# King's Counsel*

## King III at a glance

# Steering point

*The King Committee on governance issued the King Report on Governance for South Africa – 2009 (the "Report") and the King Code of Governance Principles – 2009 (the "Code"), together referred to as "King III" on 1 September 2009.*

*The issuance of King III was necessitated by the new Companies Act of South Africa[1] and changes in international governance trends since the release of the second King Report on Corporate Governance for South Africa (King II) in 2002.*

[1]The Companies Act, 2008 (which constitutes the redraft of the Companies Act, 1973) was assented to and signed by the President on 8 April 2009. The Act will come into operation on a date which is yet to be fixed by the President.

*In this Steering Point we focus on the key changes from King II. The next edition on King III will contain a King III disclosure checklist*



*connectedthinking

PricewaterhouseCoopers

## 1. Applicability of King III

King III applies to all entities regardless of the manner and form of incorporation or establishment. The principles, if adhered to, will result in any entity practising good governance. For that reason, the Code does not address the application of its principles and each entity will have to consider the approach that best suits its size and complexity. Application of the Code may however be mandated by law or regulation (such as by the JSE Limited Listings Requirements).

The terms "company", "boards" and "directors" refer to the functional responsibility of those charged with governance in any entity and should be adapted as appropriate. Furthermore as certain aspects of governance are legislated in the Companies Act and the Public Finance Management Act, the use of instructive language is important in reading and understanding the Report and Code. The word "must" indicates a legal requirement. In aspects where it is believed the application of the Code will result in good governance, the word "should" is used. The word "may" indicates areas where certain practices are proposed for consideration.

## 2. Governance framework – "Apply or explain"

King III follows an "apply or explain" approach. Where entities have applied the Code and best practice recommendations in the Report, a positive statement to this effect should be made to stakeholders. In situations where the board of directors (the "board") or those charged with governance decide not to apply a specific principle and/or recommendation, this should be explained fully to the entity's stakeholders.

## 3. Structure of King III – Code and Report

All entities should apply both the principles in the Code and the best practice recommendations in the Report. Each principle is of equal importance and together forms a holistic approach to governance. Consequently, 'substantial' application of the Code and Report does not achieve compliance.

## 4. King III – Key risk and reporting implications

### 4.1 Integrated reporting

King II had a chapter dedicated to integrated sustainability reporting. The concept of reporting on economic, social and environmental performance (the so-called "triple bottom line") is thus not new. However, there is growing global and local attention to sustainability issues.

King III requires the statutory financial information and sustainability information to be integrated in the "integrated report". An integrated report should be prepared annually.

The integrated report should have sufficient information to record how the company has positively and negatively affected the economic life of the community in which it operated during the year under review. The report should also contain forward-looking information on how the board believes it can enhance the positive aspects and negate the negative aspects that affect the economic life of the community in which it operates, in the future.

Integrated reporting cannot however be a matter of collating sustainability information and reporting at year end – sustainability reporting should be integrated with other aspects of the business process and managed throughout the year.

*Assurance on sustainability reporting*

King III requires that a formal process of assurance with regard to sustainability reporting should be established. The audit committee should recommend to the board the need to engage an external assurance provider to provide assurance over material elements of the sustainability part of the integrated report.

The board is responsible for the integrity of integrated reporting. However, it may assign the overseeing of sustainability issues in the integrated report to the audit committee. The audit committee should also assist the board in their review of the sustainability reporting by ensuring that the information is reliable and that no conflicts or differences arise when compared to the financial results.

*Impact on companies, boards and audit committees*

- Companies will be required to dedicate time and resources to the preparation of the integrated report.
- Integrated reporting entails more than a mere "add-on" of economic, social and environmental information in the annual report – sustainability reporting should be embedded in the organisation.
- The responsibility of the audit committee has been extended beyond financial reporting to include sustainability reporting.
- The expansion of responsibilities of audit committees has a direct impact on the required skill set of the committee.

### 4.2 Combined assurance

Management, internal assurance providers (such as internal audit) and external assurance providers (such as external audit) are role-players in providing assurance to the board over risks in an enterprise.

A combined assurance model effectively co-ordinates the efforts of management and internal and external assurance providers, increases their collaboration and develops a shared and more holistic view of the organisation's risk profile. A combined assurance model aims to be the antidote to "assurance fatigue" which can result from an uncoordinated assurance approach.

