

# King's Counsel\*

Similarities and differences between King II and King III





# Table of contents

Introduction	5
<b>Chapters of the Code</b>	
1. Ethical leadership and corporate citizenship	8
2. Boards and directors	10
3. Audit committees	17
4. The governance of risk	22
5. The governance of information technology	25
6. Compliance with laws, rules, codes and standards	30
7. Internal audit	33
8. Governing stakeholder relationships	36
9. Integrated reporting and disclosure	39
<b>Our view on specific issues raised in the Code</b>	
10. Business rescue	42
11. Alternative dispute resolution	44
12. Internal financial controls	46
13. Solvency and liquidity tests	48
14. Remuneration of directors and senior executives	50

## A note on terminology

For the purposes of this document:

- 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 in King III and here.
- 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.
- Although the terms 'company', 'boards' and 'directors' are used, King III refers to the functional responsibility of those charged with governance in any entity.

# 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 organisations that embrace its principles.

## 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 and King II, 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 a company 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 company 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.

## 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.”

It can be convincingly argued that self-regulation, in which an organisation voluntarily monitors its own adherence to legal and ethical standards, is far preferable to having an outside agency such as government monitor and enforce those standards. This approach allows organisations to maintain control over the standards to which they are held by successfully self-policing themselves. Apart from the bureaucratic burden that would be imposed by external enforcement, the cost of setting up such a mechanism is also avoided.

## 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. 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 company 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
  - 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 board believes it to be in the best interests of the company, 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, results in 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 organisation. This is good news for companies in South Africa as it avoids some of the pitfalls seen in the United States where a ‘one size fits all’ approach was initially adopted.

## 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 incorporation or establishment. Principles are drafted on the basis that, if they are adhered to, any entity would have practiced good governance.

It is recommended that all entities 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 board to improve the level of governance within an organisation.

## 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 organisation 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 company's system of internal control, including internal financial controls
- 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.

# 1. Ethical leadership and corporate citizenship

## Overview

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

The notion of corporate citizenships 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, company strategy and sustainability.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 1. Ethical leadership and corporate citizenship</b>			
Leadership	1.2. The board should ensure that the company is and is seen to be a responsible corporate citizen	The board should: <ul style="list-style-type: none"> <li>1.2.1. consider not only financial performance but also the impact of the company’s operations on society and the environment</li> <li>1.2.2. protect, enhance and invest in the wellbeing of the economy, society and the environment</li> <li>1.2.3. ensure that the company’s performance and interaction with its stakeholders is guided by the Constitution and the Bill of Rights</li> <li>1.2.4. ensure that collaborative efforts with</li> </ul>	Similar to King II

Governance element	Principle/s	Summary recommendation/s	Difference to King II
		stakeholders are embarked upon to promote ethical conduct and good corporate citizenship 1.2.5. ensure that measurable corporate citizenship programmes are implemented 1.2.6. ensure that management develops corporate citizenship policies	

### Implications

The leadership of an organisation, including its directors, boards and committees, will have to review the corporate values that drive their behaviour to ensure that they and the organisation 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.

Leaders will also have to give due consideration to the full range of material economic, social and environmental dimensions and impacts that the company and its processes have on the community in which it operates, when developing corporate strategy.

## 2. Boards and directors

### Overview

Boards and directors, acting in the best interests of the company, form the focal point of corporate governance with responsibilities extending to shareholders and other stakeholders: “Companies should be headed by a board that should direct, govern and be in effective control of the company”.

