

King's Counsel*

King III – a higher education perspective

Steering point

The King Committee on governance issued the third 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.

While King II, released in 2002, focused on the corporate sector, it is intended that King III be applied by all entities, including Higher Education Institutions (HEI's).

This paper aims to provide a high-level insight into how the principles incorporated in King III relate to HEI's, and also to provide reference to current legislation governing aspects of governance issues within HEI's.

The need to implement the key principles of good governance, as set out in King III, are not new to the higher education arena.

The Ministerial Statement on Higher Education Funding: 2006/7 to 2008/9 makes reference to the requirement for higher education "to make major contributions to the social transformation of South African society and, at the same time, to national economic growth and development. Higher education is expected to deliver the high level professional skills, the new research, and the innovative ideas which are needed by a growing economy. Higher education is also expected, through its student admissions and its teaching/ learning activities, to assist with the creation of a fairer, more just, society in South Africa".

The Ministerial Statement also refers to the Accelerated and Shared Growth Initiative for South Africa (ASGISA) which stresses that "stronger focus on middle and high level skills development is critical if the growth trajectory target of 6% between 2010 and 2014 is to be achieved."

These objectives will only be achieved through accountability, transparency and good governance.



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1. Applicability of King III

King III applies to all entities regardless of the manner and form of their incorporation or establishment. The principles, if adhered to, will result in any entity practicing good governance. For this 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.

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 by reading 'Higher Education Institution (HEI)', 'council' and 'members of council' respectively. Furthermore, as certain aspects of governance are legislated in higher education through the Higher Education Act, 1997 (HEA) and institutional statutes, the use of instructive language is important in reading and understanding the Report and the Code.

The word 'must' indicates a legal requirement. In aspects where 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 put forward in the Report, a positive statement to this effect should be made to stakeholders. In situations where the council or those charged with governance decide not to apply a specific principle and/or recommendation, this should be explained fully to the HEI's stakeholders.

3. Structure of King III – Code and Report

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

4. King III – Key risk and reporting implications

4.1 Integrated reporting

Public higher education institutions in South Africa enjoy considerable statutory autonomy. This autonomy makes it important that the structures of governance and management of these institutions should account to both internal and external stakeholders in a consistent and prescribed manner. Reporting by public higher education institutions is prescribed in the Regulations for Annual Reporting by Public Higher Education Institutions, 2007.

In HEI's, the annual report is the equivalent of the integrated report. The annual report covers both the financial and non-financial performance of a HEI in an integrated manner. Guidelines on reporting are issued by the Department of Higher Education and Training and we expect the Department to take cognisance of King III and issue updated content guidelines in due course.

King II dedicated a chapter 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 being paid to sustainability issues.

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

The integrated/annual report should have sufficient information to record how the HEI has positively and negatively affected the socio-economic life of the community in which it operated during the year under review. The report should also contain forward-looking information detailing how the council believes it can enhance the positive aspects and negate the negative aspects that affect the socio-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 a HEI's strategic and business processes and managed throughout the year.

The integrated approach to reporting should be applied not only at year end through the annual report, but throughout the year when issuing any interim reports.

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 council the need to engage an external assurance provider to provide assurance over material elements of the sustainability component of the annual report.

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

HEI's will be required to dedicate time and resources to the preparation of the annual 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 skills 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 council over risks in a HEI.

A combined assurance model effectively coordinates the efforts of management and internal and external assurance providers, increases their collaboration and develops a shared and more holistic view of the institution'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 HEI's combined assurance model and ensuring that significant risks facing the HEI are adequately addressed.

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.

A combined assurance model may result in the increased utilisation of external assurance providers as well as expanding the skill set of internal audit.

4.3 Annual review of internal financial controls

King III requires the audit committee to conclude on and report annually to the stakeholders and the council 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 council and stakeholders.

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

Section 30 of the HEA assigns the responsibility for management and administration of a public higher education institution to the principal (the chief executive and accounting officer of a public higher education institution, which includes a vice-chancellor and a rector), whilst the Implementation Manual for Annual Reporting by Higher Education Institutions, 2007 subscribes to the requirements of King II for annual reporting (as it relates to governance and management, including internal controls). Since King II has been superseded by King III, it can be reasonably assumed that the principles embodied in King III, would be endorsed equally in future revisions of the manual. Currently, internal financial control reporting is done by internal and external audit to the audit committee, management and council. Material breakdown in internal control would be reported to council by the audit committee. The audit committee is now required to conclude and report to stakeholders on an annual basis on the effectiveness of 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 its conclusion on internal financial controls to the council and stakeholders

- Increased time and resource commitments for audit committees, management and internal audit regarding a formally documented review of internal financial controls and material frameworks.
- Audit committees should assess the adequacy of available skills to conduct internal financial control reviews against defined frameworks and standards.
- The audit committee's 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 important 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 HEA does not address the role of internal audit directly. However, through the regulations issued by the Department of Higher Education and Training, the HEA prescribes compliance with King III (as discussed under 4.3) thus referring to the role of internal audit.

