal audit unit, of which the chief audit executive should be the custodian. The service may be outsourced or co-sourced in compliance with section 165.(3) of the MFMA.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 7. Internal audit</b>					
Internal audit's approach and plan	7.2. Internal audit should follow a risk-based approach to its plan	<p>Internal audit planning should be informed by the strategy of the institution.</p> <p>The chief audit executive (CAE) should discuss the adequacy and resources of skills available to address risk identified with the audit committee.</p>	<p>In preparing strategic plans for internal audit, internal audit functions in the public sector are required to take into account the current operations of the institution, its strategic plan and its risk management strategy.</p> <p>There is no specific requirement for internal audit to discuss resources and skills with the audit committee, although this is implied as the audit committee is required to assess the performance of the internal audit function. In addition, the internal audit function is required to operate in terms of the Standards set by the Institute of Internal Auditors. These Standards require the CAE to ensure that internal audit resources are appropriate and sufficient.</p>	<p>Treasury Regulation 3.2.7(a) requires internal audit to take into account the strategy of the institution when developing risk-based strategic plans.</p> <p>Treasury Regulation 3.2.6 requires internal audit to be conducted in terms of the Standards set by the Institute of Internal Auditors. Standard 2030 of these Standards requires the CAE to ensure that internal audit resources are appropriate, sufficient and effectively deployed to achieve the approved plan.</p>	<p>Section 165.(2)(a) of the MFMA requires that the internal audit plan should be risk based.</p> <p>Internal audit must report on the implementation of the internal audit plan and the adequacy of resources and skills should be reported in terms of section 165.(2)(i) of the MFMA.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 7. Internal audit</b>					
	7.3. Internal audit should provide a written assessment of the effectiveness of the company's system of internal controls and risk management	Internal audit should form an integral part of the combined assurance model and should provide a written assessment of the effectiveness of the company's system of internal control and risk management.	<p>The current requirement in the public sector is that internal audit should coordinate with other internal and external assurance providers to ensure proper coverage and to minimise the duplication of audit effort.</p> <p>To address this principle, the role of internal audit would have to be expanded, possibly through the internal audit charter, so that the internal audit function leads this assurance process and is able to give an overall assessment on the system of internal control.</p>	Treasury Regulation 3.2.10 requires internal audit to coordinate with other assurance providers, both internal and external. Treasury Regulation 3.1.13(a) also requires the audit committee to comment on the effectiveness of internal controls in the institution's annual financial report. Though there is not direct requirement for internal audit to provide an assessment of internal controls, this requirement is implied as audit committees mainly rely on internal audit in order to make this assessment.	Internal audit should report on internal controls, risk and risk management in terms of section 165.(2)(b)(ii) and (iv) of the MFMA.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 7. Internal audit</b>					
	7.4. The audit committee should be responsible for overseeing internal audit	<p>Internal audit pay, bonus and benefits to be determined separately from the rest of the business to ensure appropriate independence.</p> <p>Internal audit to perform the pivotal role of effecting combined assurance.</p>	<p>Currently, the only requirement is that the audit committee is responsible for assessing the effectiveness of the internal audit function.</p> <p>This principle could be addressed by further empowering audit committees, through their charters, to make recommendations for salaries and bonuses of the internal audit function. This would, however, have to be done within prescribed Public Service Regulations.</p>	Treasury Regulation 3.1.10(b) requires the audit committee to evaluate the effectiveness of the internal audit function.	<p>Internal audit must report to the audit committee in terms of section 165.(2)(a) of the MFMA, while the audit committee must liaise with internal audit in terms of section 166(3)(a).</p> <p>The audit committee reviews the work of internal audit through the internal audit reports.</p> <p>For in-house staff, salaries and allowances paid are as agreed with the South African Local Government Bargaining Council, except possibly where the CAE is a Section 57 employee and his/her remuneration is approved by council.</p> <p>Fees paid to outsourced service providers must be in accordance with SCM policy.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 7. Internal audit</b>					
Internal audit's status in the company	7.5. Internal audit should be strategically positioned to achieve its objectives	<p>The chief audit executive (CAE) to have a standing invitation to attend exco as an invitee to protect independence.</p> <p>Internal audit to report functionally to the chairman of the audit committee.</p> <p>Internal audit should establish and maintain a quality assurance and improvement programme.</p>	<p>There is currently no requirement, nor is there any standard practice across all institutions in the public sector, for the CAE to attend exco meetings. There is, however, no regulation against this, such that implementation of this principle would not require any changes to standing legislation. Internal audit could be extended right through the internal audit charter.</p> <p>Current regulations already require the CAE to report functionally to the audit committee, and administratively to the accounting officer, or equivalent.</p> <p>There is no direct requirement for internal audit to establish a quality assurance and improvement programme, though this is implied, as internal audit is required to work in accordance with standards set by the IIA.</p>	<p>Section 38(a)(ii) of the PFMA prescribes that internal audit should be under the control and direction of the audit committee.</p> <p>Standard 1300 of the IIA Standards requires the CAE to develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity.</p>	<p>Internal audit must report to the audit committee in terms of section 165.(2)(a) of the MFMA.</p> <p>Section 62.(1)(c)(ii) of the MFMA requires internal audit to operate in accordance with prescribed norms and standards. This would imply that the Standards for the Professional Practice of Internal Audit (SPPIA) would apply.</p>