The chapter discusses key governance responsibilities that directors 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 recommendation/s	Difference to King II
<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.	Similar to King II
	2.2. The board should appreciate that	The board should inform and approve the	Greater emphasis on opportunity as

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	strategy, risk, performance and sustainability are inseparable	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.	opposed to only risk.
	2.3. The board should provide effective leadership based on an ethical foundation	Explained in chapter 1	Refer to chapter 1
	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
	2.5. The board should ensure that the company's ethics are managed effectively	Explained in 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
	2.7. The board should be responsible for the governance of risk	Explained in chapter 4	Refer to chapter 4

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<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
	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
	2.10. The board should ensure that there is an effective risk-based internal audit	Explained in chapter 7	Refer to chapter 7
	2.11. The board should appreciate that stakeholders' perceptions affect the company's reputation	Explained in chapter 8	Refer to chapter 8
	2.12. The board should ensure the integrity of the company's integrated report	Explained in chapter 9	Refer to chapter 9
	2.13. The board should report on the effectiveness of the company's system of internal controls	Explained in section on internal financial controls	Refer to section on internal financial controls
	2.14. The board and its directors should act in the best interests of the	Directors act in the best interests of the company by, amongst other actions, disclosing conflicts	Similar to King II

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	company	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.	
	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 Act	Explained in chapter 10	Refer to chapter 10
	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.	King II did not contain a requirement that the CEO should not become the chairman until three years has elapsed. Lead independent director concept already introduced in King II and refined in King III.
	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.	Similar to King II
	2.18. The board should comprise a	The majority of non-executive directors should be	King II did not contain a requirement that

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	balance of power, with a majority of non-executive directors. The majority of non-executive directors should be independent	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 CEO and directors responsible for finance be appointed to the board.
	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.	King II required the board to comprise a balance of executive and non-executive directors, preferably with a majority of non-executive directors of which sufficient should be independent of management.  King II did not suggest that the memorandum of incorporation of the company should allow the board to remove any director from the board, including executives, without shareholder approval.
	2.20. The induction of and ongoing training and development of directors should be 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.	Similar to King II
	2.21. The board should be assisted by a competent, suitably qualified and	The board appoints and removes the company secretary. The requirements of the Companies	King II did not contain the same level of detail regarding the responsibility of the

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	experienced company secretary	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.	company secretary.
	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 requisite before reappointment.	King III requires the board to consider whether the evaluation of performance should be done by the chairman or independently by professional service providers.
	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 references 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.	King II required that, at a minimum, companies have an audit and remuneration committee.
	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.	King II did not address interaction with subsidiaries.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
	2.25. Companies should remunerate directors and executives fairly and responsibly	Refer to section on remuneration	Refer to section on remuneration
	2.26. Companies should disclose the remuneration of each individual director and certain senior executives	Refer to the section on remuneration	Refer to section on remuneration
	2.27. Shareholders should approve the company's remuneration policy	Refer to the section on remuneration	Refer to section on remuneration

## Implications

The board and its committees must have clear terms of reference in place. These need to be reviewed annually to ensure that there are no gaps or overlaps.

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

Performance evaluations of executive and non-executive directors are key, not only to assess efficiency and competence, but also to appraise reappointment and training needs.

A formal process for the appointment of directors must be in place and this should be disclosed in the integrated report.

Obtaining sufficiently skilled directors who are non-executive and independent as suggested by King III will require careful recruitment.

# 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.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
	3.1. The board should ensure that the company has an effective and independent audit committee	<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>King II required ‘affected’ companies to establish audit committees.</p> <p>King II did not address the frequency of meetings nor discussions with internal audit without management being present.</p>
	3.2. Audit committee members should be suitably skilled and experienced	The audit committee should consist of at least three members, all of whom should be independent non-executive directors. It should	King II did not address the minimum number of members required for the audit committee and required that only the

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
	independent non-executive directors	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.	majority of members should be independent non-executive directors.  Audit committees at subsidiary level were not addressed in King II.  King III specifies minimum areas over which audit committees should have sufficient expertise, while King II only required the majority of members to be financially literate.
	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.	King II required the audit committee to elect the chairman of the audit committee.
	3.4. The audit committee should oversee integrated reporting	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.  The audit committee should consider the need for summarised information and engage external	King II did not discuss the audit committee's responsibility for sustainability in the detail that King III does.  King II did not address summarised