King III expects that internal audit planning should be undertaken by the chief audit executive (CAE) or the head of internal audit. It should take the form of an assessment of the risks and opportunities facing the HEI and should:

- Align with the HEI's risk assessment process (considering the risk maturity of the HEI);
- Focus on providing an assessment of the HEI's control environment;
- Consider the HEI'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.

- Internal audit planning and approach should be risk based rather than compliance based.
- Internal audit planning should be informed by the strategy of the HEI at a strategic, operational and compliance level.
- A CAE of appropriate stature, who has the respect and cooperation of the council 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 so as to ensure that 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, council or other committee meetings.

4.5 Governance of information technology

Education systems (HEI's in particular) have an obligation to deliver on public expectations of quality education for economic growth and social development. However, in the context of developing countries, quality improvement and the enhancement of excellence must take into consideration the need for increased access, equity and redress. These efforts are, in most instances, undermined by factors such as fiscal constraints, spatial barriers and other capacity-related limitations to delivery. As demonstrated in various contexts, information and communication technologies (ICTs) have the potential and capacity to overcome most of these barriers. [White Paper on e-Education: Transforming learning and teaching through Information and Communication Technologies (ICTs), issued in Notice 1922 of 2004, Government Gazette 26762 of 2 September 2004]

The effective use of Information Technology (IT) is a key success factor enabling institutional agility and the ability to respond speedily to students' demands for educational services. In South Africa, Vision 2014 describes an inclusive information society in which the use of IT will be harnessed to ensure that everyone has fast, reliable and affordable access to information and knowledge that will enable them to participate meaningfully in the community and economy. [Presidential National Commission on Information Society & Development, "Towards an Inclusive Information Society for South Africa, A Country Report to Government", November 2005].

IT governance is dealt with in detail in King III. King III recognises that 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 and is therefore not only an operational enabler for an organisation, but an important strategic asset, which can be leveraged to create opportunities and to facilitate service delivery and to gain competitive advantage. However, as well as being a strategic asset to the organisation, IT also presents significant risks.

The strategic assets of IT and its related risks and constraints should be well governed and controlled to ensure that IT supports the strategic objectives of the organisation.

In exercising their duty of care, members of council should ensure that prudent and reasonable steps have been taken in regard to IT governance.

IT governance should focus on:

- Development and implementation of an IT governance framework;
- Value delivery: concentrating on optimising expenditure and proving the value of IT;
- Risk management and sustainability: addressing the safeguarding of IT assets, disaster recovery and continuity of operations; and
- The protection and management of information.

Impact on HEI's, councils and audit committees

- The council should assume responsibility for IT governance.
- IT controls and risk mitigation should safeguard the integrity of information.
- IT performance should be measured and reported to the council.
- The council 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 sound financial reporting and the going concern assumption.

4.6 Governing stakeholder relationships

The stakeholder-inclusive approach to governance is not a new concept in the King reports and effective stakeholder engagement is recognised as essential to good governance. Stakeholder relationships provide a platform for the council to take into account the concerns and views of students and other stakeholders in its decision making, which is fundamental to the process of annual reporting. King III provides guidance and recommendations on how stakeholder relationships should be dealt with.

Section 35 of the HEA determines that the institutional statute should determine the establishment and other matters relating to the students' representative council (SRC) as a means to facilitate student input into the affairs of the HEI. The standard institutional statute provides for the matters on which the students may be represented by the SRC. Likewise, section 31 of the HEA provides for the role of the institutional forum – an 'advisor' to the council – on matters affecting the institution, including:

- Implementation of the HEA and the national policy on higher education;
- Employment equity;
- Selection of candidates for senior management positions;
- Codes of conduct, mediation and dispute resolution;
- Institutional culture; and
- Language policy.

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 that enables shareholders to express their views on the remuneration policy. The remuneration of senior management and members of council in public higher education institutions is not legislated as these institutions enjoy considerable statutory autonomy. However, the Regulations for Annual Reporting by Public Higher Education Institutions, 2007, stipulates the disclosure of remuneration of senior management in the annual financial statements, including payments for attendance of meetings by members of council and its committees.

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. Currently it is only the overall performance of the HEI in terms of the council's performance management system that is evaluated in accordance with the Implementation Manual for Annual Reporting by Higher Education Institutions, 2007.