## Implications

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

- Providing an organisational custodian function in situations where internal audit is outsourced;
- Reviewing institutional ethics;
- Cost optimisation and the prevention of assurance fatigue;
- An assessment of the control environment;
- The relationship between internal audit, the audit committee and management;
- The role and attributes of a chief audit executive;
- The implementation of an internal audit quality assurance and improvement programme; and
- The interdependency between internal audit and other assurance providers such as risk management.

## Expert opinion

Internal audit functions in the public sector are required to be aligned with the IIA Standards. The IIA Standards are reflected in the King III principles. Thus the current public sector internal audit function requirements are addressed in King III.

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

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

The current skills base and maturity of the internal audit units in the public sector will have to be assessed to determine if the requisite skill sets and desired level of maturity exists to be able to apply the principles of King III effectively.

Remuneration will still fall within the ambit of the DPSA regulations, and the audit committee can then assess and make recommendations on the performance of the chief audit executive to the accounting officer.

Leadership, strategic inquisitiveness and other attributes will need to drive the expectations of the chief audit executive. This, coupled with strong analytical skills and the ability to interact at the highest levels of the institution, are fundamental to internal audit using the opportunities it is afforded in King III to reach a level that populists conclude is internal audit's rightful place. Appropriate technology leverage in the performance of internal audit becomes non negotiable.

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

## Key questions leadership should be asking

- Is the internal audit unit adequately equipped in terms of funding and skill to perform its role?
- Is internal audit aligned to strategy and does its plan focus on areas that are most likely to impact stakeholder value?

- Is the CAE adequately empowered and/or appointed at the correct level in the institution to fulfil his/her duties in terms of the relevant legislation?
- Is the internal audit plan really based on risk?
- Is internal audit effective and frequent enough in its communications with the audit committee and us?
- When last was an objective assessment done to ascertain whether internal audit has the appropriate level of technical and analytical skills required to address the industry risk and risk requirements of our business?
- Is our internal audit function poised to lead a combined assurance initiative?
- Is there sufficient assurance of our ethics and risk management programmes?
- Does internal audit utilise technology in its processes and use existing systems and data effectively in the performance of its work?
- What were our most recent loss events and what comfort did internal audit provide us with on these?
- How does our internal audit function compare against its peers in benchmark studies?

- Is our chief audit executive subjected to a robust annual assessment based on key attributes relevant to our business?
- What is our true absorbed cost of internal audit?
- Is our internal audit agile enough to address emerging institutional issues?
- Does the internal audit function have the necessary and diverse skills required to give assurance to the audit committee on internal financial control?
- Does internal audit add value and is it seen as an extension of business?