King III tasks the audit committee with the responsibility of monitoring the appropriateness of the company's combined assurance model and ensuring that significant risks facing the company are adequately addressed.

*Impact on companies, boards and audit committees*

- An assessment of in-house skills and the qualifications/ track record of external assurance providers should be performed.
- Audit committees to coordinate the utilisation of appropriate assurance providers in the assurance model to provide assurance on the identified risks.
- A combined assurance model may result in the increased utilisation of external assurance providers.

### 4.3 Annual review of internal financial controls

King III requires the audit committee to conclude and report annually to the stakeholders and the board on the effectiveness of internal financial controls. This statement should be supported by a formally documented annual review of internal financial controls performed by internal audit. The audit committee should determine the nature and extent of the formal documented review.

To the extent that material weaknesses in financial control that resulted in actual material financial loss, fraud or material errors are identified, these should be reported to the board and stakeholders.

In contrast to, for example, the Sarbanes-Oxley Act, King III does not require external attestation on internal financial controls.

*Process of reporting on internal financial controls*

Audit committee to determine the nature and extent of an annual review of internal financial controls

↓

Internal audit to conduct a formal documented review of internal financial controls

↓

Internal audit to report to the audit committee on the effectiveness of internal financial controls

↓

Audit committee to holistically consider all information from management, internal audit, and external assurance providers and report their conclusion on internal financial controls to the board and stakeholders

*Impact on companies, boards and audit committees*

- Increased time and resource commitments for audit committees, management and internal audit regarding a formally documented review of internal financial controls.
- Audit committees should assess the adequacy of available skills to conduct internal financial control reviews.
- The audit committees conclusions on the effectiveness of internal financial controls are on public record.
- Does the internal audit function possess the necessary and diverse skills required to give assurance to the audit committee?

### 4.4 Risk–based internal audit

King II acknowledged the role of an effective internal audit function in good corporate governance. King III emphasises that internal audit should follow a risk based approach to its plan. The chief audit executive's (CAE) internal audit planning should take the form of an assessment of the risks and opportunities facing the company and should:

- align with the company's risk assessment process (considering the risk maturity of the company);
- focus on providing an assessment of the company's control environment;
- consider the company's risks and opportunities identified by management and other key stakeholders;
- take cognisance of industry relevant emerging issues; and
- discuss the adequacy of the resources and skills available to the CAE with the audit committee.

*Impact on companies, boards and audit committees*

- Internal audit planning and approach should be risk-based rather than compliance-based.
- A CAE of appropriate stature, who has the respect and cooperation of the board and management, should be appointed.
- Internal audit reporting lines should be evaluated – internal audit should report functionally to the audit committee chairman in order to allow it to remain independent and objective to ensure it fully achieves its responsibilities.
- The CAE should have a standing invitation (as an invitee and not a member of the committee) to any of the executive or other comittee meetings.

### 4.5 IT governance

IT governance is dealt with in detail in King III for the first time. In exercising their duty of care, directors should ensure that prudent and reasonable steps have been taken in regard to IT governance.

IT governance should focus on:

- strategic alignment with performance and sustainability objectives of the company;
- development and implementation of an IT governance framework;
- value delivery: concentrating on optimising expenditure and proving the value of IT;
- risk management: addressing the safeguarding of IT assets, disaster recovery and continuity of operations; and
- the protection and management of information.

*Impact on companies, boards and audit committees*

- The board should operate with IT governance in mind.
- IT should be on the board agenda.
- IT performance should be measured and reported to the board.
- The board may consider appointing an IT steering committee or similar function to assist with its governance of IT.
- The risk committee has the responsibility to oversee the broader risk implications of IT. The audit committee should consider IT as it relates to financial reporting and the going concern assumption.

## 5. Other new concepts/topics introduced in King III

### 5.1 Shareholder approval of remuneration policies

King III requires the board (with the assistance of the remuneration committee) to put forward a policy of remuneration to the shareholders. The vote on the policy is a non-binding advisory vote which enables shareholders to express their views on the remuneration policy.

### 5.2 Directors' performance evaluation

While King II recommended the self-evaluation of the board, its committees and the contribution of each individual director, King III requires the board to consider whether the evaluation of performance should be done in-house or conducted professionally by independent service providers, subject to legislative requirements.

### 5.3 Business rescue

A section on business rescue has been included in the Boards and Directors chapter to address governance in business rescue proceedings. In summary, King III requires the board to commence business rescue proceedings as soon as the company is financially distressed.