5.3 Business rescue

A section on business rescue has been included in the chapter on boards and directors to address governance in business rescue proceedings. In summary, King III requires the board to commence business rescue proceedings as soon as the entity is financially distressed. In terms of the institutional statute (as required by s.32 of the HEA), the council has some functions that relate to business rescue:

- The determination of tuition fees, accommodation fees and other fees,
- Approval of institutional budget, and
- Conclusions on loan or overdraft arrangements.

These functions may not be delegated.

The Minister of Higher Education and Training may also appoint an independent assessor under circumstances that involve financial or other maladministration of a serious nature or which seriously undermines the effective functioning of the public higher education institution.

5.4 Alternative dispute resolution

King III recognises that alternative dispute resolution (ADR) has become an important element of good governance. Through the institutional forum as provided for in the HEA, HEI's have 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, include reaching conclusions faster, the ability to conduct ADR processes in private and the opportunity to find creative or novel solutions.

Mediation is not defined in the HEA, but may be defined as a process in which parties to a 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 HEA. 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

Governance element	King III principle/recommendation	Higher education perspective
Board (council) structure	Unitary board structure with executive directors and non-executive directors interacting in a working group.	Council structure is determined by section 27 of the HEA. The various committees are elected by the council in terms of section 29 of the HEA. Although the senate of a HEI reports to its council, it is established in terms of section 28 for the purpose of the academic and research functions of the HEI. These requirements are supported by the institutional statute (based on the standard institutional statute).
Composition of the board (council)	The board should comprise a balance of executive and non-executive directors, with a majority of non-executive directors. The majority of non-executive directors should preferably be independent.	In terms of section 27 of the HEA, at least 60 per cent of the members of a council must be persons who are not employed by, or students of, the public higher education institution concerned.
Executive director (member of council/rectorate)	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.	The institutional statute (based on the standard institutional statute) determines the principal (vice-chancellor and rector) to be the chief executive officer of the HEI and in terms of section 30 of the HEA, the principal is responsible for management and administration of the HEI. The principal is supported by the executive committee/rectorate as a committee of council.

Governance element	King III principle/recommendation	Higher education perspective
Non-executive director (member of council)	<p>An individual not involved in the day-to-day management and not a full-time salaried employee of the company or of its subsidiaries.</p> <p>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.</p>	The equivalent would be all members of council, but excluding the principal and other executive members as contemplated in the institutional statute.
Independent non-executive director (member of council)	The board should include a statement in the integrated report regarding the assessment of the independence of the independent non-executive directors.	Paragraph 17 of the standard institutional statute deals with instances of conflict of interest among council members, requiring amongst other things, the disclosure of such direct or indirect financial, personal or other interest.
Minimum number of directors (members of council) 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.	In terms of section 27 of the HEA and paragraph 9 of the standard institutional statute, the number of members and the ratio of members are defined as the minimum membership of council.
Frequency of board (council) meetings	The board should meet at least four times a year	Paragraph 15 of the standard institutional statute requires council to have at least four ordinary meetings during each academic year.
Rotation of non-executive directors (members of council)	<p>A programme ensuring staggered rotation of non-executive directors should be put in place.</p> <p>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.</p> <p>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.</p>	Members of council are elected for a term of not more than four years (excluding student members) as determined by the standard institutional statute.
Removal of CEO (principal/ vice-chancellor and rector)	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.	The principal is appointed by council on terms as determined in his/her contract as stipulated in paragraph 52 of the standard institutional statute.

Governance element	King III principle/recommendation	Higher education perspective
Chairman of the board (council)	The chairman of the board should be an independent non-executive director. The chairman of the board should not be the CEO.	As contemplated in paragraph 13 of the standard institutional statute, the chairman and vice-chairman of council is elected by majority vote of members of council and for a period of two years. The following members of council are not eligible for this position: The principal, A vice-principal, A member of the senate, An academic employee, and A student.
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.	Not applicable.
Share options for non-executive directors	Non-executive directors should not receive share options.	Not applicable.
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.	Council committees are established in terms of section 29 of the HEA and further defined per paragraph 18 of the standard institutional statute.

6.2 Council committees

Section 29 of the HEA determines that the council and the senate of a public higher education institution may individually (or jointly) establish committees to perform any of their functions and may appoint persons, who are not members of the council or the senate, as the case may be, as members of such committees. The composition, manner of election, functions, procedure at meetings and dissolution of a committee and a joint committee are determined by the institutional statute, institutional rules or an Act of Parliament.

Paragraph 18 of the standard institutional statute prescribes that at least 50 per cent of the members of a committee must be persons who are not employees or students of the HEI. Also, the chairperson of a committee may not be an employee or a student of the HEI. Furthermore, the minutes of all committee meetings must be included in the agenda of the next ordinary meeting of the council following the respective committee meetings.