### How we can help you

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

- Strategic assurance reviews that go beyond a quality assurance checklist and align to your institutional strategy;
- Assistance in the formulation of a control environment assessment;
- Assistance in the implementation of a combined assurance model;
- Assessment of internal audit technology leverage;

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

# 8. Governing stakeholder relationships

## Overview

The stakeholder-inclusive approach to corporate governance is not a new concept in the King reports nor in the public-sector environment and effective stakeholder engagement is recognised as essential to good corporate governance. The days when leaders could merely pay lip service to concerns such as corporate responsibility, ethical business practices and sustainability are over. The Batho Pele values establish not only principles to facilitate effective service delivery, but also mechanisms to enhance stakeholder participation and feedback in service delivery matters.

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

King III provides guidance and recommendations on how stakeholder relationships should be dealt with. Within the public sector, the stakeholders are the public at large, including Parliament. The Batho Pele handbook further assists in identifying both direct and indirect public sector stakeholders.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 8. Governing stakeholder relationships</b>					
	<p>8.1. The board should appreciate that stakeholders' perceptions affect a company's reputation</p>	<p>8.1.1. The gap between stakeholder perceptions and the performance of the company should be managed and measured to enhance or protect the company's reputation</p> <p>8.1.2. The company's reputation and its linkage with stakeholder relationships should be a regular board agenda item</p> <p>8.1.3. The board should identify important stakeholder groupings</p>	<p>Within the public sector, managing stakeholder perceptions and relationships is an integral part of the day-to-day operations, particularly with the increased emphasis on service delivery.</p>	<p>Guidance with regards to managing stakeholder relationships within the public sector is extensively discussed in the Batho Pele handbook.</p>	<p>Section 55.(1)(o) of the MSA tasks the municipal manager with the responsibility of developing and maintaining a system that assesses community satisfaction with municipal services.</p> <p>Section 41.(1)(c) of the MSA mandates that development priorities, objectives, key performance indicators and targets should be monitored.</p> <p>Section 24 of the MSA requires councils to liaise with other spheres of government.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 8. Governing stakeholder relationships</b>					
	<p>8.2. The board should delegate to management to proactively deal with stakeholder relationships</p>	<p>8.2.1. Management should develop a strategy and formulate policies for the management of relationships with each stakeholder grouping</p> <p>8.2.2. The board should consider whether it is appropriate to publish its stakeholder policies</p> <p>8.2.3. The board should oversee the establishment of mechanisms and processes that support stakeholders in constructive engagement with the company</p> <p>8.2.4. The board should encourage shareholders to attend AGMs</p> <p>8.2.5. The board should consider not only formal, but also informal, processes for interaction with the company's stakeholders</p> <p>8.2.6. The board should disclose in its integrated report the nature of the company's dealings with stakeholders and the outcomes of these dealings</p>	<p>See comments under 8.1 above.</p> <p>There are no annual general meetings in the public sector environment. However, broader stakeholder participation includes meeting with portfolio committees and SCOPA. The public can voluntarily attend.</p> <p>Disclosure is limited to the extent of service delivery.</p>	<p>See comments under 8.1 above.</p>	<p>These should be included in the council's IDP according to section 26.(d) of the MSA.</p> <p>Section 15 of the MSA requires a municipality to prepare a municipal code, which must be made available. Policies may also be published in terms of sections 21 and 21A of the MSA.</p> <p>Section 16 of the MSA states that a municipality should develop a culture of community participation.</p> <p>Council meetings are to be open to the public and notice given in terms of sections 19 and 20 of the MSA.</p> <p>The annual report must include any relevant information, as determined by the municipality in terms of section 121.(3)(i) of the MFMA. Due consideration should be given to this recommendation.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 8. Governing stakeholder relationships</b>					
	8.3. The board should strive to achieve the appropriate balance between its various stakeholder groupings, in the best interests of the company	8.3.1. The board should take account of the legitimate interests and expectations of its stakeholders in its decision making in the best interests of the company	Addressed in the Batho Pele principles.	No requirement in the PFMA, but covered in the Batho Pele handbook.	Section 16 of the MSA requires that the IDP be prepared through a formal interactive process with the community, stakeholders and council.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 8. Governing stakeholder relationships</b>					
	<p>8.5. Transparent and effective communication with stakeholders is essential for building and maintaining their trust and confidence</p>	<p>8.5.1. Complete, timely, relevant, accurate, honest and accessible information should be provided by the company to its stakeholders whilst having regard to legal and strategic considerations</p> <p>8.5.2. Communication with stakeholders should be in clear and understandable language</p> <p>8.5.3. The board should adopt communication guidelines that support a responsible communication programme</p> <p>8.5.4. The board should consider disclosing in the integrated report the number and reasons for refusals of requests of information that were lodged with the company in terms of the Promotion of Access to Information Act 2000</p>	<p>The PFMA and MFMA prescribe the reporting duties of accounting officers to National Treasury or provincial treasuries, the Auditor-General and the public at large.</p> <p>The PFMA and MFMA prescribe the contents of the annual reports of the institutions to which the acts relate. These prescriptions include the timing of these reports. The required reporting on performance against pre-determined objectives covers the mandate of the institution and its performance against it (including service delivery and sustainability matters).</p>	<p>Guidance with regards to managing stakeholder relationships within the public sector is discussed extensively in the Batho Pele handbook.</p> <p>The PFMA deals with stakeholder communication in the context of required reporting to Parliament or provincial legislatures as captured in sections 40 and 41 of that Act.</p>	<p>Section 20 of the MSA requires council meetings to be open to the public.</p> <p>An annual performance report is to be published in terms of section 46 of the MSA and included in the annual report in terms of chapter 12 of the MFMA.</p> <p>The language used in the annual report should be clear and understandable.</p> <p>Section 121.(3)(i) of the MFMA requires the annual report to include any relevant information as determined by the municipality. Due consideration. The annual report should be enhanced to incorporate these disclosure requirements.</p>