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
		auditors to provide assurance on the summarised results.	sustainability information.
	3.5. The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities	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.	Combined assurance was not discussed in King II in the level of detail contained in King III.
	3.6. The audit committee should satisfy itself of the expertise, resources and experience of the company's finance function	The review of the finance function should be performed annually and the results thereof disclosed in the integrated report.	King II did not require a review of the finance function.
	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.	King III did not address an independent quality review of the internal audit function.
	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.	Responsibilities defined in the new Companies Act have been incorporated into King III.  King II did not specifically assign oversight of IT risk as it relates to financial reporting to the audit committee.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
	3.9. The audit committee is responsible for recommending the appointment of the external auditor and overseeing the external audit process	<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>3.9.5. should be informed of any Reportable Irregularities identified and reported by the external auditor</p> <p>3.9.6. should review the quality and effectiveness of the external audit process.</p>	King II did not address reportable irregularities.
	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</p>	<p>King II did not contain reporting responsibilities to shareholders for the audit committee.</p> <p>King II did not assign responsibility for recommending sustainability reporting for approval by the board to the audit</p>

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 3. Audit committees</b>			
		<p>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>	committee.

### Implications

The board and management of any company, 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 constitution, size and sufficiency and appropriateness of the skills set of the audit committee may need to be reconsidered by the board
- An assessment of in-house skills and the qualifications/track record of external assurance providers should be performed
- Audit committees are to coordinate the utilisation of appropriate assurance providers in the assurance model to provide assurance on the identified risks
- Increased time and resource commitments are needed for audit committees, management and internal audit to adequately review internal financial controls
- Audit committees will be reporting publicly on the effectiveness of internal financial controls. This may increase committee members' liability risk.

# 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.” In this context, risk is positioned as a cornerstone of corporate governance and risk governance is substantially different to the requirement to implement risk management. Greater emphasis is placed on the board to ensure that it is satisfied with the management of risk.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<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.	No difference
	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).	No requirement to articulate risk appetite/tolerance
	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.	No difference
Management’s responsibility for risk	4.4. The board should delegate to management the responsibility to	The risk management plan requires specific	No requirement in respect of a risk

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 4. The governance of risk</b>			
management	design, implement and monitor the risk management plan	activities to be completed.	management plan
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.	Minimum of annual assessment
	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.	No explicit requirement on the adoption of frameworks and methodologies
Risk response	4.7. The board should ensure that management considers and implements appropriate risk responses	Annual risk management plan approval, implementation and monitoring.	No requirement in respect of a risk management plan
Risk monitoring	4.8. The board should ensure continuous risk monitoring by management	Annual risk management plan approval, implementation and monitoring.	No requirement in respect of a risk management plan
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 organisation is exposed.	No requirement

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<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.	Disclosure only on how risk management is applied

## Implications

The requirement to disclose how the board has satisfied itself that risk assessments, responses and interventions are effective will need to be effectively evidenced. Due care and diligence will need to be exercised and disclosed.

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 recognised frameworks, methodologies, continuous assessments and monitoring
- Applying risk considerations into the decision-making frameworks (appetite and tolerance) and on specific decisions
- Ensuring that the board receives adequate assurance on the effectiveness of the risk management process and on the management of specific risks
- Disclosing how the board is satisfied with the effectiveness of risk management.

# 5. The governance of information technology

## Overview

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 organisations. IT cuts across all aspects, components and processes in business and is therefore not only an operational enabler for a company, but an important strategic asset which can be leveraged to create opportunities and to gain competitive advantage.

As well as being a strategic asset to the company, IT also presents organisations with significant risks. The strategic asset of IT and its related risks and constraints should be well governed and controlled to ensure that IT supports the strategic objectives of the organisation.