6.3 Audit committees

Governance element	King III principle/recommendation	Higher education perspective
Membership	<p>All members should be independent non-executive directors.</p> <p>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.</p>	<p>The council determines the membership of its committees taking into consideration the minimum requirements set out in the HEA and standard institutional statute. Furthermore, in the Implementation Manual for Annual Reporting by Higher Education Institutions, 2007, the membership of the audit committee is further emphasised as comprising members of council (mainly) or if not members of council, then specialists in the field. This is based on the requirements of King II. Since King II has been superseded by King III, it can be reasonably assumed that the principles embodied in King III, would be endorsed equally in future revisions of the manual.</p>
Minimum number of members	<p>Audit committees should consist of at least three members.</p>	<p>The HEA and standard institutional statute does not address the minimum membership of the audit committee. In light of its subscription to the principles of King II and by default also King III, the minimum membership would be adopted.</p>
Qualifications	<p>The audit committee as a whole should have a good understanding of:</p> <ul style="list-style-type: none"> Integrated reporting, including financial reporting, and sustainability issues; Internal financial controls; Internal and external audit processes; Corporate law and risk management; IT governance as it relates to integrated reporting; and The governance processes within the company. 	<p>Committee membership requirements are not expressly dealt with in the HEA. However, it is envisaged that the prescripts of King III should be followed as well as the spirit of the HEA on council membership be adhered to.</p>
Frequency of meetings	<p>As frequently as is necessary, but at least twice a year.</p>	<p>The Implementation Manual on Annual Reporting by Higher Education institutions, 2007 depicts a perceived requirement that audit committees should meet at least twice a year. However, this is not expressly dealt with in the HEA or standard institutional statute.</p>
Responsibility regarding sustainability reporting	<p>The board may assign the overseeing of sustainability issues in the integrated report to the audit committee.</p> <p>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.</p> <p>The audit committee should consider and recommend to the board on the need to engage an external assurance provider to provide assurance over the accuracy and completeness of sustainability reporting.</p>	<p>The functions of audit committees are defined by council in terms of section 29 of the HEA via the institutional statute. The Implementation manual on Annual Reporting by Higher Education Institutions, 2007 outlines a process in which the audit committee acts within written terms of reference and provides assistance to council on matters such as compliance with laws and regulations, reporting and disclosure.</p>

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 our other corporate governance specialists, have the necessary expertise to assist you in the application of the King III requirements.

Our services in this area include:

- Advising HEI's on governance and ethics;
- Advising on effectiveness of internal audit;
- Providing an outsourced internal audit function;
- Assisting with risk management solutions; and
- Sustainability reporting assurance.

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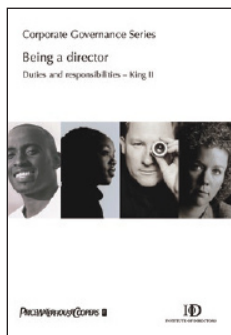
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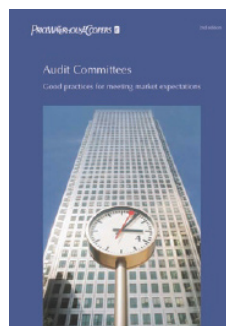
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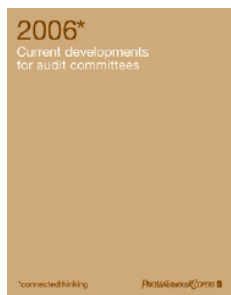
Being a director, Duties and Responsibilities – King II

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



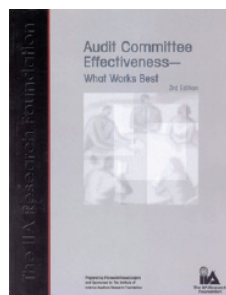
2003 – Audit Committees – Good practices for meeting market expectations (2nd edition)

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.



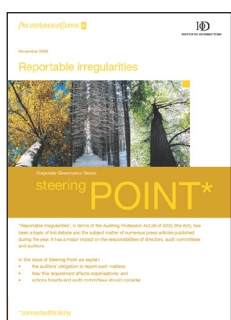
2006 – Current developments for audit committees

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.



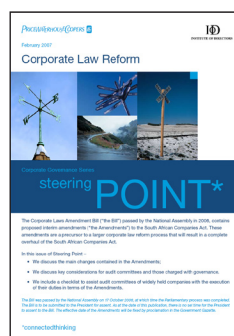
2005 – Audit committee effectiveness – What works best (3rd edition)

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.

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