## Implications

King III proposes a host of interventions that institutions and leadership should be making:

- Identifying material stakeholders and assessing the related risks and opportunities they present;
- Developing and implementing stakeholder strategies and policies;
- Developing a mechanism for constructive stakeholder engagement with all of their material stakeholders;
- Adopting communication guidelines for stakeholders covering the content of the report, publishing policies and the nature of the interaction with stakeholders; and
- The reporting templates issued by National Treasury need to be revised to accommodate the disclosure requirements detailed in King III.

## Expert opinion

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

The Batho Pele principles were established to underpin effective public-sector service delivery and the handbook was developed to assist the public sector in identifying and managing stakeholder relations, through stakeholder participation and other interventions. The principles and handbook extensively set out the requirements for public sector officials to ensure effective quality service delivery in accordance with their mandates.

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

There is still, however, a need for mechanisms for effective stakeholder engagement to be developed within institutions to support:

- Comprehensive risk and opportunity assessments;
- The development of an institutional strategy that supports the long-term sustainability of the institution; and
- The institution's ability to meet the objectives of the integrated report.

### Key questions leadership should be asking

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

### How we can help you

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

Our services include:

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



# 9. Integrated reporting and disclosure

## Overview

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

In order to comply with the recommendations of the Code, “reporting should be integrated across all areas of performance, reflecting the choices made in the strategic decisions adopted by the board, and should include reporting in the triple context of economic, social and environmental issues. The leadership should be able to report forward-looking information that will enable stakeholders to make a more informed assessment of the economic value of the institution as opposed to its book value.” To this extent, the format and content of the annual report is driven by the templates issued by the National Treasury. The integrated report referred to in King III refers in most respects to the annual report required in the public sector. It is imperative for changes to be made to the templates to incorporate the forward-looking information.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 9. Integrated reporting and disclosure</b>					
Transparency and accountability	9.1. The board should ensure the integrity of the company's integrated report	<p>9.1.1. A company should have controls to enable it to verify and safeguard the integrity of its integrated report</p> <p>9.1.2. The board should delegate to the audit committee to evaluate sustainability disclosures</p> <p>The integrated report should:</p> <p>9.1.3. be prepared every year;</p> <p>9.1.4. convey adequate information regarding the company's financial and sustainability performance; and</p> <p>9.1.5. focus on substance over form.</p>	<p>In practice within the public sector, the accounting officer relies on the review performed by internal audit, external audit and management of the institution to ensure the integrity of the annual report.</p> <p>The audit committee is responsible for evaluating the annual financial statements, which includes financial and performance information disclosures.</p> <p>The annual report must be prepared on an annual basis.</p>	<p>Section 40 of the PFMA requires the annual report of an institution to report on, in addition to the standard financial statements, performance against predetermined objectives as well as other matters that may be prescribed by National Treasury. Responsibility for this rests with the accounting officer. These reporting requirements are further supported by section 40(3) of the PFMA and Treasury Regulation 18.3. These deal with the content of annual reports and state, amongst other things, "information about the institution's efficiency, economy and effectiveness in delivering programmes and achieving its objectives and outcomes" including elements of sustainability reporting.</p>	<p>Section 45 of the MSA provides for the annual report to derive much of the information disclosed from the performance management system, which is audited by internal audit and the Auditor-General.</p> <p>New to the public sector is a requirement for the audit committee to review performance management, the financial statements and the external audit report in terms of sections 166.(2)(a)(v), (b) and (c) of the MFMA.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 9. Integrated reporting and disclosure</b>					