King III stipulates that in exercising their duty of care, directors should ensure that prudent and reasonable steps have been taken with respect to IT governance.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
Chapter 5. The governance of information technology			
	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	Was not part of King II

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 5. The governance of information technology</b>			
		<p>establishment of an IT governance framework.</p> <p>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.</p>	
	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.	Was not part of King II
	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 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>	Was not part of King II

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 5. The governance of information technology</b>			
	5.4. The board should monitor and evaluate significant IT investments and expenditure	<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 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>	Was not part of King II
	5.5. IT should form an integral part of the company's risk management	<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</p>	Was not part of King II

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 5. The governance of information technology</b>			
		compliance requirements.	
	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</li> <li>• That personal and sensitive information has been identified and is protected according to relevant laws and regulations.</li> </ul>	Was not part of King II
	5.7. A risk committee and audit committee should assist the board in carrying out its IT responsibilities	<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>	Was not part of King II

## Implications

The requirement to disclose how the board 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 is 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 board 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 board is with the effectiveness of IT governance.

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

## Overview

Companies must comply with all applicable laws. Laws should be understood not only in terms of the obligations that they create, but also for the rights and protection that they afford. The board is responsible for the company's compliance with applicable laws and with those non-binding rules, codes and standards with which the company has elected to comply. One of the most important responsibilities of the board is to monitor the company's compliance with all applicable laws, rules, codes and standards.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<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 board is now to ensure legal and regulatory compliance as part of its risk management and internal control activities.
	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.	As above

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<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.	As above
	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/organisational 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>	As above

## 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 entity/organisation wishes to comply
- Ensuring that the board and board members understand the requirements and are updated on the changes. This can be part of the board's continuing education programme
- Implementing a comprehensive compliance policy and regularly monitoring compliance to the policy through the governance structures and inclusion on the board agenda
- Managing compliance risk through the risk management process adopted
- Embedding compliance in the operations and process, ethical conduct and culture of the business/organisation
- 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.

# 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 organisation. Value is now seen to vest in the relevance of a function. As such, the head of internal audit needs to understand the organisation’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 is required to provide an annual assessment of an organisation’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 recommendation/s	Difference to King II
<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	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.  Evaluation of governance processes, including	Board to demonstrate how effective internal control, processes and systems assurance were obtained  Ethics not specifically mentioned

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 7. Internal audit</b>			
		ethics, especially 'tone at the top'.  A senior or executive or director to be responsible for internal audit where internal audit is fully outsourced.	No mention of custodian function in an outsourced scenario
Internal audit's approach and plan	7.2. Internal audit should follow a risk-based approach to its plan	Internal audit planning should be informed by the strategy of the organisation.  The chief audit executive should discuss the adequacy and resources of skills available to address risk identified with the audit committee.	Not a requirement in King II  Not a requirement in King II
	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.	Not a requirement in King II
	7.4. The audit committee should be responsible for overseeing internal audit	Internal audit pay, bonus and benefits to be determined separately to process undertaken for the rest of the business to ensure appropriate independence.  Internal audit to perform the pivotal role of effecting combined assurance.	Not a requirement in King II  Only mention of the avoidance of duplication of assurance effort in King II

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<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 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>Not a requirement of King II</p> <p>Internal audit should report to an appropriate level in the organisation</p> <p>Not a requirement of King II</p>

## Implications

The challenge that the board 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:

- Annual report disclosure in the event that an effective internal audit function was not maintained
- An organizational custodian function in situations where internal audit is outsourced
- Reviewing organisational ethics
- Cost optimisation and the prevention of assurance fatigue
- An assessment of the control environment
- The relationship between internal audit and audit committees
- The role and attributes of a chief audit executive
- The implementation of an internal audit quality assurance and improvement programme
- The interdependency between internal audit and other assurance providers such as risk management.

# 8. Governing stakeholder relationships

## Overview

The stakeholder-inclusive approach to corporate governance is not a new concept in the King reports and effective stakeholder engagement is recognised as essential to good corporate governance. The days when boards could merely pay lip service to concerns such as corporate responsibility, ethical business practices and sustainability are over.