### 5.4 Alternative dispute resolution (ADR)

King III recognises that ADR has become an important element of good governance. This is in line with the Companies Act which offers parties the option of resolving disputes through ADR. King III favours mediation or conciliation and, failing that, arbitration. Benefits of ADR over more traditional dispute resolution processes, such as referral to a court or utilisation of formal dispute resolution institutions created by statute (for example the Companies Tribunal), include reaching conclusions faster, the ability to conduct ADR processes in private and the opportunity for creative or novel solutions.

Mediation is not defined in the Act but may be defined as a process where parties in dispute involve the services of an acceptable, impartial and neutral third party to assist them in negotiating a resolution to their dispute, by way of a settlement agreement. The mediator has no independent authority and does not render a decision. All decision making powers in regard to the dispute remain with the disputing parties.

Conciliation is similarly not defined in the Act. Conciliation is a structured negotiation process involving the services of an impartial third party. The conciliator will, in addition to playing the role of a mediator, make a formal recommendation to the parties as to how the dispute can be resolved.

## 6. Highlights of selected chapters

### 6.1 Boards and directors - Comparison with King II

| | King III | King II |
|---|---|---|
| **Board structure** | Similar to King II. | Unitary board structure with executive directors and non-executive directors interacting in a working group |
| **Composition of the board** | The board should comprise a balance of executive and non-executive directors, with a majority of non-executive directors.<br><br>The majority of non-executive directors should preferably be independent. | The board should comprise a balance of executive and non-executive directors, **preferably** with a majority of non-executive directors of whom **sufficient** should be independent of management. |
| **Executive director** | Similar to King II. | An individual who is involved in the day-to-day management and/or is in the full time salaried employment of the company and/or any of its subsidiaries. |
| **Non-executive director** | Similar to King II. | An individual not involved in the day-to-day management and not a full-time salaried employee of the company or of its subsidiaries.<br><br>An individual in the full-time employment of the holding company or its subsidiaries, other than the company concerned, would also be considered to be a non-executive director unless such individual by his/her conduct or executive authority could be construed to be directing the day-to-day management of the company and its subsidiaries. |

| | King III | King II |
|---|---|---|
| **Independent non-executive director** | A non-executive director who:<br><br>i. Is not a representative of a **shareholder** who has the ability to control or significantly influence management;<br><br>ii. Similar to (ii) in King II;<br><br>iii. Similar to (iii) in King II;<br><br>iv. Similar to (iv) in King II;<br><br>v. Is free from any business or other relationship which could be seen to **interfere materially** with the individual's capacity to act in an independent manner.<br><br>vi. Does not have a direct or indirect interest in the company (including any parent or subsidiary in a consolidated group with the company) which is either material to the director or to the company. A holding of five percent or more is considered material; and<br><br>vii. Does not receive remuneration contingent upon the performance of the company. | A non-executive director who:<br><br>i. Is not a representative of a **shareowner** who has the ability to control or significantly influence management;<br><br>ii. Has not been employed by the company or the group of which it currently forms part, in any executive capacity for the preceding three financial years;<br><br>iii. Is not a member of the immediate family of an individual who is, or has been in any of the past three financial years, employed by the company or the group in an executive capacity;<br><br>iv. Is not a professional advisor to the company or the group other than in a director capacity;<br><br>v. Is free from any business or other relationship which could be seen to **materially interfere** with the individual's capacity to act in an independent manner;<br><br>vi. Is not a significant supplier to, or customer of the company or group; and<br><br>vii. Has no significant contractual relationship with the company or group. |
| **Minimum number of directors on the board** | As a minimum, two executive directors should be appointed to the board, being the chief executive officer and the director responsible for the finance function. For listed companies, a financial director must be appointed to the board from June 2009. | Not addressed. |
| **Frequency of board meetings** | Similar to King II. | The board should meet regularly, at least once a quarter if not more frequently as circumstances require. |