			<p>The annual report must include both financial and performance information disclosures. However, the performance information disclosures are somewhat limited when compared to King III requirements.</p> <p>Generally Recognised Accounting Practice (GRAP) as determined by the Accounting Standards Board (chapter 11 of the PFMA) requires the annual financial statements to reflect a substance over form approach.</p>	<p>Articulated in Treasury Regulation 3.1.13 is a requirement for the audit committee to comment in the annual report on the annual financial statements. It is therefore not a requirement of the PFMA to comment on sustainability disclosures.</p> <p>However, the Public Service Regulations, 2001 (as amended) in chapter 1, part 3 J determine that “the annual report shall include such information on planning, service delivery, institution, job evaluation, remuneration, benefits, personnel expenditure, the utilisation of consultants, affirmative action, recruitment, promotions, termination of services, performance management, skills development, injury on duty, labour relations, leave and discharge due to ill health, as the Minister determines”, thus broadening the scope of the annual report.</p>	<p>The chairman of the audit committee is also required to sit on the performance evaluation panel by the Performance Management Regulations, which puts the audit committee in a position to carry out this function.</p> <p>An annual performance report is to be prepared every year in terms of Section 46 of the MSA and an annual report in terms of section 121 of the MFMA.</p> <p>While sustainability is limited to financial information, it is discussed in detail at the municipal project level in the IDP.</p> <p>IDP reporting is to be enhanced to focus on substance over form.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 9. Integrated reporting and disclosure</b>					
	<p>9.2. Sustainability reporting and disclosure should be integrated with the company's financial reporting</p>	<p>9.2.1. The board should include commentary on the company's financial results</p> <p>9.2.2. The board must disclose if the company is a going concern</p> <p>9.2.3. The integrated report should describe how the company has made its money</p> <p>9.2.4. The board should ensure that the positive and negative impacts of the company's operations and plans to improve the positives and eradicate or ameliorate the negatives in the financial year ahead are conveyed in the integrated report.</p>	<p>The accounting officer and audit committee provide commentary on this.</p> <p>The Auditor-General's report will disclose any doubts over the going concern status of an institution.</p> <p>The annual report must disclose details of the revenue earned.</p> <p>While performance information is currently disclosed, this disclosure is limited when compared to the requirements of King III – specifically in terms of the requirements “to improve the positives and eradicate or ameliorate the negatives in the financial year ahead”.</p>	<p>Treasury Regulations 18.2, 18.3 and 7.3.2 deal with annual reporting and are prescriptive about the content of which, as mentioned above, includes reporting on the financial position and performance and also information on how income was derived and spent.</p> <p>The Auditor-General's Reporting Guide establishes the requirement for the Auditor-General to report going concern/ sustainability matters.</p>	<p>The mayor, municipal manager and chief financial officer provide commentary on this in terms of GRAP and Institute of Municipal Finance Officers (IMFO) standards. The municipal manager accordingly discloses this and the Auditor-General reports on this if he/ she disagrees.</p> <p>Annual report disclosures are to be made according to the requirements of section 46 of the MSA, section 121 of the MFMA and guidelines issued by National Treasury.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 9. Integrated reporting and disclosure</b>					
	9.3. Sustainability reporting and disclosure should be independently assured	<p>9.3.1. General oversight and reporting of sustainability should be delegated by the board to the audit committee</p> <p>9.3.2. The audit committee should assist the board by reviewing the integrated report to ensure that the information contained in it is reliable and that it does not contradict the financial aspects of the report</p> <p>9.3.3. The audit committee should oversee the provision of assurance over sustainability issues</p>	<p>The audit committee is responsible for evaluating the annual report and preparing a report thereon for inclusion in the annual report.</p> <p>The audit committee performs this function, as described above.</p>	<p>Treasury Regulation 3.1.13 determines that the audit committee must report on the evaluation of annual financial statements, which would include an assessment of the institution’s going concern/ sustainability status.</p> <p>The Auditor-General’s Reporting Guide establishes the requirement for the Auditor-General to report going concern/ sustainability matters.</p>	<p>This is a new requirement for leadership, which may be accommodated through Section 166.(2)(a)(ix) of the MFMA.</p>