Stakeholder relationships provide a platform for the board to take into account the concerns and objectives of the company'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.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 8. Governing stakeholder relationships</b>			
	8.1. The board should appreciate that stakeholders' perceptions affect a company's reputation	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  8.1.2. The company's reputation and its linkage with stakeholder relationships should be a regular board agenda item  8.1.3. The board should identify important stakeholder groupings	Similar to King II

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 8. Governing stakeholder relationships</b>			
	8.2. The board should delegate to management to proactively deal with stakeholder relationships	<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>	Similar to King II
	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	Similar to King II
	8.5. Transparent and effective communication with stakeholders is essential for building and maintaining	8.5.1. Complete, timely, relevant, accurate, honest and accessible information should be provided by the company to its stakeholders	Similar to King II

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 8. Governing stakeholder relationships</b>			
	their trust and confidence	<p>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>	New requirement

## Implications

King III proposes a host of interventions that companies and boards 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

# 9. Integrated reporting and disclosure

## Overview

The board 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 a company’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 board should be able to report forward-looking information that will enable stakeholders to make a more informed assessment of the economic value of the company as opposed to its book value.”

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<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	9.1.1. A company should have controls to enable it to verify and safeguard the integrity of its integrated report  9.1.2. The board should delegate to the audit committee to evaluate sustainability disclosures  The integrated report should:  9.1.3. be prepared every year;  9.1.4. convey adequate information regarding the	King II did not specifically assign oversight of sustainability reporting to the audit committee.  While King II required that sustainability reporting should be repeated at least annually, it did not require the preparation of an integrated report.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 9. Integrated reporting and disclosure</b>			
		company's financial and sustainability performance; and  9.1.5. focus on substance over form.	
	9.2. Sustainability reporting and disclosure should be integrated with the company's financial reporting	9.2.1. The board should include commentary on the company's financial results  9.2.2. The board must disclose if the company is a going concern  9.2.3. The integrated report should describe how the company has made its money  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.	Similar to King II
	9.3. Sustainability reporting and disclosure should be independently assured	9.3.1. General oversight and reporting of sustainability should be delegated by the board to the audit committee  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	New requirement

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 9. Integrated reporting and disclosure</b>			
		report  9.3.3. The audit committee should oversee the provision of assurance over sustainability issues.	

**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 as financial matters are dealt with.

# 10. Business rescue

## Overview

In determining the role and function of the board, King III is keen to emphasise the importance of the board acting as both the focal point and custodian of corporate governance. In the context of business rescue, King III recognises that this is both a change of culture and a significant change in legislation.

The importance of this is to ensure the board (and directors individually) recognise their new obligations both to conform with chapter six, Business Rescue, proceedings in the Companies Act and to accept that this is emerging legislation and requires a change in culture from corporate liquidation to commercial renewal and recovery. Additionally, the board and directors must understand the risks and abuse that could arise, given the absence of precedents to support actions and early stages of the legislation and its supporting regulations.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 10. Boards and directors</b>			
Business rescue proceedings	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 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</p>	Was not part of King II

		business rescue is adopted  2.15.4. the practitioner furnishes security for the value of the assets of the company	
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## Implications

Boards (and individually directors) will need to understand how crucial it is to act independently, quickly and decisively, in line with the obligations and regulations of the Companies Act in distressed trading situations.

It is paramount that the board (and directors) recognise that early intervention and action protects against exposure to reckless trading allegations and also, crucially, demonstrates the fulfilment of their obligations to all stakeholders.

The board and directors must explore all turnaround opportunities proactively, prior to the company being financially distressed (as per the Act) and recognise that business rescue proceedings (and decisions around commencement thereof) offer a final and formal consideration after other avenues have been vigorously pursued prior to this.

The board and directors must be fully conversant with both their obligations to commence business rescue proceedings and conversely, the actions required of them if other 'affected parties' (shareholders, creditors, unions and employees) instigate such proceedings first, or if liquidation proceedings have already been commenced.

They must also be cognisant of the role and authority of the 'business rescue practitioner', including their own responsibility in the selection of this individual and/or right and obligation challenge of this individual's appointment (if proceedings were commenced by other affected parties).

The board and directors must fully understand the need to co-operate with the practitioner in the fulfilment of their duties in preparing and executing a 'business rescue plan'. In so doing, they must recognise and support the practitioner's authority (as a court official within the context of the Act) and control of the company in substitution for its board and pre-existing management.