| | King III | King II |
|---|---|---|
| **Rotation of non-executive directors** | A programme ensuring staggered rotation of non-executive directors should be put in place.<br><br>Rotation of board members should be structured so as to retain valuable skills, to have continuity of knowledge and experience and to introduce persons with new ideas and expertise.<br><br>At least one third of non-executive directors should retire by rotation at the company's AGM or other general meetings. The retiring board members may be re-elected, provided they are eligible. | Rotation of non-executive directors not addressed specifically.<br><br>Regarding rotation of directors in general:<br><br>There should be an effective programme of continuing rotation of appointments in respect of each individual director. All companies should adopt a process of staggered continuity and re-election of their boards to ensure continuity of experience and knowledge. |
| **Removal of CEO** | The memorandum of incorporation of the company should allow the board to remove any director from the board, including executive directors, without shareholder approval being necessary. | Not addressed. |
| **Chairman of the board** | The chairman of the board **should be** an independent non-executive director.<br><br>The chairman of the board **should not be** the CEO. | The chairperson should **preferably be** an independent non-executive director.<br><br>It is **preferable** that the chairperson and the CEO functions are kept separate. |
| **Lead independent non-executive director** | Should be appointed if the chairman of the board is not independent and free of conflicts of interest on appointment. | Consideration should be given to appointing a senior independent or "lead" director to fulfil a role where any difficulties or conflicts arise between the non-executive component of the board and the executives, as well as in assisting the chairperson in fulfilling his tasks where required.<br><br>Such an appointment should be considered where the roles of the chairperson and the CEO are combined, or even where both the chairperson and deputy chairperson might be executive directors. |
| **Share options for non-executive directors** | Non-executive directors **should not** receive share options. | Share options **may be** granted to non-executive directors but must be the subject of prior approval of shareowners. |
| **Board committees** | Unless legislated otherwise, the board should appoint the audit, risk, remuneration and nomination committees as standing committees. Smaller companies need not establish formal committees to perform these functions but should ensure that these functions are appropriately addressed by the board. | All companies should have, as a minimum, audit and remuneration committees. |

### 6.2 Chairman of the board, CEO and membership/chairmanship of board committees

*Summary of King III requirements:*

| | Member of the audit committee | Member of the remuneration committee | Chairman of the remuneration committee | Member of the nomination committee | Chairman of the nomination committee | Member of the risk committee | Chairman of the risk committee |
|---|---|---|---|---|---|---|---|
| Chairman of the board | No[9] | Yes[1] | No | Yes[2] | Yes[3] | Yes[4] | No |
| Chief Executive Officer | No[5] | No[6] | No | No[7] | No | Yes[8] | No |

### 6.3 Board committees

Board committees should only comprise members of the board. External parties may be present at committee meetings by invitation.

The respective committees' chairmen should give at least an oral summary of their committee's deliberations at the board meeting following the committee meeting.

| | Audit committee | Remuneration committee | Nomination committee | Risk committee |
|---|---|---|---|---|
| **Chairman** | Independent non-executive director | Independent non-executive director | Independant non-executive director | Not specified in King III |
| **Membership** | All members must be board members<br><br>All members should be independent non-executive directors | All members must be board members<br><br>Majority should be non-executive directors<br><br>Majority of non-executive directors should be independent | All members must be board members<br><br>Majority should be non-executive directors<br><br>Majority of non-executive directors should be independent<br><br>Board chairman to be a member | All members must be board members<br><br>Executive and non-executive directors |

[1]The chairman of the board may be a member of the remuneration committee
[2]The chairman of the board should be a member of the nomination committee
[3]The chairman of the board may chair the nomination committee
[4]The chairman of the board may be a member of the risk committee
[5]The CEO should attend by invitation
[6]The CEO should attend by invitation
[7]The CEO should attend by invitation
[8]King III does not prohibit the CEO from being a member of the risk committee
[9]The chairman of the board may attend audit committee meetings by invitation

### 6.4 Audit committees - Comparison with King II

| | King III | King II |
|---|---|---|
| **Membership** | All members should be independent non-executive directors.<br><br>Audit committees at subsidiary level that will act as a subcommittee of the holding company may appoint executive directors within the group as audit committee members provided the directors are non-executive in relation to the specific subsidiary. | Majority of the members should be independent non-executive directors.<br><br>Audit committees at subsidiary level not addressed. |
| **Minimum number of members** | Audit committees should consist of at least three members. | Not addressed. |
| **Qualifications** | The audit committee as a whole should have a good understanding of:<br>• integrated reporting, including financial reporting, and sustainability issues<br>• internal financial controls<br>• internal and external audit processes<br>• corporate law and risk management<br>• IT governance as it relates to integrated reporting<br>• the governance processes within the company. | Majority of members should be financially literate. |
| **Frequency of meetings** | As frequently as is necessary, but at least twice a year. | Not addressed. |
| **Responsibility regarding sustainability reporting** | The board may assign the overseeing of sustainability issues in the integrated report to the audit committee.<br><br>The audit committee should assist the board in reviewing the sustainability reporting to ensure that the information is reliable and that no conflicts or differences arise when compared with the financial results.<br><br>The audit committee should consider and recommend to the board the need to engage an external assurance provider to provide assurance over the accuracy and completeness of sustainability reporting. | Not addressed. |