## Implications

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

## Expert opinion

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

The current annual report format issued by the National Treasury covers the requirements of King III to a large extent. Since the strategic plan forms the basis of the annual report, it would be most user-friendly and transparent if the performance information sections are enhanced to incorporate disclosures on measures to be implemented to eradicate or ameliorate the negatives in the financial year ahead.

This will give stakeholders the opportunity to monitor

the pattern of progress over the course of a three-year rolling strategic plan.

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

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

## Key questions leadership should be asking

- Does the institution have a sustainability strategy and policy?
- Is sustainability considered part of ongoing business activities?
- Are sustainable development issues integrated into business management systems and institutions such as risk, environmental, legal and financial?
- Have sustainability criteria been built into individual performance agreements?
- Does the institution have suitably qualified officials with responsibility for sustainable development?
- Who in the company is the custodian of the content and assurance of the integrated report?

## How we can help you

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

- Director and specialised management training in sustainable development;
- Sustainability strategy and policy formulation;
- Sustainability systems and process development;
- Integrated report writing;
- Integrated report assurance using a methodology based on a combination of the ISAE3000 and AA1000AS assurance standards;
- Facilitation of the stakeholder engagement process;
- BEE strategy and implementation; and
- Technical health, safety and environmental services:
  - Climate change strategy development, carbon footprints and life cycle assessments; and
  - Health and safety and environmental compliance
  - ISO certification (9001, 14001, 18001).

# 10. Alternative dispute resolution

## Overview

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

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

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

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

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

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 11. Governing stakeholder relationships</b>					
Dispute resolution	8.6. The board should ensure that disputes are resolved as effectively, efficiently and expeditiously as possible	<p>8.6.1. The board should adopt formal dispute resolution processes for internal and external disputes</p> <p>8.6.2. The board should select the appropriate individuals to represent the company in ADR</p>	<p>All internal disputes are handled in terms of the regulations set out by the Public Service Commission.</p> <p>Presiding officers are appointed to manage the internal dispute processes together with labour relations units.</p>	<p>Treasury Regulations 11 and 12 deal with the management of debtors and losses and claims. These regulations determine the alternative methods/authority that accounting officers must pursue in order to resolve disputes as it relates to the matters of debtors and losses and claims. Furthermore, Treasury Regulation 16A deals with supply chain management as it relates to contracts and contract management.</p> <p>It is important to note that the accounting officer cannot commit the institution to any liability for which money has not been appropriated (section 38(2) of the PFMA).</p>	<p>This is a new requirement for leadership, although dispute resolution is provided for in the MFMA:</p> <ul style="list-style-type: none"> <li>• With organs of state – section 44;</li> <li>• Debt – section 48.(2)(f);</li> <li>• Supply chain management –section 112.(1)(p); and</li> <li>• Contracts – section 116.(1)(b)(ii).</li> </ul>

## Implications

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

## Expert opinion

Resolving disputes outside the rigid confines of the judicial process represents the future of dispute resolution. This promises many benefits for the public sector since the outcome of disputes are often delayed for long periods of time and are often very costly to the institution. While skills remain a challenge, it is a positive development that institutions can now explore the boundaries of disputes to come up with creative solutions. Uncompromising and dogmatic legal confrontations with adversaries seldom result in an optimal outcome and usually create a winner and a loser. ADR can result in two winners and we endorse King III's view that this approach improves the prospects of a better outcome for institutions and their stakeholders.