The board must understand the fundamental aspects and intentions of the business rescue proceedings. These include, but are not limited to:

- Temporary supervision of the company
- A temporary moratorium on the rights of claimants
- The development and implementation of a plan to rescue the business.
- Furthermore, the board and directors must understand, comply with and manage the consequences of key principles within the business recovery proceedings surrounding trading restrictions, post-commencement finance and employee contracts.

# 11. 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 organisational 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, boards and directors should explore more creative methods of dispute resolution.

The Code endorses mediation and conciliation firstly and failing that, arbitration. The two former 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 the opposing argument 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 recommendation/s	Difference to King II
<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	8.6.1. The board should adopt formal dispute resolution processes for internal and external disputes  8.6.2. The board should select the appropriate individuals to represent the company in ADR	New requirement

### Implications

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

# 12. Internal financial controls

## Overview

The purpose of this section is to highlight those areas of King III that apply to an organisation’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 board 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 company’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
- 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 recommendation/s	Difference to King II
<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	Similar to King II but implications are broader considering new King III recommendations

Governance element	Principle/s	Summary recommendation/s	Difference to King II
Chapter 2. Boards and directors			
Chapter 3. Audit committees			
Internal assurance providers	3.8. The audit committee should be an integral component of the risk management process	The audit committee should specifically have oversight of:  Financial reporting risks Internal financial controls Fraud risk as it relates to financial reporting IT risk as it relates to financial reporting.	New requirement

## 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, companies 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
- 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.

# 13. Solvency and liquidity tests

## Overview

In section four of the introduction to the Code, entitled “The link between governance principles and law”, it is stated that certain recommendations made in King II have now become matters of law because they are contained in the new Companies Act.

These new provisions of the Act create duties on directors which, if not discharged in the appropriate manner, can result in personal liability exposure.

One of the sections of the Act that has been revised substantially and is specifically referred to in King III revolves around the requirements for solvency and liquidity tests to be applied by directors for certain transactions.

## Implications

The main categories of transactions that now require formal solvency and liquidity tests include:

- Financial assistance to third parties for the acquisition of or subscription for the company’s own shares
- Loans or financial assistance to related parties (including subsidiaries, fellow subsidiaries, holding companies and directors)
- Any dividends or distributions to shareholders
- Capitalisation shares (where there is an option to receive capitalisation shares or cash)
- Share buybacks.

Directors are required, amongst other things, to ensure that following any of these transactions, the company would satisfy the solvency and liquidity test. The requirement for the solvency and liquidity test is much wider under the new Act and includes common transactions such as dividend payments and inter-group lending, which previously did not require directors to perform this test. Directors therefore have to be particularly vigilant that any transaction proposed, falling into the above new categories, does not breach the application of the test.

In performing a solvency and liquidity test, a director needs to satisfy himself/herself, considering all reasonably foreseeable financial circumstances of the company at the time, that after the transaction:

- The assets (fairly valued) of the company must exceed liabilities (this would include all reasonably foreseeable contingent assets and liabilities)
- The company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months.

A director is personally liable for loss, damage or costs sustained by the company as a direct or indirect consequence of his or her actions if he or she:

- Was present at the meeting where the resolution was considered or participated in the decision
- Failed to vote against the resolution despite knowing that it was inconsistent with the requirements of the Act or the company's memorandum of incorporation or the director did not responsibly consider its impact (this would include the instance where the company undertook any of the above transactions when it was not in a position of solvency and/or liquidity).