## 7. Our services

Directors Suresh Kana and Anton van Wyk serve on the King Committee and chaired the King III Accounting and Auditing and Internal Audit subcommittees respectively. Suresh, Anton, directors Alison Ramsden and Rob Newsome, supported by other corporate governance experts, have the necessary expertise to assist you in the application of the King III requirements. Our services in this area include:

- advising companies on governance and ethics,
- advising on effectiveness of internal audit,
- providing an outsourced internal audit function,
- assisting with risk management solutions,
- sustainability reporting assurance.

*For further information, please contact your PwC engagement partner or any of the following:*


### Brendan Deegan
011 797 5472
Assurance Leader

### Anton van Wyk
011 797 5338
Risk Advisory Services Leader

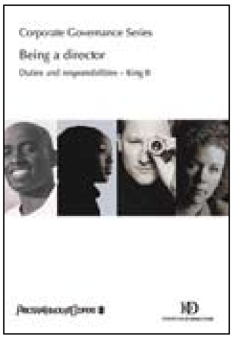
### Alison Ramsden
011 797 4658
Director – Governance and Sustainability

### Rob Newsome
011 797 5560
Director – Risk and Regulatory Services

### Shirley-Ann Bauristhene
031 271 2007
Director – Risk Advisory Services

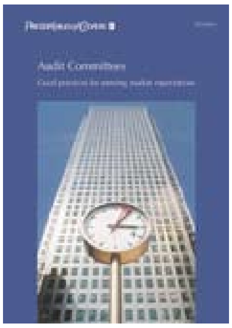
### Steve Roberts
021 529 2009
Director – Risk Advisory Services

## Publications available from the PricewaterhouseCoopers Library on corporate governance:




**Being a director, Duties and Responsibilities – King II**

The publication covers the duties and responsibilities of directors for the effective governance of their companies.

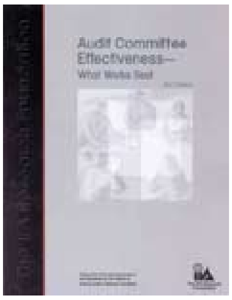


**2003 – Audit Committees – Good practices for meeting market expectations (2nd edition)**

The 2nd edition of our global guide on Audit Committees summarises best practices and requirements in over 40 countries. It covers all aspects of an audit committee's work, including: organisation (terms of reference, membership, meetings): key responsibilities; communicating and reporting by the committee; and evaluating audit committee effectiveness.

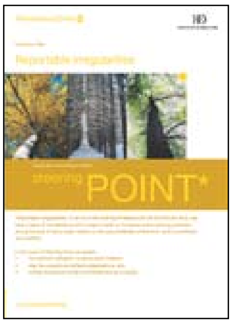

**2006 – Current developments for audit committees**

In addition to supporting the role of audit committee oversight of Section 404 of the US Sarbanes-Oxley Act, this publication highlights some of the other significant governance developments and their implications to help audit committees cope with ongoing regulatory, legislative and other changes in the business environment.



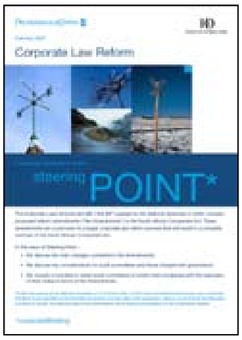

**2005 – Audit committee effectiveness – What works best (3rd edition)**

The report captures how leading audit committees are effectively and thoughtfully discharging their expanded duties. It also provides numerous examples of how leading audit committees are not just complying with, but surpassing, requirements.




**Steering Point – November 2006**

This edition explains the auditor's obligations to report "reportable irregularities" and examines how the requirement to report affects organisations and more specifically boards and audit committees.




**Steering Point – February 2007**

This edition summarises the main changes contained in the Corporate Laws Amendment Act, 2006. It discusses the key considerations for audit committees and those charged with governance.

For further information on these and other publications, please contact your engagement partner or the PricewaterhouseCoopers library at +27 (11) 797 5062.

www.pwc.com



09-06220