## Key questions leadership should be asking

- Is our institution involved in significant disputes?
- What do these disputes teach us about our customers/suppliers and our own approach to service delivery?
- Has negotiation failed in these disputes?
- Can we consider ADR processes? E.g. mediation, conciliation
- Is there potential value to be added in changing the dispute mechanism from an enforcement of rights process to a 'partnership' approach?
- Has the institution considered adopting a dispute response plan?

## How we can help you

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

- Mediation;
- Arbitration; and
- Independent expert accounting services.



# 11. Internal financial controls

## Overview

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

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

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

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
Role and function of the board	2.13. The board should report on the effectiveness of the company's system of internal controls	Refer to chapters 7 and 9.	<p>In public sector institutions without a board of directors, the role of reporting on the institution's effectiveness of internal controls is formally delegated to the audit committee.</p> <p>Such a report is included in the Annual Report of the institution.</p>	Treasury Regulation 3.1.13 requires that an institution's audit committee comment on the effectiveness of the institution's internal control in the annual report.	Section 52.(d) of the MFMA requires the mayor to submit a report to council on the implementation of the budget and the financial state of affairs of the municipality.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 3. Audit committees</b>					
Internal assurance providers	3.8. The audit committee should be an integral component of the risk management process	<p>The audit committee should specifically have oversight of:</p> <ul style="list-style-type: none"> <li>• Financial reporting risks;</li> <li>• Internal financial controls;</li> <li>• Fraud risk as it relates to financial reporting; and</li> <li>• IT risk as it relates to financial reporting.</li> </ul>	<p>The responsibilities of audit committees in public institutions include the review of the adequacy, reliability and accuracy of financial information and the effectiveness of internal control systems.</p> <p>There is no specific requirement for the audit committee to have oversight of responsibilities for fraud and IT risks. However, they have a general requirement to review the institution’s compliance with legal and regulatory compliance. There is a regulatory requirement for institutions to develop a risk management strategy, which must include a fraud prevention plan.</p> <p>Another requirement is for internal audit, which is under the control of the audit committee, to evaluate the information systems environment of the institution.</p>	<p>Treasury Regulations 3.1.10(a) to (g) set out the general responsibilities of an institution’s audit committee, including the oversight role over financial information, internal controls and legal and regulatory compliance.</p> <p>Treasury Regulation 3.2.11(a) requires internal audit to subject the information systems environment to evaluation.</p>	<p>Sections 166.(2)(a) (i), (ii) and (iv) of the MFMA require the audit committee to advise the council on internal financial control, risk management and the adequacy of, reliability and accuracy of financial reporting and information.</p>

## Implications

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

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

## Key questions the audit committee should be asking

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

## How we can help you

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

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

# 12. Remuneration of directors and senior executives

## Overview

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

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

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

Within the national and provincial public sector environment, remuneration for public sector officials is established via the Public Service Act of 1994 amended by the Public Service Amendment Act 30 of 2007 (PSA), read together with the Public Service Regulations (PSR) of 2001, amended by Government Notice No. R.332 of 20 March, 2009, with effect from 20 March, 2009.

The financial manuals issued by the DPSA assist the public sector with the determination of salary levels and bands. The manuals are comprehensive and set out remuneration frameworks for the various levels within the public sector, including specific guidance on middle management service (MMS), senior management service (SMS) and structuring of packages.

The local government sphere is guided by their own dispensation applications and salary level and bands differ.