# 14. 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
- Shareholders should approve the company's remuneration policy.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
Remuneration of directors and senior executives	2.25. Companies should remunerate directors and executives fairly and responsibly	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.  The remuneration committee should assist the	The provisions in King III are more prescriptive than the general wording included in King II.  For example, King II stated that performance-related elements of

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
		<p>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</li> <li>• Should be reviewed regularly to ensure that they remain appropriate.</li> </ul>	<p>remuneration should constitute a substantial portion of the total remuneration of executives.</p>
		<p>Share-based and other long-term incentive schemes:</p> <ul style="list-style-type: none"> <li>• Participation should be restricted to employees and executive directors. The chairman and other non-executive directors should not receive share options or other incentive awards geared to share price or corporate performance</li> <li>• Vesting of rights, whether settled in cash or shares, should be based on performance conditions measured over a period appropriate to the strategic objectives of the company. This should be not less than three years</li> <li>• Where performance conditions are not met, they should not be re-tested in subsequent</li> </ul>	<p>As regards the granting of share options to non-executive directors, King II stated that it should be left to the shareholders' discretion and approval.</p> <p>Detailed provisions relating to share-based and long-term incentive schemes were not included in King II.</p>

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
		<p>periods</p> <ul style="list-style-type: none"> <li>• Regular annual grants of awards is desirable</li> <li>• There should be no re-pricing or surrender and re-grant of share options which are 'underwater'</li> </ul>	King II stated that the re-pricing of share options should be subject to shareholder approval.
		<ul style="list-style-type: none"> <li>• There should be no automatic waiving of performance conditions on a change of control, a capital reconstruction or termination of employment. It may be appropriate to prorate the benefit both for time and performance</li> <li>• On termination of employment, where early vesting is deemed to be appropriate, vesting should be dependant upon the extent to which performance conditions have been met over the period, as well as the time served.</li> </ul>	
	2.26. Companies should disclose the remuneration of each individual director and certain senior executives	<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</p>	King II required full disclosure of remuneration paid to directors on an individual basis. This requirement has been extended under King III to certain senior employees.

Governance element	Principle/s	Summary recommendation/s	Difference to King II
<b>Chapter 2. Boards and directors</b>			
		<p>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>King II required a company to establish a formal and transparent procedure for developing a policy on director and executive remuneration, which should be supported by a statement of remuneration philosophy in the annual report.</p>
	<p>2.27. Shareholders should approve the company's remuneration policy</p>	<p>On an annual basis, the company's remuneration policy should be tabled to shareholders for a non-binding advisory vote at the annual general meeting.</p> <p>This vote enables shareholders to express their views on the remuneration policies adopted and on their implementation.</p>	<p>Was not part of King II</p>

## Implications

King II laid the foundations for 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 companies with a clear framework with which to comply and enable them to achieve best practice standards.

It will, however, increase the burden on companies in so far as disclosure is concerned. Companies would also be well-advised to review their policies in light of King III to assess the extent of their compliance.

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.

## Contacts

### **Brendan Deegan**

Assurance Leader

Tel: +27 11 797 5338

E-mail: [brendan.deegan@za.pwc.com](mailto:brendan.deegan@za.pwc.com)

### **Anton van Wyk**

Risk Advisory Services Leader

Tel: +27 11 797 5338

E-mail: [anton.b.van.wyk@za.pwc.com](mailto:anton.b.van.wyk@za.pwc.com)

### **Rob Newsome**

Director – Risk and Regulatory Services

Tel: +27 11 797 5560

E-mail: [rob.newsome@za.pwc.com](mailto:rob.newsome@za.pwc.com)

### **Alison Ramsden**

Director – Risk Advisory

Tel: +27 11 797 4658

E-mail: [alison.ramsden@za.pwc.com](mailto:alison.ramsden@za.pwc.com)

### **Zubair Wadee**

Director – National Technical

Tel: +27 11 797 5875

E-mail: [zubair.wadee@za.pwc.com](mailto:zubair.wadee@za.pwc.com)

### **Nicholas Ganz**

Director – Capital Markets Group

Tel: +27 11 797 5568

E-mail: [nicholas.ganz@za.pwc.com](mailto:nicholas.ganz@za.pwc.com)

### **Annerie Pretorius**

Associate Director

Tel: +27 11 797 4199 – National Technical

E-mail: [annerie.pretorius@za.pwc.com](mailto:annerie.pretorius@za.pwc.com)



[pwc.com](http://pwc.com)

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