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
Remuneration of directors and senior executives	2.25. Companies should remunerate directors and executives fairly and responsibly	<p>Companies must adopt remuneration policies that create value for the company over the long term. Short-term and long-term performance-related awards must be fair and achievable.</p> <p>The remuneration committee should assist the board in setting and administering remuneration policies.</p> <p>Annual bonuses:</p> <ul style="list-style-type: none"> <li>• Should clearly relate to performance against annual objectives consistent with long-term value for shareholders; and</li> <li>• Should be reviewed regularly to ensure that they remain appropriate.</li> </ul>	<p>The remuneration structures for national and provincial government are determined via section 37 of the Public Service Act (PSA), and articulated in Part V of the PSR.</p> <p>Part III and Part VIII of the PSR sets out the performance management systems to be established and adopted in institutions.</p>	Driven by DPSA through the PSA.	<p>Salaries and allowances for councillors are determined in terms of the Remuneration of Public Office Bearers Act in consultation with the MEC for local government.</p> <p>The salaries and allowances of the municipal manager and heads of Departments are approved by the council.</p> <p>Municipalities must also enforce a proper performance management system, as prescribed in chapter 6 of the Municipal Systems Act. The system is subject to quarterly auditing by internal auditors in terms of the Local Government: Municipal Planning and Performance Management Regulations, 2001.</p> <p>Salaries are subject to annual review linked to a cost of living adjustment based on market indicators per regulation 7.(4) of the Performance Management Regulations for Municipal Managers and Managers Directly Accountable to Municipal Managers, 2006.</p>

Governance element	Principle/s	Summary recommendations	Applicability to the public sector	Requirements for national and provincial government	Requirements for local government
<b>Chapter 2. Boards and directors</b>					
	<p>2.26. Companies should disclose the remuneration of each individual director and certain senior executives</p>	<p>Full disclosure of remuneration paid to each executive director and non-executive director must be made. Details should be provided of base pay, bonuses, share-based payments, granting of options or rights, restraint payments and all other benefits.</p> <p>Disclosure of the maximum and expected potential dilution that may result from incentive awards granted in the current year is also required.</p> <p>In addition, this information must also be disclosed for the three most highly-paid employees who are not directors in the company.</p> <p>The company's annual remuneration report must explain the remuneration policies followed throughout the company and explain the strategic objectives that the policies seek to achieve.</p> <p>The remuneration report must also explain the company's policy on base pay and the use of appropriate benchmarks.</p>	<p>Disclosure is limited to number of employees per level and band within a level.</p>	<p>There is no specific requirement in the PFMA. However, the annual report templates issued by National Treasury require disclosure of employee costs and vacancies.</p>	<p>Section 124.(1)(c) of the MFMA requires disclosure of the remuneration of the municipal manager, chief financial officer and other Section 57 employees in the financial statements.</p> <p>Section 58 of the Municipal Systems Act requires disclosure in the media before 31 October each year of the remuneration of the municipal manager and every manager directly accountable to the municipal manager.</p>

## Implications

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

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

It will, however, increase the burden on public sector in so far as disclosure is concerned.

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

## Expert opinion

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

Remuneration structures developed by the DPSA are in place and set various levels, each containing bands within them. However, there are instances where individuals are compensated at a higher level and it is here that disclosure in the annual report is lacking and showing a lack of transparency. The tables for disclosure need to be enhanced to accommodate such declarations. Political office bearers are compensated in terms of the Political Officers Act and no disclosure is made in the institution's annual report as the cost of such remuneration is not a direct cost to the institution.

## Key questions directors should be asking

- Does our remuneration policy comply with the principles of King III and reflect current international best practice?
- Are our long-term incentive plan rules consistent with the principles of King III in terms of the use and application of performance conditions?
- Does our annual bonus plan link performance to clearly set objectives that create long-term value for shareholders?
- Do we fully disclose remuneration paid in our annual remuneration report?
- Can we explain how our remuneration policy links into our strategic objectives?

## How we can help you

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

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

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

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

- Advise on executive remuneration – base pay, benefits, annual bonuses and long-term incentives;
  - Advise on non-executive fees;
  - Devise performance targets and measures for annual bonuses;
  - Design and implement short-term and long-term incentive arrangements (including drafting the relevant documentation, providing tax and accounting opinions and assistance with investor relations);
  - Advise on benchmarking and best practices
  - Provide training to remuneration committee members and advise them on trends and risks in the remuneration field.
- Assess the remuneration policy against the King III principles and assist with the development of a policy that is fully compliant;
  - Assist with the preparation of an annual remuneration report;



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**The governance of risk**

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**The governance of information technology**

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